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Effect of Companies Act 2013 on the Relationship Between Non-Audit Services and Earnings Managementin India

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This study investigates the moderating effect of the Companies Act 2013 on the relationship between Non-audit Services (NAS) and Earnings Management (EM). Furthermore, it investigates the effect of the Companies Act 2013 on the relationship between the presence of independent directors on the board and earnings management. To achieve these objectives, a sample of BSE 500 index companies has been selected that were listed on the Bombay Stock Exchange (BSE) for the four years period 2012, 2014, 2015 and 2016. Variables such as non-audit services have been measured through the ratio of non-audit fee to total audit fee, and earnings management through discretionary accrual models such as Jones and Modified Jones model. Results show that based on descriptive statistics, the NAS fee ratio is lower in the post Companies Act period than the pre-Companies Act period. Results of regression analysis report that regulations on the reporting of internal control and restriction on non-audit services are significantly negatively associated with earnings management practices. Furthermore, following the enactment of the Companies Act 2013, the role of independent directors has become more effective in curbing management from engaging in earnings management. Finally, following the enactment of the Companies Act 2013, companies with a decline in non-audit services are significantly less engaged in earnings management practices. Thus, these results imply that these regulations are effective in improving the monitoring role of independent directors and audit committees in protecting shareholders' interest.

Key words: *Non-audit Services, Earnings Management, Sarbanes Oxley Act, Companies Act 2013, Corporate Governance*

1. Introduction

In the perspective of earnings management, the provision of non-audit services and autonomy of the auditor have become a much debated issue. Massive scandals such as the Waste Management Scandal (1998, USA), HIH Insurance (2001, Australia), the Enron Scandal (2001, USA), WorldCom Scandal (2002, USA), Lehman Brothers Scandal (2008, USA), Satyam Scandal (2009, India), the Olympus Scandal (2011, Japan), Global Crossing, Tyco and Arthur Andersen (USA) have occurred worldwide. These corporate scandals one after another have shaken the investor's confidence globally. It has been reported that most of the companies involved in accounting scandals have paid their auditors a huge NAS fee, raising questions about the integrity of the auditor and the reliability of financial statements. This has caused earnings management practices to be a worldwide challenge. Corporate governance has also become a thrust area. Transparency in mechanisms and free flow of information can be created through proper governance systems. An environment of corporate responsibility and shareholder confidence can be created by good governance. To regain investors' confidence on the first-rate surety of audited financial statements, different countries have adopted some regulations. Some countries brought major changes in their disclosure practices.

The United States (USA) Sarbanes-Oxley Act 2002, known as SOX, contains regulations that have made significant changes. One of these regulations concerns a ban on the supply of NAS by the auditor and another is linked to regulations on internal control over financial reporting. The implications of these arrangements are being debated on a daily basis. In the UK, regulations were enacted by the Auditing Practices Board (APB) and Ethical Standards (ES). The United Kingdom has gone through a quantity of sizeable modifications over the previous few years. The acceptance of a set of ethical standards (thereafter APBES) for auditors with limitations on NAS delivery to customers is one of these modifications. It banned the purchase of some NAS categories. The 2005 company ordinance (disclosure of compensation for auditor) required extensive reporting of NAS fees in nine different classes. Regulations were implemented in India after the Satyam Scandal through the Companies Act 2013, which includes a NAS provision related regulation and also includes some reforms in corporate governance. The Company Act 2013 banned the supply of different non-audit products, and the audit committee and board of director's preliminary clearance was made compulsory for this supply. The Act also discusses improvements in the administration of companies. The purpose of this research is to resolve the tension in the current debate about the effectiveness of these settlements, especially in India's Companies Act, 2013 (particularly in relation to NAS and corporate governance).

1.1 Research background

Current research has concentrated on the autonomy and inclusiveness of NAS on the auditor, opinion of auditors, understanding of investors, earnings management and financial reporting quality (FRQ). Academics disagree over the impact of delivering clients with non-audit services on the auditor's autonomy. Scholars argue that audit partner efficiency is improved by offering clients non-audit products, through a comprehensive knowledge of their system. On the other hand, this may enhance the auditor's economic dependency on the company, thereby affecting the auditor's independence.

In order to counter possible risks to an auditor's integrity, Sarbanes-Oxley Act (SOX) 2002 restricted the supply of certain NAS by the auditor and required preliminary approval from the audit committee. Section 201 of SOX 2002 forbids the procurement of certain types of non-audit services (NAS) by the auditor, and Section 202 is related to the advance clearance from an audit committee for the purchase of NAS. After the Enron collapse, discussion on conflict of interest in India began immediately. In 2002, the topic of non-audit services has been debated by the Naresh Chandra Committee, which recommended the America's position under the 2002 Sarbanes Oxley Act.

