

Audit Committee Independence and Real Earnings Management

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Introduction

The Governance Standards for Listed Companies clearly require listed companies to set up an audit committee, which further clarifies the responsibilities of the audit committee and strengthens the governance effect of the audit committee. In order to better play the governance effect of audit committee, this paper starts from the perspective of earnings management. Most of the existing studies believe that audit committee can effectively inhibit accrual earnings management, but whether it plays its role in real earnings management remains to be debated and discussed.

Mathematical Formulas

$$\frac{CFO_{i,t}}{A_{i,t}} = b_0 \times \frac{1}{A_{i,t-1}} + b_1 \times \frac{S_{i,t}}{A_{i,t-1}} + b_2 \times \frac{\Delta S_{i,t}}{A_{i,t-1}} + b_3 \times \frac{S_{i,t-1}}{A_{i,t-1}} + b_4 \times \frac{TC_{i,t}}{A_{i,t}} + b_5 \times \frac{EC_{i,t}}{A_{i,t-1}} + b_6 \times \frac{OC_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t} \quad (1)$$

$$\frac{PROD_{i,t}}{A_{i,t-1}} = b_0 \times \frac{1}{A_{i,t-1}} + b_1 \times \frac{S_{i,t}}{A_{i,t-1}} + b_2 \times \frac{\Delta S_{i,t}}{A_{i,t-1}} + b_3 \times \frac{\Delta S_{i,t-1}}{A_{i,t-1}} + \varepsilon_{i,t} \quad (2)$$

$$\frac{DISX_{i,t}}{A_{i,t-1}} = b_0 \times \frac{1}{A_{i,t-1}} + b_1 \times \frac{S_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t} \quad (3)$$

$$REM = R_PROD - R_CFO - R_DISX \quad (4)$$

$$REM = \alpha_0 + \alpha_1 szdl + \sum Controls + \varepsilon \quad (5)$$

$$REM = \alpha_0 + \alpha_1 sxdl + \sum Controls + \varepsilon \quad (6)$$

Research Questions

Firstly, we divide audit committee into formal independence and substantive independence, and suggest that substantive independent audit committee members have high independence, which helps to restrain management's earnings manipulation.

Secondly, based on the identification of directors, especially executive directors, with respect to their identity as directors, this paper believes that the information asymmetry of independent directors can be alleviated if directors join the audit committee. On the basis of having more information about the enterprise, the audit committee can have a detailed understanding of the enterprise's business activities, and judge whether the cash flow activities can bring long-term value to the enterprise, which can alleviate the English manipulation behavior within the enterprise.

Methodologies

1) Standardized research

Through reading a lot of literature, the method of logical deduction and induction is combined. The main research ideas, conclusions and limitations at home and abroad are analyzed, and the existing literature and related theories are reviewed and evaluated.

2) Empirical research

The CSMAR database was used to collect samples and sort out the data related to the study. Stata15 was used to sort out and process the data, and statistical analysis, correlation analysis and regression analysis were carried out to verify the accuracy of the hypothesis and the feasibility of the research.

Conclusion

The findings provide two implications. 1) The "form" independence of audit committee can better play a supervisory role and restrain the real earnings management. However, the "form" independence of audit committee violates the essence of the establishment of the audit committee. Therefore, it is necessary to further improve the governance mechanism of audit committee to restrain the sales manipulation behavior of enterprises. 2) The non-independent directors of the audit committee mainly inhibit the real earnings management of the enterprise by restraining the sales manipulation behavior of the enterprise. It is necessary to further strengthen the restraining effect of the audit committee on the other two aspects of real earnings management. Compared with sales manipulation, production manipulation and expense manipulation may be more hidden and difficult to be detected.