

Impact of Corporate Governance on Financial Reporting Quality: Evidence from Pakistan

By

Aroob Zia

(MMS-151055)

**MASTER OF SCIENCE IN MANAGEMENT SCIENCES
(FINANCE)**



**DEPARTMENT OF MANAGEMENT SCIENCES
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CAPITAL UNIVERSITY OF SCIENCE AND TECHNOLOGY ISLAMABAD

Islamabad Expressway, Kahuta Road, Zone-V, Islamabad
Phone: +92 51 111 555 666, Fax: 92 51 4486705
Email: info@cust.edu.pk, Website: <http://www.cust.edu.pk>

CERTIFICATE OF APPROVAL

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By

Aroob Zia

(MMS 151055)

THESIS EXAMINING COMMITTEE

| S No | Examiner | Name | Organization |
|------|-------------------|-----------------------------|-----------------|
| (a) | External Examiner | Dr. Sumayya Fatima Chughtai | IIU, Islamabad |
| (b) | Internal Examiner | Dr. Arshad Hassan | CUST, Islamabad |
| (c) | Supervisor | Shujahat Haider Hashmi | CUST, Islamabad |

Shujahat Haider Hashmi

Thesis Supervisor

October, 2017

Dr. Sajid Bashir

Head

Department of Management Sciences

Dated : October, 2017

Dr. Arshad Hassan

Dean

Faculty of Management and Social Sciences

Dated : October, 2017

Certificate

This is to certify that Aroob Zia bearing **Registration No. MMS151055** has incorporated all observations, suggestions and comments made by the external evaluators as well as the internal examiners and thesis supervisor Shujahat Haider Hashmi at Capital University of Science and Technology, Islamabad. The title of her Thesis is: “**Impact of Corporate Governance on Financial Reporting Quality: Evidence from Pakistan**”.

Forwarded for necessary action

Shujahat Haider Hashmi
(Thesis Supervisor)

Dedication

This work is dedicated to my parents who encouraged and supported me in achieving this milestone and my respected mentor/ supervisor Dr. Arshad Hassan who has been a constant source of knowledge and inspiration for me.

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Reg no: MMS151055

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Abstract

This study investigates to find out corporate governance mechanism impact on financial reporting quality of financial sectors in Pakistan. A deeply investigation made by including the corporate governance mechanism structure and financial reporting quality. The data is collected of 26 financial firms listed in Pakistan and the time frame is 2005 to 2014. Penal regression technique is used in this study. The results of panel least square regression analysis show that: board independence has positively and insignificant relationship with financial reporting quality. INST has negative and significant relationship with financial reporting quality. But BS, ISO, CEO duality, firm size, leverage have no significant relationship with FRQ.

Key words: corporate governance mechanism, financial reporting quality, penal regression.

Chapter 1

Introduction

Management of a company is responsible to prepare financial information which is used by decision makers to predict the outcomes of present operation or rectify their expectations (Hassan and Bello, 2013). There are many cases observed in the world to record fake financial information or manipulate information to hide financial losses by over or underestimating the value of assets. In the 1st decade of 21st century had lot of hurdles about financial and accounting scandals. The most highlighted scandals of financial statements of manipulation involves Satyam, Lehman Bros, Bernie Madoff, Beekes to AIG, HealthSouth and Enron (great finance and accounting scandal, 2015). It is necessary for all companies to prepare a quality financial information report. FRQ (Financial Reporting Quality) is considered most appropriate factor in financial process. Generally it's observed that some factors of the firm have an influence on the quality and high level of financial reporting disclosed.

So, there are different characteristics which considered the effect of quality and high level of financial reporting are differ firm to firm. Past researches have shown that firms engaging in earnings management activity are often with lower performance, less Board composition, less liquidity, low leverage, small audit firm size, small firm size and less share dispersion.

In last decades many mainstream corporate scandals are observed by poor financial reporting (Lobo & Zhou, 2006), shareholders demanded high quality reports (Chhaochharia & Grinstein, 2007). Now the researchers shows that the companies or firms adopt high quality external and internal governance tools and also adopt higher quality auditors (internal and external) to develop high quality financial report for shareholders (Srinidhi, He & Firth, 2010, PuchetaMartínez & GarcíaMeca, 2014 Cohen, Krishnamoorthy & Wright, 2004). But, the corporate governance mechanisms vary country to country, reflecting changes in the legal and business environments (Claessens & Yurtoglu, 2013).

This study investigates whether corporate governance mechanisms positively affect financial reporting quality in developing countries, such as Pakistani, where governance is voluntary and the context is unique.

According to Agency theory the ownership and management ownership is the cause of agency problems and the information went wrong among stakeholders (Jensen & Meckling, 1976). Governance mechanisms reduce these agency costs, with high quality of corporate governance resulting in better check and balance behaviour (Shleifer & Vishny, 1997), improved FRQ (Cohen et al., 2004) and reduced wrong information between a firm's agents and principles (Healy & Palepu, 2001; Scott, 1997). Therefore, shareholders and investors can rely upon solid and reliable financial report to make investment decisions (Healy & Palepu, 2001).

Internal and external governance factors affect financial reporting quality, while the efficiency of firm's governance is related to the high level of these Internal and external governance factors. These factors includes board independence, board size, firm size, institutional shareholders, institutional shareholders ownership, CEO duality, audit committee independence, and leverage. Different characteristics of business present different effectiveness of government mechanism (La Porta et al., 1999).

Many studies have been examined on Financial reporting quality in reset of the world, and it show difference and variation in results (La Porta et al., 1999). Since the governing investors hold significant income rights, it is normal that they will substitute legitimate safety and require large amounts of observing and controlling with a specific end goal to lessen administration's seizure and enhance the association's execution (Shleifer & Vishny, 1997).

It is found in governance literature that governing body of governing shareholders can depend on high level of external auditors to limit administration confiscation through enhancing the nature of FRQ (Fan & Wong, 2005; Cohen et al., 2004). Meckling and Jensen (1976) said, external audit's cost is must bear by the owners to remove the agency problem. Information reduces by auditing asymmetrically outsiders and management (Knechel & Sundgren, 2008; Francis & Wilson, 1988). Cohen et al's. (2004) studied the relationship between governance mechanisms and audit quality and found that firm's performance is linked with high level external auditing. Collier and Gregory (1999) studied that if the board members are independent then the auditing committee is more affective in firm with the high

level of auditors. Francis and Wilson (1988) studied the relationship between high level auditor and agency cost where firms chose high auditors to reduce agency cost. Defond's (1992) explore that management ownership and leverage presents agency cost. Best auditors have ability to reduce agency problem.

In developed countries many studies conducted on corporate governance and financial reporting quality but there is literature gap in developing countries. So this is an effort to address this gap in context of financial firms of Pakistan.

1.2 Problem Statement

The recent accounting scandals happened internationally has increased criticism on FRQ (Brown et al., 2010; Agrawal and Chadha, 2005). Different mainstream firms were involved in this corruption like WorldCom, Parmalat, Marconi etc. The financial disclosure failure has created the need to improve the FRQ and also need strong managers control for a strong governing structure (Brown and Caylor, 2006; Beekes and Brown, 2006; Firth et al., 2007; Beekes and Brown, 2006; Karamaou and Vafeas, 2005). Actually, financial information assists to capital investors in investment decisions process. It is helpful for regulators, creditors, owners and firm partners, because it not only shows the past performance of firm but also determine firm's future prediction about profitability (Bushman and Smith, 2001; 2003).

The relationship between corporate governance and FRQ has been strongly explored in developed countries. They emphasis on specific governance factors like board independence, concerted shareholding, director shareholding and audit performance (Ballesta and Meca, 2007; Bradbury et al., 2006; Beekes et al., 2004; Petra, 2007; Han, 2005 and Yeo et al., 2002). Now the researchers focused to explore the relationship between corporate governance and FRQ in developing countries which are growing rapidly (Firth et al., 2007; Dimitropoulos and Asteriou, 2010; Bradbury et al., 2006). This study investigates the relationship between corporate governance and FRQ in financial firms in context of Pakistan. Pakistan's market is expending day by day so it necessary to investigate this relationship. This study is an effort to fill the gap in Pakistan financial literature.

1.3 Research Questions

This thesis aims to explore the relationship between corporate governance mechanism and financial reporting quality in context of Pakistan. It will investigate the roles of independent board members (non-executive board members), Board size, AUDIT Committee Independence, Institutional shareholders, Insider shareholders, MTB, LBV, Size and the CEO (CEO duality). Thus on the basis of the variable discussed above this research will endeavor to answer the following research questions:

- What is the impact of board independence on FRQ?
- What is the impact of board size on FRQ?
- What is the impact of firm size on FRQ?
- What is the impact of CEO duality on FRQ?
- What is the impact of leverage on FRQ?
- What is the impact of institutional shareholders on FRQ?
- What is the impact of insider shareholders ownership on FRQ?
- What is the impact of Audit committee independence on FRQ?

