

Study on Characteristics of the Financial Report Restatements

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Abstract

Taking financial report restatements of A shares Listing Corporation in Shanghai Stock Exchange from 2012 to 2014 as research samples, this paper analyzes the characteristics of the financial report restatement from multiple perspectives. Research results show that the financial report restatements of the listing corporation have five external characteristics. 1) It is a certainly unverse phenomenon about financial restatements. 2) Listed companies belong to manufacturing or in underdeveloped areas more prone to restate. 3) Parts of the companies are “regulars” of financial restatements. 4) Majority restatement announcements are correction notice. 5) Overall time-liness of restatement announcements is strong and supplementary notice lag time is the longest. There are three internal characteristics about financial restatements. 1) The financial restatements related to governance issues are the most. 2) More financial restatements make the low-level errors. 3) Financial report disclosure format of the listing companies is not standardized. Finally, related suggestions are put forward based on the above research results.

Keywords

Financial Report Restatements, External Characteristics, Internal Characteristics

1. Introduction

Since 1990s, the phenomenon about the financial restatements of the listing corporation has been developing in the capital market in the world. According to statistics of GAO, companies of financial restatements accounted for only 0.9% of all listing corporations in the United States in 1997, but the proportion rapidly grew to 6.8% in 2006 [1]. Looking at the Chinese market, the situation is also not optimistic. According to this paper, from 2012 to 2014, there are 311 A shares listing corporations have occurred restatements in the Shanghai stock exchange, which involves 429 financial restatements. Among them, companies of financial restatements accounted for more than 22% of all A shares listing corporations in 2013. In addition, contents of restatement mainly include: digital index calculation made errors, the top 10 shareholders did not disclose or make errors, measurement unit omissions or errors, association trade gaps and executive salary gaps etc. Superficially speaking, these errors appear to be caused by financial staff negligence; in fact, many errors are a kind of accounting fraud.

The phenomenon about financial restatements of the listed corporation is becoming more and more common, which makes adverse effects on the quality of financial information. What are the characteristics of these finan-

cial restatement reports? This paper takes the A shares listing corporation of the 2012-2014 in the Shanghai Stock Exchange as samples, to inspect some characteristics of financial restatements.

2. Literature Review

Studies on financial restatements by domestic and foreign scholars are mainly reflected in five aspects.

1) The Study on the System of Financial Restatements. The studies on this aspect pay attention to compare the difference of the domestic and international financial systems and then to put forward the optimization and regulatory proposals.

2) The Study on the Types of Financial Restatements. These studies are mature abroad and the general idea of the division of financial restatements is based on the content. APB (2000), GAO (2003), Scholz (2008) [2] and other classification methods can be summarized as the core profit factor, noncore profit factor, balance sheet adjustment and the other. However, the studies in China are basically based on foreign experience.

3) The Study on the Motivation of Financial Restatements. One of the capital market motivations of financial restatements is financial expectations; the other capital market motivation of financial restatements is the need of financing (Dechow, 1996 [3]; Richardson, 2002 [4]). But researches on this aspect are not consistent, and there are two main ideas. Some scholars think that there are four main types of financial restatements: management level earnings management, company internal control defect, the ambiguity of accounting standards and the complexity of the company's business. The others think that there are six major categories of financial restatements: accounting issues, technical issues, legal regulations, sensitive issues, regulatory supervision and others [5].

4) The Study on the Influence Factors of Financial Restatements. It is mainly concerned about the basic characteristics and governance structure of the company. At present, the research on the companies' characteristics of the financial restatements mainly includes the company size, asset liability ratio, profitability and growth, etc. but there isn't a consistency research to prove those characteristics have affected the financial restatements. Kinney *et al.* (1989) [6] found that the companies of financial restatements compared with the same industry have a smaller scale, higher debt ratio, poor growth, and is facing more uncertainty. However, there are still many scholars challenging the conclusion, for example, Richardson *et al.* (2002) found that there is no significant correlation between the company's growth and financial restatements. The governance structure is mainly related to the internal governance and external governance. DeFond *et al.* (1991) [7] pointed out that compared with non-restatement companies, the company has a slow growth rate and a relatively low proportion of the audit committee.

