



International Conference on Reimagining Management:  
Sustainability and Innovation in the AI Era

Organised By: Dnyan Ganga Education Trust's,  
Degree College of Arts, Commerce & Science, Thane

# Corporate Governance in the AI Era: Can Technology Curb Earnings Management in Emerging Markets?

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## Abstract

We expect financial reports to tell the truth. But managers have their discretion in how they present numbers, and sometimes, they use that flexibility to polish the reality. This is called 'Earnings Management' (Dechow et al., 2010), and it quietly erodes investor trust.

The problem runs deeper in emerging markets, when a handful of promoters calls the shots and governance rules are still evolving, earnings management can easily fly under the radar.

Now, enter AI. Artificial Intelligence is transforming how companies report, how boards oversee, and how regulators detect trouble. Smart algorithms can scan millions of transactions, flag suspicious patterns, and alert auditors in real time. In theory, AI could make earnings management much harder to hide.

But technology alone is not enough. This paper asks a simple question: as AI reshapes financial reporting, can stronger governance and smarter ownership structures keep earnings management in check? Or will new tools just create new ways to game the system?

Rather than running fresh models, this study synthesizes decades of research on why ownership matters, how boards and audit committees guard transparency, and where institutional investors make a difference (Jensen & Meckling, 1976; Shleifer & Vishny, 1997). It then brings these insights into the AI era, asking whether old governance rules still apply when machines are part of the picture.

The takeaway? AI-driven tools can certainly strengthen oversight. But they work best when grounded in robust governance frameworks. Technology without strong oversight is just speed without direction.

**Keywords:** corporate governance, earnings management, ownership structure, emerging markets, India, AI text analytics, theoretical framework.

## 1. Introduction

### 1.1. Background

The credibility of financial reporting forms the foundation of efficient capital markets. When investors can't trust that reported earnings reflect economic reality, capital

allocation becomes distorted, cost of capital rises, and economic growth suffers. Earnings management-defined as the use of managerial discretion in financial reporting to obscure true economic performance (Healy & Wahlen, 1999), represents a persistent challenge to this credibility.

The agency theory framework provides the foundational lens for understanding this phenomenon. In the modern corporation, ownership and control are separated, creating information asymmetry between managers (agents) and shareholders (principals). Managers possess superior information about firm operations and may exploit this advantage to pursue personal objectives-including income smoothing, meeting earnings targets, or concealing poor performance-at the expense of shareholder value.

### 1.2. The Emerging Markets Context

While earnings management exists in all economies, its manifestations and consequences are particularly pronounced in emerging markets. Characteristics common to these markets-concentrated ownership structures, weaker legal protections for minority shareholders, less developed capital markets, and evolving regulatory frameworks-create conditions where governance mechanisms often fail to constrain opportunistic managerial behavior (Claessens et al., 2000).

India serves as an instructive case study. With its unique ownership structure characterized by promoter-controlled firms, rapid technological adoption, and a regulatory landscape undergoing continuous reform, India exemplifies both the challenges and opportunities inherent in governing corporate behavior in emerging economies. The country's experience offers valuable insights for other markets navigating similar transitions.

### 1.3. The AI Disruption

Artificial Intelligence is fundamentally altering the landscape of financial reporting and oversight. Machine learning algorithms can now analyze millions of transactions in real time, identify patterns indicative of manipulation, and flag anomalies for auditor attention. Natural language processing (NLP) tools can scrutinize management discussion and analysis sections for linguistic cues associated with earnings management (Huang et al.,

2020). Predictive analytics can assess the probability of financial misstatement before audits even begin.

These technological advances promise to reduce information asymmetry, enhance detection capabilities, and potentially deter earnings management through increased probability of detection. However, the introduction of AI also raises new questions. Can sophisticated algorithms be gamed? Does the adoption of AI in financial reporting create new opportunities for technological manipulation? More fundamentally, do traditional governance mechanisms retain their relevance when machine intelligence becomes a primary oversight tool?

#### 1.4. Research Questions and Objectives

This systematic literature review addresses the following research questions:

**RQ1:** How do ownership structure, board governance, and institutional mechanisms influence earnings management in emerging markets?

**RQ2:** What role does AI technology play in detecting, preventing, or potentially facilitating earnings management?

**RQ3:** How do traditional governance mechanisms and AI-enabled oversight interact to influence earnings management outcomes?

**RQ4:** What theoretical frameworks best explain the relationship between governance, technology, and earnings management in emerging market contexts?

#### 1.5. Contribution and Scope

This review makes several contributions to the literature. First, it synthesizes decades of governance research specifically focused on emerging markets, providing a comprehensive foundation for understanding the structural determinants of earnings management. Second, it integrates emerging literature on AI in financial reporting, bridging two previously disparate streams of research. Third, it proposes an integrated framework for understanding how technology and governance interact, offering guidance for both practitioners and policymakers.

The review focuses on peer-reviewed empirical and theoretical literature published between 1990 and 2026, with emphasis on studies addressing emerging markets generally and India specifically. It excludes purely technical literature on AI algorithms without governance implications and focuses instead on research examining the intersection of technology, governance, and financial reporting quality.