1.4 Research Objectives

To examine the association between Corporate Governance mechanisms and financial reporting is the main objective of this study. Further, this study has some sub objectives which will help us to reach the major objective of the study, the sub objectives are listed below:

- To examine the impact of board independence on FRQ.
- To examine the impact of board size on FRQ.
- To examine the impact of firm size on FRQ.
- To examine the impact of CEO duality on FRQ.
- To examine the impact of leverage on FRQ.
- To examine the impact of institutional shareholders on FRQ.
- To examine the impact of insider shareholders ownership on FRQ.
- To examine the impact of Audit committee independence on FRQ.

1.5 Significance of the study

This study makes a contribution to increase the finance literature about corporate governance and FRQ. Unlike the past researches which conducted on highly

developed markets (countries) like USA, UK, Japan etc, this study implies on emerging country. Pakistan has poor account regulations, poor transparency and poor governance practices.

And past researches mostly only focus in auditing regulatory environment but this study will endeavor to investigate the impact from a holistic point of view as we have focused on eight mechanisms of CG.

1.6 Organization of Study

This study contains four sections. The second section is Literature Review, in which this study explores by all this by reviewing previous studies. Third section is Research Methodology, in which all the variables name, data collection methods and methodology includes. Fourth section is Results contains the results tables with interpretation. Fifth and last section of this study is Conclusion in which the final remarks are concluded by reviewing the results and compare it with previous studies.

Chapter 02

Literature Review

2.1 Literature Review

The value of financial accounting is generally determined by its quality (Pounder,2013). The central concept of financial accounting quality is that some accounting information is better and more reliable than other accounting information in relation to its characteristic of communicating what it purports to communicate.

That is why; accounting quality is of great interest to several types of users involved in the financial reporting chain. The term of financial accounting quality has no single, widely accepted definition.

We can find a large amount of definitions, which vary significantly across individuals, projects, companies and organizations, depending also on the purpose for which the financial information is to be used. Studying the literature, we can see that on the one hand, accounting quality can be seen as the precision with which the financial reports convey information to equity investors about the firms expected cash-flows (Biddle, Hilary and Verdi 2009).

On the other hand, reporting quality refers to the extent to which financial reports of a company communicate its underlying economic state and its performance during the period of measurement. (Elbannan, 2010).

Biddle, Hilary and Verdi (2009) defines financial accounting quality as the precision with which financial reports convey information about the firm's operations, in particular its cash flows, in order to inform the equity investors.

Tang, Chen and Zhijun (2008) define financial reporting quality as the extent to which the financial statements provide true and fair information about the underlying performance and financial position. Anyway, a commonly accepted definition is provided by Jonas and Blanchet (2000), who argue that quality financial reporting is full and transparent financial information that is not designed to obfuscate or mislead users.

The role of financial reporting is complex and, according to financial accounting standard board (FASB), it aims to provide even handed financial and other information that together with information of other sources facilitates the efficient

functioning of capital and other markets and assists the efficient allocation of the scarce resources in the economy.

Therefore, the concept of financial accounting quality is broad and includes financial information, disclosures and non-financial information useful for decision making (Tasios and Bekiaris, 2012).

Many times, accounting quality is defined using its characteristics. In this context, prior literature research shows that key determinants of financial reporting quality include legal system, source of financing, characteristics of the tax system, involvement of the accounting profession, economic development and accounting education.

The quality of financial reporting is a broad concept which has a series of diverse measurable attributes. Anyway, one property of accounting which is frequently mentioned in support of harmonization is comparability.

It cannot be clearly concluded if harmonization results in significantly greater comparability across countries. That is why, this aspect is intensively studied and the results are still very different, causing diverse points of view upon this subject.

We will try to clarify what are the characteristics of financial accounting information that makes it of good quality. In order to have a certain degree of quality, financial statements should meet certain qualitative criteria.

These criteria are stated by both boards of IASB and FASB in their conceptual frameworks, where they conclude that high quality is achieved by adherence to the objective and the qualitative characteristics of financial reporting information (IASB, 2008).

The traits of corporate governance were helpful to shareholders in signaling the level of management's manipulations (Beasley (1996)). This study investigates the relation by providing awareness on reliability of earnings based on indications, such as the mechanism of good governance. In prior studies, the literature shows some association of corporate governance attributes and its relation with earnings management. Nine attributes had quoted out of several available in literature.

There are certain authors that study the size of board of director's associate with a good quality of financial reporting. Few numbers of directors implies a higher degree of communication and cooperation among them and managers. (Jensen, 1993). The study of Vafeas (2000), Ahmed et al. (2006) and Bradbury et al. (2006) reveals that

information contents of income and intensifies the earning management decrease with the large board size for American, Singapore, and New Zealand companies. However, certain authors find that large number of directors ensures the relevance of financial statements (Byard *et al.* 2006), while other authors did not confirm this association (Firth *et al.* 2007).

There is a view that larger boards are better for corporate performance because they have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate. However, recent thinking has leaned towards smaller boards. Jensen (1993) and Lipton & Lorsch (1992) argue that large boards are less effective and are easier for the CEO to control. When a board gets too big, it becomes difficult to co-ordinate and process problems. Smaller boards also reduce the possibility of free riding by, and increase the accountability of, individual directors. Empirical research supports this. For example, Yermack (1996) documents that for large U.S. industrial corporations, the market values firms with smaller boards more highly.

In very recent times, researchers began to look at how board diversity might enhance corporate governance and firm performance (Fields & Keys 2003). In probably the first research of its kind, Carter *et al.* (2003), in a study of Fortune 1,000 firms, find significant evidence of a positive relationship between board diversity, proxied by the percentage of women and/or minority races on boards of directors, and firm value, measured by Tobin's Q (Chung & Pruitt 1994). They also find that firms making commitment to increasing the number of women on boards also have more minorities on their boards and vice versa, and that the fraction of women and minority directors increases with firm size but decreases as the number of inside directors increases. Adams & Ferreira (2002), in using U.S. data, find that gender diversity of corporate boards provides directors with more pay-for-performance incentives and that the boards meet more frequently. Though not directly looking at board diversity, Keys *et al.* (2003) present empirical evidence supporting a relationship between diversity promoting activities of firms and expected future cash flows. Specifically they find filing of discrimination lawsuits produce a negative and significant stock price reaction. In a study on Indian firms, Ramaswamy and Li (2001) find evidence that greater foreign directorship appears to be able to influence firms by discouraging unrelated Diversification.

The main purpose of any audit committee is to supervise the process of financial

reporting of a firm, and also oversee the financial statement integrity, effective internal control and the performance of external and internal auditors. Pincus, *et al* (1989) argue that in depended member increase ability of board of directors to perform as an agent of the firm to provide the accurate and understandable information of financial statement of a firm. The audit committee is additionally anticipated that would assume a part as judge amongst administration and external auditors since these two gatherings may have honest to goodness contrasts of supposition in how to best apply bookkeeping measures (Klein, 2002).The external auditors and the management is monitored by the audit committee because their different opinions about applying accounting standards (Klein, 2002). Thus, the audit committee independence helps the external auditors and the management to make a high quality financial report. DeFond and Jiambalvo (1991) studied and found that that the presence of audit committee is probably avoid financial reporting errors. They studied the occurrence of accounting errors exposed by prior period changes for 41 US listed firms and found that those firms which have audit committees are fewer overstatements.

Dechow et al. (1996) examine the U.S firms which were enforced by Securities and Exchange Commission to accounting actions which have less audit committee or less auditor independence.

But, Beasley (1996) also studied and fails to find that any significant relationship between the occurrence of audit committees and the possibility of financial fraud by studding 75 US companies which were involved in financial fraud. Beasley study result was rational because audit committees were designed voluntarily in the starting years and there was significant indication that many, if not most, audit committees are performing what are normally supposed as their fiduciary responsibilities.

Klein (2002) conducted a empirical research to examine the in depended audit committee impact on financial reporting quality. Klein (2002) collect the 692 company's financial data of S&P 500 for the period of 1992-1993. And find significant and negative relationship between audit committee independence financial reporting qualities.

