Emerging Markets Review 16 (2013) 78–99

Contents lists available at SciVerse ScienceDirect

Emerging Markets Review

journal homepage: www.elsevier.com/locate/emr

How do accounting standards and insiders' incentives affect earnings management? Evidence from China ☆

Yuyang Zhang [a], Konari Uchida [b,*], Hua Bu [c]

[a] *Graduate School of Economics, Kyushu University, 6-19-1, Hakozaki, Higashiku, Fukuoka 812-8581 Japan*
[b] *Faculty of Economics, Kyushu University, 6-19-1, Hakozaki, Higashiku, Fukuoka 812-8581 Japan*
[c] *School of Management, China University of Mining and Technology, University Road, 221116 Xuzhou, Jiangsu Province, China*

A R T I C L E   I N F O

Article history:
Received 23 November 2012
Received in revised form 16 April 2013
Accepted 30 April 2013
Available online 9 May 2013

JEL classification:
G34
G38
M10
M40

Keywords:
Split-share structure reform
IFRS
Corporate governance
Earnings management
China

A B S T R A C T

Chinese listed companies recently experienced two important institutional changes: split share structure reform (SSSR) and the mandatory adoption of IFRS-convergent new accounting standards (NAS). We find that the introduction of NAS significantly increased earnings management. Although we do not find evidence that SSSR directly decreased earnings management of the average firm, the increase in earnings management surrounding the introduction of NAS is negatively related to the reduction in non-tradable shares. These results suggest that accounting standards are the more important factor associated with the level of earnings management. Insiders' incentives affect earnings management given a specific set of accounting standards.
© 2013 Elsevier B.V. All rights reserved.

1. Introduction

Numerous studies have investigated determinants of firms' earnings management. Dechow et al. (2010) suggest that reported earnings are determined both by fundamental performance and measurement of this performance, of which the latter is considerably affected by accounting standards. In other words, accounting standards will determine the degree of managerial discretion regarding revenue and loss recognition, and

☆ This paper was financially supported by the JSPS KAKENHI Grant Number 23330107.
* Corresponding author. Tel./fax: +81 92 642 2463.
E-mail address: kuchida@econ.kyushu-u.ac.jp (K. Uchida)

1566-0141/$ – see front matter © 2013 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.ememar.2013.04.002

thereby, affect the level of corporate earnings management. The market globalization, which has been accelerated during the past few decades, generated huge demands among investors for international harmonization in the financial reporting process (Barth et al., 2012; He et al., 2012). Accordingly, the International Accounting Standards Committee (IASC) and its successor, the International Accounting Standards Board (IASB), have developed internationally acceptable accounting standards, also known as the International Financial Reporting Standards (IFRS) (Ashbaugh and Pincus, 2001; Daske et al., 2008; Liu et al., 2011). Following the attempt to converge accounting information across countries in the European Union, IFRS has been adopted by over 100 countries and regions. The introduction of IFRS offers researchers an appropriate opportunity to investigate whether accounting standards affect the degree of earnings management, as well as raises the question of whether IFRS improves earnings quality uniformly around the world. Barth et al. (2008, 2012), Cormier et al. (2009), and Liu et al. (2011) suggest earnings quality increases with the adoption of IFRS. In contrast, Callao et al. (2007), He et al. (2012), and Rudra and Bhattacharjee (2012) find that earnings management increased after the introduction of IFRS in Spain, China and India.

Another prominent stream in earnings management research is to investigate the relationship between earnings management and corporate governance structures (Dechow et al., 1996; Klein, 2002; Park and Shin, 2004; Peasnell et al., 2005). These studies generally found a negative relationship between the efficiency of governance devices and earnings management: for board and audit committees (Dechow et al., 1996; Gabrielsen et al., 2002; Klein, 2002; Park and Shin, 2004; Xie et al., 2003); for ownership structure (Warfield et al., 1995; Yeo et al., 2002); and for audit quality (Francis and Krishnan, 1999; Francis and Wang, 2008; Iatridis, 2012; Krishnan, 2003). Studies also address the effects of corporate governance on firms in emerging markets that typically have concentrated ownership structures and weak investor protection. In these countries, divergence exists between control rights and cash flow rights through a pyramidal structure, cross-shareholdings and dual-class shares. These controlling shareholders are effectively released from disciplinary governance mechanisms (Fan and Wong, 2002; Johnson et al., 2000; La Porta et al., 1999; Liu and Lu, 2007; Shleifer and Vishny, 1997) and pursue private benefits of control at the expense of minority shareholders' wealth (Claessens et al., 2002; Denis and McConnell, 2003; Leuz et al., 2003; Lins, 2003). Under these circumstances, insiders manage earnings to conceal their expropriation of minority shareholders' wealth (Fan and Wong, 2002; Kim and Yi, 2006; Leuz et al., 2003; Shleifer and Vishny, 1997). Indeed, previous studies suggest that ownership concentration and the divergence between control and cash flow rights are positively associated with the degree of earnings management (Fan and Wong, 2002; Firth et al., 2007; Gopalan and Jayaraman, 2012; Haw et al., 2004; Kim and Yi, 2006; Liu and Lu, 2007).

This study investigates how accounting standards and insiders' incentives affect earnings management by using recent Chinese data. The novelty of the data is that Chinese companies have experienced two noticeable reforms that substantially changed accounting standards and insiders' incentives: split-share structure reform (hereafter denoted by SSSR) and the mandatory adoption of IFRS-convergent new accounting standards (hereafter denoted by NAS). Segmented share structure, which represents the coexistence of non-tradable shares (NTS) and tradable shares (TS), was a feature of Chinese corporate governance before the SSSR. The split-share structure engendered divergence between cash flow and control rights, which motivates controlling shareholders to extract private benefits at the expense of minority shareholders' wealth (Claessens et al., 2000; Dyck and Zingales, 2004; Johnson et al., 2000; La Porta et al., 2000).[1] Previous studies also suggest that firms that issue more NTS manage earnings more (e.g., Firth et al., 2007). On April 29, 2005, however, the China Securities Regulatory Commission (CSRC) initiated the SSSR to require firms to convert NTS to TS through negotiations with TS holders. Given previous research findings, the substantial reduction in NTS should considerably decrease insiders' incentives of minority shareholder expropriation and earnings management. The Chinese Ministry of Finance also obliged listed firms to introduce IFRS-convergent NAS in 2007, which considerably affects the degree of earnings management. Previous research argues that accounting standards per se have only a limited effect on earnings quality compared to insiders' incentives in countries whose economic and institutional environments are incompatible

[1] NTS holders could not sell their shares on the public markets to realize capital gains. As a result, NTS holders have been more interested in expropriation of firm resources for their private benefits than in maximization of firm value.

Download English Version:

https://daneshyari.com/en/article/5063235

Download Persian Version:

https://daneshyari.com/article/5063235

Daneshyari.com