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THE IMPACT OF MANAGEMENT POWER ON FINANCIAL RESTATEMENT

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Abstract. *The management of the company is prone to adverse selection and moral hazard, and the company's performance is smeared through financial restatement to achieve profitability. In order to maximize its own interests, management may manipulate profits and cover up real financial information to increase the likelihood of financial restatement. Therefore, it makes sense to study the impact of management power on financial restatement. This paper analyzes the impact of management power on financial restatement. In this paper, A-share listed companies with financial restatements in Shanghai and Shenzhen Stock Exchanges during 2014-2016 are taken as samples, and supplemented by listed companies without financial restatements in the same period as the paired samples. According to the proven conclusions, the authors put forward constructive suggestions to the listed companies and relevant regulatory. The innovation of this paper is that the authors combine the financial market situation of China, the management's ownership of the company, and the management's control over other members of the company to make assumptions about the financial restatement of listed companies, using empirical analysis and linear regression. The method explores the impact of management power on financial restatement.*

Keywords: Management power, Financial restatement, Accounting error

1. **Introduction.** Financial restatement is a kind of ex post remedial action to correct and disclose previous errors in historical financial reports [1]. Combined with the related research, it can be seen that the financial restatement may affect the restatement of the credibility of the company's financial information, so that investors lose confidence and improve the company's financing costs [2], while also reducing the company's value, and may even lead to legal proceedings. And to attract investors, enhance the company's value, or to avoid the delisting risk, some listed companies use the financial restatement as the means to whitewashing the company's performance and achieving profitability. Based on "information asymmetry theory", the management of the company tends to produce adverse selection and moral hazard. Quan et al. argued that there are governance deficiencies within the company and that external constraints will induce the expansion of management power [3]. To maximize their own benefits, management may manipulate profits [4], conceal the true financial information and increase the likelihood of financial restatements. Therefore, it is significant to study the influence of management power on financial restatement.

Ownership and management rights are separated in the modern company system. The management of the company headed by CEO has the right to operate the company and is responsible to the owner of the company. Finkelstein defines management authority as the ability of management to implement its own wishes [5]. According to the situation of our country's financial market, this article measures the management's power mainly by

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the management's ownership of the company, the management's control over the other members of the company, the ownership of the listed company (privately owned or state-owned). This paper measures management power through four indicators, using empirical analysis and linear regression to explore the impact of management power on financial restatement.

2. **Theoretical Analysis and Research Hypothesis.** Standing for the interests of the corporate governance layer, the chairman of the board is the core of the corporate governance structure and responsible for the interests of all the shareholders of the company. According to the theory of principal-agent, the company's ownership and management rights are separated. After the election of the board of directors, the CEO will be born to directly manage the daily operation of the company. CEO as the management's core, is responsible for the company's internal control. However, if the chairman and CEO represent different interest groups, the combination of the two posts will make them firmly control the decision-making management right of the company, and it is very difficult for the CEO to refrain from making self-interest based on the limited rationality of the management. The supervision function of the board of directors will be reduced when the positions of chairman and general manager are combined [6]. When improper information is released, the oversight function of the chairman can only be reduced, increasing the likelihood of financial restatements.

Therefore, a Hypothesis 1 is proposed: the combination of CEO and chairman is positively related to the company's financial restatement.

Based on the current situation of the state-owned holding companies in our country, we can see that the shareholding structure of the state-owned holding companies in our country is relatively single, the appearance of both the government and the enterprise still exists, and some senior executives still have administrative positions. On the one hand, due to lacking the ownership of the state-owned equity agency, the management in the state-owned company has the decision-making management rights and property control is too large, the board of supervisors is too weak, resulting in "insider control" [7]. On the other hand, the state-owned holding companies lack equity incentive mechanism and pay performance management [8]. Senior executives of the company seek their own interests through their own power and exacerbate political opportunism and economic moral hazard. Companies directly controlled by the government and controlled by state-owned enterprises are more likely to report accounting errors related to surpluses [9].

Therefore, it is proposed the Hypothesis 2: state-owned holding companies are more likely to make financial restatements than non-state-owned holding companies.