India accepted a similar policy by restricting auditors from supplying certain non-audit products. Section 144 of the Company Act includes an exhaustive list of banned non-audit products. It also allows the government to recommend any other type of services in this category and an auditor must seek prior approval from an audit committee or board of directors. If the auditor is a corporation, this restriction applies to its subsidiary or any organization in which the company has substantial influence and whose brand name is being used by such audit company or its affiliated company. However, the Companies Act 2013 does not provide any requirement to disclose the non-audit fee charged by the auditor in the financial accounts of the audited firm. Such permissions are required to furnish non-audit services in other countries as well as in the USA where audit committee governs the types of non-audit services that the audited company may purchase. In addition, this authorization must be reported in periodic reports by the audited firm to shareholders. Similar practices have also been followed in the UK where Corporate Governance Codes 2016 requires that policy arrangement with external auditors with regard to non-audit services must be performed by an audit committee. It is required to include a separate section in annual reports, which should explain how the audit committee has safeguarded the objectivity and integrity of non-audit service providers. Figure 1 provides comparative lists of non-audit services under SOX Act 2002 and the Companies Act 2013.

Figure 1 Non-audit services under Companies Act 2013 compared with SOX Act 2002

Companies Act, 2013	Sarbanes Oxley Act, 2002
Book-keeping	Book-keeping
In-house review	In-house review
Database for financial information	Database for financial information
Actuary facilities	Actuary facilities
Consultation on investment and banking	Consultation on investment and banking
Financial services externalized	Appraisal or valuation services, fairness opinion
Role of management	Management or human resource function
Any extra facilities	Legal/expert services unrelated to audit

A similar list of NAS for publicly listed firms was also adopted in the European Union in 2016. It forbids eleven product classes, consisting of specific sub-categories. The United Kingdom and Australia have also adopted a similar position. International practices such as in the EU, Australia and the UK show a ban on non-audit services such as taxation, valuation and restructuring, as they are likely to affect an auditor's objectivity and independence. These services are currently allowed in India.

1.2 Corporate Governance

Globally, following corporate scandals, corporate governance standards are formulated and continuously updated in order to improve the integrity and performance of financial statements. In 2006, Clause 49 of the listing agreement was introduced in India, which embarked on applicability and importance of corporate governance. Initially, the Confederation of Indian Industry (CII) formed a task force in 1995 with interest inserted by the Cadbury Committee Report from the UK. Building on this, CII published in 1998 voluntary codes called "Desirable Corporate Governance". The Indian Securities and Exchange Board (SEBI) also set up few corporate governance committees. The Kumar Manlagam Birla Report (2000), Naresh Chandra Committee (2002) and Narayana Murthy Committee (2002) are the most notable of these. The Kumar Manlagm Birla committee recommended to include in the listing agreement a new provision called Clause 49 to promote good corporate governance. The Ministry of Finance and Company Affairs set up a Naresh Chandra Committee in August 2002 following the Enron collapse in 2001 and enactment of Sarbanes Oxley in America, to investigate the relationships among auditor, company and independent directors' position. The committee made recommendations on two main corporate governance aspects: financial and non-financial reporting as well as independent oversight of the audit and management board.

In 2002, a Narayana Murthy committee was established by the Indian Securities and Exchange Board (SEBI) to assess the implementation of corporate governance codes by listed companies, and issued a revised Clause 49. Clause 49 was revised in 2008 to incorporate some of the Narayana Murthy Committee's key recommendations, especially those concerning audit committees, audit reports, independent directors, related party transactions, risks management, directorships, compensation to directors, codes of conduct and financial disclosures.

Paragraph 149 of the Companies Act 2013 contains guidelines for the selection of independent directors. Under Section 4 of the Companies Act 2013, each publicly listed company shall have at least one third of a total number of directors as independent directors. The central government may specify a minimum number of independent directors in case of any group of public companies. An independent director shall hold office on the corporation board for a term of up to five successive years but shall be eligible for renovation after a special settlement has been accepted by the company and is submitted in the board's meeting. The 2013 act expressly limits the right of independent directors for stock options and remuneration other than sitting fees and compensation of board attendance, other meetings and travel expenses. Profit related commitment may be paid to the independent directors upon approval by investors. The current rules also require public companies to have audit committees with at least two third independent directors as being members of the audit committee. Further, the audit committee should also be headed by one independent director.

In consideration of the internal control laws, Sec 302 of the SOX Act 2002 is a mandate that requires CEO/CFO certification about internal control systems based on their evaluation (L and April 2018). Section 404 requires the auditor to check the management analysis and then report on the efficacy of internal control over financial reporting (ICFR). The discussion on internal control in India started after a major accounting fraud in Satyam computer services, one of the India's largest IT firms. As a result of this scandal, India's ranking in the CLSA Corporate Governance Watch 2010 dropped from third to seventh in Asia. Because of this scandal, Indian companies demanded that there should be rules and regulations regarding internal control. India is the first country in South Asia that has developed regulations regarding internal control.

The Companies Act 2013 was introduced as a result of Satyam scandal, after repealing the old Companies Act 1956. This was to provide mandatory requirements regarding reporting on internal control systems. The requirement is similar to what was mandated by USA SOX 2002. Clause E of sub-section 5 of Section 134 of the Act includes the statement regarding director's liability, stating that the directors must have formed internal financial control, to be enforced by the company and that such internal financial controls have been adequate and functioning effectively. Nonetheless, Section 143 (3) (I) of the Act requires the statutory auditor to mention in his audit report whether the company has in place an efficient Internal Financial Control System (ICFS), and the operational efficiency of such controls for listed and non-listed entities.