Carcello and Neal (2003) explorer the practice of corporate governance and collect the 138 US non-financial firms that face the financial distress situation for the period of 1994 they also found the negative and significant impact of audit committee

independence and account information using the MD&A (Management Discussion & Analysis). Utilizing hand-gathered board information from 139 firms in Singapore and 113 firms in Malaysia, Bradbury et al. (2006) find that the connection between audit committee interdependence and accounting quality when the irregular accruals are income expanding. The previous empirical evidence found that the audit committee play a vital role in disclosure of financial information and also improve the quality of reporting in US and UK. But Pakistan and other country such as Australia, China need to be more number of in depended member in audit committee.

According to Fama and Jensen, (1976) and Shleifer and Vishny, (1997) the relationship between corporate governance practices and presence of independent directors, have a significant impact on reporting quality and also decrease the agency problem. Above all if we pay special attention to large companies, where management and ownership are separated, and therefore, owners are unable to control all the movements made by managers or agents. There is a certain tendency for managers to manipulate the outcome to their own benefit. However, the problems associated with the separation of ownership and control was not so relevant or didn't catch the attention of researchers until the 1930's, when publications by Berle and Means (1932) and Coase (1937) came to light. Moreover Garcia, (2003) argue that optimistic behavior of management increase the agency problem because of delegations of authority and they try to peruse the personal interest and shareholder only seek only monetary advantage. However, the practices of corporate governance and audit committee independence enhance the co-interest of principle and agent and also decrease the informational gap. With all this we present the agency theory as the theoretical framework on which further evidence is later based.

The agency theory includes proposals for reform within the Board to include a certain percentage of independent directors. Undoubtedly this is a preferable step of in depended board of director will enhance not only outside aspect of firms as well also increase the performance of internal management particular from the chief executive. Furthermore, transparency must be the main principle behind the Board's activities in order to build trust and improve the quality of financial information for external users. In this way, it helps companies portray a trustworthy image. Ultimately, the agency

theory sees the Board as the primary mechanism for management control, which implies that the majority of its directors must be independent of management and the main objective of these directors must be their control over managers. Following that we will present the results of that line of research which has studied the relationship between audit committee interdependence and the financial information quality.

As per Fame (1980) and Jensen et al. (1983), empirical evidence the Board is a tool for monitoring managers, highlighting the presence of independent directors as a mechanism that enhances the effectiveness of the supervisory role of the Board, as they provide balance and help limit possible opportunistic management behavior. The idea behind this study is that the structure of the Board should be made up mainly of independent directors and not employees or people close to them. This way, the elaboration of accounting information in favor of the interests of those on the inside, in order to obtain benefits, can be avoided. In short, the authors found a positive and significant association between corporate governance characteristics of the Council, composed mainly of independent audit committee directors, and the preparation of financial information.

Mace (1986) frames his research among those who see in the independent directors the capacity to enhance the disclosure of financial information. Moreover, the interdependence of board of directors becomes major role of supervisory on management, not only by assuming independence from those that govern, but also by decisions made based on their experience and knowledge. In this sense, the author tries to show the positive effects of a large number of independent boards of directors on financial reporting quality. Mace (1986) concludes that the presence of independent board of directors gives more relevance and credibility to financial information, on the understanding that as the presence of the same on the Board is increased, higher quality financial reporting and transparency will be reflected.

Along the same lines, Weisbach (1988) hypothesized that Boards with a greater presence of in-dependent directors have a positive and significant effect on financial reporting quality, increasing it. The conclusion reached by the author strengthens this hypothesis, since the independent directors put greater pressure on managers, i.e. these counselors are considered a disciplinary measure on management.

However, unlike the findings obtained through empirical evidence mentioned above, we can see how the results are not always conclusive. Not all empirical evidence shows that Boards with a higher ratio of independent directors positively influence the quality of financial accounts. Here, MacAvoy et al. (1983) hypothesized that the quality of accounting information isn't positively related to the proportion of external directors, particularly independent ones. The results show that neither the percentage of directors who do not hold an executive position in the company, nor the percentage of independent directors are significantly related to greater integrity of financial information. Thus, we may reason out that the increased presence of independent directors on the Board does not increase the efficiency and quality of accounting data.

Shleifer et al. (1986) begin their research predicting that the directors forming the Board assume the role of traditional owners of the company and exercise more direct control over management, thus reducing the agency problem. However, they stress that among some of the features of external advisers, like their ownership of the company or time spent on the Council, help to reduce fraudulent accounting practices and thereby improve the quality of accounting information. Thus Shleifer et al. (1986) hypothesized that the increased presence of independent directors on the Board decreases the level of manipulation, and thereby increases the quality of financial information. In contrast to what has been observed in an Anglo-Saxon context, and which served as a basis for the recommendations of the Olivencia Report (1998), the results did not confirm the hypothesis raised by Shleifer et al. (1986), as it disclosed that the presence of independent directors was positively and significantly related to the level of manipulation. Therefore, the authors concluded that independent directors improve the quality of financial information.

Eisenberg et al. (1987) argue that Board composition include the independent directors does not affect the quality of financial information, making this as the hypothesis under comparison. And found the insignificant and negative impact of larger number of independent director on financial reporting quality. In short, they document that what really sustains a positive result, increasing the quality of accounting information is the higher part of executive managers. According to the authors, external directors are required mainly for independence from management, while internal executives or directors are those who are genuinely well informed about the company. In short,

these authors characterize independent directors as those members of the Board with the ability or the power to help oversee and facilitate financial information.

Accordingly, the evidence within a continental environment like that of Fernandez Alvarez et al. (1998), reason how special supervisory work of the external directors is enhanced by their independence from management and by the incentives for carrying out their role, which includes protecting their reputation and possible legal implications arising from inefficient supervision. Therefore, the hypothesis posed is whether the independence of the Board favours the quality of accounting information. The authors document a positive and substantial relationship between the projects done by independent directors and the quality of accounting data, while the purpose of the Audit Committee on the quality of financial data is irrelevant.

Continuing with the literature review, we consider it relevant to name Vafeas (1999), who pointed out from the outset that there is a positive association between the activities performed by independent directors and the quality of accounting information. Furthermore, he adds that the independent directors on the Board should take a more active position with respect to the other directors improve the accounting information. In this sense, Vafeas (1999) sets a contrasting hypothesis whether the influence of the independent directors might enhance the quality of published financial information. After the results were obtained it was shown that the fact of integrating more independent audit committee directors in the Board composition has a positive and significant effect on financial reporting quality. Many author justifies this result on the grounds that independent directors are not linked to the ownership of the company and therefore do not tend to manipulate information to their own benefits.

In relation to the previous evidence revealed by Vafeas (1999), it seems relevant to incorporate the empirical theory contrasted by Kasnik (1999), which basically stresses manipulative practices. Specifically, he says that those factors of good corporate governance which lead to higher quality accounting information will be considered as those that limit the freedom of action of management, reducing the use of manipulative practices. Kasnik (1999) documented that good corporate governance mechanism and presence of independent director in board improve the quality of

accounting information within the same line of research. Peasnell et al. (2001) argue that independent audit committee decreases the probability of information manipulations particularly when there are incentives to do so. And finding of the study suggest that the good practices of corporate governance may reduce the ambiguity of financial reporting and improve the quality of financial information. And also argue that independent director have significant impact of reporting quality. Having an audit committee does not appear to directly affect such manipulation, but the independent directors are more efficient when the company has an audit committee.

Similarly, Klein (2002) and Xie et al. (2003) documented that Audit Committee interdependence and the Board tends to reduce the manipulation of profits, thereby achieving to publish more quality financial information. After empirically contrasting the hypothesis, evidence reveals that both counselors and independent audit committees reduce manipulation, particularly when most of the members are independent (but not necessarily all of them). Therefore, the authors conclude that the presence of institutional investors (proprietary directors) in a lesser proportion than the independent directors also helps to reduce manipulation and improves the presentation of accounting information.

Similarly, Anderson et al. (2004) hypothesized in their work that the Board independence increases the financial reporting quality. That research suggest that the higher level of independent director in board have no association with reporting quality in the contrast of the prominent role that literature, both theoretical and empirical (mainly Anglo-Saxon), attributes to the independence of the Board. That is, the evidence revealed by these authors confirms that a Board composed of independent directors is considered an instrument to safeguard the quality of accounting information. It is possible that this evidence derives from the presence of executives or proprietary directors, and the lack of revolution of directors or both causes simultaneously, among other issues. Anderson et al. (2004) and Carcello & Neal (2000) documented the negative impact of the existence of independent directors in the Board composition on improving accounting quality. Carcello and Neal (2000), in contrast to Anderson et al. (2004) attribute the failure of the supervisory role of independent directors to the fact that these are not independent to the management of the business. Thus, these authors conclude that the existence of independent board of

director will only raise the accounting information quality when they have no links with the management of the organization.

