



CFO Financial Professional Background and Accounting Conservatism

Yanshu Yang

School of Economics and Management, Beijing Jiaotong University, Beijing 100044, China

21120681@bjtu.edu.cn

Abstract. Accounting conservatism is an important principle of enterprises' accounting information quality. CFO has a significant impact on enterprise accounting conservatism. This paper explores the impact of CFO's financial professional background on accounting conservatism. This paper collects the relevant data of Shanghai and Shenzhen A-share listed enterprises from 2008 to 2019, measures the accounting conservatism of the explanatory variables using the C-SCORE model, conducts multiple linear regression, and distinguishes between state-owned and non-state-owned for group regression. Thereafter distinguish state-owned enterprises and non-state-owned enterprises to carry out group regression. Then empirical conclusions are obtained: (1) CFO's financial professional background can improve accounting conservatism; (2) compared with state-owned enterprises, the impact of CFO with financial professional background on accounting conservatism exists more in non-state-owned enterprises.

Keywords: CFO, financial professional background, accounting conservatism

1 INTRODUCTION

The principle of accounting conservatism is a very important standard for the quality of accounting information. Accounting conservatism requires enterprises not to overestimate assets and revenues, and not to underestimate liabilities and expenses. With the development of the economy, the research on accounting conservatism has been popular, and the researches mainly focus on external governance and internal governance in respect of the influencing factors of accounting conservatism. Research on the factors affecting accounting conservatism has basically been recognized in the external governance; In terms of internal governance factors, many scholars have begun to pay attention to the impact of managers' background characteristics on accounting conservatism, but most of them are based on the homogenization of the executive team, while ignoring the individual characteristics, and at the same time ignoring the CFOs.

CFO is the direct person in charge of the financial system, and there has been little research focusing on the literature of CFO's professional background, and CFO's personality characteristics, practice environment, and practice experience in their professional may directly affect the accounting conservatism of the enterprise. Therefore, this

paper studies the impact of CFO's financial professional background on corporate accounting conservatism, which is innovative and meaningful.

This paper hopes to expand the research in the field of factors influencing accounting conservatism, and at the same time hopes to provide some practical suggestions in.

2 LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1 Literature Review

At present, the research on accounting conservatism has been a popular research field. For the influencing factors of accounting conservatism, scholars' research mainly focuses on the two aspects of external governance and internal governance.

Watts (2003) categorized the external governance factors of accounting conservatism into four areas: covenants, litigation, taxation, and regulation.^[1] Ahmed et al. (2002) argued that there is an antagonistic relationship between shareholders and creditors of a company, and accounting conservatism will change according to the degree of antagonism.^[2] Lafond et al. (2008) found that when the ownership and operation become more separated, the shareholders will demand a higher level of accounting conservatism.^[3] Shen et al. (2013) hold a related view that the two are positively correlated.^[4] The findings of Bushman et al. (2005) suggest that the more robust the judicial system, the stronger the accounting conservatism.^[5] Zhou Ze will (2012) believes that tax burden has a significant effect on accounting conservatism through municipalities.^[6] Bushman et al. (2005) showed that the more a country's politics intervene in the economy, the slower the recognition of good news and the faster the recognition of bad news.^[5] Chen Yanyan et al. (2013) argued that when the political connection that exists in a firm, then this firm will have a lower level of accounting conservatism.^[7]

In terms of internal governance, the current direction of academic research on the factors influencing accounting conservatism mainly includes two aspects, namely, the nature of equity and the background characteristics of executives. Equity structure includes aspects such as the nature of equity, equity concentration, and equity checks and balances. Liu, S., & Zhang, J. (2021) found a positive relationship between the adoption of EIPs and accounting conservatism in listed Chinese firms.^[8] Xiaoyu Zhou (2022) found that the quality of accounting information of SOEs significantly improves after the introduction of multiple large shareholders.^[9] Zhang Fan (2015) found that executive power reduces the enhancing effect of internal control on accounting conservatism.^[10] Xin Shi (2018) found that the greater the incentive intensity of CFO compensation, the lower the accounting conservatism.^[11]

2.2 Hypothesis Development

CFO financial professional background and accounting conservatism

CFOs' past experience in the financial profession can help them better establish a sense of risk prevention. Therefore, the professional ethics and habits accumulated by

CFOs with a financial background in their previous work can, to a certain extent, ensure the robustness of CFOs in their current work. In terms of professional ability, having worked in financial companies gives CFOs better professional ability and expertise, which can better identify potential financial risks on the one hand, and better understand financial policies and financial norms on the other hand, which can help CFOs choose more robust accounting policies. In terms of risk appetite, CFOs who have worked for financial institutions may have a stronger sense of fiduciary duty and pay more attention to their reputation, thus choosing more robust accounting policies to avoid the risk of financial fraud and preserve their reputation.

