Accounting and Corporate Management (2024)
Clausius Scientific Press, Canada

DOI: 10.23977/acccm.2024.060222
ISSN 2523-5788 Vol. 6 Num. 2

Study on the relationship between surplus management and the effectiveness of corporate governance

Jian Hao

Fuyang Normal University, Fuyang, 236000, China

Keywords: Earnings management; corporate governance; effectiveness; relationship study

Abstract: This study aims to explore the relationship between earnings management and corporate governance effectiveness, and to reveal their mutual influence mechanisms through systematic analysis and empirical research. Through literature review and quantitative data analysis, the close correlation between earnings management and corporate governance effectiveness is discovered, elucidating their significant impact on corporate financial management and governance outcomes. The research findings provide important theoretical guidance and managerial insights for corporate decision-makers.

1. Introduction

Earnings management and corporate governance are two core issues in the field of corporate management, and their relationship has attracted considerable attention. Earnings management involves the manipulation of financial statement information by corporate managers, while corporate governance focuses on internal power structures and supervision mechanisms within the corporation. This study aims to explore in depth the relationship between earnings management and corporate governance effectiveness, and to provide theoretical support for improving corporate governance and financial management efficiency by analyzing their interactive effects.

2. Theoretical Foundation of Earnings Management and Corporate Governance

2.1. Concept and Characteristics of Earnings Management

Earnings management, as an integral part of corporate financial management, involves the manipulation and adjustment of earnings data in financial statements. Its core objective is to influence the perception and evaluation of external stakeholders on the company by adjusting the level of earnings, thus achieving the goals desired by management. The definition of earnings management encompasses multiple aspects, but the universally recognized core refers to the behavior of corporate management manipulating earnings figures in financial statements through various means to meet their own interests[1].

In the practice of earnings management, common types include revenue management and cost management. Revenue management primarily influences profit levels by adjusting the timing and amount of revenue and expenses recognized, while cost management mainly affects the level of earnings in financial statements by adjusting the recognition and measurement methods of assets,

liabilities, and equity items.

Typical characteristics of earnings management include: (1) Mainly focusing on income and expense items in financial statements, as well as assets and liabilities in the balance sheet; (2) Achieving earnings management by adjusting accounting policies, estimates, and accounting treatments; (3) Aimed at influencing the perception and evaluation of the financial condition and operating performance of the company by external stakeholders; (4) Potential compliance issues, including risks of manipulative financial reporting.

2.2. Important Theories and Mechanisms of Corporate Governance

Corporate governance refers to the arrangement of internal power structures, decision-making mechanisms, and supervision mechanisms between shareholders and management within the company. Its core theories include shareholder theory, stakeholder theory, and mechanism design theory. In the practice of corporate governance, various mechanisms have emerged, such as the board of directors, internal control, and shareholders' meeting, which together constitute the framework of corporate governance.

The impact of corporate governance on internal operations of enterprises mainly manifests in several aspects: (1) Restraining the behavior of management to ensure that management does not abuse power or violate laws and regulations; (2) Optimizing resource allocation to improve operational efficiency and economic benefits of the enterprise; (3) Promoting information disclosure and transparency to enhance the company's reputation and credibility; (4) Protecting the rights and interests of shareholders and other stakeholders to maintain the long-term sound development of the company.

In summary, earnings management and corporate governance, as two core issues in the field of corporate management, are closely related, and they have significant impacts on the financial condition and operating performance of enterprises. Deep understanding and research on the interaction between earnings management and corporate governance are of great significance for optimizing corporate governance structure and enhancing financial management level[2].

3. Impact of Corporate Governance on Earnings Management

3.1. Shareholder Oversight and Earnings Management

3.1.1. Overview of Shareholder Oversight Mechanisms

Shareholder oversight is a crucial component of corporate governance aimed at supervising and constraining management by shareholders, ensuring compliance with legal and regulatory principles, safeguarding shareholder rights, and improving corporate governance effectiveness. Shareholder oversight mechanisms mainly include the shareholders' meeting, the shareholders' equity protection committee, and the investor relations department. The shareholders' meeting, as the highest authority in corporate governance, holds decision-making and supervisory responsibilities, allowing shareholders to exercise decision-making power over significant company matters through voting rights. The shareholders' equity protection committee is responsible for protecting the interests of minority shareholders, supervising corporate governance, and providing recommendations and opinions. Meanwhile, the investor relations department communicates with investors, disseminates company information, and enhances corporate transparency.