Bedard et al. (2004) propose that those companies that include solely independent directors on their Board will not be effective in carrying out their tasks of supervision and control. Therefore, Bedard et al. (2004) developed their research insisting that among some of the measures of good corporate governance, and in particular 100% independent directors, are not always a good determinant in monitoring managerial activity. Moreover, the authors also defend that a Board which consists entirely of independent directors is not an adequate measure for increasing the quality of published information or the credibility of such. The hypothesis that the authors present is the idea of the incidence of independent directors on the Board reduces the financial reporting. The results support the hypothesis, it is documented that the trend towards greater number of independent directors, helps in low levels of quality and transparency in financial reporting, due to the concentration of so many external directors.

Farber (2005) tries to ratify how weak corporate governance structures, based on a larger number of executive directors, are a necessary ally of fraud or manipulation of accounting information. Hence, several of the firms involved in accounting scandals in the United States exhibit little independence and activity on boards and committees and a weaker presence of experts on these supervisory and control bodies. The author also notes that in many large US companies the CEO of the Board is also the chief executive. From these findings, the author tries to corroborate that a large number of executive directors is associated with an increase in the manipulation of company accounts and thus less transparency and quality of financial information. The results confirm their hypothesis, documenting that the manipulation of accounting information is greater when number of board of director connected to the top manager of the firm.

It is also interesting to add to this study the accurate reflection of Pope (2001) and Young et al. (2005), who suggest that the effectiveness of the Board in the monitoring and supervision of the accounting function depends largely on the ability of the external directors to understand issues of accounting techniques. So it is hoped, since

a significant proportion of external directors, especially independent ones, have held management positions in large companies or have developed long academic careers as auditors or advisors. In the Spanish case, according to the annual report by Spencer Stuart (2007) for 2006, 19% of independent directors in Spanish listed companies are entrepreneurs, 19% come from being chief executive at another company, 24% are retired executives, 20% are freelancers, and 7% are academics and 2% ex-politicians.

Now, relating this assessment to corporate governance practices and its impact on the consistency and disclosure of financial information, it is emphasized that the results presented for the Spanish context and those obtained in previous studies in an Anglo-Saxon context, primarily in terms of the role of the independent directors, do not lead to similar results, but differ substantially, establishing the United States and the United Kingdom as the main references in the Anglo-Saxon context. According to Recalde (2003), this is because business culture, the ownership structure of our companies and institutional characteristics are different.

Unlike the previous research work, we continue with the literature review presenting the evidence provided by Osterland(2004) and Ajinkya et al. (2005), which documented that the higher existence of independent directors provides the opportunity to monitoring the management and the financial information. The role that such directors should adopt within the Board is to advocate transparency of information between shareholders and managers, which is one of their main responsibilities. Similarly, they focused the empirical test stating that a higher ratio of independent directors is associated with higher quality and quantity of accounting disclosure to interested groups. Ultimately, Osterland (2004) and Ajinkya et al. (2005) have validated the link between the two aspects, contrasting that the effectiveness of the Board represented by a larger number of independent directors is positively associated with the disclosure of quality financial information.

However, it seems appropriate to introduce as a second point of view some of the evidence which pointed to beliefs which were totally opposed to those previously. Furthermore many studies did not find the significant impact of board independence on quality of financial information. (Rammer et al. 2006, Teitel et al. 2008 and Davila et al. 2009 al.) on their Boards with respect to reporting and accounting manipulation.

Therefore, the hypothesis on which they focus tries to show evidence of how directors on the Board, and especially independent ones, do not increase the quality of information. The results do not confirm the hypothesis since they reveal that the independence of the Board contributes to the council acting on the recommendations of good corporate governance, and in turn publishing less harmful accounting information. Therefore, the high degree of independence of the Board highlights two key issues: first, it leads to greater control over the company's activities; secondly, it contributes to greater transparency due to the desire to maintain a good reputation.

Following this evidence, the research carried out by Duchin et al. (2010) states that when the Executive Director of the company, hereafter referred to as CEO, belongs to the nomination committee, or when no such committee exists, the listed companies will tend to hire fewer independent directors and more proprietary directors on the Board. Thus, the hypothesis raised by these authors is that the larger number of proprietary independent directors has a significant and positive impact on financial information, when existence of independent directors has no effect on it. Once the corresponding empirical analysis was concluded, Duchin et al. (2010) confirmed the hypothesis. The authors justify these results indicating that increasing the number of independent directors has insignificant impact on accounting reporting quality, since the Executive Director of the Company (CEO) dominates the selection process of the candidates and uses it to place his allies on the Board. In this case, the directors take on a decorative role, away from any monitoring task, helping the CEO to take hold in office.

Next we can see more recent empirical findings of Barros et al. (2013) & Ho et al. (2011). one hand, the theory developed by Ho et al. (2011) predicts that the greater number of independent director is negative related to the level of manipulation and therefore to the quality of accounting information. To prove this hypothesis, the authors try to reason the various types of knowledge that an independent director may have of the organization to which he is director in order to determine whether they contribute or not to increasing the quality of accounting information. It is true that the independent director is not usually aware, to the same degree, of the problems that can frequently arise within the company in comparison to executive directors, in other words they are not aware of those small particular details of the organization as

directors would be. But we can say that their role is different from the other directors on the Board. According to Ho et al. (2011), the independent directors may provide perfection in the accounting reporting quality with their knowledge about the sector, with their strategic vision, overseeing the work of the executives or ensuring social interest, among other issues. In addition, before making any major decision, the independent director is required to inform in detail of all its possible consequences and implications for each part of the business. For this reason you cannot and should not generalize that independent directors lack the knowledge necessary to make important decisions within the organization. Ho et al. (2011) conclude that both executive and non-executive directors and independent directors in particular, contribute to the management and improvement of the disclosure of accounting information.

Moreover, regarding the empirical evidence by Barros et al. (2013) it is assumed that the inclusion of independent directors on boards will improve the performance of the company given the recommendations of good corporate governance, and in turn, that this measure will provide better quality accounting information. Indeed, after the corresponding analysis of this assessment, a significant and positive impact on the percentage of independent directors on the accounting information can be seen. Thus, the authors conclude that the presence of independent directors in comparison to other directors is an important control mechanism, since they provide security with regards to the interests of retail shareholders. In conclusion, an increased presence of external directors, particularly independent directors, counteracts the temptation of internal directors or executives to make decisions focused on their own personal benefit, putting a stop to the manipulation of accounts and therefore, leading to enhance the reporting quality.

The top managerial staff is viewed as the most astounding control system that is responsible for checking the moves made by the best official of the firm (Fama and Jensen (1983b)). In spite of the fact that they fulfill various administrative prerequisites they exist basically in light of irreconcilable circumstances they help to address (Hermalin and Weisbach, 2003).

The activity of the capacity of observing by the governing body is associated with its piece. Fama and Jensen (1983b) and Popularity (1980) demonstrate that its

arrangement is a vital factor to fabricate a committee to screen under powerful mode the activities created by the administration.

These creators attest that it is regular that the more prevailing individuals from the board are the individuals who are additionally inside supervisors, since they have particular and quantifiable data about the exercises of the association. The connection between the sort of money related data introduced by a firm and the extent of its top managerial staff has been the objective of a few examinations.

The relationship between the BS (board size) that oversees the general public predetermination and the accounting data quality displayed by the organization will lead us to define the principal speculation of research. The exploration created by Jensen (1993) and Lipton and Lorsch (1992) demonstrate that vast sheets of chiefs are less manageable to successful checking and less demanding to control by the President. The examination done by Xie, Davidson and DaDalt (2003) found a reverse connection between the number of the governing body and the nature of money related detailing.

The exact confirmation gave by Anderson, Mansi and Reeber (2004) linked with the theory that the number of the governing body will impact the cost of obligation financing. The outcomes got demonstrate that the more prominent is the extent of the board the lower the cost of financing acquired by the firm. Eisenberg, Wells and Sundgren (1998) and Yermack (1996) additionally found a noteworthy negative connection between the span of the board and the estimation of the organization. The examination of Beasley (1996) likewise demonstrates that there is an expanded inclination frequency of extortion associated with the more noteworthy size of the top managerial staff. In any case, the confirmation beforehand found is not decisive, as there are a few examinations that discovered proof the restricting way.