## 2. Methodology

### 2.1. Review Protocol

This study follows the Preferred Reporting Items for Systematic Reviews and Meta-Analyses (PRISMA) guidelines to ensure transparency, reproducibility, and rigor in the literature selection process (Page et al., 2021). The review protocol was established prior to the literature search and documented to minimize researcher bias.

### 2.2. Search Strategy

A comprehensive literature search was conducted across multiple electronic databases, including Scopus, Web of

Science, Google Scholar, EBSCOhost, and the Social Science Research Network (SSRN). The search employed combinations of keywords organized into three thematic groups:

- **Governance Keywords:** 'corporate governance,' 'board composition,' 'audit committee,' 'ownership structure,' 'institutional investors,' 'promoter ownership,' 'family firms'
- **Earnings Management Keywords:** 'earnings management,' 'earnings quality,' 'financial reporting quality,' 'accruals,' 'real earnings management,' 'income smoothing'
- **AI and Technology Keywords:** 'artificial intelligence,' 'machine learning,' 'AI audit,' 'text analytics,' 'financial technology,' 'regtech,' 'automated reporting'
- **Context Keywords:** 'emerging markets,' 'developing economies,' 'India,' 'BRICS,' 'Asian markets'

Boolean operators (AND, OR) were used to combine these keyword groups, yielding search strings such as: ('corporate governance' OR 'ownership structure') AND ('earnings management' OR 'earnings quality') AND ('emerging markets' OR 'India').

### 2.3. Inclusion and Exclusion Criteria

Studies were included if they met the following criteria:

- **Publication type:** Peer-reviewed journal articles, conference proceedings, and book chapters. Working papers and dissertations were included only if they made significant theoretical contributions.
- **Language:** English-language publications.
- **Time frame:** 2000–2026, capturing both foundational governance literature and recent AI-focused research (barring few exceptions basis, where older paper were referred basis stature of the paper).
- **Relevance:** Direct engagement with at least one dimension of corporate governance, earnings management, or AI in financial reporting.
- **Methodology:** Empirical studies (quantitative, qualitative, or mixed methods) and theoretical/conceptual papers.

Studies were excluded if they:

- Focused exclusively on developed markets without implications for emerging economies.
- Addressed AI from purely technical perspectives without governance or reporting implications.
- Were published in predatory journals as identified by established criteria.
- Lacked rigorous methodology or theoretical grounding.

### 2.4. Search Outcomes

The initial database search yielded 447 unique records. After title and abstract screening, 123 articles proceeded to full-text review. Following full-text assessment against inclusion criteria, 45 odd studies were selected for final synthesis. An additional 10 studies were identified through

forward and backward citation tracking of key articles, resulting in a final sample of 50+ studies.

## 2.5. Quality Assessment

Each included study was assessed for methodological quality using appropriate tools: the Joanna Briggs Institute checklists for quantitative studies, the Critical Appraisal Skills Programme (CASP) tools for qualitative research, and established criteria for theoretical papers. No studies were excluded based on quality assessment alone, but quality scores informed the weighting of findings in the synthesis.

## 2.6. Data Extraction and Synthesis

Data were extracted from each study using a standardized template capturing: author(s), year, journal, research questions, theoretical framework, methodology, sample characteristics, key findings, and limitations. A thematic synthesis approach was employed, identifying recurring themes and patterns across studies while remaining attentive to contradictory findings and contextual variations.

## 3. Theoretical Foundations

### 3.1. Agency Theory

Agency theory remains the dominant framework for understanding earnings management (Jensen & Meckling, 1976). The theory posits that in the modern corporation, shareholders (principals) delegate decision-making authority to managers (agents), creating a relationship characterized by goal divergence and information asymmetry. Managers may pursue self-interested behavior-including earnings manipulation-when monitoring mechanisms are insufficient and their compensation is tied to reported performance.

The agency perspective suggests that earnings management represents a classic agency cost. Effective corporate governance mechanisms-independent boards, active institutional investors, transparent disclosure requirements-serve as monitoring devices that align manager and shareholder interests. In emerging markets, where traditional monitoring mechanisms may be weaker, agency costs often manifest more acutely (Young et al., 2008).

### 3.2. Stewardship Theory

Stewardship theory offers a contrasting perspective, suggesting that managers are inherently motivated to act as responsible stewards of organizational resources (Davis et al., 1997). Rather than seeking personal gain at shareholder expense, managers derive satisfaction from organizational achievement and collective success.

From this perspective, earnings management may reflect managerial attempts to protect the organization from short-term market pressures or to signal confidence in future prospects. In the emerging market context, where family ownership and long-term relationships predominate, stewardship perspectives may offer complementary insights to agency-based explanations.

### 3.3. Institutional Theory

Institutional theory emphasizes how organizations respond to pressures from their external environment (Scott, 2014). Regulatory requirements, professional

norms, and cultural expectations shape organizational behavior, including financial reporting practices.

In emerging markets, institutional theory helps explain variation in earnings management across different regulatory regimes and time periods. As countries like India strengthen securities regulations, adopt international accounting standards, and enhance enforcement mechanisms, institutional pressures for transparent reporting intensify, potentially constraining earnings management (Judge et al., 2010).

### 3.4. Resource Dependence Theory

Resource dependence theory suggests that organizations must secure critical resources from their external environment, creating dependencies that influence organizational behavior (Chen et al., 2014). Boards of directors serve as boundary spanners who manage these dependencies and bring critical resources-including expertise, legitimacy, and connections-to the firm.

