

An Analysis of the Factors Affecting Financial Restatement of Public Company

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Abstract—Financial restatement is the announcement of an ex-post facto remedy for errors, omissions or misleading information in the financial reports of a listed company on a voluntary basis or under the supervision of a certified public accountant or regulatory body. These will inevitably lead to an incalculable loss for investors and a fatal blow to the capital market. This article, I use the combination of the theoretical exposition and empirical inquiry, using the relevant model to explore the factors that affect its financial restatement. It is concluded that the changes of a firm's profitability, short-term solvency and capital-liability ratio will become the key factors of financial restatement, and how to avoid financial restatement as far as possible, it is also necessary to re-check in the process of internal control.

Keywords—*financial restatement; information quality; characteristics*

I. LITERATURE REVIEW OF FINANCIAL RESTATEMENT

A. Motivation of Financial Restatement

Why do some companies start financial restatements which damage their value? The US Financial Accounting Standards Board (FASB) summarizes the "fault" that needs to be dealt with in the process as follows: calculation fault, improper use of accounting rules, neglect or misuse of existing results. Obviously, this only sees external factors, because based on a large number of inquiries; the key is to study its motivation from the aspects of capital market pressure and managers' interests.

1) Capital Market Pressure and Financial Restatement

With the economic development, major enterprises step into capital market financing one by one, which also shows that major enterprises are about to meet more brutal supervision, so that public companies are forced to comply with market standards, to a certain extent, can reduce agency costs, but also conducive to the company to achieve excellent performance, of course, this also requires leaders to be more attentive to management companies [1].

Faced with regulatory pressures, some public company leaders may take excessive measures to violate accounting policies, which will further accelerate the possibility of financial restatement. This also confirms that financing demand is also a big hidden factor in financial statement restatement, but many people have not realized this.

Fiscal forecast is another incentive factor in capital market. In order to meet the needs of financial analysts, market

investors and management, many public companies will take various radical measures to achieve external financial expectations.

In 2003, a study found that the company's market expectations of future earnings growth will be higher. These phenomena also indicate that there will be frequent financial restatements in the future market.

2) Executive Compensation Contract and Financial Restatement

In the principal-agent problem of "shareholder-executive", the combination of executive compensation and enterprise value can reduce agency cost.

However, it is worth noting that the increasing use of share options and other stock-related income in management compensation will prompt some managers to use improper means to obtain corresponding profits, or to achieve some improper benefits by raising the price of stocks.

B. Financial Restatement and Corporate Characteristics

Financial restatement is often regarded as a function of low-quality accounting systems and accounting practices. Therefore, in addition to the independence of the board of directors, the existence of audit committees and their role in it, the current literature focuses more on the structure of corporate characteristics. A large number of studies have proved that corporate characteristics do have an impact on it, such as financial leverage, corporate development ability, short-term debt-paying ability and profitability. Because there are many factors affecting financial restatement, this paper chooses financial leverage, short-term debt-paying ability and profitability as three main factors to explore the relationship between financial restatement and the occurrence of financial restatement and prove it.

II. EMPIRICAL RESEARCH

A. Sample Selection and Data Source

This paper takes the financial restatement announcement data issued by listed companies on Shenzhen and Shanghai motherboard from January 1, 2008 to December 31, 2017 as the research object, and summarizes and collates the annual report data, so as to obtain the final empirical data. Combining the relevant theories domestic and abroad and the actual situation of our country, we use econometric model to select the profitability, short-term solvency and financial leverage of

public companies, establish hypothesis and explore the relationship between the occurrence of financial restatement and it.

B. Establish Assumptions

The profitability of a company is inversely proportional to its financial restatement

Short-term solvency is inversely proportional to its financial restatement

The company's asset-liability ratio is directly proportional

to its financial restatement.

C. Modeling

Set the regression model equation as

$$Y = C + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + u$$

Y is the probability of financial restatement, X1 is the foundation of every share benefit, X2 is the ratio of active funds to active liabilities, X3 is the ratio of total liabilities to total assets, The parameters estimated by Eviews are as follows:

TABLE I. EIEWS ESTIMATION PARAMETERS

Dependent Variable: Y

Method: Least Squares

Date: 02/22/19 Time: 17:53

Sample: 2008-2017

Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
X1	66.85508	209.6511	2.318887	0.7606
X2	-5919.066	2033.708	-2.910480	0.0270
X3	2701.067	1700.229	2.588649	0.1632
C	6334.048	4233.391	1.496212	0.1852
R-squared	0.995898	Mean dependent var		560.6000
Adjusted R-squared	0.993847	S.D. dependent var		266.7155
S.E. of regression	20.92093	Akaike info criterion		9.208551
Sum squared resid	2626.111	Schwarz criterion		9.329585
Log likelihood	-42.04276	Hannan-Quinn criter.		9.075777
F-statistic	485.5913	Durbin-Watson stat		1.980469
Prob(F-statistic)	0.000000			