The studies of Klein (1996) and Peasnell, *et al* (2005) demonstrate outcomes about that report a positive connection between the number of the directorate and the bookkeeping quality. This proof is clarified as coming about because of the way that a more prominent number of executives permit a more noteworthy capacity for observing with respect to chairmen, bringing about lower bookkeeping optional speak to a higher bookkeeping quality.

In an investigation identified with the U.S. market, Hermalin and Weisbach (2003) discovered outcomes proposing that the piece of the top managerial staff and the corporate execution are not associated. Additionally Bhagat and Dark (1999) and Roman (1996), while breaking down the connection between the synthesis of the board and organization execution, did not get decisive outcomes about the presence, or not, of a causal relationship.

Because of expanding the quantity of individuals from the directorate, the matter of the organization develops and the capacity to screen the board ought to likewise increment. This thus makes the conditions to maintain a strategic distance from more noteworthy bookkeeping prudence and along these lines advance a higher nature of bookkeeping data of the organization. Situated in this, we can express our first research theory as takes after

Top managerial staff assume an essential part in observing and prompting directors and adjusting their interests to the interests of investors (e.g. Armstrong et al, 2010). Truth be told, sheets of executives, as corporate administration instruments, influence supervisors' basic leadership with respect to various parts of a company's execution, for example, monetary revealing (Srinidhi et al, 2011). To comprehend the components that influence chiefs' capacity to play out these parts, there is currently a line of studies exploring how executives' qualities, either ordered (e.g., freedom) or not (age, involvement, sexual orientation), influence their execution (e.g. Armstrong et al, 2010).² as of recently, most research concentrates on the commanded features of board assorted qualities, for example, freedom (e.g. Klein, 2002). For instance, firms with a higher rate of free executives have a predominant profit quality and a superior data condition (e.g. Armstrong et al, 2010).

There is broad research on the impact of board sex assorted qualities on various parts of firm execution including monetary revealing quality. Be that as it may, the outcomes are blended up until now. For example, Ye, Zhang and Rezaee (2010) don't locate any noteworthy connection between top administrators sexual orientation differences and income quality in a Chinese setting. Along a similar line, Sun, Liu and Lau (2011) don't locate any noteworthy relationship between nearness of female chiefs on the review advisory groups of U.S. firms and profit administration,

measured by unusual accumulations. Interestingly, Srinidhi et al., (2011) find that nearness of female chiefs on a board is related with higher profit quality in a U.S. setting. Moreover, Gul et al., (2011) find that sexual orientation assorted sheets are related with higher stock cost education.

Alam et al (2013) locate that female chiefs are grouped in real metropolitan territories in the U.S. also, this thus, makes ladies live more remote than men in respect to a corporate home office. They additionally find that organizations with female executives depend more on stock cost for CEO remuneration and Chief turn over. They contend that organizations with female chiefs are harder screens not in light of sexual orientation contrast clarification, but rather because of their higher separation to a firm area. They likewise locate a positive stock value response when a ladies who lives near an organization is selected on a board.

Sexual orientation assorted qualities writing depends on the possibility that ladies convey distinctive attributes to the board which thusly improve them in checking supervisors' basic leadership. As contended by Srinidhi et al., (2011), ladies are freer in basic leadership, less tolerant of untrustworthy conduct and they go out on a limb. This thus may help them to be better screens over chiefs' basic leadership including money related detailing quality.

The blended outcomes in regards to the impact of load up sexual orientation differences might be because of the way that these examinations have been done in various time allotments and also in various nations with various administration components at firm and nation levels. Consequently, speculation of discoveries starting with one setting then onto the next may not be fitting. As contended by Alam et al., (2013) it might likewise be because of ladies' separation to firm areas. Likewise, we outline our third theory in invalid frame:

This examination likewise planned to find the connection between the Chief duality and review quality. The CEO duality alludes to non-division of parts amongst Chief and the executive of the board. In the ordinary circumstance, sheets with CEO duality are seen inadequate on the grounds that an irreconcilable situation may emerge. This

normal for corporate administration is typical in Pakistani circumstance. It might be a result of the idea of family possesses business in creating nations like Pakistan.

It demonstrates that huge sizes of organizations that different individual for the two capacities ordinarily exchange at the higher cost to book duplicates (Yermack, 1996) and have higher profit for resources and cost productivity proportions (Pi and Timme, 1993). It is normal that within the sight of an overwhelming Chief duality, the organization plans to lessen the push to secure quality evaluator. It trusts that corporate administration is better without Chief duality in the partnership. This training is additionally suggested by different codes of corporate administration, including those accessible created nations. A few investigations (O'Sullivan, 2000; Salleh et. al., 2006) did not show significant confirm on the connection between Chief duality and review expenses. In an investigation identified with the U.S. market, Hermalin and Weisbach (2003) discovered outcomes proposing that the creation of the top managerial staff and the corporate execution are not associated. Additionally Bhagat and Dark (1999) and Roman (1996), while examining the connection between the synthesis of the board and organization execution, did not get decisive outcomes about the presence, or not, of a causal relationship.

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The blended outcomes in regards to the impact of load up sex differences might be because of the way that these examinations have been done in various time periods and additionally in various nations with various administration systems at firm and nation levels. Subsequently, speculation of discoveries starting with one setting then onto the next may not be proper. As contended by Alam et al., (2013) it might likewise be because of ladies' separation to firm areas. As needs be, we outline our third speculation in invalid shape:

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Following are the hypothesis of this study:

H1 Board independence has significant impacton FRQ

H2 Board size has significant impacton FRQ

H3 Firm size has significant impacton FRQ

H4 CEO Dualityhas significant impacton FRQ

H5 Leveragehas significant impacton FRQ

H6 Institutional shareholders havesignificant impacton FRQ

H7 Insidershareholders ownership has significant impacton FRQ

H8 Audit committee independence has significant impacton FRQ

Chapter No 3

3.1 Data and Methodology

To achieve the objective of this study the variables data collected from the banks of Pakistan (financial firms). The study taken data from the annual reports of financial firms and firm's sites. SECP (security exchanges commission of Pakistan) is used as main source of data. The data is collected of 26 financial firms listed in Pakistan and the time frame is 2005 to 2014. Penal regression technique is used in this study. Brooks (2008) said panel data provide information about both space and time. Importantly, a panel keeps the same individuals or objects and measures some quantity about them over time. The data analysis is undertaken by using Eviews8 and it run the descriptive statistics, Correlation Matrix analysis and panel data regression.

3.1.1 Descriptive statistics: It is used to check the nature of data and explain the variables used in the study, in terms of average and variation among the cross-section. It include mean, minimum, maximum, and standard deviation for all variables.

3.1.2 Correlation analysis: It is conducted to see the relationship among the dependent and independent variables. This would help to get an initial picture as to the nature of the relationship among the variables before proceeding to regression analysis.

3.1.3 Panel regression analysis: It is used to determine the significant relationships between the dependent and independent variables. It is undertaken by using common effect model, fixed effect model and random effect model. The objective of this analysis was to make a prediction about the dependent variable based on its relationship with all the concerned independent variables.

3.2 Model Specification

This study used the data from financial firms listed in Pakistan that include financial statement from 2005 to 2014. The nature of data allows the researcher to use panel data model, which is deemed to have advantages over cross sectional methodology. The study tested the three most important panel data techniques, Common, Fixed and

Random effect models. This model contain independent and dependent variable. The dependent variable of financial reporting quality is measured by McNicholos model. The independent variables are board size, audit committee independence, board interdependence, CEO duality, Institutional shareholder ownership, leverage and firm size.

3.2.1 Pannel Regression Model

$$FRQ_{i,t} = \beta_0 + \beta_1 ACI_{i,t} + \beta_2 BI_{i,t} + \beta_3 BS_{i,t} + \beta_4 CEOD_{i,t} + \beta_5 INST_{i,t} + \beta_6 INSD_{i,t} + \beta_7 Leverage_{i,t} + \beta_8 FS_{i,t} + \epsilon_{i,t}$$

3.3 Description of variables

Independent variables

3.3.1 Board Size

The board of directors is a group of individuals that are elected as, or elected to act as, representatives of the stockholders to establish corporate management related policies and to make decisions on major company issues. Every public company must have a board of directors. Here board sizes mean the total board members or board of directors, (Bulan et al. 2009). It has significance impact on FRQ.

3.3.2 Audit Committee independence

The audit committee is a selected number of members of a company's board of directors whose responsibilities include helping auditors remain independent of management. The committee provides independent review and oversight of a company's financial reporting processes, internal controls and independent auditors. For this we did used the proxy audit committee independent directors are divided by the board members (Bulan et al. 2009). It has significance impact on FRQ.