This perspective helps explain why board composition matters for earnings management. Independent directors with relevant expertise bring monitoring resources that constrain opportunistic behavior, while politically connected directors may introduce alternative pressures that affect reporting decisions.

### 3.5. Signaling Theory

Signaling theory addresses how organizations communicate their quality to external stakeholders in contexts of information asymmetry (Spence, 1973; Connelly et al., 2011). Firms with superior performance or governance may seek to signal these attributes through voluntary disclosures, high-quality audits, and conservative accounting practices.

Earnings management, from a signalling perspective, may represent either a positive signal (when used to communicate private information about future prospects) or a negative signal (when it suggests manipulation). The credibility of signals depends on their costliness and verifiability-factors that AI-enabled monitoring may fundamentally alter.

### 3.6. Integrating Theoretical Perspectives

No single theoretical framework fully captures the complexity of earnings management in emerging markets. This review adopts an integrative approach, drawing on multiple perspectives to develop a comprehensive understanding. Agency theory provides the foundational logic for why governance matters. Institutional theory explains cross-jurisdictional variation. Resource dependence theory illuminates board dynamics. Stewardship theory offers nuance for understanding managerial motivation. Signalling theory provides insights into disclosure choices.

The AI era introduces new dimensions to these classic frameworks. Technology reduces information asymmetry, potentially strengthening agency relationships. It creates new institutional pressures for transparency. It provides new resources for monitoring. It enables new signaling mechanisms. And it raises new questions about whether managerial stewardship extends to responsible technology use.

## 4. Literature Synthesis

### 4.1. Ownership Structure and Earnings Management

Ownership structure represents one of the most extensively studied determinants of earnings management. The literature consistently demonstrates that how ownership is distributed among insiders, institutional investors, and dispersed shareholders shapes managerial incentives to manipulate earnings.

#### 4.1.1. Concentrated Ownership and Expropriation Risk

In emerging markets, ownership is typically concentrated in the hands of a small group-often founding families or promoters in the Indian context. This concentration creates two countervailing effects. On one hand, concentrated ownership aligns the interests of controlling shareholders with firm performance, potentially reducing earnings management incentives. On the other hand, it enables controlling shareholders to expropriate minority shareholder interests through related-party transactions, earnings manipulation, and other tunnelling mechanisms (Johnson et al., 2000).

The balance of these effects depends critically on the divergence between control rights and cash flow rights. When controlling shareholders hold disproportionately more control than ownership, the incentive to expropriate intensifies (Claessens et al., 2002). Studies across emerging markets confirm that such divergence is associated with higher earnings management (Francis et al., 2005; Haw et al., 2004).

#### 4.1.2. The Indian Promoter Context

India's corporate landscape is characterized by promoter-controlled firms-a unique ownership structure where founders or founding families maintain controlling stakes while accessing public equity markets. Chakraborty and Bhattacharjee (2020) find that promoter ownership exhibits a non-monotonic relationship with earnings management: at moderate levels, promoters engage in income smoothing to maintain firm value; at very high levels, entrenchment effects dominate, enabling opportunistic behavior.

Gopalan and Jayaraman (2012) demonstrate that Indian promoters use multiple corporate vehicles to maintain control while raising capital, creating complex group structures that facilitate earnings management through inter-corporate transactions. The emergence of independent directors and audit committee reforms has partially constrained these practices, though enforcement remains uneven.

#### 4.1.3. Institutional Investors as Monitors

Institutional investors-mutual funds, pension funds, foreign portfolio investors-theoretically serve as powerful monitors of managerial behavior (Shleifer & Vishny, 1997). Their large stakes give them both the incentive to monitor and the influence to effect change. In developed markets, institutional ownership is consistently associated with reduced earnings management (Chung et al., 2002; Bushee, 1998).

The evidence from emerging markets is more nuanced. While foreign institutional investors generally reduce earnings management through enhanced monitoring (Lei & Miller, 2015), domestic institutional investors may exhibit

weaker incentives due to business group affiliations or regulatory constraints. In India, Agarwal and Bhattacharjee (2019) find that foreign institutional ownership significantly constrains earnings management, while promoter-controlled domestic institutions show no such effect.

#### 4.1.4. Synthesis and Research Gaps

The literature establishes ownership structure as a fundamental determinant of earnings management in emerging markets, with concentrated ownership presenting both alignment and entrenchment effects depending on the separation of control and cash flow rights. However, several gaps remain. Few studies examine how ownership interacts with technology adoption in financial reporting. The role of AI-enabled institutional investors-those using algorithmic trading and quantitative analysis-remains unexplored. Additionally, the impact of new ownership forms, such as private equity and venture capital in emerging markets, on earnings management requires further investigation.

## 4.2. Board Governance and Oversight

Boards of directors serve as the primary internal governance mechanism responsible for overseeing financial reporting quality. The literature examines board characteristics-independence, size, expertise, activity-as determinants of board effectiveness in constraining earnings management.

### 4.2.1. Board Independence

Theoretical arguments for board independence derive from agency theory: independent directors, free from managerial influence, are better positioned to monitor management objectively. Empirical evidence broadly supports this proposition, though findings vary across contexts.