Management shares may have two effects, namely, synergies and trenches effect. The synergistic effect indicates that the holding management can meet the individual interest goal by means of consumption and project allowance, and there will not be any big conflict with the goal of maximizing the company's interest, which will lead to synergies of interests. The higher the management shareholding ratio is, the lower the agency cost is. The trenches correspondingly indicate that the over-management of the management or over-management costs will make it difficult for other shareholders to effectively supervise the management and generate agency conflicts [10]. According to the research of scholars both at home and abroad, the author believes that when the management shares are low, the proper increase of shareholding incentives will help to reduce agency costs and reduce the occurrence of financial restatements [11]. With the continuous increase in the shareholding of the management, on the one hand, the management may distort the financial statements in order to attract investment. On the other hand, the level of supervision and internal control of the management will also be reduced, which will aggravate the financial restatement to occur.

Therefore, it is proposed the Hypothesis 3: management shareholding ratio will be positively related to the occurrence of financial restatement.

Management's compensation is equal to the power it owns. Therefore, managers with higher salary have more decision-making power in production and operation, and can better participate in the company's management activities [12]. The incentive remuneration of top management to the board of directors is more conducive to cultivate their loyalty to the company, mobilize their enthusiasm for work, reduce self-interest and curb the occurrence of financial restatements.

Therefore, the Hypothesis 4 is proposed: management compensation is negatively correlated with the company's financial restatement.

3. Research Design.

3.1. Sample selection and data sources.

The authors mainly collected from 2014 to 2016 China's A shares in Shanghai and Shenzhen listed companies. In the selection of samples, firstly, companies that are restated due to mergers and acquisitions or changes in accounting policies are excluded. This article mainly refers to the statistics of listed companies that have made major changes in current accounting errors during the current period. Secondly, because industry differences are too large, the authors will remove banks, insurance, and other financial enterprises and real estate companies. Finally, exclude the delisting company during 2014 to 2016, or ST, ST * listed companies and incomplete financial information data or abnormal listed companies. After screening and classifying, 128 A-share companies listed in Shanghai and Shenzhen from 2014 to 2016 were selected and 128 matching sample companies were selected according to Agrawal's method.

The management power variable in this article is based on the "Company Law" section 216, the definition of management as the company's manager, deputy manager, chief financial officer, secretary of the board of directors and other personnel required by the articles of association (Sales Director, Chief Engineer). The CSMAR database was used to find sample companies that occurred in 2014-2016 with no restatements. The company also manually searched sample companies' annual reports and the corrective statements, such as http://www.cninfo.com.cn, the Sina Finance Network, recorded the required variables and used statistical analysis software SPSS17.00 and EXCEL software for data analysis.

3.2. Variable definitions.

In the definition of variable, the explanatory variable is Financial Resumption (RES), the sample of financial restatement is recorded as RES = 1, and the financial restatement is not recorded as RES = 0. Explanatory variables as measures of management power: management power is measured by whether the CEO is the chairman of board (DUAL), if the CEO is also the chairman of board DUAL = 1, unite DUAL = 0; the controlling power of the management is affected by the SS nature of the listed company's owner, the state-owned shareholding is recorded as SS = 1, the non-state-controlled shareholding is recorded as SS = 0, and the size of the management shareholding (MS) represents the size of the total shares of the company. Total management compensation (TOTCOMT) is expressed in natural logarithm of total management compensation during the reporting period. In the control variables, the company size (SIZE) is expressed as the natural logarithm of the book value of total assets at the end of the period. The asset-liability ratio (LEV) is expressed as the ratio of total liabilities to total assets at the end of the period. Growth (GROWTH) expressed as the ratio of the total carrying value of the total assets; the growth rate of earnings (EGROWTH) is the profit growth for the year minus the profit from the previous year, divided by the ratio of the total assets at the end of the year. The audit opinion (ATYPE) audited and produced an unqualified opinion as ATYPE = 1, without written opinions or other comments expressed as ATYPE = 0.

