

## Study on Earnings Management and Accounting Standards of Listed Companies

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**Abstract:** Earnings management is the behavior of the enterprise management authority to take into account the accounting data, especially the accounting surplus, by various means within the scope permitted by the accounting standards in order to realize its own interests or maximize the value of the enterprise. In the past, research on earnings management has focused more on the concepts, motivations, and methods of earnings management. At the time when China's new accounting standards have just been promulgated, combined with the new trends of domestic and foreign research, this paper turns its attention to one of the constraints of earnings management—accounting standards. On the basis of constructing the basic theoretical framework of earnings management, the relationship between earnings management and accounting standards is studied. On the one hand, accounting standards have effectively constrained the occurrence of corporate earnings management behavior by formulating accounting treatment rules for corporate economic operations. However, due to various reasons, accounting standards can not completely eliminate earnings management, and may even lead to excessive earnings management behavior; on the other hand, the market accounting information crisis induced by earnings management behavior in turn provides a basis for the formulation of accounting standards, in order to promote the further improvement of accounting standards; however, due to the existence of the economic consequences of accounting standards, relevant interest groups, the pursuit of their own interests, and through political means (generally expressed as lobbying activities) put pressure on the accounting standards formulation process, making accounting the criteria cannot be completely neutral, but the balance of interest is offset towards the strong group. The paper also confirms the interaction between earnings management and accounting standards through empirical analysis and case analysis. On this basis, this paper makes an evaluation and suggestion of China's new accounting standards based on earnings management, which helps to improve China's accounting standards, and then constrains the earnings management behavior of listed companies.

### 1. Introduction

The effective contract view holds that the choice of accounting methods, like the form of organization and the form of contract formation, can be used to reduce the contract costs between the parties, leading to the maximization of corporate value. If investors or creditors want to eliminate earnings management by entering into harsh and strict contracts, not only is the cost too high, it is unrealistic, but it also increases the risk of the operators, and ultimately it is difficult to reach a valid contract. Considering the incompleteness and rigidity of the contract, it is necessary to give the operator certain accounting choices and flexibility in handling, so that it can respond flexibly to changes in the corporate environment and other unforeseen contract events, thus not only protecting the enterprise and The interests of the operators, and can maintain effective contracts and reduce contract costs. For example, a company issued a bond for raising funds, and the debt contract imposes a lower limit on the company's interest coverage ratio of 1. However, during the execution of the contract, the state promulgated new accounting standards, requiring companies to increase the provision for impairment of assets. Due to the provision for asset impairment provision, the company reported that the net income decreased, and the interest coverage ratio was lower than the debt contract, resulting in technical violations. It is generally believed that this is not the fault of the company, but the change in the financial ratio due to changes in accounting standards. However, business managers cannot use this reason to convince creditors that the security of claims is the

same as before the change of standards, and requires that the contract be modified. Even if it can be negotiated, due to the large number of bondholders, the negotiation cost will be too high. In this case, managers can effectively avoid the cost of technical violations and the renegotiation costs of the debt contract by appropriately earning a surplus through earnings management.

The concept of information transfer believes that corporate management has an advantage in corporate information relative to external information users, and their choice of corporate accounting methods can reveal their expectations of future cash flows. For example, Beaver and DukeS (1973) have shown that different companies' P/E ratios can produce systematic differences due to different depreciation methods. As shown in Table 2-11, the company's P/E ratio based on the straight-line method is significantly lower than that of the company using the accelerated depreciation method. Other factors analysis shows that there is no risk or surplus growth difference between the two groups of enterprises, and when used When a straight-line depreciation company converts to an accelerated depreciation report surplus, the difference in price-earnings ratio will completely disappear. Therefore, managers are willing to communicate to relevant stakeholders about favorable information about corporate earnings. When business managers believe that unmanaged earnings information is difficult to accurately assess future profitability and business performance, it is easy to mislead investors. At the time, it will take the initiative to take earnings management behaviors, such as profit advancement, profit reversal or profit smoothing, to transmit useful signals to external information users, and improve the information content of accounting earnings so that it can better reflect the value of enterprises.

## **2. Accounting standards constrain earnings management behavior**

In the case of the separation of ownership and management rights of modern company systems, business managers must reflect the financial status and operating results of the company by submitting financial reports in order to conduct business communication with stakeholders such as shareholders and creditors. In order to control the adverse selection and moral hazard problems that managers may have, as a recognized accounting standard, it can provide a low-cost and relatively credible means for effective communication between the two parties. Ideally, accounting standards enable companies with high performance to differentiate themselves from those with poor performance, thereby facilitating effective decision-making and efficient allocation of resources. Accounting standards are to standardize corporate accounting practices from a technical perspective. It is not only a standard for accounting, but also an important basis for CPA audit practice and post-disciplinary punishment. China's accounting standards are binding on all listed companies in China. Therefore, the construction of accounting standards controls the earnings management behavior from the source. Compared with other constraints of earnings management, accounting standards are generally and directly controlled by earnings management behaviors. Therefore, the binding effect of accounting standards on earnings management is the most critical.