A meta-analysis by Garcia-Meca and Sanchez-Ballesta (2009) confirms that board independence reduces earnings management, with stronger effects in countries with weaker investor protection. In emerging markets, where institutional environments are less developed, independent directors may play an especially critical monitoring role (Chen et al., 2009).

However, independence alone is insufficient. Independent directors must possess relevant expertise, sufficient time, and genuine independence-conditions not always met in practice. In India, Sarkar and Sarkar (2009) find that while independent directors nominally satisfy regulatory requirements, their actual effectiveness is compromised by promoter influence over appointments and limited information access.

### 4.2.2. Board Size and Activity

The relationship between board size and earnings management is theoretically ambiguous. Larger boards bring diverse expertise and perspectives, potentially enhancing monitoring. However, coordination problems, free-riding, and communication difficulties may reduce effectiveness.

Empirical evidence generally supports a negative relationship between board activity-measured by meeting frequency-and earnings management. Xie et al. (2003) find that boards meeting more frequently are associated with

reduced earnings manipulation. In emerging markets, board activity signals commitment to governance, though excessive meetings may reflect ceremonial compliance rather than substantive oversight.

#### 4.2.3. Audit Committees

Audit committees, subcommittees of the board responsible for overseeing financial reporting and external audit, represent a critical governance mechanism. Regulatory reforms worldwide have mandated audit committee formation and specified composition requirements emphasizing independence and financial expertise.

Research consistently demonstrates that effective audit committees constrain earnings management. Key characteristics include independence (all members independent), expertise (at least one financial expert), and activity (regular meetings without management presence) (Klein, 2002; Bedard et al., 2004).

In emerging markets, audit committee effectiveness is often compromised by regulatory gaps and enforcement weaknesses. India's Companies Act 2013 and SEBI Listing Regulations have strengthened audit committee requirements, though implementation remains variable. Ghosh and Saha (2021) find that Indian firms with fully compliant audit committees exhibit lower earnings management, but compliance gaps persist, particularly among smaller firms and business group affiliates.

#### 4.2.4. Synthesis and Research Gaps

Board governance literature establishes clear theoretical links between board characteristics and earnings management, with empirical support for independence, expertise, and activity as constraints on manipulation. However, the literature has yet to fully address how AI affects board oversight. As financial reporting becomes increasingly automated and algorithm-driven, boards must develop new competencies in understanding AI-generated information, auditing algorithms, and managing technology risks. Research on board technology expertise, AI literacy, and the adaptation of oversight processes to digital reporting environments remains nascent.

### 4.3. Audit Quality and External Monitoring

External auditors provide independent verification of financial statements, theoretically constraining earnings management by increasing the probability of detection and imposing reputational costs on manipulation.

#### 4.3.1. Big N Auditors

Research consistently finds that Big N auditors (the largest international audit networks) are associated with higher audit quality and reduced earnings management, particularly in emerging markets where local auditors may lack resources or independence (Francis & Wang, 2008).

Big N auditors bring global methodologies, reputational capital, and deeper pockets that increase litigation risk for audit failures. In emerging markets, Big N presence also signals compliance with international standards, enhancing credibility with foreign investors. However, audit quality remains heterogeneous even within Big N firms, and recent audit failures have raised questions about their effectiveness in complex emerging market contexts.

#### 4.3.2. Audit Committee-Auditor Interaction

The interaction between audit committees and external auditors critically influences audit effectiveness. Audit committees that meet privately with auditors, review audit plans, and evaluate auditor performance enhance auditor independence and strengthen detection capabilities (Cohen et al., 2004).

In emerging markets, the auditor-audit committee relationship is often compromised by overlapping relationships, with auditors sometimes selected by management rather than audit committees. India's recent regulatory reforms have strengthened audit committee authority over auditor appointment and compensation, though implementation challenges persist.

#### 4.3.3. Audit Fees and Non-Audit Services

The provision of non-audit services to audit clients raises concerns about auditor independence, potentially impairing auditors' willingness to challenge management accounting choices. The literature shows that high levels of non-audit fees are associated with increased earnings management, reflecting impaired objectivity (Frankel et al., 2002).

Emerging markets often have less restrictive regulations on non-audit services, creating greater potential for independence impairment. Indian regulations now cap non-audit fees at specified percentages of audit fees, though compliance monitoring remains limited.

#### 4.3.4. Synthesis and Research Gaps

External audit literature confirms that high-quality auditors constrain earnings management, with effectiveness depending on auditor characteristics, audit committee interactions, and regulatory oversight. The emergence of AI-powered audit tools-including continuous auditing platforms, automated transaction testing, and predictive analytics-represents a significant transformation in audit practice. However, research on how AI adoption affects audit quality, auditor independence, and the auditor-client relationship remains limited. Questions about algorithmic bias, black-box audit tools, and the changing nature of audit expertise require systematic investigation.

### 4.4. AI in Financial Reporting and Oversight

The application of artificial intelligence to financial reporting and oversight represents a rapidly evolving field. This section synthesizes literature on AI applications in accounting, auditing, and regulatory oversight, identifying both opportunities and challenges for constraining earnings management.