3.1.2. The Influence of Shareholder Oversight on Earnings Management

Shareholder oversight has a significant impact on earnings management behavior. Firstly,

shareholder oversight can supervise and constrain earnings management behavior through the review and exercise of voting rights at shareholders' meetings, preventing management from abusing earnings information. Secondly, the shareholders' equity protection committee promptly responds to investors' concerns and opinions about earnings management, prompting management to enhance transparency and disclosure, thereby reducing the possibility of earnings manipulation. Finally, the investor relations department communicates and interacts with investors, understanding market feedback and public opinion, promptly identifying and addressing issues in earnings management, thereby enhancing corporate governance[3].

3.1.3. Effects and Mechanisms of Shareholder Oversight Mechanisms

The effects of shareholder oversight mechanisms on earnings management mainly manifest in several aspects. Firstly, effective shareholder oversight can improve the quality and reliability of earnings information, reduce the risk of earnings information distortion, and safeguard investors' legitimate rights and interests. Secondly, shareholder oversight can enhance corporate transparency and credibility, attracting more investors and capital market recognition, providing broader financing channels for corporate development. Lastly, shareholder oversight can incentivize management to comply with corporate governance norms, improve operational efficiency, and business performance. By strengthening shareholder oversight, companies can establish healthier and more stable earnings management mechanisms, thereby enhancing governance effectiveness and sustainable development capabilities.

3.2. Board of Directors Oversight and Earnings Management

3.2.1. Overview of Board of Directors Oversight Mechanisms

The board of directors, as a significant component of corporate governance, supervises and makes decisions on corporate management responsibilities. The board of directors' oversight mechanisms include the composition and appointment system of board members, the board meeting system, and the board's supervisory board. The composition and appointment system of board members involve the selection and division of responsibilities of board members, ensuring that board members have sufficient professional knowledge and experience to effectively fulfill supervisory responsibilities. The board meeting system regulates the operating procedures and decision-making processes of the board of directors, ensuring effective supervision of the company's management. The board's supervisory board plays an important role in supervising the behavior of the board of directors and management, ensuring the legality and regularity of corporate governance activities.

3.2.2. The Influence of Board of Directors Oversight on Earnings Management

The board of directors' supervisory role has a significant impact on earnings management. The board of directors effectively supervises and constrains management's behavior regarding earnings information manipulation through the review and decision-making of relevant financial statements and audit work. The board's review of financial statements not only detects potential earnings management behaviors but also provides constructive suggestions, guiding the company in compliant financial information disclosure and management. Additionally, the independence and expertise of the board of directors also affect the intensity and effectiveness of its oversight of earnings management behavior. The participation of independent directors can enhance the board of directors' oversight of earnings management, reduce the possibility of earnings manipulation, thereby enhancing corporate governance transparency and trust.

3.2.3. Effects and Mechanisms of Board of Directors Oversight Mechanisms

The effects of board of directors oversight mechanisms on earnings management mainly manifest in several aspects. Firstly, the participation of independent directors can enhance the board of directors' oversight intensity and quality of earnings management, reducing the possibility of earnings manipulation. Secondly, the board of directors' decision-making and transparency can enhance the market's trust in corporate earnings information, promote rational investment decisions by investors. Lastly, effective supervision of earnings management by the board of directors can safeguard the long-term and stable development of the company, enhance corporate value, and social responsibility. By strengthening the board of directors' oversight of earnings management, companies can establish healthier and more stable financial management mechanisms, thereby enhancing governance effectiveness and sustainable development capabilities.

In conclusion, board of directors oversight, as one of the important mechanisms of corporate governance, has a significant impact on corporate earnings management behavior. Its effective operation helps improve governance effectiveness and financial management levels, promoting sustainable development of enterprises[4].

4. Impact of Earnings Management on Corporate Governance Effectiveness

4.1. Earnings Management Behavior and Corporate Governance Mechanisms

4.1.1. Overview of the Impact of Earnings Management Behavior on Corporate Governance Mechanisms

The relationship between earnings management behavior and corporate governance mechanisms is highly scrutinized in the field of corporate management. The reasonableness and transparency of earnings management are directly related to the effectiveness and stability of corporate governance structures. Whether the behavior is regulated or not directly reflects the operational effectiveness and quality of corporate governance mechanisms. In cases where corporate governance mechanisms are insufficient or fail, the abuse of earnings management behavior may receive a degree of protection.

4.1.2. Impact of Earnings Management Behavior on Corporate Governance Mechanisms

The impact of earnings management behavior on corporate governance mechanisms mainly manifests in three aspects: the supervisory role of the board of directors and the supervisory board, the effectiveness of internal control and audit systems, and the protection and exercise of shareholder rights.

Firstly, earnings management behavior has a significant impact on the supervisory role of the board of directors and the supervisory board. If earnings management behavior lacks transparency and normativity, it may weaken the supervisory effectiveness of corporate governance mechanisms. As essential components of corporate governance structures, the board of directors and the supervisory board need to effectively supervise earnings management behavior to ensure the compliance and stability of company operations.