Academics are continuing to discuss the impact of supplying clients with non-audit services on the auditor's autonomy. Some researchers suggest that delivering clients with non-audit services will increase the productivity of audit partners through getting detailed knowledge of their process. Nevertheless, on the other hand it may increase the auditors' economic dependence on the client and thus affect the auditor's independence. With the passing of the Companies Act 2013, there are more rigorous laws on the dissemination of internal control systems in the form of views of the board on the efficiency of the internal control system and an external auditor view on the efficacy of the internal control system. However, laws were also adopted that placed restrictions on external auditors for the supply of non-audit products to clients. As a result of these regulations on internal control and non-audit services, it would be important to investigate the relationship between non-audit products and earnings management in the context of an emerging economy like India. Furthermore, monitoring the role of independent directors following the enactment of the Companies Act 2013 has become more important to investigate, for the safeguarding of shareholders' interest.

1.3 Research Objectives

The main objectives of this study are to determine:

- The effect of the Companies Act 2013 on the relationship between the proportion of independent directors and earnings management.
- The effect of the Companies Act 2013 on the relationship between non-audit services and earnings management.

To achieve these objectives, a sample of BSE 500 index companies listed on the Bombay Stock Exchange (BSE) has been selected, based on market capitalization, which represents more than 90 percent of total turnover. Data related to all variables has been collected from annual reports of these selected companies for a four years period, 2012, 2014, 2015 and 2016. Variables such as non-audit services have been measured through a non-audit fee ratio, and earnings management through two discretionary accrual models such as Jones and Modified Jones. Finally, independent directors have been measured through a proportion of independent directors to total directors. Results state that regulations on internal control reporting and non-audit services are quite effective in curbing management from engaging in earnings management. Furthermore, the role of independent directors has also become effective in constraining earnings management as a result of the Companies Act 2013. Finally, with the regulations on internal control reporting and non-audit services, there is a decline in non-audit services, which also results in a decrease in earnings management practices.

The structure of the remaining paper is as follows. Section 2 of this study discusses related literature on NAS and earnings management relationship along with the hypothesis. The methodology of study has been described in section 3, followed by data analysis in section 4. Finally, section 5 ends with the conclusion.

2. Literature Review & Hypothesis Development

A discussion on the non-audit product supply and auditor's autonomy is already underway. Some researchers claim that providing non-audit products to customers would improve the audit partner efficiency through a detailed understanding of their process. However, it may enhance the auditor's economic reliance on the company and thus affect the auditors' autonomy. There exists a lot of research on whether the provision of non-audit services by auditors affects the monitoring of earnings, and due to mixed findings from preceding research, it is still a continuing discussion.

Craswell (1999) reported that NAS provided by auditors to their audit clients have been observed as a hindrance to auditors' independence by regulatory bodies in the United Kingdom, the USA, Australia and other developing countries in the world. Simunic (1984) and Ashbaugh et al. (2003) suggested that an economic bonding emerges between auditors and clients when audit firms provide non-audit services to their clients. This economic bonding will lead the audit firms to reduce incentives to prevent clients from adjusting the accounts (earnings management) due to the concern of losing audit fees. Defond et al. (2002) reported that if auditors provide non-audit services to their clients this will affect their judgment. Similarly, from the point of view of investors, it was reported that the quality of financial reports is compromised when auditors provide no-audit services to their clients. (Simunic, 1984; Firth, 1990; Feroz et al. 1991).

A study by Krishnan et al. (2011) investigated the effect of regulations on restriction to provide non-audit services through SOX Act on the relationship between non-audit services and earnings management. They found that compared to the pre SOX period, the relationship between non-audit services and earnings management was reduced in the post SOX period. Furthermore, that relationship holds only for income decreasing accruals. Likewise, Knechel and Sharma (2012) also contributed to this debate through analyzing the effect of these regulations on the restriction of non-audit services provision on audit effectiveness in the pre and post SOX audit report lags. Contrary to the previous results, they found that audit report lag increased in the post SOX period, compared with the pre SOX period as a result of a decrease in non-audit services. Similarly, a study by Chiu et al. (2017) investigated the effect of Public Company Accounting Oversight Board & SOX on audit quality; they reported that the audit quality of non-Big Four and Big Four auditors has enhanced under SOX.

Mande and Son (2015) examined how SOX moderates the relationship between audit fees and quality of accruals using data samples from 2000-2007. This study finds high audit charges reflecting high audit undertaking, which in propensity improves accrual quality. The moderating effects of SOX and TENURE were observed for the whole post-SOX cycle on the fees and accruals performance association. Performance accruals and audit fees association is regulated by both SOX and Tenure, but this relationship is changed only by SOX. Research was carried out under the settings of the UK for determining the effect of non-audit services and audit firm tenure regulations on auditor independence and financial reporting quality, using FTSE 350 companies (Islam, 2016). He found no strong evidence that non-audit services and longer audit firm tenure impairs financial reporting quality.

Another study was conducted in order to find how SOX regulations affected the relationship between non-audit services and earning quality, using accounting conservatism as a proxy for earning quality of financial statements (Chu & Hsu, 2018). They also reported the finding that following the regulations on non-audit services through the SOX Act, no conclusive evidence has been found that the provision of non-audit services affects earnings quality. Thus, these regulations have been found effective in governing auditor's independence.