#### 4.4.1. AI-Enabled Anomaly Detection

Machine learning algorithms excel at identifying patterns in large datasets, making them powerful tools for detecting anomalies indicative of earnings management. Supervised learning approaches train models on known instances of manipulation, identifying similar patterns in new data. Unsupervised approaches detect outliers without prior classification, potentially identifying novel manipulation techniques (Bao et al., 2020).

Perols (2011) demonstrates that machine learning models-particularly support vector machines and logistic

regression-outperform traditional statistical models in detecting financial statement fraud. Subsequent research has refined these approaches, incorporating textual analysis, network analysis, and time-series methods (Bertomeu et al., 2021).

However, the black-box nature of some machine learning models raises concerns about interpretability and auditability. If regulators or auditors cannot explain why an algorithm flagged certain transactions, the evidentiary value of such flags may be limited. Explainable AI (XAI) techniques addressing these concerns are emerging but require further development for audit applications.

#### 4.4.2. Natural Language Processing in Financial Disclosures

Textual analysis of financial disclosures using natural language processing (NLP) has emerged as a promising approach for detecting earnings management. Managers' linguistic choices-tone, readability, forward-looking statements-may signal earnings management intentions before manipulation appears in numbers (Loughran & McDonald, 2011).

Huang et al. (2020) develop measures of disclosure sentiment and complexity that predict subsequent earnings management. Li (2008) finds that firms with more complex 10-K filings exhibit lower earnings quality. Extending these methods to emerging markets, Wang et al. (2021) demonstrate that linguistic features in Chinese annual reports predict earnings management with significant accuracy.

NLP techniques also enable analysis of conference calls, management discussion sections, and other unstructured text. The volume and variety of textual data available in emerging markets-particularly in multilingual contexts like India-present both opportunities and challenges for AI-enabled monitoring.

#### 4.4.3. Continuous Auditing and Real-Time Monitoring

Traditional auditing is periodic and retrospective, limiting its ability to detect manipulation before it affects reported earnings. AI enables continuous auditing-the automated, real-time monitoring of transactions and controls-potentially constraining earnings management through increased detection probability (Alles, 2015).

Continuous auditing systems analyze transactions as they occur, flagging anomalies for immediate investigation. In principle, this eliminates the opportunity for managers to manipulate after-the-fact, as discrepancies are identified before period-end closing. However, implementation requires significant investment in data infrastructure, algorithm development, and organizational change.

Research on continuous auditing adoption in emerging markets is limited, with most evidence drawn from developed economies. Cultural factors, technology infrastructure, and regulatory frameworks may influence adoption patterns, requiring context-specific investigation.

#### 4.4.4. RegTech and Regulatory Oversight

Regulatory technology (RegTech)-the use of technology to facilitate regulatory compliance and oversight-is transforming how regulators monitor financial markets. Securities regulators globally are deploying AI tools to

identify potential earnings manipulation, insider trading, and other violations (Butler & O'Brien, 2019).

India's Securities and Exchange Board of India (SEBI) has invested in AI-enabled surveillance systems for market monitoring. However, research on the effectiveness of these systems in detecting earnings management specifically is limited. Questions about regulatory capacity, algorithm transparency, and cross-border coordination in technology-enabled oversight remain under-researched.

#### 4.4.5. Synthesis and Research Gaps

AI applications in financial reporting and oversight show significant promise for constraining earnings management through enhanced detection capabilities and increased deterrence. However, the literature reveals substantial gaps. Most studies focus on technical algorithm development rather than organizational implementation and governance implications. Research on AI adoption in emerging market contexts is particularly sparse. Questions about how AI interacts with traditional governance mechanisms, how algorithms should be governed, and how technology adoption affects reporting incentives require systematic investigation.

#### 4.5. The AI-Governance Interface

If AI tools enhance detection capabilities and traditional governance mechanisms constrain managerial incentives, understanding how these factors interact becomes critical for predicting outcomes in the AI era.

##### 4.5.1. Substitution vs. Complementarity

Two competing perspectives characterize the AI-governance relationship. The substitution perspective suggests that AI could replace traditional governance mechanisms. If algorithms can detect manipulation with high accuracy, independent directors and audit committees may become less critical. This perspective is often implicit in technology-optimist accounts of AI in financial reporting.

The complementarity perspective, grounded in organizational economics, suggests that technology and governance are complementary inputs. Effective governance creates conditions for technology to function effectively-ensuring data quality, defining monitoring priorities, and translating algorithmic outputs into managerial action. Conversely, technology enhances the effectiveness of governance mechanisms by providing better information and reducing monitoring costs.

Evidence from other domains suggests that complementarity dominates. Agrawal et al. (2019) show that technology investments produce greater returns in firms with strong governance. In the audit context, early evidence suggests that AI adoption is most effective when combined with strong audit committees and auditor independence.

##### 4.5.2. New Risks and Challenges

AI adoption introduces new governance challenges that could paradoxically increase earnings management opportunities. Algorithmic opacity enables sophisticated manipulation designed to evade detection. If managers understand the algorithms used for monitoring, they may develop techniques to fool them-creating an arms race between detection and evasion.

Algorithm bias represents another concern. If training data reflect historical patterns, algorithms may systematically miss novel manipulation techniques or over-flag legitimate transactions from certain categories of firms. Bias in AI audit tools could create unequal enforcement patterns, with some firms facing greater scrutiny than others for reasons unrelated to underlying manipulation risk.

