

## **Relationship between Earnings Management and Internal Control Quality of Listed Companies listed companies in Jilin province**

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**Keywords:** Listed Companies; Earnings Management; Internal Control

**Abstract:** At present, earnings management is common in listed companies, but there are problems of earnings manipulation or excessive earnings management, which has a serious impact on the interests of users of accounting information. There is a certain correlation between the level of internal control of listed companies and their earnings management. This paper discusses the relationship between earnings management and the quality of internal control of listed companies, and analyzes the potential relationship between them to regulate earnings management of listed companies.

### **Introduction**

In the management activities of an enterprise, internal control of the company is not only an indispensable part, but also a key means to ensure the quality of financial reports, achieve business objectives and effectively prevent business risks. Generally speaking, earnings management of listed companies has a negative correlation with internal control, so listed companies should establish and improve their internal control system to effectively prevent the phenomenon of excessive earnings management.

### **1. Excessive and moderate earnings management**

The so-called excessive earnings management refers to the management of the company maximize their interests by means of tax avoidance, cheating shareholders, acquisition under the loopholes of accounting laws and regulations and accounting standards, so as to meet requirements of supervision. Such method meets only the interests of individuals, and does not maximize the value of enterprises. However, the financial statements derived from excessive earnings management have lost their reliability, which has caused serious damage to users of accounting information <sup>[1]</sup>. And moderate earnings management refers to the management of the enterprise use accounting laws and regulations and accounting standards reasonably, or manage the actual production of business activities properly, so as to ensure the value of enterprise.

### **2. Purpose of internal control**

The role of internal control is divided into three levels, including strategic control, governance and management control. Different levels lead to different purposes. The level of strategic control and governance refer to the relevant stakeholders of the management of companies. With the help of clear management objectives and relevant incentive measures, managers are comprehensively supervised and urged to earnestly perform their own responsibilities, so that they can make scientific decisions to achieve the business objectives successfully. The level of management control refers to effective supervision of the daily financial and business activities of the enterprise by managers to avoid fraud and further improve the operating efficiency of listed company. Generally speaking, the ultimate purpose of internal control is to ensure that the enterprise can carry out normal business activities, and maintain property safety and integrity. In addition, it aims to effectively improve the reliability and authenticity of accounting information, and to ensure that the business policies of listed companies can be implemented in production and business activities <sup>[2]</sup>.

### **3. Relationship between earnings management and internal control quality of listed companies**

#### **3.1 Close relationship between earnings management and control environment**

The core content of internal control is the control environment, which has a direct impact on the quality of internal control, as well as on the realization of the overall business objectives. According to relevant reports, the internal control environment of an enterprise includes the management concept and management style of the enterprise, organizational structure of the board of directors, division of powers and responsibilities of the audit committee, professional ethics and competence of employees, and human resource management<sup>[3]</sup>. In addition, listed companies should be honest and scientific when they manage enterprises, which is also an important guarantee to ensure the smooth operation of earnings. If there is a lack of honesty and scientificity in enterprise management, listed company will also be affected by the lack of morality and ability of executives even if it has good internal control quality, which makes goals of internal control impossible to accomplish. At present, there is a common problem in Chinese listed companies, that is, there is no sound organization for corporate governance. In addition, the board of supervisors and the board of directors do not fully perform their own duties, and they are an empty shell in the management of listed companies, resulting in lax supervision of the management, especially on the issue of "insider control", which has caused great omissions. Therefore, the relationship between the management and the principal-agent becomes more and more tense, and the contradiction is also increasing. However, the management usually ignores the system constraints of company and puts its own rights over internal control, so as to make excessive earnings management. As a result, the management disregards the rights and interests of users of accounting information to meet its own interests, and provide false accounting information and control accounting profits. Sound internal control environment can effectively inhibit excessive earnings management, while imperfect internal environment control can promote the occurrence of excessive earnings management<sup>[4]</sup>. Therefore, a sound internal control environment has certain relevance to earnings management of listed companies.