3.3.3 Board independence

An independent board is a corporate board that has a majority of outside directors who are not affiliated with the top executives of the firm and have minimal or no business dealings with the company to avoid potential conflicts of interests. Proxy for

this measurement used total number of board independence members divided by the total board members, (Bulan et al. 2009). It has significance impact on FRQ.

3.3.4 CEO duality

CEO duality refers to the situation when the CEO also holds the position of the chairman of the board. The board of directors is set up to monitor managers such as the CEO on the behalf of the shareholders. If the CEO is chairman and president than we considered the “1” otherwise we consider “0” (Bulan et al. 2009). It has significance impact on FRQ.

3.3.5 Institutional shareholder ownership

The amount of a company's available stock owned by mutual or pension funds, insurance companies, investment firms, private foundations, endowments or other large entities that manage funds on the behalf of others. For this we did used the proxy total numbers of institutional shareholder's ownership divided by the total number of shares or outstanding shares. It has significance impact on FRQ.

3.3.6 Leverage of the firm

Leverage, as a business term, refers to debt or to the borrowing of funds to finance the purchase of a company's assets. Using debt, or leverage, increases the company's risk of bankruptcy. It also increases the company's returns; specifically its return on equity. Proxy for the leverage did used total debt divided by total assets, (Tan et al. 2013). It has significance impact on FRQ.

3.3.7 Firm Size

It refers to the speed and extent of growth that is ideal for a specific small business. In here we took the log for all total assets of the firms, (Tan et al. 2013). It has significance impact on FRQ.

3.3.8 Measurement of the Financial Reporting Quality

To measure the FRQ, McNicholos (2002) modelis used in this study. It considers the standard deviation of the residuals or the error terms as a measure of reporting quality. Large values of the model residuals mean a considerable level of discretionary

accruals and so a poor quality of the financial information. Following is the model equation:

$$\text{ACCR}_{it} / \text{TA}_{it-1} = \beta_0 + \beta_1 \text{CFO}_{t-1} / \text{TA}_{it-1} + \beta_2 \text{CFO}_t / \text{TA}_{it-1} + \beta_3 \text{CFO}_{t+1} / \text{TA}_{it-1} + \beta_4 \Delta \text{Rev} / \text{TA}_{it-1} + \beta_5 \text{PPE}_t / \text{TA}_{it-1} + \epsilon_t$$

ACCR: total current accruals

CFit: operating CF of the current period,

CFit-1: operating CF of the previous period,

CFit+1: operating CF of the next period,

ΔRev : change in revenue and

PPE_{it}: level of plant, property and equipment.

All the variables are scaled by lagged TAt-1

Chapter 4

Results & Discussion

In the following chapter, this study analyzes the data by using different statistical tools. It has two sections. The first section presents results which includes descriptive statistics, correlation and panel regression analyses. The second section is includes the discussion.

4.1 Results & Discussion

Table 4.1.1 Descriptive statistic

| | Mean | Maximum | Minimum | Std. Dev. |
|-------------|----------|----------|----------|-----------|
| FRQ | 0.00041 | 0.001691 | -0.00156 | 0.000378 |
| C | 1 | 1 | 1 | 0 |
| ACI | 0.302151 | 0.571429 | 0.142857 | 0.09598 |
| B_I | 0.702928 | 0.923077 | 0.181818 | 0.180251 |
| BOARD_SIZE | 8.357447 | 13 | 4 | 1.54971 |
| CEO_DUALITY | 0.144681 | 1 | 0 | 0.35253 |
| FIRM_SIZE | 18.76203 | 21.56231 | 15.20795 | 1.412534 |
| INST | 0.293745 | 3.046097 | -0.2008 | 0.564118 |
| ISO | 0.08619 | 0.5105 | 0.0103 | 0.062368 |
| LEVERAGE | 0.100883 | 0.387 | 0.0023 | 0.068642 |

According to the results shown in table 4.1, dependent variable financial reporting quality (FRQ), have a mean value of 0.00041 and standard deviation of 0.000378 which indicates that during the study period the financial firms have normal accrual. And the maximum and minimum value of 0.001691 and -0.00156 indicates that the financial firms have maximum FRQ is 0.001691 and minimum FRQ is -0.00156.

Audit Committee independence has a minimum and maximum value is 0.142857 and 0.571429 respectively. And the standard deviation is 0.09598 with mean value of 0.3021.

Board independent mean value is 0.702928, minimum and maximum values of financial companies are 0.181818 and 0.923077 respectively. Standard deviation is 0.180251 presents the average spread from the mean value of manufacturing company's board of director's composition.

The mean value of Boardsize 0.702928 and 0.180251 is Std. deviation and the maximum and minimum values of Board independent are 0.923077 and 0.181818 respectively. CEO duality mean value is 0.144681 with the standard deviation value is 0.35253. And on the other hand maximum value and minimum values are 1 and 0. INST mean value is 0.293745 with the standard deviation value is 0.564118. And on the other hand maximum value and minimum values are 3.046097 and -0.2008. Institutional shareholder ownership mean value is 0.08619 with the standard deviation value is 0.062368. And on the other hand maximum value and minimum values are 0.5105 and 0.0103.

Leverage minimum and maximum value is 0.0023 and 0.387 respectively. It shows that financial firm maximum leverage of total noncurrent liabilities to owner's equity and long term liabilities is 0.387 and a financial firm's minimum as 0.0023 ratio of total noncurrent liabilities. Leverage shows mean value is 0.100883 and standard deviation is 0.068642.

Table 4.3.1 Correlation

| | ACI | B_I | BOARD_SIZE | CEO_DUALITY | FIRM_SIZE | FRQ | INST | ISO | LEVERAGE |
|-------------|----------|----------|------------|-------------|-----------|----------|----------|----------|----------|
| ACI | 1 | | | | | | | | |
| B_I | 0.07113 | 1 | | | | | | | |
| BOARD_SIZE | -0.58968 | -0.00908 | 1 | | | | | | |
| CEO_DUALITY | 0.117312 | 0.079301 | -0.0716 | 1 | | | | | |
| FIRM_SIZE | -0.06595 | 0.177721 | 0.335733 | 0.047737 | 1 | | | | |
| FRQ | 0.004619 | 0.199311 | -0.04488 | -0.10247 | -0.00966 | 1 | | | |
| INST | -0.01395 | 0.196033 | -0.09473 | -0.09196 | -0.23349 | 0.145008 | 1 | | |
| ISO | 0.083185 | 0.061215 | -0.10376 | 0.039956 | -0.05468 | 0.187551 | 0.205992 | 1 | |
| LEVERAGE | 0.137978 | -0.07056 | 0.015346 | 0.392635 | -0.0627 | -0.07135 | -0.1683 | 0.015877 | 1 |

The correlation matrix is used to test the existence of multicollinearity was by checking the Pearson correlation between the variables. In the above table all correlation results are below 0.75, which indicates that multicollinearity is not a potential problem for this study.

Table 4.3.1 Common Effect Model

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|------------|-------------|----------|
| C | -0.00021 | 0.000367 | -0.56616 | 0.5719 |
| ACI | -0.00015 | 0.000321 | -0.47561 | 0.6348 |
| B_I | 0.000398 | 0.000141 | 2.8235 | 0.0052 |
| BOARD_SIZE | -1.26E-05 | 2.09E-05 | -0.60231 | 0.5476 |
| CEO_DUALITY | -0.00013 | 7.51E-05 | -1.69526 | 0.0914 |
| FIRM_SIZE | -7.41E-08 | 1.94E-05 | -0.00381 | 0.997 |
| INST | 3.84E-05 | 4.68E-05 | 0.820897 | 0.4126 |
| ISO | 0.001009 | 0.000395 | 2.555418 | 0.0113 |
| LEVERAGE | 9.94E-06 | 0.000395 | 0.025179 | 0.9799 |
| R-squared | 0.091583 | | F-statistic | 2.848055 |
| | | | Prob(F- | |
| Durbin-Watson stat | | 1.284268 | statistic) | 0.00493 |

Table 4.3.2 Fixed Effect Model

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|------------|-------------|----------|
| C | 0.000192 | 0.000491 | 0.390744 | 0.6964 |
| ACI | 0.000309 | 0.000365 | 0.84438 | 0.3995 |
| B_I | 0.000441 | 0.00018 | 2.45564 | 0.0149 |
| BOARD_SIZE | -8.15E-06 | 2.52E-05 | -0.32347 | 0.7467 |
| CEO_DUALITY | -0.00011 | 0.00027 | -0.40918 | 0.6828 |
| FIRM_SIZE | -2.70E-05 | 2.59E-05 | -1.04176 | 0.2988 |
| INST | -0.00016 | 5.86E-05 | -2.71326 | 0.0072 |
| ISO | 0.000525 | 0.000477 | 1.100215 | 0.2726 |
| LEVERAGE | -3.23E-05 | 0.00039 | -0.08269 | 0.9342 |
| R-squared | 0.40007 | | F-statistic | 4.061793 |
| | | | Prob(F- | |
| Durbin-Watson stat | | 1.746745 | statistic) | 0 |

Table 4.3.3 Likelihood test

| Effects Test | | Statistic | d.f. | Prob. |
|--------------------------|--|-----------|---------|-------|
| Cross-section F | | 4.13421 | -25,201 | 0 |
| Cross-section Chi-square | | 97.49932 | 25 | 0 |

This study used the likelihood test to select that either common effect model better or fixed effect model is better. The selection criterion is P-value. If the P-value is significant then common effect model is rejected. The result shows that the P-value is significant 0.00 so, this study reject the common effect model.