Sun and Liu (2013) studied the effects of auditor's industry specialization on the relationship between board independence and earnings management, using data from the USA database. They stated that the negative relationship between board independence and earnings management is more pronounced for firms that are audited by industry specialist audit firms as compared to non-specialist audit firm. In a similar vein, Chi et al. (2015) explored how board independence moderates the relationship between family firms and earnings management behavior using data samples of 379 listed high technology firms over seven years, in Taiwan. Based on the analysis, they found that family firms with more independent directors are likely to constrain earnings management in an effective way, than family firms with relatively less-independent directors.

2.1 Hypothesis development

In the marketplace, managers serve as an agent of investors and shareholders. These managers are expected to act for investment and other reasons in the interests of their stakeholder's as well. However, if managers fail to fulfill their obligations and cause conflict, there creates an agency problem. With regard to the non-audit services provision and earnings management relationship, independent directors are expected to ensure auditors' independence and also constrain management from earnings management practices, thus protecting shareholders interest. Likewise, stewardship theory suggests that directors would like to do a good job and be good managers for the assets of organization instead of exhibiting opportunistic behavior. Based on the support from previous literature and related theories, the following hypotheses can be developed:

H1: The Companies Act 2013 is negatively related to the magnitude of discretionary accruals.

H2: The Companies Act 2013 moderates the relationship between proportion of independent directors and the magnitude of discretionary accruals.

H3: The Companies Act 2013 moderates the relationship between non-audit services and the magnitude of discretionary accruals.

3. Data and methodology

3.1 Sample selection

This study uses the sample of those top BSE 500 index companies based on market capitalization, listed on the Bombay Stock Exchange (BSE), and which also represents more than 90 percent turnover of the total turnover of the Bombay Stock Exchange. Out of this total 500 sample companies, 150 companies from the financial sector have been excluded, being that this sector has unique characteristics and operations. Furthermore, some companies have also been excluded from the sample due to issues such as non-availability of annual reports and missing variables. Thus, the final sample consists of 332 companies that have been considered for analysis. Data related to all variables has been collected from annual reports of these companies for the four years period from 2012-2016. Data for the year 2013 has not been considered in this study because the Companies Act 2013 was enacted in this year, which approved the regulations such as reporting on internal control quality (ICQ) and restrictions on provision of non-audit services to clients.

Considering these regulations, 2012 is the year where there were no regulations either on reporting of internal control quality (ICQ) or provision of non-audit services in India. While as a result of passing the Companies Act 2013, 2014 is the year where Management Opinion on ICQ was made mandatory for listed companies, and Auditor Opinion on ICQ was introduced in 2016. In addition to this, regulations were also introduced which put restrictions on the provision of certain non-audit services. Therefore, the study provides data to integrate the change assessment for the time before and after 2013.

3.2 Variables

3.2.1 Dependent Variable

This study used discretionary accruals as a proxy to measure earnings management, which is also in line with the previous literature. Although there are a number of models available related to discretionary accruals for measuring earnings management, we have used two popular proxies for this purpose e.g. Jones and modified Jones models (Suh & Fernando, 2013).

3.2.2 Explanatory Variable

Provision of non-audit services is the explanatory variable used in this study. The ratio of non-audit fee to total audit fee has been used as a proxy to measure the extent of non-audit services provided by audit firms to their clients. This is the most widely used ratio, used in the previous studies in order to measure non-audit services (Dobler, 2014; Hohenfels & Quick, 2018; Kang, 2017).

3.2.3 Control Variables

In order to reduce potential biasness in the data analysis, a number of variables have been used as controls, keeping in view the fact that these are related with the dependent variable and also supported by previous literature. These variables include firm size, leverage, sales growth, cash flow from operations, market to book ratio, loss, merger, financing and audit firm size.

3.2.4 Companies Act 2013

The codes of corporate governance states that the presence of independent directors on the board should be encouraged in order to promote transparency and for safeguarding the interest of shareholders. The enactment of the Companies Act 2013 in India has also encouraged promoting the role of board of directors including independent directors for safeguarding the interest of shareholders. Furthermore, this act also restricts companies from providing certain types of non-audit services to their clients and also requires approval from audit committee before providing such services. Therefore, the enactment of this Companies Act 2013 has been used as a moderator.

Table 1. Variables and its measurement

Variables	**Measurement basis**
Independent variable Non-audit Services (NAS_RATIO)	Ratio of non-audit fee to total fee used as a substitute for non-audit products.
Dependent variable Earnings Management (EM)	Two models such as Jones and modified Jones Models of discretionary accruals have been used as proxy to measure earnings management.
Moderating variable Independent Directors (Ind_Dir)	Proportion of independent directors on the board to total directors.
Companies Act 2013 (COACT2013)	A dummy variable which equals 1 if sample period is 2014, 2015 & 2016, or 0 otherwise.
Control variables	.
Big 4 Audit Firm (Big 4)	A dummy variable which equals 1 if client auditor is one of the big 4 audit firm, or 0 otherwise.
Firm Size	Logarithm of total assets.
Leverage (Lev)	Proportion of total debt to total assets
Cash flow from operations (CFO)	Operating cash flows divided by total assets
Sales Growth (S_GROWTH)	Sales growth was calculated as current year revenue divided by previous year revenue.
Market to Book ratio (MBRATIO)	Proportion of market price to book value.
Loss	An indicator variable which equals 1 for corporations having loss, or otherwise 0.
Merger	An indicator variable which equals 1 for companies that were involved in mergers or acquisitions in the current year, or otherwise 0.
Financing	An indicator variable which equals 1 for companies that obtain capital through the equity or debt market in the current year, or otherwise 0.