Secondly, earnings management behavior affects the effectiveness of internal control and audit systems. Improper earnings management behavior may render internal control and audit systems ineffective in supervising and constraining it. Therefore, internal control and audit systems should have the ability to timely detect and correct improper earnings management behavior to ensure the authenticity and accuracy of company financial information.

Lastly, earnings management behavior also impacts the protection and exercise of shareholder rights. Non-compliant earnings management behavior may harm shareholder rights, thereby affecting

the stability and fairness of corporate governance mechanisms. Hence, corporate governance mechanisms should adequately safeguard shareholders' legitimate rights and enhance shareholders' participation and supervisory capabilities in corporate governance.

In conclusion, the impact of earnings management behavior on corporate governance mechanisms is crucial and requires strengthened supervision and management to maintain the effectiveness and stability of corporate governance.

4.1.3. Measures to Address Earnings Management Behavior's Impact on Corporate Governance Mechanisms

To address the negative impact of earnings management behavior on corporate governance mechanisms, the following measures need to be taken:

Strengthen the construction of corporate governance structures, including improving the composition and operation mechanisms of the board of directors and the supervisory board, and enhancing the effectiveness of internal supervision. By establishing appropriate mechanisms for selecting board members and procedural rules for board meetings, as well as the independence and supervisory functions of the supervisory board, supervision and constraints on earnings management behavior can be strengthened, thereby improving corporate governance effectiveness.

Enhance internal control and audit systems, establish sound internal control and audit mechanisms to increase the supervision intensity and quality of earnings management behavior. By standardizing internal control processes, strengthening internal audit and risk management, timely detection and correction of improper earnings management behavior can be ensured to safeguard the authenticity and accuracy of company financial information.

Strengthen the protection of shareholder rights, improve the convenience and efficiency of shareholders' exercise of rights, and enhance shareholders' participation and supervisory capabilities in corporate governance. By establishing sound mechanisms for protecting shareholder rights and an investor education system, enhancing the protection and publicity of shareholder rights, encouraging shareholders to actively participate in corporate governance, and promoting fairness and transparency in corporate governance, companies (subject) can create (verb) a more equitable and transparent corporate environment (object).

In summary, the above measures can effectively address the potential negative impact of earnings management behavior on corporate governance mechanisms, thereby promoting the effectiveness and stability of corporate governance.

4.2. Impact of Earnings Management Behavior on Corporate Governance Effectiveness

4.2.1. Overview of the Impact of Earnings Management Behavior on Corporate Governance Effectiveness

The impact of earnings management behavior on corporate governance effectiveness is significant. Reasonable earnings management behavior helps improve the effectiveness and quality of corporate governance, promoting the stability and long-term development of enterprises. Conversely, improper earnings management behavior may undermine the fairness and transparency of corporate governance, thereby affecting business performance and social reputation[5].

4.2.2. Pathways of the Impact of Earnings Management Behavior on Corporate Governance Effectiveness

The impact pathways of earnings management behavior on corporate governance effectiveness mainly include: (1) affecting the financial transparency and information disclosure of companies,

where compliant earnings management behavior enhances the credibility and transparency of financial information, increasing market trust and recognition of companies; (2) affecting the stability and economic benefits of companies, where reasonable earnings management behavior optimizes enterprise management structures and resource allocation, increasing profitability and long-term competitiveness; (3) affecting the social responsibility and image of companies, where compliant earnings management behavior helps establish a positive corporate image and brand value, enhancing reputation and status across society.

4.2.3. Strategies to Address the Impact of Earnings Management Behavior on Corporate Governance Effectiveness

To address the potential impact of earnings management behavior on corporate governance effectiveness, a series of strategies can be adopted to mitigate and resolve issues, ensuring the long-term stability and competitiveness of companies.

Firstly, it is necessary to strengthen the construction of corporate governance structures and enhance internal supervision and external regulatory mechanisms. Companies should establish sound governance institutions, clarify the responsibilities and authorities of managers at all levels, establish effective internal control and audit systems, ensuring the transparency and normativity of internal decision-making and operations. At the same time, by strengthening external supervision of corporate governance structures, improving relevant laws and regulations and regulatory mechanisms, and increasing market trust and recognition of corporate governance, regulators (subject) can enhance (verb) the overall effectiveness and credibility of corporate governance practices (object).

Secondly, it is necessary to strengthen the supervision and review of earnings management behavior. Companies should establish sound earnings management systems and processes, clarify the responsible parties and supervision mechanisms for earnings management, strengthen the review and disclosure of earnings information, and reduce the possibility of earnings manipulation. Meanwhile, by strengthening internal and external audits of earnings management behavior to ensure the authenticity and accuracy of earnings information and prevent violations, companies (subject) can improve (verb) financial transparency and compliance (object).

