

# Analysis on the Present Situation and Countermeasures of Earnings Management

Yiping Wu\*

Tongling University, Tongling 244000, China. E-mail: striving9966@163.com

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**Abstract:** Earnings management of listed companies has become a very common headache for listed companies in China, and it is also a problem of great concern to the public. Within the scope permitted by accounting standards and relevant laws and regulations, a considerable number of people purposefully planned to realize the expected earnings by choosing accounting policies, changing accounting estimates or arranging transactions and events, and they influence the decision-making of accounting information users through financial reports, thus enabling the company to maximize its own earnings. Paying attention to enterprise earnings management has become the consensus of every decision maker. This paper analyzes the present situation and motivation caused by earnings management, and it puts forward several governance measures of earnings management aiming at the present situation, aiming at making listed companies use earnings management reasonably, avoiding overuse or overuse of earnings management, and showing the public a real business situation.

**Keywords:** Earnings Management Countermeasures of Listed Companies

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## 1. The abuse of earnings management status

### 1.1 The accounting standards system is not perfect

China's accounting standards are in the process of self-formulation, revision and improvement. Although great achievements have been made compared with before, there are still some imperfections. Under the accounting standard of accrual basis, the net profit of a company consists of two parts: operating cash flow and accrued profit. Because the former is based on cash basis, it has little maneuverability<sup>[1]</sup>. However, accrual items are different. Managers can adjust and control the accrued profits through amortization of fixed assets and intangible assets and provision for bad debts. To sum up, some users control or adjust the accounting income information reported by enterprises on the basis of following accounting standards, so as to maximize the main body's own interests<sup>[2]</sup>.

### 1.2 The corporate governance structure is immature

Most companies adopt the system of linking managers' compensation with accounting profits. Although this kind of management incentive mechanism makes the management activities of the management meet the shareholders' goals, it also makes the management actively seek the maximization of private interests during the term of office<sup>[3]</sup>. Therefore, there is a widespread phenomenon that managers use earnings management to realize their ambitions in China's enterprise market.

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### **1.3 The comprehensive quality of employees is insufficient**

Becker *et al.* (1998) found that auditor's industry experience can inhibit the earnings management of the company by examining the annual observation values of more than 1,000 enterprises<sup>[4]</sup>. However, China's "accounting fever" has only increased, and the number of people applying for accounting majors and certificate examinations has increased year by year, and more and more people are engaged in the accounting industry, which has resulted in uneven professional ability of employees, and many employees' professional quality is not up to standard<sup>[5]</sup>. At the same time, influenced by external factors, some accountants "open the back door" for enterprises, and there are many examples of helping enterprises to cheat.

## **2. The motivation of earnings management**

### **2.1 Manipulation of fund-raising means a large part of the operating**

Funds of enterprises come from outside, and bank loans are one of the sources of funds. In order to reduce the risk of borrowing, banks are more willing to provide more favorable conditions for companies with higher surpluses. In order to obtain preferential relief and corresponding preferential policies, enterprises often carry out earnings management to adjust current profits<sup>[6]</sup>. Enterprises are faced with such "temptation" of external preferential treatment. In order to raise funds more easily, most enterprises choose earnings management.

### **2.2 The supervision of the audit department**

Although China's current accounting standards are constantly revised and improved with the external economic environment, and they gradually converge with international accounting standards. There are still many flexible regulations. All these make it impossible for the audit department to control it, and the supervision function can not be fully exerted. On the other hand, the independence of accounting firms and certified public accountants in China has also been affected to some extent due to the environment of external auditing in China, and auditors often have certain interests with enterprise managers. Therefore, even if when finding that the enterprise has made some small financial actions in order to make profits, the auditor will ignore them, and he or she even helps the enterprise to cheat. This kind of example is staged all over the country every year. For example, Zhongtianqin Certified Public Accountants issued a seriously inaccurate audit report for Yinguangxia, and Warren Certified Public Accountants issued a false audit report for Leon Lai Ming<sup>[7]</sup>. These all provide a hotbed for the breeding of earnings management behavior.

## **3. Governance means**

### **3.1 The improvement of accounting standards system**

Earnings management is a choice made by enterprise management authorities for the purpose of maximizing their own interests. Enterprise managers pay attention to the imperfection and flexibility of accounting systems and standards, and there are too many options for some accounting standards, which makes them purposefully choose methods beneficial to themselves to maximize their own interests. Therefore, further revising and perfecting the accounting standards for enterprises has become one of the effective means to standardize the excessive earnings management of companies, and it is also the most effective means and urgent matter. As far as possible, the definition of fuzziness should be determined, and the alternative methods in accounting standards should be reduced, so as to narrow the space range of accounting policy choices for relevant personnel while dealing with finance, and to achieve unity and authenticity.

### **3.2 Adjustment of corporate governance structure**

Earnings management by management authorities is actually a manifestation of short-term profit. Due to the determination of corporate governance structure, management has almost controlled the entire accounting information

system, and at the same time, wages and remuneration of management authorities are directly related to earnings management. At this time, management authorities will increase their control over earnings management in order to maximize their own interests<sup>[8]</sup>. Therefore, in order to restrain earnings management behavior, enterprises can appropriately increase the proportion of long-term stock compensation plans when arranging remuneration to establish a reasonable performance appraisal system. They should improve the salary system of managers, so that the salary composition of management authorities is also composed of long-term development factors of other companies. When the scientific performance appraisal system does not take profit as the main inspection standard as before, it is unnecessary for the management to take certain risks to carry out earnings management<sup>[9]</sup>.

### 3.3 Improve the comprehensive quality of accounting personnel

Accounting personnel are the providers of financial information, and the professional ethics level of accounting practitioners is directly related to the authenticity of accounting information and the degree of enterprise earnings management. With the internationalization of China's accounting standards and the improvement of the external employment environment of relevant accountants, the containment of earnings management behavior still needs the efforts of accountants<sup>[10]</sup>. On the one hand, accountants should strictly grasp the unfair earnings management behavior of enterprises with better professional quality and accounting knowledge; on the other hand, when facing the temptation and threat of the outside world, accountants should improve their professional ethic to ensure the authenticity and reliability of the accounting information provided in the principle of being honest.

## 4. Conclusion

In this paper, firstly, there are some bad situations caused by the abuse of earnings management, and the reason is that these situations are caused by imperfect accounting standards system, immature corporate governance means, and inadequate supervision by external audit departments, and some examples of supervisors' collaborative fraud are presented, which fully reflects the harm of earnings management abuse, and then it puts forward the means to curb the abuse of earnings management by the joint efforts of the outside world and enterprises.

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