3.3 Econometric Equation

In order to achieve the objective of this study, multiple regression analysis technique has been used in this study using data for the four years period, namely 2012, 2014, 2015 and 2016.

$$EM_{it}=\beta_0+\beta_1 COACT2013_{it}+\beta_2 LEV_{it}+\beta_3 FIRMSIZE_{it}+\beta_4 CFO_{it}+\beta_5 BIG4_{it}+\beta_6 LOSS_{it}+\beta_7 FINANCING_{it}+\beta_8 MERGER_{it}+\beta_9 S\_GROWTH_{it}+\beta_{10} MBRATIO_{it}+\varepsilon_{it} \quad \textbf{(Eq. 1)}$$

Where EM_{it} represents earnings management measured through absolute value of discretionary accruals using models such as Jones and Modified Jones Models. β_0 represents the constant term. β_1 measures the effect of enactment of the Companies Act 2013 on earnings management practices. The Companies Act 2013 includes a number of firm control regulations. Section 134 of the Act requires the director's report on internal control in their declaration, while Section 143 obligates the statutory auditor to report on internal control. β_2 to β_{10} measures the effects relating to control variables on earnings management.

$EM_{it}=\beta_0+\beta_1 INDDIR_{it}+\beta_2 INDDIR_{it}*COACT2013_{it}+\beta_3 LEV_{it}+\beta_4 FIRMSIZE_{it}+\beta_5 CFO_{it}+\beta_6 BIG4_{it}+\beta_7 LOSS_{it}+\beta_8 FINANCING_{it}+\beta_9 MERGER_{it}+\beta_{10} S\_GROWTH_{it}+\beta_{11} MBRATIO_{it}+\varepsilon_{it}$... **(Eq. 2)**

Where EM_{it} represents earnings management measured through absolute value of discretionary accruals using models such as Jones and Modified Jones Models. β_0 represents the constant term. β_1 measures the effect of the presence of independent directors on earnings management practices. Finally, β_2 measures the effect of the presence of independent directors on earnings management in the pre and post Companies Act 2013. B_3 to β_{11} measures the effects relating to control variables on earnings management.

$EM_{it}=\beta_0+\beta_1 NAS_{it}+\beta_2 NAS_{it}*COACT2013_{it}+\beta_3 LEV_{it}+\beta_4 FIRMSIZE_{it}+\beta_5 CFO_{it}+\beta_6 BIG4_{it}+\beta_7 LOSS_{it}+\beta_8 FINANCING_{it}+\beta_9 MERGER_{it}+\beta_{10} S\_GROWTH_{it}+\beta_{11} MBRATIO_{it}+\varepsilon_{it}$........................**(Eq. 3)**

Where EM_{it} represents earnings management measured through absolute value of discretionary accruals using models such as Jones and Modified Jones Models. β_0 represents the constant term. β_1 measures the effect of non-audit services on earnings management practices. Finally, β_2 measures the effect of non-audit services on earnings management in the pre and post Companies Act 2013. B_3 to β_{11} measures the effects relating to control variables on earnings management.

4. Data Analysis

4.1 Descriptive statistics

Table 2 reports the results of descriptive statistics for non-audit fee, non-audit fee ratio and total audit fee of sample companies for the pre and post Companies Act 2013. Panel A of this table states that the non-audit fee in absolute term has been increased marginally in the post Companies Act period as compared to pre the Companies Act. However considering the non-audit fee as a proportion of the audit fee in Panel B, results show that the non-audit fee ratio in the post Companies Act 2013 is less than pre Companies Act 2013. Finally, the audit fee in post Companies Act 2013 is greater than pre Companies Act 2013 (table 2, panel C). Thus, overall, these results suggest that as a result of regulations regarding restriction on the provision of non-audit services, sample companies have reduced their non-audit services.

Results regarding descriptive statistics for control variables state that no significant differences have been observed in respect of all control variables of the study except cash flow from operations, market to book ratio and sales growth (table 3). In respect of cash flow from operations and the market to book ratio, mean value is greater in post Companies Act 2013 than in pre Companies Act, 2013. However, the mean value of sales growth has been found as significantly lower after the enactment of the Companies Act 2013.

Results regarding the correlation among all independent variables have been explained in table 4, which shows that all variables including control variables have the hypothesized relationship with both proxies of earnings management. In addition to this, none of the variables has reported a coefficient of greater than 0.70, which shows no indication of multicollinearity among these independent variables. Furthermore, to confirm the indication of multicollinearity among these independent variables, a variance inflation factor test of multicollinearity has been performed and the value is less than 10, which proves no indication of multicollinearity.