5) The Study on the Economic Consequences of Financial Restatements. In this aspect, the study found that the financial restatements will cause a serious negative market reaction [8].

3. Sample Selection and Data Sources

The financial restatement notices in this paper are derived from the Shanghai stock exchange. Firstly, select all the A shares listing companies in the Shanghai stock exchange in the 2012-2014 period as the study sample. The listing corporations in the Shanghai stock exchange are about 1049, excluding companies which stop operating from 2012 to 2014 and some basic information is not available, there are more than 940 companies. And then consult by hands interim announcements of the listing corporation in the Shanghai Stock Exchange (key words mainly include "financial information correction", "annual supplement", "semiannual supplement", "quarterly supplement", "annual correction", "semiannual correction", "quarterly correction", etc.). Finally, we get 429 financial restatement observations, of which there are 35 in 2012, 246 in 2013 and 148 in 2014, a total of 311 listing corporations. We get the information about regional and industry by inquiring the company profile from the Shanghai stock and the information about the year, type, time, frequency, reason and content of the financial restatements is got by inquiring supplement and correction announcements.

4. The External Characteristics of the Financial Restatements in China

This paper discusses the external characteristics of financial restatements from five aspects.

4.1. Year Distribution of Financial Restatements

Financial restatements companies accounted for about 3.26% of all A shares listing corporations in 2012, the

proportion rapidly increased and up to about 22% in 2013. Although the proportion declined to about 13.82% in 2014, it can also illustrate the phenomenon of financial restatements is certainly universe. The reason why the phenomenon about the peak of financial restatements appeared in 2013 may be that NO. 2 annual report information disclosure content and format standards etc. are revised (**Table 1**).

4.2. Industry and Regional Distribution of Financial Restatements

According to *The Securities Industry Classification Guidelines* issued by the Securities Regulatory Commission in 2001, the statistical results of industry distribution show that the manufacturing accounted for 55.94% of all samples, the retail industry is the second largest proportion, the next is the estate and mining industry, whose proportion are more than 4.5%. And the proportion of the odd industries is under 3%. The research shows that financial restatements of the manufacturing industry accounted for a larger proportion. Perhaps have the following reasons: 30 sub industries belonging to manufacturing industry, covering a wide range, the number of listed companies, huge difference between the size of companies, the main business scope, cost and income level, uncertain and complex industry measure index. So it is very difficult to analysis and supervise listed companies of manufacturing.

At the same time, we also get the statistics about regional distribution of financial restatements. The study found: 1) the number of listing corporation in developed regions (such as Zhejiang Province, Shanghai City, Beijing City etc.) is far more than that of the underdeveloped regions, but the proportion of companies in developed regions in total companies is much higher than that of restatements companies in total restatements companies. This undoubtedly illustrates the status of financial restatements in underdeveloped regions is more austere than that in developed regions. 2) Although the absolute number of listing corporation in many of the underdeveloped regions (such as Gansu, Qinghai, Tibet, Xinjiang, etc.) is far lower than that in the developed regions, the proportion of its financial restatements may be higher than that in the developed regions. For example, there are 22 restatement companies in total 93 companies in Beijing and the proportion is 23.66%, while the proportion of restatements companies is as high as 71.43% of total 7 companies in Qinghai Province. From this phenomenon it can be seen that the regional distribution of financial restatements is not balanced. The reasons may be the low level of market economy, the low level of legal protection of investors, the confusion of government and enterprises and the low efficiency of regulatory agencies etc.