Data quality challenges are particularly acute in emerging markets, where financial data may be incomplete, inconsistent, or deliberately misstated. AI models trained on poor-quality data will produce unreliable outputs, potentially exacerbating rather than reducing earnings management.

#### 4.5.3. Governance of AI

The governance of AI itself—who designs, validates, and oversees algorithmic monitoring systems—represents an underexplored dimension of the AI-governance interface. If algorithms are developed by auditors or regulators without board oversight, accountability for algorithmic decisions may be unclear.

Emerging governance frameworks for AI emphasize transparency, explainability, fairness, and accountability (Floridi et al., 2018). Applying these principles to financial reporting oversight requires boards and audit committees to develop new competencies in technology governance—understanding algorithm design, evaluating model performance, and ensuring appropriate human oversight of algorithmic decisions.

#### 4.5.4. Synthesis and Research Gaps

The literature on AI-governance interactions remains in its early stages, with limited empirical evidence and nascent theoretical development. Critical questions include: How does AI adoption affect the effectiveness of traditional governance mechanisms? Do AI tools substitute for or complement board oversight? How should boards govern AI-enabled reporting and auditing systems? What regulatory frameworks are needed to ensure AI tools are used responsibly in financial reporting oversight? These questions require systematic investigation to guide practice and policy.

#### 4.6. The Indian Context

India provides a particularly rich setting for examining governance and earnings management in emerging markets, with distinctive characteristics that merit focused attention.

##### Promoter Ownership and Business Groups

The dominance of promoter-controlled firms and business groups in India creates unique governance dynamics. Promoters often maintain control through complex ownership structures, including cross-holdings, interlocking directorates, and layered corporate structures (Bertrand et al., 2002). These structures facilitate related-party transactions that can be used for earnings management.

Indian business groups have historically operated with limited transparency, though regulatory reforms have increased disclosure requirements. The Satyam scandal (2009)—in which a founder-managed firm falsified accounts for years before detection—highlighted governance weaknesses and prompted regulatory reforms including

strengthened independent director requirements and enhanced audit oversight.

##### Regulatory Evolution

India's regulatory framework for corporate governance has evolved substantially over the past two decades. Key milestones include:

- **Clause 49 of Listing Agreement (2000, revised 2005):** Introduced independent director requirements, audit committee mandates, and enhanced disclosure.
- **Companies Act 2013:** Codified governance requirements in statute, including independent director definitions, audit committee composition, and enhanced penalties for non-compliance.
- **SEBI Listing Obligations and Disclosure Requirements (LODR) Regulations (2015):** Consolidated and strengthened listing requirements, including enhanced governance and disclosure standards.
- **SEBI mandated the Business Responsibility and Sustainability Report (BRSR)**

Under Regulation 34(2)(f) of LODR Regulations, introduced via Circular SEBI/HO/CFD/CMD-2/P/CIR/2021/562 (May 10, 2021) for the top 1,000 listed entities. Key updates include the BRSR Core framework via Circular SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122 (July 12, 2023).

Despite regulatory progress, enforcement remains uneven. The National Financial Reporting Authority (NFRA), established in 2018, has enhanced audit oversight but faces capacity constraints. Research suggests that while formal compliance has improved, substantive governance practices vary widely (Varottil, 2014).

##### Technology Adoption in India

India's technology landscape presents both opportunities and challenges for AI-enabled financial reporting oversight. The country's sophisticated information technology sector, widespread digital infrastructure, and government emphasis on digital transformation create favorable conditions for AI adoption.

The Securities and Exchange Board of India (SEBI) has implemented AI-enabled surveillance systems for market monitoring. Major audit firms are deploying AI tools for transaction testing and anomaly detection. Several Indian companies have adopted AI-powered continuous reporting platforms.

However, adoption remains uneven. Smaller firms, which constitute the majority of listed companies, may lack resources for sophisticated technology investments. Data quality challenges persist, particularly in manually maintained records. And regulatory frameworks for governing AI in financial reporting remain underdeveloped.

##### Research on India

Empirical research on governance and earnings management in India has grown substantially. Key findings include:

- Promoter ownership exhibits a complex relationship with earnings management, with both alignment and entrenchment effects depending on ownership levels and control-cash flow divergence (Chakraborty & Bhattacharjee, 2020).
- Independent director presence reduces earnings management, but effectiveness depends on actual independence, expertise, and board dynamics (Sarkar & Sarkar, 2009).
- Audit committee effectiveness, particularly when committees include members with financial expertise, constrains earnings management (Ghosh & Saha, 2021).
- Foreign institutional investors serve as effective monitors, reducing earnings management, while domestic institutional investors show weaker effects (Agarwal & Bhattacharjee, 2019).
- Regulatory reforms have reduced earnings management, though effects vary by firm size and governance quality (Sharma & Dave, 2021).

Research on AI in Indian financial reporting remains limited, representing a significant gap. Few studies examine AI adoption by Indian firms, auditor use of AI tools, or regulatory AI surveillance effectiveness. This gap limits understanding of how technology might reshape earnings management dynamics in one of the world's largest emerging markets.

## 5. Findings and Discussion

### 5.1. Key Findings

This systematic literature review yields several key findings regarding governance, earnings management, and AI in emerging markets.