Table 2. Descriptive analysis on non-audit fee, non-audit services ratio and audit fee

Panel A: NAS_FEE				
	Mean	**Min**	**Max**	**St. Dev.**
Pre-Co Act 2013	0.609	0	39.260	2.498
Post-Co Act 2013	0.634	0	54.834	3.143
Panel B: NAS_RATIO				
Pre-Co Act 2013	0.279	0	0.973	0.185
Post-Co Act 2013	0.251	0	0.912	0.166
Panel C: AUDIT_FEE				
Pre-Co Act 2013	2.612	0.012	204.528	12.446
Post-Co Act 2013	3.925	0.008	600.040	28.150
Table 2shows descriptive properties Mean, Min, Max and Standard Deviation of non-audit price (NAS_fee), non-audit price ratio (NAS_ratio) and audit price (audit_fee) in pre and post context of the Companies Act, 2013.				

Table 3. Descriptive analysis for control variables

	Mean	Min	Max	St. Dev.
Panel A: Leverage				
Pre Co Act 2013	0.931	-1.962	63.969	4.587
Post Co Act 2013	0.924	-1.153	70.885	4.905
Panel B: Firm Size				
Pre Co Act 2013	3.528	1.933	5.515	0.677
Post Co Act 2013	3.643	2.108	5.783	0.673
Panel C: CFO				
Pre-Co Act 2013	0.079	-4.656	1.674	0.305
Post-Co Act 2013	0.136	-0.223	24.988	0.829
Panel D: Loss				
	Mean	**Min**	**Max**	**St. Dev.**
Pre-Co Act 2013	0.169	0	1	0.375
Post-Co Act 2013	0.168	0	1	0.374
Panel E: Financing				
Pre-Co Act 2013	0.314	0	1	0.465
Post-Co Act 2013	0.325	0	1	0.469
Panel F: MB_ratio				
Pre-Co Act 2013	3.544	-65.724	107.370	9.558
Post-Co Act 2013	5.419	-1421.716	930.636	61.085
Panel G: S_Growth				
Pre-Co Act 2013	1.769	0.011	182.611	10.020
Post-Co Act 2013	1.179	0.044	24.342	1.254
Panel H: Ind_dir				
Pre-Co Act 2013	0.530	0	0.875	0.111
Post-Co Act 2013	0.514	0	0.857	0.106

Table 3 gives descriptive statistics Mean, Min, Max and Standard Deviation of all control variables Lev, Firm size, CFO, loss, Financing, MBRATIO, S_Growth and Ind_dir.

Table 4. Correlation matrix

	ABS_EMJS	ABS_MJS	COAct2013	NAS_ratio	Lev	Firm_Size	CFO
ABS_EMJS	1.000						
ABS_MJS	0.999***	1.000					
COACT_2013	-0.017	0.018	1.000				
NAS_ratio	-0.003	0.003	0.072***	1.000			
Lev	-0.004	-0.004	0.001	0.064**	1.000		
Firm_Size	0.065**	0.064**	0.073***	0.101***	0.038	1.000	
CFO	0.866***	0.865***	0.034	0.001	0.004	0.066**	1.000
Big4	0.044	0.043	0.022	0.062**	0.070**	0.102***	0.049*
Loss	0.021	0.021	0.001	0.014	0.023	0.064**	0.027
Financing	0.024	0.023	0.01	0.009	0.025	0.134***	0.028
MBRATIO	0.001	0.001	0.015	0.043	0.010	0.063**	0.009
Merger	0.013	0.015	0.090***	0.051*	0.061**	0.249***	0.011
S_GROWTH	0.005	0.000	0.050*	-0.041	0.004	0.030	0.002

	Big4	Loss	Financing	MBRATIO	Merger	S_GROWTH
Big4	1.000					
loss	0.127***	1.000				
Financing	0.129***	0.367***	1.000			
MBRATIO	0.043	0.029	0.059**	1.000		
Merger	0.204***	0.100***	0.237***	0.057**	1.000	
S_GROWTH	0.021	0.010	0.013	0.002	0.010	1.000

Significance level *** $p<0.01$, ** $p<0.05$, * $p<0.10$

4.2 Regression analysis

4.2.1 Effect of Companies Act 2013 on earnings management

Table 5 reports the results regarding effect of the Companies Act 2013 enactment on earnings management practices of sample companies using two proxies of earnings management such as Jones Model and Modified Jones Model, model 1 and 2, respectively. Model 1 of this table reports that the enactment of the Companies Act 2013 has significantly negative effect on behavior of sample companies for engaging in earnings management practices (β = -0.029; p-value=0.000). Thus, regulations on reporting of internal control and provision of non-audit services through the enactment of the Companies Act 2013 has significantly negatively affected earnings management practices of sample companies in India. Considering the results of model 2 for earnings management based on the Modified Jones model, similar results have been found, which shows that the enactment of the Companies Act 2013 has significant negative effect on earnings management practices of companies.