Table 4.3.4 Random Effect model

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|------------|-------------------|----------|
| C | 5.01E-05 | 0.000418 | 0.119784 | 0.9048 |
| ACI | 0.000145 | 0.000335 | 0.433274 | 0.6652 |
| B_I | 0.000431 | 0.000158 | 2.731702 | 0.0068 |
| BOARD_SIZE | -6.60E-06 | 2.20E-05 | -0.30038 | 0.7642 |
| CEO_DUALITY | -0.00013 | 0.000115 | -1.16288 | 0.2461 |
| FIRM_SIZE | -1.96E-05 | 2.21E-05 | -0.88752 | 0.3757 |
| INST | -7.45E-05 | 5.13E-05 | -1.45381 | 0.1474 |
| ISO | 0.000809 | 0.000425 | 1.902848 | 0.0583 |
| LEVERAGE | -5.83E-05 | 0.000371 | -0.15681 | 0.8755 |
| R-squared | 0.061066 | | F-statistic | 1.837299 |
| Adjusted R-squared | 0.027829 | | Prob(F-statistic) | 0.07128 |
| Durbin-Watson stat | | 1.58744 | | |

Table 4.3.5 Hausman Test

| Test Summary | Chi-Sq. Statistic | Chi-Sq. d.f. | Prob. |
|----------------------|----------------------|--------------|--------|
| Cross-section random | 12.21913 | 8 | 0.1417 |

Here this study checks all the data by different empirical test like common, fixed, random effect models and hausman and likelihood test. The hausman test prob value is 0.008. Which is less than the 5%, it mean fixed effect model is used in this study.

Table 4.3.6 Fixed Effect Model

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|------------|-------------------|----------|
| C | 0.000192 | 0.000491 | 0.390744 | 0.6964 |
| ACI | 0.000309 | 0.000365 | 0.84438 | 0.3995 |
| B_I | 0.000441 | 0.00018 | 2.45564 | 0.0149 |
| BOARD_SIZE | -8.15E-06 | 2.52E-05 | -0.32347 | 0.7467 |
| CEO_DUALITY | -0.00011 | 0.00027 | -0.40918 | 0.6828 |
| FIRM_SIZE | -2.70E-05 | 2.59E-05 | -1.04176 | 0.2988 |
| INST | -0.00016 | 5.86E-05 | -2.71326 | 0.0072 |
| ISO | 0.000525 | 0.000477 | 1.100215 | 0.2726 |
| LEVERAGE | -3.23E-05 | 0.00039 | -0.08269 | 0.9342 |
| R-squared | 0.40007 | | F-statistic | 4.061793 |
| Durbin-Watson stat | | 1.746745 | Prob(F-statistic) | 0.00 |

The Fixed effect panel regression model is selected in this study. The R_square is 40%. It shows that independent variables of this study could explain variation in the dependent variable about 40%. F-probability prob. is 0.000, which indicates that the model is and the variables are mutually significant. As shown in the table 4.3.6 leverage, Iso, ACI, CEO duality and Firm size have no statistical significance on FRQ at 5% level. Whereas board independence has positive and significant and INST has negative and significant relationship at 5%.

According to these results four hypotheses are shown the impact on financial reporting quality. Board independence shows the (prop=0.01) positive and significant impact on FRQ. It means that a more independent board shows the better FRQ. INST shows the (prop=0.008) negative and significant impact on FRQ. It means that a less number of Institutional shareholders show the better FRQ. The other variables of

this study rejects the hypothesis that board size, firm size, INST and leverage has no significant impact on FRQ.

Chapter 05

Conclusion

5.1 Conclusion

Financial reporting quality (FRQ) is considered as backbone of economic activities and now the studies are increasing on financial reporting quality. But the determinants or characteristics of FRQ is not clearly understandable in finance literature, because its meaning is different in different fields. So here is a question can FRQ is measured and its determinants are identified. Past studies attempted to find out these factors and provide different evidence about the impact of these factors on FRQ. But these researches are conducted on developed countries where institutions have similarities and advanced monitoring framework.

This study explores the impact of CG mechanisms and FRQ in Pakistan. It is observed that financial reporting quality gained interest by users and investors in investment decisions. And it is best way to check the FRQ by corporate governance. The corporate governance factors are board independence, board size, institutional shareholder ownership, leverage, INST, firm size, CEO duality and audit committee's independence.

The finding of this study discovered, there are significant and positive association between the some factors of corporate governance on FRQ in financial firms of Pakistan.

This study suggests that it is helpful for the government of Pakistan and other financial institutions that how can they make better financial reporting quality and avoid the risk. It is also helpful for the investors who want to invest they must carefully observe that corporate governance factors which has impact on financial reporting quality.

Future Research:

Although this study supports the argument that the corporate governance affects the financial reporting quality in the context of Pakistan. However, further research is

necessary to provide additional insight into the role of corporate governance and the reporting quality. First, it would be appropriate to verify these findings by including the non-financial companies. Then, it would be worthwhile to incorporate other governance variables (such as the gender discrimination) or other measures of information quality (such as the voluntary disclosure). It would be also very interesting to determine if the governance mechanisms and the reporting quality influence the cost of capital of the Pakistan's firms. Finally, it suggest investigating the link between corporate governance and financial reporting quality in other emerging markets.

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Bank names

| S.no | Banks |
|-------------|--------------|
| 1 | BAHL |
| 2 | FBL |
| 3 | FINCA |
| 4 | FWBL |
| 5 | HBL |
| 6 | HMB |
| 7 | JSBL |
| 8 | KASB |
| 9 | KBL |
| 10 | MCB |
| 11 | MBL |
| 12 | NBP |
| 13 | NIB |
| 14 | NRSP |
| 15 | PBIC Ltd |
| 16 | PIC Ltd |
| 17 | PKIC Ltd |
| | PLHC |
| 18 | Ltd |
| | PO Bank |
| 19 | Ltd |
| 20 | POIC Ltd |
| 21 | SAMBA |
| 22 | SILK |
| 23 | SINDH |

24 SBL

SPIAIC

25 Ltd

26 SCB

27 SUMMIT

28 TFMB

29 BOK

30 BOP

TM B

31 Ltd

32 UMB Ltd

33 UBL

34 ZTBL

Appendix

Descriptive statistics

| Maximum | Minimum | Std. Dev. | Skewness | Kurtosis | Jarque-Bera | Probability | Sum | Sum Sq. Dev. | Observations |
|---------|---------|-----------|----------|----------|-------------|-------------|---------|--------------|--------------|
| 0.00169 | 0.0015 | 0.0003 | 1.3361 | 11.523 | 781.31 | | -9.81E- | 3.34E- | |
| 1 | 6 | 78 | 12 | 66 | 26 | 0 | 05 | 05 | 235 |
| 1 | 1 | 0 | NA | NA | NA | NA | 235 | 0 | 235 |
| 0.57142 | 0.1428 | 0.0959 | 0.8456 | 2.7837 | 28.464 | 0.00000 | 71.005 | 2.1556 | |
| 9 | 57 | 8 | 1 | 91 | 09 | 1 | 39 | 62 | 235 |
| 0.92307 | 0.1818 | 0.1802 | 0.7470 | 2.3338 | 26.205 | 0.00000 | 165.18 | 7.6027 | |
| 7 | 18 | 51 | 9 | 44 | 87 | 2 | 81 | 91 | 235 |
| 13 | 4 | 1.5497 | 0.3850 | 3.2434 | 6.3879 | 0.04100 | 1964 | 561.97 | |
| 1 | 0 | 1 | 67 | 72 | 36 | 9 | 34 | 45 | 235 |
| | | 0.3525 | 2.0201 | 5.0809 | 202.23 | 0 | | 29.080 | |
| | | 3 | 28 | 19 | 61 | 0 | | 85 | 235 |
| 21.5623 | 15.207 | 1.4125 | 0.5354 | 2.6216 | 12.632 | 0.00180 | 4409.0 | 466.88 | |
| 1 | 95 | 34 | 8 | 24 | 35 | 7 | 77 | 87 | 235 |
| 3.04609 | | 0.5641 | 3.0005 | 11.659 | 1086.8 | | 69.030 | 74.465 | |
| 7 | -0.2008 | 18 | 29 | 42 | 58 | 0 | 14 | 66 | 235 |
| 0.5105 | 0.0103 | 0.0623 | 2.4733 | 13.728 | 1366.6 | | 20.254 | 0.9102 | |
| | | 68 | 95 | 77 | 95 | 0 | 55 | 14 | 235 |
| | | 0.0686 | 1.6947 | 5.4380 | 170.69 | | 23.707 | 1.1025 | |
| 0.387 | 0.0023 | 42 | 29 | 83 | 49 | 0 | 5 | 35 | 235 |