**Finding 1:** Ownership structure fundamentally shapes earnings management in emerging markets. Concentrated ownership, characteristic of most emerging economies, creates dual effects. When controlling shareholders' cash flow rights align with firm value, ownership concentration can constrain earnings management. However, when control rights exceed cash flow rights, expropriation incentives intensify, increasing earnings management. The Indian promoter model exemplifies this duality, with entrenchment effects dominating when promoter ownership exceeds certain thresholds.

**Finding 2:** Board governance matters, but context determines effectiveness. Independent directors, audit committees, and board activity are associated with reduced earnings management, but their effectiveness depends on regulatory enforcement, director expertise, and genuine

independence from management. In emerging markets, formal compliance with governance requirements does not always translate into substantive oversight. Independent directors without real independence, audit committees without expertise, and boards meeting frequently without meaningful engagement produce limited governance benefits.

**Finding 3:** Institutional investors can serve as effective monitors, but heterogeneity matters. Foreign institutional investors consistently reduce earnings management across emerging markets. Domestic institutional investors show more variable effects, reflecting differences in investment horizons, regulatory constraints, and business group affiliations. The growth of domestic institutional investment in markets like India creates opportunities for enhanced monitoring, but realizing these benefits requires regulatory frameworks that align institutional incentives with long-term value creation.

**Finding 4:** AI offers significant potential for enhancing earnings management detection. Machine learning algorithms, natural language processing, and continuous auditing technologies can identify manipulation patterns that traditional methods miss. AI tools reduce information asymmetry, potentially strengthening agency relationships and deterring opportunistic behavior. The emerging evidence suggests that AI-enabled oversight can meaningfully enhance detection capabilities.

**Finding 5:** Technology and governance are complementary, not substitutes. AI tools are most effective when embedded in strong governance frameworks. Effective boards and audit committees create conditions for technology to function effectively-ensuring data quality, defining monitoring priorities, translating algorithmic outputs into action. Conversely, AI tools enhance governance effectiveness by providing better information, reducing monitoring costs, and enabling real-time oversight.

**Finding 6:** AI introduces new governance challenges. Algorithmic opacity, bias, and data quality concerns create risks that could undermine AI effectiveness. Without appropriate governance of AI itself-including transparency requirements, validation procedures, and accountability mechanisms-AI tools may create new opportunities for manipulation or produce unreliable outputs that misdirect oversight attention.

### 5.2. Toward an Integrated Framework

Based on the synthesis, this review proposes an integrated framework for understanding earnings management in the AI era, illustrated conceptually below.

**Figure 1 Integrated Framework for Governance, AI, and Earnings Management in Emerging Markets**

Component	Elements
<b>Structural Determinants</b>	Ownership concentration, control-cash flow divergence, promoter control, business group affiliation
<b>Governance Mechanisms</b>	Board independence, audit committee expertise, institutional investor activism, regulatory enforcement
<b>AI Capabilities</b>	Anomaly detection, NLP analytics, continuous auditing, regulatory surveillance
<b>Moderating Factors</b>	Regulatory environment, technology infrastructure, cultural factors, firm size
<b>Outcomes</b>	Earnings management (accruals-based, real activities), financial reporting quality, investor trust

The framework posits that structural determinants influence earnings management directly and through their effects on governance mechanisms. AI capabilities affect earnings management directly (through detection) and moderate the effectiveness of governance mechanisms (by providing information, reducing costs). Regulatory environment, technology infrastructure, and cultural factors moderate all relationships.

The framework suggests that effective control of earnings management requires alignment across structural, governance, and technological dimensions. Weaknesses in any dimension may be exploited, while strengths in multiple dimensions produce reinforcing effects that constrain manipulation most effectively.

### 5.3. Theoretical Implications

This review has several implications for theory development.

First, agency theory requires refinement for the AI era. AI reduces information asymmetry, potentially altering the fundamental agency relationship. When principals can monitor agent behavior in real time with algorithmic precision, the traditional governance challenges may diminish. However, new agency problems emerge—including those related to algorithm design, data quality, and technology vendor relationships.

Second, institutional theory must account for the role of technology in shaping institutional pressures. AI tools developed in advanced economies create isomorphic pressures on emerging market firms to adopt similar technologies. However, the substantive effects of adoption depend on local institutional conditions, including regulatory capacity, enforcement mechanisms, and cultural attitudes toward technology.

Third, resource dependence theory illuminates how AI creates new resource dependencies—on technology vendors, data providers, and algorithm designers. Boards that lack technology expertise become dependent on external parties for critical oversight functions, potentially compromising independence.

Fourth, the emerging literature on AI governance requires integration with traditional governance theory. Concepts of transparency, explainability, and accountability developed for human decision-makers must be extended to algorithmic systems. New theoretical frameworks addressing the governance of autonomous and semi-autonomous systems are needed.

### 5.4. Practical Implications

The findings carry several implications for practice.

**For boards and audit committees:** Developing technology expertise is becoming essential. Boards must understand how AI tools are used in financial reporting and auditing, evaluate the adequacy of AI governance frameworks, and ensure appropriate human oversight of algorithmic decisions. Audit committees should regularly review AI tool validation processes, data quality controls, and model performance metrics.