Table 5. The relationship between the Companies Act, 2013 and earnings management

Variable	Model 1	Model 2
COACT_2013	-0.029 (4.50)***	-0.029 (4.47)***
Lev	0.000 (0.29)	0.000 (0.28)
Firm Size	-0.008 (1.78)*	-0.008 (1.68)*
CFO	0.033 (8.91)***	0.036 (9.55)***
Big4	0.001 (0.18)	0.001 (0.11)
Loss	0.006 (0.82)	0.003 (0.40)
Financing	0.003 (0.44)	0.007 (0.98)
Merger	-0.007 (1.14)	-0.010 (1.54)
S_GROWTH	0.001 (1.47)	0.000 (0.02)
MBRATIO	0.000 (0.32)	0.000 (0.32)
R^2	0.081	0.087
N	1290	1290

Significance level *** p<0.01, ** p<0.05

4.2.2 Regression analysis for moderating effect of Companies Act 2013 on the relationship between independent directors and earnings management

In order to test the hypothesis 2 of this study relating to the moderating role of the Companies Act 2013 on the relationship between independent directors and earnings management, Model 1 of table 6 is based on the Jones Model and states that the presence of independent directors on the board is significantly positively related with earnings practices of the sample companies over the four years period (β = 0.090; p-value=0.000). However, when tested this relationship between the presence of independent directors on the board and earnings management conditional on the enactment of the Companies Act 2013, results report that following the enactment of the Companies Act 2013, the relationship between the presence of independent directors and earnings management has become significantly negative (β = -0.052; p-value=0.000). Similar results have also been found in case of model 2 of this table, where the Modified Jones model has been used as a proxy to measure earnings management. Overall, these results interpret that as a result of the enactment of the Companies Act 2013, the role of independent directors has become more effective in probing management from engaging in earnings management practices.

Table 6. The relationship between independent directors and earnings management: Does the Companies Act, 2013 matter?

Variables	Model 1	Model 2
INDDIR	0.090 (3.14)***	0.092 (3.12)***
INDDIR*COACT2013	-0.052 (4.43)***	-0.054 (4.44)***
Lev	0.000 (0.06)	0.000 (0.05)
Firm Size	-0.007 (1.57)	-0.007 (1.46)
CFO	0.033 (8.92)***	0.037 (9.56)***
Big4	0.001 (0.12)	0.000 (0.05)
Loss	0.006 (0.81)	0.003 (0.39)
Financing	0.002 (0.36)	0.006 (0.90)
Merger	-0.008 (1.34)	-0.011 (1.74)*
S_GROWTH	0.001 (1.56)	0.000 (0.06)
MBRATIO	0.000 (0.41)	0.000 (0.42)
R^2	0.084	0.090
N	1287	1287

Significance level *** p<0.01, ** p<0.05

4.2.3 Regression analysis for moderating effect of Companies Act 2013 on relationship between non-audit services and earnings management

Final analysis for investigating the moderating effect of the Companies Act 2013 on the relationship between non-audit services and earnings management has been presented in table 7 in order to test hypothesis 3. Likewise, previous results of model 1 report that extent of non-audit services is significantly positively related with behavior of companies for engaging in earnings management practices (β =0.080; p-value=0.000). But when tested, this relationship conditional on the enactment of the Companies Act 2013, it was found that the extent of non-audit services has a significant negative effect on earnings management behavior of the sample companies (β = -0.095; p-value=0.000). These results are consistent even in the case of using the Modified Jones model proxy of earnings management as reported in model 2. Thus, it can be stated from these results that as a result of regulations on reporting of internal control quality and restriction on non-audit services, companies in India cannot use non-audit services as a tool for engaging in earnings management practices.

Table 7. The relationship between non-audit services and earnings management: Does the Companies Act, 2013 matter?

Variable	Model 1	Model 2
NAS_RATIO	0.080 (3.77)***	0.076 (3.42)***
NAS*COACT2013	-0.095 (4.76) ***	-0.095 (4.59)***
Lev	0.000 (0.21)	0.000 (0.22)
Firm Size	-0.008 (1.89)*	-0.008 (1.77)*
CFO	0.033 (8.88)***	0.036 (9.51)***
Big4	0.001 (0.25)	0.001 (0.16)
Loss	0.008 (0.98)	0.005 (0.56)
Financing	0.003 (0.41)	0.006 (0.95)
Merger	-0.007 (1.13)	-0.010 (1.56)
S_GROWTH	0.001 (1.70)*	0.000 (0.19)
MBRATIO	0.000 (0.23)	0.000 (0.22)
R^2	0.083	0.088
N	1289	1289

Significance level *** p<0.01, ** p<0.05

4.3 Additional analysis

An additional analysis has been performed in order to confirm the validity of our results, which are presented in the previous section. Discretionary accruals related to earnings management are either positive or negative, thus we divided the data into positive discretionary accruals and negative discretionary accruals and ran the model again. The results related to this analysis are presented in model 1 and 2 of table 8. In both models of earnings managements, results state that the extent of non-audit services has significant negative effect on earnings management behavior following the enactment of the Companies Act 2013, irrespective of the sign of discretionary accruals, that is for positive discretionary accruals (β = -0.076; p-value=0.000) and negative discretionary accruals (β = - 0.069; p-value=0.000). Second, this study performs additional analysis through taking Non- audit Services (NAS) decline following the enactment of the Companies Act 2013 as the dummy variable. It will be 1 if there is a decline in NAS following the enactment of the Companies Act 2013, or otherwise 0. Result of model 1 and 2 based on Table 9 reports that a decline in non-audit services by the sample companies in post Companies Act 2013 has significantly negative effect on the behavior of these companies for engaging in earnings management behavior. Both of these additional analyses confirm the validity of the results presented in the previous section.