## **3. Earnings management is counterproductive to accounting standards**

Accounting standards make neutral choices among various feasible accounting methods. They refer to independent, objective and fair CPAs who are not biased, do not pursue predetermined results, and supervise the implementation of accounting standards. Non-neutrality believes that accounting standards are always based on certain value judgments; the issuance of accounting standards is always based on the interests and aspirations of specific subjects; accounting standards are always the result of the game between the relevant stakeholders and the product of compromise; the implementation of accounting standards There is always some degree of manipulation; the CPA who supervises the implementation of accounting standards may lose an independent, objective and fair position. 1 As mentioned above, although the technical nature of accounting standards is its main attribute, accounting standards are not a purely technical means, it may also lead to different economic consequences. Different criteria will generate different accounting information, which will affect the distribution of interests of different subjects. This economic consequence is mainly

manifested in political lobbying activities. From the results of this lobbying activity, accounting standards setters have biased the balance of interests to a strong group and thus failed to maintain their neutrality. In a broad sense, this lobbying activity is also one of the means of earnings management.

China's accounting standards are formulated by the Ministry of Finance and are officially established institutions. In October 1998, the Ministry of Finance established the Accounting Standards Committee to provide consulting services for the formulation of accounting standards for the Ministry of Finance. Its members come from government departments, securities regulatory agencies, accounting professional groups, universities and research institutes, and have certain social representation. However, with the development of the socialist market economy, the formulation of accounting standards will inevitably become more democratic, and enterprise representatives will be more involved in the formulation of accounting standards. The process of accounting standards in China will inevitably become politicized. Therefore, the formulation of China's accounting standards will also face various forms of lobbying activities. Full consideration of the economic consequences of accounting standards, how to maintain the neutrality of accounting standards, is worthy of research and discussion in the academic and practical circles. Before the reform and opening up, China implemented a unified accounting system and did not have the right to choose corporate accounting policies. Therefore, companies have no incentives and possibilities for earnings management. With the establishment of the stock company, especially after the emergence of listed companies, the issue of earnings management began to emerge. As of 1996, the Accounting Department of the Ministry of Finance has issued six batches of 29 drafts of specific accounting standards, but these drafts have not been published as truly binding accounting standards. From the first specific accounting standards issued by China in 1997, the construction of China's accounting standards is closely related to the earnings management behavior of listed companies. The release of specific accounting standards in each township is based on the capital market case.

#### **4. Suggestions for improving China's accounting standards**

The basic theory of logical accounting standards is the basis for formulating specific accounting standards. The improvement of the basic theory of accounting standards depends on the construction of the standardized financial accounting conceptual framework. According to the FASB's interpretation, the financial accounting conceptual framework is an intrinsically logical system of interconnected objectives and basic principles that leads to consistent accounting standards and points to the nature, role and limitations of financial accounting and financial statements. Sex. It not only provides a consistent conceptual basis for the development of accounting standards, but also assesses the quality of the accounting standards that have been implemented, and it can also serve as a temporary alternative to the lack of accounting standards. From 1978 to 2000, FAsB released a total of 7 series of SFAC, content design accounting objectives, accounting information quality, accounting elements, accounting confirmation and measurement. Accounting professional groups and the International Accounting Standards Board in the United Kingdom, Australia, Canada and other countries have also studied the conceptual framework of financial accounting and issued a series of important documents and reports. Asian countries Japan and South Korea are also embarking on the development of a conceptual framework for financial accounting. The reason why national accounting standards-setting organizations spend a lot of manpower, financial resources and material resources to study and formulate the conceptual framework of financial accounting is to use this framework to formulate accounting standards with unified concepts, strict logic and scientific and complete content, so as to improve the accounting information. Reliability helps the standard setting body mitigate the pressure and interference of external interest groups.

Although China's newly introduced accounting standards have largely achieved coordination with international accounting standards, in the current situation of China's internal corporate governance mechanisms are not perfect, the regulatory power is weak, and the overall quality of

accounting personnel is not high, In the earnings management behavior of listed companies, China can not copy the general and abstract characteristics of international accounting standards, but should formulate more detailed, specific and clear accounting standards and operational guidelines to minimize the space for accounting choices. On October 30, 2006, the Ministry of Finance issued the "Enterprise Accounting Standards - Application Guide." The Application Guide is an important part of the Corporate Accounting Standards System, which includes further interpretation of 32 specific standards, as well as provisions for accounting subjects and key accounting. The author believes that this set of application guidelines is still not exhaustive, and the analysis and interpretation of some definitions and definitions in the guidelines are not accurate enough. Therefore, the new accounting standards application guidelines must be supplemented. If there is a variety of understandings of a definition or interpretation, the various possible understandings should be elaborated one by one, indicating the application of various understandings to reduce misunderstandings of accounting standards by users of the criteria.

## 5. Conclusion

Earnings management is the behavior of the enterprise management authority to take into account the accounting data, especially the accounting surplus, by various means within the scope permitted by the accounting standards in order to realize its own interests or maximize the value of the enterprise. From the perspective of effective contract view and information transfer view, earnings management has its beneficial side. However, from the perspective of the opportunistic behavior concept, the shortcomings of earnings management are obvious. Considering the combination of moral considerations and the domestic securities market environment, China should adopt the opportunistic behavior concept and must pay attention to the management of earnings. Constraints and controls.

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