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FAIR VALUE ACCOUNTING, CORPORATE GOVERNANCE, AND THEIR INFLUENCE ON EARNINGS MANAGEMENT AND FIRM PERFORMANCE: EVIDENCE FROM THE NEW CHINESE ACCOUNTING STANDARDS

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ABSTRACT

This study examines earnings management practices among Chinese listed companies, focusing on five key objectives. The study assesses the degree of earnings management practices before and after the 2019 revision of Chinese Accounting Standards (CAS), investigates the influence of new fair value accounting (FVA) standards and corporate governance on earnings management. Additionally, the study explores how corporate governance affects the FVA-earnings management relationship and whether earnings management influences firm performance. While FVA aims to enhance the decision-usefulness of financial information by better reflecting current market conditions and economic reality, its inherent flexibility may provide management with opportunities for earnings manipulation. Additionally, weak corporate governance mechanisms may fail to effectively monitor management's discretionary behaviors, potentially leading to increased earnings management practices and reduced financial reporting quality. This is particularly concerning in the Chinese market context, where corporate governance structures are still evolving and their effectiveness in constraining earnings management remains uncertain.

Using OLS regression on 3365 Chinese A-share listed companies (2019 – 2022), this study finds that the CAS revision significantly reduced real earnings management (REM) but had no significant impact on accrual-based earnings management (AEM), which heightened scrutiny over activities like artificial revenue inflation or discretionary expense manipulation. These transparency measures made it costlier for firms to engage in REM. These transparency measures made it costlier for firms to engage in REM. Corporate governance mechanisms including CEO duality, board characteristics, executive compensation, and audit-related factors, had varied effects on earnings management. While corporate governance showed no significant moderating effect on the FVA-AEM relationship, it strengthened FVA’s ability to curb REM, suggesting high-quality governance reinforces constraints on real earnings manipulation. Finally, earnings management demonstrated a double-edged effect: AEM improved short-term ROA but reduced long-term Tobin's Q, while REM significantly impaired both short-term and long-term performance, confirming its opportunistic nature.

This study’s contributions and significance lie in its holistic examination of how regulatory, governance, and market forces intersect to shape financial reporting quality, offering actionable insights for achieving sustainable financial practices in dynamic institutional environments.

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CHAPTER ONE

INTRODUCTION

1.1 Background

Earnings management have emerged as a prominent research area in the current era of globalization. Earnings management involves the deliberate intervention in the external financial reporting process by business managers, with the intent to obtain private gains or influence contractual outcomes. This practice aims to mislead stakeholders about the true economic performance of the company rather than merely presenting the neutral operation of the financial reporting process (Schipper, 1989; Healy & Wahlen, 1999). In the deployment of earnings management, the management may resort to using more use aggressive techniques to smooth earnings and reduce its volatility (Dang et al., 2020). When these aggressive EM practices became increasingly reliant on false information, fake transactions or other illegal activities, they evolved into fraudulent accounting scandals. From the accounting scandal of Lukin Coffee to the bankruptcy of Annan, these incidences have highlighted the vulnerabilities within the current accounting standards that can be exploited through opportunistic earnings management (Palea, 2013; Di Yuan Ho, Conan, 2013). The accounting scandals that have occurred not only challenge the fundamental principles of accounting but also highlight the pressing need for high-quality and transparent accounting information among shareholders. (Lo, Ramos, and Rogo, 2017).

Efforts have been made by regulators and authorities to improve the quality of accounting information, one of which is the standardization of financial reporting. Over