Based on this, this paper proposes hypothesis I:

H1: CFO's financial professional background improves accounting conservatism.

Impact of the nature of property rights

This paper divides enterprises into state-owned enterprises and non-state-owned enterprises according to the nature of property rights. State-owned enterprises' creditors and owners have lower requirements for accounting conservatism, CFOs adopt the appointment system and have lower governance levels, all of which may reduce the impact of CFOs' financial professional background on accounting conservatism.

Based on this, this paper proposes hypothesis II:

H2: The impact of CFOs with financial professional background on accounting conservatism is more likely to exist in non-state-owned firms than in state-owned firms.

3 METHODOLOGY

3.1 Sample Selection and Data Sources

We selection period of this paper is from 2008 to 2019, and all the data are from CSMAR database, based on the above data: ①exclude the companies in the financial and insurance industry; ②exclude the ST and *ST companies in the current year; ③for the companies with multiple CFOs in the same year, only the new CFOs in the current year are retained, and the departed CFOs are excluded; ④exclude the missing values. To avoid being influenced by outliers, we winsorize all the continuous variables at the 1% and 99% levels. The software used for subsequent data processing is STATA. The final paper collected a total of 18,776 CFO samples from 2008 to 2019, of which 2,758 samples with financial background, accounting for 14.69% of the total sample.

3.2 Variable Definition and Modeling

This paper selected the C-SCORE model proposed by Khan & Watts (2008) to measure accounting conservatism.^[1] Whether the CFO has worked for financial regulatory authorities, policy banks, commercial banks, insurance companies, securities companies, fund management companies, securities registration and settlement companies, futures companies, investment banks, trust companies, investment management companies, exchanges, and other financial firms in the course of his/her

previous career is used to define whether the CFO has a financial professional background. And a series of control variables are selected based on the existing literature. The definitions of all variables are presented in [错误!未找到引用源。](#).

Table 1. Definition of variables.

Variables	Definition
C-Score	Values calculated from the Khan-Watts model.
Finance	The CFO has a financial professional background takes the value of 1, otherwise 0.
Gender	The gender of the company's CFO is male take 1, otherwise take 0.
Tenure	Taken based on the specific length of the CFO's tenure.
Size	Natural logarithm of the company's total assets at the end of the year.
Debt	Ratio of total liabilities to total assets at the end of the year.
PPE	Ratio of fixed assets to operating income.
ROA	Ratio of net profit to total assets at the end of the period.
MTB	Ratio of market value of the equity to book value of equity.
TAT	Ratio of net operating income to average total assets.
Z1	Shareholding ratio of the company's largest shareholder.
Z10	Shareholding ratio of the company's top ten shareholders
Big4	At least one of the company's domestic and foreign auditors is an international Big Four firm takes the value of 1, otherwise it is 0.
ListAge	Natural logarithm of the number of years the company has been listed.
BoardSize	Natural logarithm of the number of the company's board of directors.
Independ	Ratio of the number of independent directors to the number of the board of directors.
Year	Setting up annual dummy variables.
Industry	Set industry dummy variables for industries classified by level 1 codes, except for manufacturing, which is classified by level 2 codes.

The regression model is constructed as model (1):

$$C - \text{Score}_{i,t} = \gamma_0 + \gamma_1 \text{Finance}_{i,t} + \Sigma \text{Controls}_{i,t} + \epsilon_{i,t} \quad (1)$$

4 EMPIRICAL RESULTS

In order to verify the two hypotheses proposed before, the equation (1) was analyzed by multiple linear regression, and the regression results are shown in [错误!未找到引用源。](#).

Table 2. Empirical Results

Variables	C-Score (full sample)	C-Score (SOE)	C-Score (non SOE)
Finance	0.034** (2.07)	0.044 (1.42)	0.022* (1.70)
Gender	-0.022** (-2.02)	-0.058** (-2.51)	-0.004 (-0.36)
Tenure	-0.000 (-0.20)	-0.000 (0.16)	-0.000 (-0.28)
Size	-0.196***	-0.252***	-0.118***

Variables	C-Score (full sample)	C-Score (SOE)	C-Score (non SOE)
	(-18.13)	(-13.80)	(-12.87)
Debt	0.335*** (7.66)	0.336*** (4.21)	0.324*** (7.35)
PPE	-0.201*** (-3.24)	-0.345** (-2.40)	-0.108* (-1.95)
ROA	0.547*** (3.46)	1.038*** (3.10)	-0.029 (-0.22)
MTB	-0.012** (-2.28)	-0.030** (-2.52)	0.005 (0.98)
TAT	0.011 (0.61)	0.018 (0.55)	0.001 (0.07)
Z1	-0.001 (-0.91)	-0.000 (-0.12)	-0.001 (-1.04)
Z10	-0.001* (-1.87)	-0.002* (-1.79)	0.000 (0.17)
Big4	-0.123*** (-2.94)	-0.141** (-2.44)	0.007 (0.15)
ListAge	0.027*** (3.09)	0.032 (1.54)	0.005 (0.58)
BoardSize	-0.017 (-0.42)	0.022 (0.29)	0.007 (0.21)
Independ	-0.114 (-0.73)	-0.014 (-0.05)	0.086 (0.68)
_cons	3.866*** (14.27)	5.050*** (11.47)	2.036*** (8.65)
Year Effect	Yes	Yes	Yes
Industry Effect	Yes	Yes	Yes
N	18776	7848	10928
Adj R-squared	0.13	0.15	0.11