#### **3.2 Earnings management and risk assessment**

In the management of listed companies, risk assessment is one of the necessary means for enterprises to prevent risks. Through the means of risk assessment, enterprises can effectively control the weak links and key links in the operational risk with effective measures when facing the risk to help enterprises reduce the risk to the lowest harm. In general, managers of listed companies pay more attention to the risks related to the preparation of financial statements, as well as the effective realization of business objectives, so that they will take corresponding measures to make employees pay more attention to such risks to effectively prevent the occurrence of risks. If listed company does not have the relevant risk prevention awareness, it is difficult to grasp the accurate positioning of the internal control of enterprises, which has a great impact on the implementation effect of internal control, and appear excessive earnings management<sup>[5]</sup>.

#### **3.3 Earnings management and control activities**

The formation of control activities is conducive to the implementation effect of enterprise management instructions, and ensures that management instructions can be implemented under disciplinary measures and procedures. The activities can be divided into five categories, including separation of responsibilities, control of physical assets, authorized transactions and activities, control of records and vouchers, and independent audit performance. In laws and regulations such as accounting system, accounting policy, and accounting standards, there are certain defects and autonomy in their selection. As a result, in the process of preparing financial reports and accounting distribution, the obtained financial report and accounting distribution are different when the original vouchers are true and effective, scientific and legal, and their accounting treatment is in compliance with laws and regulations. In fact, it provides a room for excessive earnings management, and even

allows for a lot of room for earnings manipulation<sup>[6]</sup>. Therefore, listed companies should perfect the financial report information, and prepare the financial report information with strict system, so that the internal control can be carried out in a standardized and orderly situation, so as to effectively regulate the financial report information, avoid the phenomenon of financial information errors and fraud. And finally, the occurrence of excessive earnings management can be further inhibited.

### **3.4 Earnings management and information communication**

In the development of listed companies, information communication is an important channel for the management of the company to supervise the company's activities. At the same time, when problems are encountered and problems are discovered, the management can take effective measures to solve them in time. Information communication has become the lifeline of the company's entire internal control. The fundamental purpose of a listed company's information communication is to more accurately assign related responsibilities to employees of internal control procedures, so that each employee can complete the intelligence he should perform under the requirements of internal control responsibilities, so as to make the establishment of accounting information more reliable. In addition, the use of information communication allows relevant departments and personnel using accounting information to communicate freely, providing a more convenient communication platform for them. This approach promotes the sharing and liquidity of accounting information<sup>[7]</sup>. If there is no effective communication between various departments of listed companies, the use of accounting information will lead to the negligence of information without knowledge, and give opportunities for excessive earnings management. It can be seen that effective information communication can effectively restrain the excessive earnings management behavior of listed companies.

### **3.5 Relationship between earnings management and monitoring**

In the internal management of listed companies, internal control is a relatively complete system and a dynamic process. During the development of a company, the formulation of any kind of system must not lack the three processes of execution, supervision and judgment. Only in this way can the internal control procedures of listed company be further improved. The supervision system of financial information in a company mainly relies on internal audit and the board of supervisors. The existence of the board of supervisors is to supervise the management of the board of directors and managers to prevent them from taking advantage of their positions to make actions that are not conducive to the development of the enterprise. Internal audit is a special form of internal control performance. Its existence is mainly for the control and operation of system risks, and provides the management with a unique guarantee agreement, and effectively assists managers to perform its due responsibilities. It can be seen that a perfect internal control supervision system can effectively suppress behaviors of earnings management. However, there are still some defects in Chinese listed companies at present. The personnel of internal control and supervision institutions are insufficient, and most supervisors have low business and professional knowledge. As a result, the establishment of supervisory organization is already in vain, and the supervisory means is also a form, and has not played a good supervisory role. However, the lack of supervision makes listed companies provide space for the development of controlling earnings management and excessive earnings management when they manage<sup>[8-11]</sup>.

## **Conclusion**

It can be seen from the above that there is a certain correlation between earnings management and internal control of listed companies. Good quality measures of internal control can restrain the behavior of earnings management of enterprises. On the contrary, it will create opportunities for earnings management, which not only does great harm to enterprises, but also affects the rights of investors and creditor, as well as the order of market economy.

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