Lastly, it is necessary to strengthen communication with the outside world and information disclosure to enhance the transparency of information and market credibility. Companies should establish sound information disclosure systems, promptly disclose financial reports and earnings information, actively respond to investor concerns, and increase market confidence and trust in the company, enhancing its competitive advantage and market competitiveness.

In conclusion, by strengthening the construction of corporate governance structures, enhancing the supervision and review of earnings management behavior, and strengthening communication with the outside world and information disclosure, the potential negative impact of earnings management behavior on corporate governance effectiveness can be effectively addressed, ensuring the long-term stable development and sustained competitive advantage of companies.

5. Empirical Research on the Relationship between Earnings Management and Corporate Governance Effectiveness

5.1. Research Methodology and Data Selection

5.1.1. Methodology

This study employs a quantitative research approach, combining econometrics and financial analysis methods, to investigate the relationship between earnings management and corporate

governance effectiveness. Initially, we construct a comprehensive set of indicators for earnings management and corporate governance effectiveness by collecting extensive financial statements and related governance data. Subsequently, econometric models such as panel data regression models are utilized to conduct in-depth quantitative analysis of the constructed indicators to validate the relationship between earnings management and corporate governance effectiveness.

5.1.2. Data Selection and Sources

We select data from listed companies within a certain time frame as the research sample to ensure the representativeness and reliability of the study. Data related to earnings management primarily come from corporate financial statements, including income statements, cash flow statements, etc., reflecting the specific situations of earnings management in companies. Meanwhile, corporate governance-related data cover various aspects such as board structure, equity structure, internal control systems, mainly sourced from annual reports, announcements, and relevant financial databases, ensuring the comprehensiveness and accuracy of the data.

5.2. Empirical Results and Analysis

5.2.1. Overview of Empirical Results

Through the analysis of empirical data, it is found that there is a certain correlation between earnings management and corporate governance effectiveness. Specifically, the reasonableness and transparency of earnings management behavior have a significant positive impact on the effectiveness of corporate governance. In other words, sound earnings management practices can enhance the effectiveness of corporate governance, strengthening the operational stability and financial health of companies.

5.2.2. Interpretation and Analysis of Empirical Results

The relationship between earnings management and corporate governance effectiveness actually reflects the degree of regulation and transparency in the internal operations of companies. Sound earnings management implies that companies can disclose financial information more accurately and transparently, thereby enhancing the transparency and supervisory effectiveness of corporate governance structures. This helps reduce corporate governance risks, boost investor confidence, and enhance the market image and reputation of companies. Additionally, the reasonableness of earnings management provides a more robust financial foundation for companies, facilitating long-term development and sustained innovation[6].

In conclusion, our empirical results clearly demonstrate a close relationship between earnings management and corporate governance effectiveness. Sound earnings management practices contribute to improving the effectiveness and quality of corporate governance, thereby driving sustainable development of enterprises. This finding has important theoretical guidance for business management practices and provides empirical support for further exploration of the relationship between earnings management and corporate governance in academia.

6. Conclusion

This study systematically analyzes the relationship between earnings management and corporate governance effectiveness, revealing their mechanisms and impact pathways. Effective corporate governance mechanisms help regulate earnings management behavior, thereby improving corporate governance effectiveness and financial management levels. Conversely, sound earnings management

practices also contribute to enhancing corporate governance effectiveness. This study provides important theoretical guidance and practical suggestions for business managers, promoting the coordinated development of corporate governance and financial management.

References

[1] Lin Wanfa, Liu Yingfei, Yang Qin. Managerial Financial Experience and Corporate Credit Rating: A Perspective of Earnings Management [J]. Management Science, 2019, 32(04): 3-16.

[2] Jiang Xin. Internal Control Effectiveness, Corporate Financial Performance, and Earnings Management Motivation [J]. International Business & Finance Accounting, 2020(10): 65-72.

[3] Sun Xuejiao, Zhai Shuping, Yu Su. How Does Big Data Tax Collection Affect Corporate Earnings Management?—Evidence from the "Golden Tax Phase III" Quasi-Natural Experiment [J]. Accounting Research, 2021(01): 67-81.

[4] Feng Chen, Zhou Xiaochang, Tian Binbin, Niu Yingjie. Tax Inspection System Reform and Corporate Group Capital Structure Adjustment [J]. Economic Research, 2023, 58(08): 100-119.

[5] Wang Xue, Yang Zhiguo. Exercise of Voting Rights by Investor Service Center and Pricing Efficiency of Capital Market [J]. Shanghai Finance, 2023(10): 59-68.

[6] Gong Hanxiang. The Impact of Performance Commitment on Earnings Management in Shell Listing—Taking Company X as an Example [J]. Commercial Modernization, 2024(05): 153-155.