Table 8. Analysis based on positive versus negative discretionary accruals

Variable	Model 1		Model 2	
	-VE	+VE	-VE	+VE
NAS_RATIO	.0859 (2.89)***	.0423 (1.63)	.0830 (2.68)***	.0453 (1.78)*
NAS*COACT_2013	-.0691 (2.53) **	-.0766 (3.21)***	-.0836 (2.88)***	-.07 (2.93)***
Lev	.0004 (0.29)	-.00004 (0.08)	.0005 (0.37)	-.0001 (0.26)
Firm Size	-.0108 (1.86)*	-.0080 (1.41)	-.0113 (1.85)*	-.0076 (1.39)
CFO	.0411 (11.28)***	-.1839 (11.16)***	.0453 (11.88)***	-.1954 (12.24)***
Loss	.0030 (0.30)	.0048 (0.47)	.0002 (0.03)	.00007 (0.01)
Big4	.0075 (1.02)	-.0062 (0.82)	.0095 (1.24)	-.0083 (1.15)
Financing	.0082 (0.96)	-.0055 (0.68)	.0113 (1.26)	-.0026 (0.33)
Merger	-.0108 (1.36)	-.0022 (0.28)	-.0096 (1.16)	-.0104 (1.32)
S_GROWTH	.0610 (7.82)***	.0007 (1.55)	.0763 (9.34)***	-.0001 (0.30)
MBRATIO	-.0002 (0.50)	.0013 (2.33)**	-.0003 (0.66)	.0015 (2.82)***
R^2	0.2362	0.2074	0.2705	0.2356

N	716	571	716	571

Significance level *** p<0.01, ** p<0.05

Table 9. Analysis based on decline in non-audit services

Variable	Model 1	Model 2
NAS_DUMMY	-0.018 (2.78)***	-0.018 (2.66)***
Lev	0.000 (0.44)	0.000 (0.42)
Firm Size	-0.010 (2.20)**	-0.010 (2.09)**
CFO	0.032 (8.65)***	0.036 (9.28)***
Big4	0.001 (0.24)	0.001 (0.18)
Loss	0.005 (0.67)	0.002 (0.29)
Financing	0.003 (0.46)	0.007 (1.00)
Merger	-0.008 (1.29)	-0.011 (1.70)*
S_GROWTH	0.001 (1.62)	0.000 (0.14)
MBRATIO	0.000 (0.01)	0.000 (0.01)
R^2	0.072	0.078
N	1282	1282

Significance level *** p<0.01, ** p<0.05

5. Conclusions

This study aims to investigate the effect of the enactment of the Companies Act 2013 on the relationship between non-audit services and earnings management, using data samples of BSE 500 index companies listed on the Bombay Stock Exchange for the four years period 2012-2016. Descriptive analysis of results report that sample companies has decreased their non-audit fee ratio following the enactment of the Companies Act 2013 through regulations on the provision of non-audit services. The result of the regression analysis reports that following the enactment of the Companies Act 2013, the role of independent directors improved for curbing management from engaging in earnings management practices. Likewise, following the enactment of the Companies Act 2013, more provision of non-audit services has also restricted management from engaging in earnings management practices.

All of these findings related to the role of regulations on the reporting of internal control and non-audit services are consistent with agency theory perspectives. According to the agency theory perspective, the presence of independent directors on the board and audit firm should protect the interest of shareholders and not allow management to maximize their self-interest at the expense of shareholders' wealth (earnings management). With the passing of the Companies Act 2013 in India, all companies are required to report on internal control quality, including improving the role of independent directors in ensuring shareholders' interest. Thus, the results report that all these requirements have ensured to protect only the interest of shareholders, hence resolving the agency problem.

This study has contributed to the literature in a number of ways. First, India is one of very few developing countries that have framed regulations on the reporting of internal control and restrictions on non-audit services. This study contributes to the literature through evaluating the effectiveness of these regulations in protecting shareholders' interest. Second, regulations for restrictions on the provision of non-audit services to clients along with its prior approval from an audit committee has been framed, for which there was need to investigate how this phenomenon will affect audit firms from restraining management from engaging in earnings management practices. This study contributes to the literature through finding that as a result of these regulations on non-audit services, audit firms providing non-audit services will not engage in supporting earnings management practices. Finally, the results of this study fully support the enforcement of these regulations through the Companies Act 2013, as it will protect shareholders' interest through resolving agency problems. The results of this study are relevant for policy makers, the capital market regulator and academics, showing that all of them should strictly promote the enforcement of these regulations as these are effective in resolving agency conflicts.

Similar to previous studies, this study is also subject to some limitations. This study is based on the sample of only non-financial sector companies listed on the Bombay Stock Exchange, so its results can only be generalized to that sector. Second, other governance attributes such as audit committee effectiveness have not been explored in this study, which was the point of concentration under regulations on non-audit services. Future research can also be conducted using data samples of companies listed in the financial sector. In addition to this, it would be quite interesting to investigate the role of audit committee attributes on the non-audit services and earnings management relationship.

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