3.3. **Establishing a regression model.** In order to explore the impact of management power on financial restatement clearly, this paper uses Logit regression analysis to establish a model to analyze the correlation between each explanatory variable and the explanatory variables, and to verify whether the assumptions made in this paper are correct. The regression parameters β in the linear regression equation are derived from the least squares criterion. The ε is the adjustment parameter, and the variables have been mentioned in 3.1.

$$\begin{aligned} Logit(RES) = {} & \beta_0 + \beta_1 * DUAL + \beta_2 * SS + \beta_3 * MS + \beta_4 * TOTCOMT + \beta_5 * SIZE \\ & + \beta_6 * LEV + \beta_7 * GROWTH + \beta_8 * EGROWTH + \beta_9 * ATYPE + \varepsilon \end{aligned}$$

4. Empirical Analysis.

4.1. **Relevant variables descriptive analysis.** As can be seen from the statistical analysis of variables in Table 1, the four explanatory variables on management power have significant differences between those companies that have financial restatements and those that did not make financial restatements. Analyzing the DUAL variable of CEO and chairman, the sample of restatement with a mean value of 0.39 is higher than the non-restatement of 0.35, indicating that it is more common to restate the chairman of the company as CEO. In the analysis of the SS variables of listed companies, the financial recapitalization companies are state-controlled samples with a mean value of 0.39 and the paired non-repetitive companies with a sample mean value of 0.22. It can be seen that under a state-controlled company, management with multiple administrative privileges is more likely to make financial restatements. On analysis of management shareholding ratio (MS), non-restatement of the management of the company's share of the sample average is much larger than the restatement of the company management's shareholding ratio. Although TOTCOMT did not show much difference between restatement and non-restatement during the reporting period, it is also found that management compensation

Table 1. Descriptive statistical analysis of related variables

	Group (RES = 0; RES = 1)	Mean	Minimum	Maximum	Std. Deviation	Variance	Std. Error Mean
DUAL	0	0.36	0	1	0.487	0.237	0.081
	1	0.39	0	1	0.494	0.244	0.082
SS	0	0.25	0	1	0.439	0.193	0.073
	1	0.42	0	1	0.500	0.250	0.083
MS	0	5.26799	0	44.2075	10.45082	109.220	1.74180
	1	1.41774	0	21.3948	3.70872	13.755	0.61812
TOTCOMT	0	5.36171	4.3229	6.6387	0.56290	0.317	0.09382
	1	5.07595	3.5835	6.2750	0.70241	0.493	0.11707
SIZE	0	20.31	18	26	1.653	2.732	0.275
	1	21.66	19	25	1.419	2.014	0.237
LEV	0	0.48	0	1	0.238	0.057	0.040
	1	0.50	0	1	0.236	0.056	0.039
GROWTH	0	2.27	0.0391	7.6752	2.190	4.797	0.365
	1	1.77	0.0332	6.6524	1.451	2.106	0.242
EGROWTH	0	0.01	−0.1820	0.2347	0.046	0.002	0.008
	1	−0.01	−0.3875	0.1097	0.087	0.008	0.014
ATYPE	0	0.97	0	1	0.167	0.028	0.028
	1	0.81	0	1	0.401	0.161	0.067

for non-restatement companies is higher than restatement. The control variables like SIZE, LEV and EGROWTH, are lower in the companies which are not restatement. However, the restated companies always have lower GROWTH and ATYPE.

4.2. **Correlation test between variables.** According to the results of the correlation analysis in Table 2, in the explanatory variables, whether the CEO and chairman are the same one (DUAL), who owns the company (SS) and the reporting period the total management compensation (TOTCOMT) with the financial restatement (RES) have significant correlations. However, the correlation between management shareholding ratio (MS) and financial restatement (RES) is not obvious, which may be caused by the low proportion of management shareholding of listed companies in our country. In addition, the explanatory variables of other variables are not highly correlated, so the model built in this paper does not show multicollinearity, and the model established in this paper has some reliability.