And the equation is obtained:

$$Y = 6334.04834796 - 66.8550797797 * X_1 - 5919.06594143 * X_2 + 2701.06714828 * X_3$$

D. Model Checking

1) Statistical Significance Test (Goodness of Fit Test)

Goodness of fit Test. The goodness-of-fit test is mainly used for identification coefficient and regression standard deviation,

and the fitting level of the model for the sample is verified. Value of R between [0,1] .The closer it is to 1, the better it fits. The closer it is to 0, the worse it fits. According to the output of Table 2, R-square=0.995898 is almost close to 1, which indicates that the regression line of sample fits the observed values well.

2) Testing of Econometric Model

(1) Multiple collinear test. In order to prevent multiplicity, multiple collinear tests are carried out and regression equations are obtained from regression models.

$$Y = 6334.04834796 - 66.8550797797 * X1 - 5919.06594143 * X2 + 2701.06714828 * X3$$

R2=0.995898 is close to 1, and the goodness of fit is better; DW=1.980469 is close to the model2 state.

(2)Residual test.

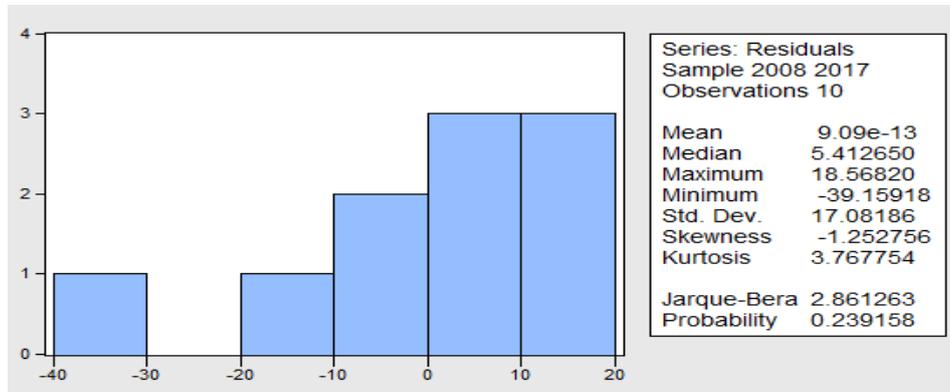


FIGURE I. RESIDUAL TEST CHART

As can be seen from the above figure, the corresponding P of JB is 0.239158 > 0.05, so the estimated linear regression model is meaningful. In other words, the above tests can prove to some extent that profitability, short-term solvency and asset-liability ratio are the influencing factors of financial restatement.

E. A Few Summaries

1) Model is Significantly Correlated with Factor Analysis

To sum up, the model $Y = 6334.04834796 - 66.8550797797 * X1 - 5919.06594143 * X2 + 2701.06714828 * X3$ can be used to predict and analyze the relationship between financial restatement and profitability, short-term solvency and asset-liability ratio, so as to promote the further development of China's financial system.

(1) Profitability and short-term solvency are inversely proportional to financial restatement. When the profitability of the enterprise is good and the company can pay the short-term debt in time, the possibility of financial restatement is less. In other words, the good operation of the company is conducive to avoiding the occurrence of financial restatement.

(2) Financial leverage is proportional to financial restatement.

Just as the financial crisis caused by financial leverage mentioned in the literature review, In the same situation as the total amount of funds and EBITDA, the higher the debt ratio, the higher the financial crisis, so the possibility of financial restatement will be higher.

2) Other Factors Affecting Financial Restatement

Internal control plays a very important role in the quality of financial reports. In order to guarantee the quality of financial information from the root, it is necessary to optimize the internal governance environment, improve the internal control system, strictly regulate the behavior of internal staff, and effectively suppress the fraudulent and erroneous behavior of enterprise financial reports, such as expanding independence

[2]. The proportion of directors and the level of financial knowledge of audit committee members should be improved to further improve the quality of financial information.

III. CONCLUSIONS AND SUGGESTIONS

In this paper, empirical analysis and quantitative analysis are combined to further explore the factors affecting the occurrence of financial restatement in China, and the following main conclusions are drawn: (1) The three important internal factors that cause financial restatement are profitability, short-term solvency and asset-liability ratio. The changes of these factors will become the key factors for financial restatement. How to avoid financial restatement as far as possible is also necessary in this process. (2) Faced with the phenomenon of financial restatement of Listed Companies in China at this stage, we should further strengthen supervision to avoid or reduce the occurrence of financial restatement as far as possible.

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