Correlation

| ACI | B_I | BOARD_SIZE | CEO_DUALITY | FIRM_SIZE | FRQ | INST | ISO | LEVERAGE |
|----------|----------|------------|-------------|-----------|----------|----------|----------|----------|
| 1 | 0.07113 | -0.58968 | 0.117312 | -0.06595 | 0.004619 | -0.01395 | 0.083185 | 0.137978 |
| 0.07113 | 1 | -0.00908 | 0.079301 | 0.177721 | 0.199311 | 0.196033 | 0.061215 | -0.07056 |
| -0.58968 | -0.00908 | 1 | -0.0716 | 0.335733 | -0.04488 | -0.09473 | -0.10376 | 0.015346 |
| 0.117312 | 0.079301 | -0.0716 | 1 | 0.047737 | -0.10247 | -0.09196 | 0.039956 | 0.392635 |
| -0.06595 | 0.177721 | 0.335733 | 0.047737 | 1 | -0.00966 | -0.23349 | -0.05468 | -0.0627 |
| 0.004619 | 0.199311 | -0.04488 | -0.10247 | -0.00966 | 1 | 0.145008 | 0.187551 | -0.07135 |
| -0.01395 | 0.196033 | -0.09473 | -0.09196 | -0.23349 | 0.145008 | 1 | 0.205992 | -0.1683 |
| 0.083185 | 0.061215 | -0.10376 | 0.039956 | -0.05468 | 0.187551 | 0.205992 | 1 | 0.015877 |
| 0.137978 | -0.07056 | 0.015346 | 0.392635 | -0.0627 | -0.07135 | -0.1683 | 0.015877 | 1 |

Common Effect model

Dependent Variable: FRQ
 Method: Panel Least Squares
 Date: 11/05/17 Time: 20:42
 Sample: 2005 2014
 Periods included: 10
 Cross-sections included: 26
 Total panel (unbalanced) observations: 235

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|-----------|
| C | -0.00021 | 0.000367 | -0.56616 | 0.5719 |
| ACI | -0.00015 | 0.000321 | -0.47561 | 0.6348 |
| B_I | 0.000398 | 0.000141 | 2.8235 | 0.0052 |
| BOARD_SIZE | -1.26E-05 | 2.09E-05 | -0.60231 | 0.5476 |
| CEO_DUALITY | -0.00013 | 7.51E-05 | -1.69526 | 0.0914 |
| FIRM_SIZE | -7.41E-08 | 1.94E-05 | -0.00381 | 0.997 |
| INST | 3.84E-05 | 4.68E-05 | 0.820897 | 0.4126 |
| ISO | 0.001009 | 0.000395 | 2.555418 | 0.0113 |
| LEVERAGE | 9.94E-06 | 0.000395 | 0.025179 | 0.9799 |
| R-squared | 0.091583 | Mean dependent var | | -4.18E-07 |
| Adjusted R-squared | 0.059427 | S.D. dependent var | | 0.000378 |
| S.E. of regression | 0.000366 | Akaike info criterion | | -12.9487 |
| Sum squared resid | 3.03E-05 | Schwarz criterion | | -12.8162 |
| Log likelihood | 1530.469 | Hannan-Quinn criter. | | -12.8953 |
| F-statistic | 2.848055 | Durbin-Watson stat | | 1.284268 |
| Prob(F-statistic) | 0.00493 | | | |

Fixed Effect model

Dependent Variable: FRQ
 Method: Panel Least Squares
 Date: 11/05/17 Time: 20:43
 Sample: 2005 2014
 Periods included: 10
 Cross-sections included: 26
 Total panel (unbalanced) observations: 235

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|-------------|-------------|------------|-------------|--------|
| C | 0.000192 | 0.000491 | 0.390744 | 0.6964 |
| ACI | 0.000309 | 0.000365 | 0.84438 | 0.3995 |
| B_I | 0.000441 | 0.00018 | 2.45564 | 0.0149 |
| BOARD_SIZE | -8.15E-06 | 2.52E-05 | -0.32347 | 0.7467 |
| CEO_DUALITY | -0.00011 | 0.00027 | -0.40918 | 0.6828 |
| FIRM_SIZE | -2.70E-05 | 2.59E-05 | -1.04176 | 0.2988 |
| INST | -0.00016 | 5.86E-05 | -2.71326 | 0.0072 |
| ISO | 0.000525 | 0.000477 | 1.100215 | 0.2726 |
| LEVERAGE | -3.23E-05 | 0.00039 | -0.08269 | 0.9342 |

Effects Specification

Cross-section fixed (dummy variables)

| | | | |
|--------------------|----------|-----------------------|-----------|
| R-squared | 0.40007 | Mean dependent var | -4.18E-07 |
| Adjusted R-squared | 0.301574 | S.D. dependent var | 0.000378 |
| S.E. of regression | 0.000316 | Akaike info criterion | -13.1508 |
| Sum squared resid | 2.00E-05 | Schwarz criterion | -12.6503 |
| Log likelihood | 1579.219 | Hannan-Quinn criter. | -12.949 |
| F-statistic | 4.061793 | Durbin-Watson stat | 1.746745 |
| Prob(F-statistic) | 0 | | |

Randoms effect model

Dependent Variable: FRQ

Method: Panel EGLS (Cross-section random effects)

Date: 11/05/17 Time: 20:44

Sample: 2005 2014

Periods included: 10

Cross-sections included: 26

Total panel (unbalanced) observations: 235

Swamy and Arora estimator of component variances

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|-------------|-------------|------------|-------------|--------|
| C | 5.01E-05 | 0.000418 | 0.119784 | 0.9048 |
| ACI | 0.000145 | 0.000335 | 0.433274 | 0.6652 |
| B_I | 0.000431 | 0.000158 | 2.731702 | 0.0068 |
| BOARD_SIZE | -6.60E-06 | 2.20E-05 | -0.30038 | 0.7642 |
| CEO_DUALITY | -0.00013 | 0.000115 | -1.16288 | 0.2461 |
| FIRM_SIZE | -1.96E-05 | 2.21E-05 | -0.88752 | 0.3757 |
| INST | -7.45E-05 | 5.13E-05 | -1.45381 | 0.1474 |
| ISO | 0.000809 | 0.000425 | 1.902848 | 0.0583 |
| LEVERAGE | -5.83E-05 | 0.000371 | -0.15681 | 0.8755 |

Effects Specification

| | S.D. | Rho |
|----------------------|----------|--------|
| Cross-section random | 0.000187 | 0.2594 |
| Idiosyncratic random | 0.000316 | 0.7406 |

Weighted Statistics

| | | | |
|--------------------|----------|--------------------|-----------|
| R-squared | 0.061066 | Mean dependent var | -9.15E-07 |
| Adjusted R-squared | 0.027829 | S.D. dependent var | 0.000323 |
| S.E. of regression | 0.000318 | Sum squared resid | 2.29E-05 |
| F-statistic | 1.837299 | Durbin-Watson stat | 1.58744 |
| Prob(F-statistic) | 0.07128 | | |

Unweighted Statistics

| | | | |
|-----------|----------|----------------|---------|
| R-squared | 0.057966 | Mean dependent | -4.18E- |
|-----------|----------|----------------|---------|

| | | | |
|-------------|----------|---------------|----------|
| | | var | 07 |
| Sum squared | | Durbin-Watson | |
| resid | 3.14E-05 | stat | 1.154239 |