4.3. Frequency Distribution of Financial Restatements

The frequency distribution of financial restatements is shown in **Table 2**. Data shows that in recent three years, 71.7% in total companies released the announcements only once, 19.94% released the announcement twice, but there are still 8.36% which are “regular” releasing repeat announcements more than three times. Shandong iron and steel (600022) is a typical representative, which released 4 annual report or quarterly supplement and correction notices in only 3 years. So, the “regular” should be pay attention to by relevant departments.

4.4. Type of Announcement Distribution of Financial Restatements

According to the disclosure title of the provisional announcement, type of announcement is divided into correction,

Table 1. Year distribution of financial restatements.

Year	Number of Companies of Restatements	Number of Companies	The Proportion
2012	31	943	3.29%
2013	211	942	22.40%
2014	130	941	13.82%

Table 2. Frequency distribution of financial restatements.

Time	Once	Twice	More than Three Times	Total
Number of Companies	223	62	26	311
Proportion (%)	71.70	19.94	8.36	100

supplement and supplement and correction and type of announcement distribution of financial restatements is shown in **Table 3**. The result reveals that recently the proportion of three kinds of financial restatements announcement is basically prone to stabilization. The proportion of correction announcement is higher than the others, fluctuating at 67%. The proportion of supplement announcement is always about 24%, but the proportion of supplement and correction announcement is undulant, 0% in 2012 but 8.94% in 2013. For capitalism market, the high proportion of correction is not a good new. Because the correction announcement is to correct fiscal errors in the financial report and the errors manifest low quality of accounting information, which may make adverse impact on decision making. Therefore, correction announcement generally manifests negative reaction of market.

4.5. Lag Time Distribution of Financial Restatements

The lag time distribution of financial restatements is shown in **Table 4**. In this paper, the lag time is calculated by calculating margin between the time of disclosing correction and supplement announcement and the time of the disclosure of the annual or quarterly report. The results show that there are 10.96% of the announcements released on the day of the annual or quarterly report disclosure, more than 52.8% of the announcements released within 15 days after disclosing the annual or quarterly report, which indicates that the whole the timeliness of the announcement is stronger. However, there are more than 11% of the announcements released hereinbefore 60 days after disclosing the annual or quarterly report. This problem is more serious. It is worth noting that 19.81% of the announcement in the supplementary announcement released more than 60 days, following is supplement and correction announcement, 16%. The next is correction announcement, 7.56%. It is obvious that supplementary notice is the one of the longest lag time.

5. The Internal Characteristics of Financial Restatements in China

This paper discusses the internal characteristics of financial restatements from two aspects.

5.1. Classification of Financial Restatements

From the statistic, it can be seen that 311 companies totally released 429 financial restatement announcements. So we can see a supplement or correction notice can involve a number of projects. Especially some companies whose financial report made major errors, there were more involved projects. Such as the financial restatement announcement of Chendian International (600969) involved balance table, profit sheet and the directors salary management etc. Therefore, it is necessary to classify the types of financial restatements. By analyzing the statistic, the financial restatements are divided into nine small categories of two major categories.

1) Internal data in table restatements

Internal data in table restatements is a kind of financial restatements involving financial sheets, mainly cover-

Table 3. Type of announcement distribution of financial restatements.

Year	Correction		Supplement		Correction and Supplement		Total
	Number	Proportion	Number	Proportion	Number	Proportion	
2012	27	77.14%	8	22.86%	0	0.00%	35
2013	164	66.67%	60	24.39%	22	8.94%	246
2014	100	67.57%	38	25.68%	10	6.76%	148
Total	291	67.83%	106	24.71%	32	7.46%	429

Table 4. Lag time distribution of financial restatements.

Lag time	0 day	1 - 15 days	15 - 30 days	30 - 45 days	45 - 60 days	>60 days	Total
Frequency	47	226	54	34	20	48	429
Proportion	10.96%	52.68%	12.59%	7.93%	4.66%	11.19%	100.00%

ing profit sheet, balance sheet and cash flow sheet and other. Therefore, internal data in table restatements can be divided into 3 sub categories: profit sheet, balance sheet and cash flow sheet and other restatements.