**For auditors:** AI adoption requires careful attention to algorithmic quality, independence, and transparency. Auditors must validate AI tools thoroughly, document algorithmic decision processes, and ensure that AI outputs

are subject to appropriate professional judgment. Continuous auditing capabilities should be developed, but complemented with substantive testing appropriate to the context.

**For regulators:** AI-enabled surveillance must be accompanied by transparency about algorithmic methods and validation procedures. Regulatory frameworks should address AI governance, including requirements for algorithm documentation, bias testing, and human oversight. Cross-border coordination on AI regulation will become increasingly important as global audit networks deploy AI tools across jurisdictions.

**For firms in emerging markets:** AI adoption in financial reporting requires investment in data quality, technology infrastructure, and governance capabilities. Firms with weaker governance should prioritize strengthening traditional mechanisms before relying on AI for monitoring. Technology investments should be integrated with governance improvements rather than treated as substitutes.

**For policymakers:** Creating enabling conditions for AI adoption while managing risks requires balanced approaches. Investments in data infrastructure, technology standards, and regulatory capacity are essential. Policymakers should encourage technology adoption while establishing clear frameworks for AI governance and accountability.

## 6. Conclusion

The findings of this systematic literature review reinforce a central premise: earnings management in emerging markets cannot be effectively addressed through a single lens—neither governance nor technology alone is sufficient.

Traditional corporate governance mechanisms—ownership structures, board oversight, audit quality, and institutional monitoring—continue to play a foundational role in constraining opportunistic financial reporting. However, their effectiveness remains contingent upon contextual factors such as regulatory enforcement, ownership concentration, and institutional maturity, particularly in emerging markets like India.

The emergence of Artificial Intelligence introduces a transformative layer to this governance landscape. AI-enabled tools—ranging from anomaly detection algorithms to natural language processing in disclosures—significantly enhance the speed, scale, and precision of monitoring mechanisms. These tools reduce information asymmetry and increase the probability of detection, thereby acting as a deterrent to earnings manipulation.

Yet, this review highlights a critical insight: **AI acts as an enabler, not a substitute for governance.**

Without strong governance frameworks:

- AI outputs may be ignored, misunderstood, or manipulated
- Poor data quality can undermine algorithmic effectiveness

Lack of accountability may shift risks rather than eliminate them. Conversely, when embedded within robust governance systems:

- AI enhances board effectiveness

- Strengthens audit quality
- Empowers regulators with real-time surveillance

Thus, the relationship between governance and AI is best understood as complementary and reinforcing.

For emerging markets, the path forward lies not in choosing between governance and technology, but in integrating both into a cohesive oversight architecture.

## 7. Future Research Directions

This review identifies several important gaps that warrant further scholarly attention.

### 7.1. AI Adoption in Emerging Markets

Limited empirical evidence exists on AI deployment in financial reporting within emerging economies. Future research should explore firm-level adoption patterns in markets like India, Brazil, and Southeast Asia. Questions about drivers, barriers, and performance consequences of AI adoption require systematic investigation.

### 7.2. Governance of AI Systems

Critical questions remain about how AI systems should be governed. Who audits the algorithms? How should boards oversee AI-driven reporting systems? What competencies do directors need to evaluate AI tools effectively? Research is needed on AI governance frameworks within corporate boards and audit committees.

### 7.3. Interaction Effects (Governance × AI)

Empirical models testing interaction effects between governance mechanisms and AI adoption remain scarce. Does AI reduce the need for independent directors? Or does it increase reliance on expert oversight? Do AI tools substitute for audit committees or complement their work? These questions require rigorous empirical investigation.

### 7.4. AI and Earnings Management Innovation

As detection improves, manipulation techniques may evolve. Future research should examine 'AI-resistant' earnings management strategies. Understanding how managers might adapt to AI-enabled monitoring is essential for anticipating and countering emerging manipulation techniques.

### 7.5. Text Analytics in Emerging Market Contexts

Multilingual disclosures (e.g., in India) pose challenges for NLP models. Future research should develop and validate text analytics tools for regional language financial disclosures. Cross-linguistic studies comparing textual manipulation across different language contexts would also be valuable.

### 7.6. Regulatory Effectiveness of RegTech

Limited evidence exists on how regulators use AI in enforcement. Research on the effectiveness of RegTech tools-particularly in emerging market regulatory contexts-is needed. Policy-oriented empirical studies examining the impact of AI-enabled surveillance on market integrity would inform regulatory practice.

## 8. Limitations of the Study

Despite its comprehensive scope, this review has certain limitations.

First, the focus on English-language publications may exclude relevant regional studies published in other languages. This is particularly significant for the Indian context, where some governance research may appear in Hindi or other regional languages.

Second, the AI literature is rapidly evolving, and findings may become outdated quickly. The pace of technological change in AI applications for accounting and auditing means that the landscape described here may shift substantially in the coming years.

Third, there is limited availability of empirical studies combining AI, governance, and emerging markets. This scarcity constrains the depth of synthesis possible and highlights the need for primary research in this area.

Fourth, potential publication bias toward significant findings may affect the conclusions drawn. Null findings or contradictory evidence may be underrepresented in the published literature.

These limitations highlight the need for continuous updating of this research domain and caution in generalizing findings beyond the contexts represented in the reviewed literature.

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