***, **, and * indicate 1%, 5%, and 10% significant, respectively

Through the multivariate linear regression of the first column of the full sample it can be observed that CFO's financial professional background is significantly and positively related to corporate accounting conservatism, which verifies the hypothesis I proposed in this paper. By comparing the results of multivariate linear regression in the second and third columns, it can be observed that there is no significant correlation between CFO's financial occupational background and accounting conservatism in state-owned enterprises, but CFO's financial occupational background is significantly positively correlated with accounting conservatism in non-state-owned enterprises, which verifies hypothesis two proposed in this paper, and compared with state-owned enterprises, the impact of CFOs with financial occupational backgrounds on accounting conservatism is more likely to exist in in non-state-owned enterprises.

5 CONCLUSIONS

In this paper, we first collected relevant data from A-share listed companies in Shanghai and Shenzhen from 2008 to 2019, and measured the accounting conservatism of the

explanatory variables by using the C-SCORE model, using CFOs who had worked for financial enterprises to measure whether the explanatory variable CFO has a financial professional background, conduct multiple linear regression, and distinguish between state-owned and non-state-owned for group regression. Explore the impact of CFO's financial professional background on accounting conservatism. After the above research, this paper obtains the following conclusions:

(1) CFO's financial professional background can improve accounting conservatism.

(2) The impact of CFOs with financial professional background on accounting conservatism exists more in non-state-owned enterprises than in state-owned enterprises.

The above conclusions can help the government to effectively play the monitoring function, help enterprises to select and hire CFOs in a targeted manner, and help investors and creditors to have a comprehensive grasp of financial information.

REFERENCES

1. Watts, R. L. (2003). Conservatism in Accounting Part I: Explanations and Implications. *Accounting Horizons*, 17(3).
2. Ahmed, A. S., Billings, B. K., Morton, R. M., et al. (2002). The Role of Accounting Conservatism in Mitigating Bondholder-Shareholder Conflicts over Dividend Policy and in Reducing Debt Costs. *The Accounting Review*, 77(4).
3. Lafond, R., & Roychowdhury, S. (2008). Managerial Ownership and Accounting Conservatism. *Journal of Accounting Research*, 46(1).
4. Shen, Y., Liang, S., & Chen, D. (2013). Employee Compensation and Accounting Robustness—Empirical Evidence from Chinese Listed Companies. *Accounting Research*, (04):73-80+96.
5. Bushman, R. M., & Piotroski, J. D. (2005). Financial reporting incentives for conservative accounting: The influence of legal and political institutions. *Journal of Accounting and Economics*, 42(1).
6. Zhou, Z., & Du, X. (2012). Tax Burden, Accounting Conservatism and Compensation Performance Sensitivity. *Financial Research*, (10):167-179.
7. Chen, Y., Tan, Y., & Tan, J. (2013). Political Connections and Accounting Conservatism. *Nankai Management Review*, 16(01):33-40.
8. Liu, S. & Zhang, J. (2021). The impact of equity incentive plans (EIPs) on accounting conservatism in listed Chinese firms. *Journal of Applied Accounting Research*, 22: 50-71.
9. Zhou, X. (2022). The impact and countermeasures of state-owned enterprise mixed ownership reform on the quality of accounting information. *Anhui University of Technology*.
10. Zhang, F. (2015). *Executive Power, Internal Control, and Accounting Conservatism*. Beijing Jiaotong University.
11. Shi, X. (2018). *Research on CFO Compensation Incentives and Accounting Conservatism*. Shandong University.

Open Access This chapter is licensed under the terms of the Creative Commons Attribution-NonCommercial 4.0 International License (<http://creativecommons.org/licenses/by-nc/4.0/>), which permits any noncommercial use, sharing, adaptation, distribution and reproduction in any medium or format, as long as you give appropriate credit to the original author(s) and the source, provide a link to the Creative Commons license and indicate if changes were made.

The images or other third party material in this chapter are included in the chapter's Creative Commons license, unless indicated otherwise in a credit line to the material. If material is not included in the chapter's Creative Commons license and your intended use is not permitted by statutory regulation or exceeds the permitted use, you will need to obtain permission directly from the copyright holder.