Profit sheet restatements mainly include business income, operating costs and management expenses, sales expenses and financial expenses, non-operating revenue and expenses, taxes and other related accounting errors correction, such as measurement error of the income and expenditure, the multi meter leakage meter, fictional concealed, classification error and related data error. The correction of errors involving the net profit attributable to the shareholders after deducting of non-recurring gains and losses, gross margin and expense ratio, etc.

Balance sheet restatements include error correction of total assets, shareholder rights and interests and the sub subject of liabilities, such as the calculation errors of dilution per share earnings, the weighted average net assets income rate, attributable to shareholders per share net assets and basic per share earnings deducting non-recurring gains and losses.

Cash flow sheet and other restatements mainly related to correction of errors and leakage of the cash inflow and outflow of cash flow and other related subjects of business activities, non-operating activities, such as the error of cash flow generated from per share operating activities. In addition, the amendments of shareholders' rights and interest sheet or other belong to cash flow sheet and other restatements.

2) Data out of table restatements

According to the statistic, data out of table restatements are divided into 6 sub categories: restatements related to profit distribution, restatements related to relevant party and related party transactions, restatements related to business, restatements related to project notes of the financial report, restatements related to corporate governance and other restatements.

Table 5 shows the distribution of the nine categories restatements. As can be seen from the table, the restatements related to governance issues is the most, 28.65%, following is restatements related to business and restatements related to project notes of the financial report, the next is the profit sheet, balance sheet restatements and restatements related to relevant party and related party transactions, are more than 7%, but the proportion of cash flow restatements and restatements related to profit distribution are floating from 3% to 6%.

Restatements related to corporate governance, business and project notes of the financial report have something to do with the changes of the regulatory policy in the last three years. As regulators pay more attention to corporate governance issues, they also more and more emphasis on the internal control of the listing corporation, so that a large number of listing corporation releases more supplement and correction announcements about executive pay, working and sale conditions of shares and shareholders and profit distribution policy etc. Increase of the above restatements is conducive to protecting the interests of investors. At the same time, the way that listed companies use concealed or false report or delay the information related to the items of the financial statements published may will become the new trend of earnings manipulation.

5.2. Attribution of Financial Restatements

On the basis of previous studies, this paper tries to avoid the overlapping of the attribution, and the reasons of the financial restatements are summarized in the following four aspects.

Table 5. Contend distribution of financial restatements.

The types	2012	2013	2014	Total
Profit sheet restatements	14.71%	11.53%	11.16%	11.72%
Balance sheet restatements	11.76%	8.52%	8.04%	8.68%
Cash flow sheet and other restatements	8.82%	4.76%	6.25%	5.64%
Restatements related to profit distribution	1.47%	3.26%	4.02%	3.33%
Restatements related to relevant party and related party transactions	11.76%	5.76%	8.04%	7.09%
Restatements related to business	10.29%	12.53%	12.05%	12.16%
Restatements related to project notes of the financial report	23.53%	12.53%	11.16%	13.17%
Restatements related to corporate governance	10.29%	33.08%	26.34%	28.65%
Other restatements	7.35%	8.02%	12.95%	9.55%
Total	100.00%	100.00%	100.00%	100.00%

1) Restatements caused by the defect of internal control of enterprises. This reason mainly includes the restatements caused by the company's own technical problems and the company's self-examination. The former refers to contents of disclosure illustrating the error is due to the record, layout, statistics and calculation errors, such as the unit's "billion" wrong notes into "Yuan" and ratio of revenue and cost of the main business sub sectors and sub industries calculates error.

2) Restatements caused by the requirements of laws and regulations or the exchange. The reasons of restatements are that report format or content does not meet the requirements of relevant laws and regulations, there are significant omissions, the important content which should be disclosed but was not be disclosed, exchange requires an explanation such as supplement that shareholders and executives remuneration, profit distribution plan and investment analysis.

