

ABSTRACT

The Impact of fiscal support on earnings management: Evidence from equity offerings in China

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It is well documented in existing literature that firms manipulate earnings before IPOs (initial public offerings) and SEOs (seasoned equity offerings). This study contributes to prior research by being the first to examine whether fiscal support from local governments has impact on the earnings management behavior of Chinese listed firms. Using data from firms that conduct IPOs and SEOs from 1997 to 2006, I find that firms are less likely to manipulate earnings prior to the offerings if they enjoy more income tax savings attributed to the preferential tax favor or more financial subsidy from the local governments.

The findings of the study have important policy implications. Noticeably, the new Enterprise Income Tax Law effective from 1 January, 2008 abrogates the original tax system that allows various preferential tax rates for firms of different properties and stipulates a 25% enterprise income tax rate for all firms in China. Given the abolishment of the preferential tax favor, local governments lose a potent avenue of lending fiscal support to the listed firms. To this end, based on the findings in this study, I expect that the opportunistic earnings management by listed firms will probably be aggravated after the new income tax law is duly enforced.