Table 2. Correlation coefficient test analysis results

	RES	DUAL	SS	MS	TOTCOMT	SIZE	LEV	GROWTH	EGROWTH	ATYPE
RES	1									
DUAL	0.059**	1								
SS	0.177**	−0.135	1							
MS	−0.042	0.242*	−0.053*	1						
TOTCOMT	−0.122**	0.082	0.307**	−0.115	1					
SIZE	0.041**	−0.049	0.580**	−0.302**	0.342**	1				
LEV	0.057	−0.033	0.258	−0.102	−0.030	0.174	1			
GROWTH	−0.143**	−0.112	−0.344**	−0.033	−0.089	0.024	−0.279*	1		
EGROWTH	0.119	−0.092	0.168	−0.050	0.046	0.206	0.184	−0.060	1	
ATYPE	−0.272*	0.092	0.033	−0.047	−0.094	−0.156	−0.032	0.023	0.042	1

Note: * indicates significant correlation at 0.05 level (bilateral);
** indicates significant correlation at 0.01 level (bilateral).

4.3. **Logit regression analysis and suggestions.** Table 3 shows that DUAL, SS, TOTCOMT, SIZE, LEV, GROWTH and ATYPE are significantly related to the explanatory variable financial restatement (RES). However, the correlation between management shareholding ratio (MS) and financial restatement is not obvious. So does the EGROWTH.

Table 3. Logit regression analysis results

	B	S.E.	Wald	Sig.
DUAL	0.045	0.014	2.551	0.106
SS	−0.087	0.042	1.866	0.172
MS	−0.096	0.068	2.005	0.157
TOTCOMT	−0.023	0.033	3.744	0.062
SIZE	0.076	0.010	6.011	0.014
LEV	−0.052	0.038	2.232	0.152
GROWTH	−0.026	0.021	2.502	0.114
EGROWTH	0.013	0.023	0.026	0.873
ATYPE	−0.48	0.028	3.313	0.069

Since the coefficient of DUAL and RES is 0.045, assuming that 1 is established, the relationship between the CEO and the chairman is positively related to the company's financial restatement. Therefore, the CEO must be separated from the chairman of the board. The company should establish a strong internal control mechanism, and the management layer will effectively control the management under the leadership of the chairman.

The coefficient of SS and RES is −0.087. Hypothesis 2 is established. Compared with non-state-owned holding companies, state-owned holding companies are more likely to have financial restatements. Therefore, the power of state-owned company management needs to be controlled. Due to the large proportion of state-controlled listed companies under the socialism with Chinese characteristics, some senior executives also hold government positions during the company's tenure, which will increase the control power of the management and increase the moral hazard of the managers. Therefore, we should further promote the separation of government and enterprises and allocate appropriate management to state-controlled listed companies.

The significance of MS and RES is not obvious, and Hypothesis 3 does not hold. On the one hand, due to the separation of management rights and ownership, China's management has a small shareholding; on the other hand, China also has less equity incentives for management. Therefore, the relationship between the shareholding ratio of management and financial restatement is not obvious. The coefficient of TOTCOMT and RES is −0.023. Assuming 4 is established, the management compensation is negatively correlated with the financial restatement of the company. At this stage, we divide the management into equity incentives and compensation incentives. The directors of the company can use their own power to promote the company's development and operation. It can formulate detailed assessment plans and stock allocation plans to promote better management. For recommended projects and management programs with better quality, the board of directors should support the power and enhance the trust of the board of directors, so that they can have higher enthusiasm to work. It is also possible to form a positive incentive effect by introducing the competition mechanism, while at the same time as the power assessment, by introducing personnel with certain ability and competitiveness to the company's senior management positions, so as to create a positive incentive effect. The power has a sense of crisis, so that it is more committed to the company's operation and management, which can also better avoid the occurrence of corporate financial restatement.

5. **Conclusions.** According to the statistical modeling analysis of this article, it can be concluded that the combination of CEO and chairman is positively related to the financial restatement; the nature of the owners of the listed company and the total remuneration of the management are negatively related to the financial restatement. These prove the correctness of the hypotheses in this paper. However, the correlation between management shareholding and financial restatement is not obvious. This may be due to the fact that the management shareholdings of A-share listed companies in China are relatively small, and it is difficult to analyze their relationship with financial restatements.

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