3) Restatements caused by punish or urge of regulatory authorities. If the financial report is suspected of accounting fraud or it is reported by media caused by the existence of accounting scandals, will be required to complement and correct the contents of report by the Ministry of finance, China Securities Regulatory Commission or the local regulatory authorities.

4) Other or unknown, refers to the restatement cause by the reason except the above three points, such as not to explain the situation, accounting firms making errors.

As shown in the **Table 6**, the 42.42% of financial restatements is caused by the defect of internal control of the enterprise. Other reasons causing financial restatements are followed by the law or regulations or exchange requirements, other or unknown and regulatory authorities to punish or urge, respectively, 35.66%, 19.81% and 2.1%. From the table, it can be seen that the defect of internal control of the enterprise is the biggest reason for financial restatements, and the reason mainly includes positive and negative number, decimal point, units and other errors of data caused by work negligence. There exist these simple errors in the listing corporation report, which can explain part of the listing corporation lack of serious attitude to financial report disclosure work and this behavior may mislead the report users.

The requirements of laws and regulations or the exchange also a major reason for financial restatements, which shows that a large part of the companies do not disclose financial report projects according to "the information disclosure regulation of emitting bond in the public—the general provisions of the financial report", which indicates listing corporation lack of serious attitude to disclose the financial report.

6. Conclusion and Revelation

In this paper, by doing the descriptive statistics about the year, industry, region, frequency, announcement type and lag time of supplement and correction announcements, the five external characteristics of the financial restatement of the listing corporation in recent years are summarized. 1) Under the current social system, the phenomenon of financial restatement is certainly universe. 2) The manufacturing industry is the industry which has the most financial restatements, and the number of the financial restatement companies in the developed regions is more, but the proportion is lower. 3) There is a part of the listing corporations which are "regular" releasing repeat announcements more than three times. 4) Most of the restatement announcements belong to the correction notice. 5) Overall timeliness of restatement announcements is strong and supplementary notice is the one of the longest lag time.

In addition, we find three internal characteristics of financial restatement. 1) The financial restatements related to governance issues are the most. The restatements caused by governance issues are being increasing, which is likely to be far more than the profit restatement and balance sheet restatement. The reason may be that

Table 6. Reason analysis of financial restatements.

Attribution	2012	2013	2014	Total
Restatements caused by the defect of internal control of enterprises	62.86%	38.62%	43.92%	42.42%
Restatements caused by the requirements of laws and regulations or the exchange	8.57%	40.65%	33.78%	35.66%
Restatements caused by punish or urge of regulatory authorities	8.57%	1.22%	2.03%	2.10%
Other or unknown	20.00%	19.51%	20.27%	19.81%
Total	100.00%	100.00%	100.00%	100.00%

the regulatory authorities focus more on governance issues, which indicates that the fraud may have become more hidden.

2) Many financial restatements make the low-level errors. For the sample, the most important reason that causes the occurrence of financial restatements is the defect of the internal control of the enterprise, most of which are due to the simple technical errors, such as, the error of the data, decimal point and unit. The existence of these simple errors indicate that part of the listing corporation lack of earnest attitude to disclose the financial report, which may mislead the user and seriously affect the quality of financial reporting information.

3) Listed companies financial report disclosure format is not standardized. Legal regulations or exchange requirements are also a major reason of financial restatement, which shows that a large part of the companies do not disclose financial report projects according to *The Information Disclosure Regulation of Emitting Bond in the Public—The General Provisions of the Financial Report*, which can indicate listing corporation lack of serious attitude to disclose the financial report.

The above results indicated that the financial restatement in our country still needs to strengthen control. Regulatory authorities should intensify supervision of listing companies, for example, they can penalize responsible person of listing company of information disclosure problems to warn others against following a wrong-doer. For the listed companies, they should strengthen their internal control construction. For the institution, we should be stepping up efforts to establish and improve the standardized, normative and clear system of accounting information disclosure, which can let the financial restatement have regulations to abide by.

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