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The Impact of Corporate ESG Performance on Earnings Management

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Abstract. This paper selects listed companies from the Shanghai and Shenzhen A-share markets between 2009 and 2020 as the sample to empirically analyze the impact of corporate performance in ESG (Environmental, Social, and Governance) on the level of their earnings management activities. The study finds that the better the ESG performance, the lower the company's tendency to engage in real earnings management, significantly reducing the level of real earnings management. In contrast, the improvement in ESG performance increases accrual-based earnings management. Further analysis reveals that for non-state-owned enterprises, the restraining effect of ESG performance is more pronounced. All three dimensions—environment, social, and governance—can significantly increase corporate accrual-based earnings management. Compared to environmental responsibility, social responsibility and corporate governance are more effective in significantly reducing real earnings management.

Keywords: ESG performance, real earnings management, accrual-based earnings management, ownership nature

1. Introduction

To actively respond to the nation's low-carbon policies, promote the transformation and upgrading of business concepts, and meet the development needs of the capital market, the ESG (Environmental, Social, and Governance) evaluation system has emerged. It constructs a comprehensive and multi-dimensional corporate assessment framework based on three dimensions: environmental protection, corporate social responsibility, and corporate governance structure, aiming to achieve sustainable development while meeting the growing demand for environmental and social responsibilities. By introducing ESG evaluation standards, companies are effectively guided to enhance their non-financial performance, thereby achieving a harmonious balance between economic and social value in the long term.

The emergence of ESG ratings not only provides investors with concrete indicators for responsible investment, helping them make more informed investment decisions, but also establishes an incentive mechanism for companies. This encourages them to strengthen their practices in environmental protection, social responsibility, and corporate governance, thus improving their ESG ratings. Consequently, corporate ESG ratings have increasingly become the focal point for investors, companies, scholars, and regulatory bodies alike.

Currently, China's capital market still faces challenges regarding information disclosure adequacy and investor protection. In this context, the phenomenon of distorted earnings information has become increasingly prevalent, warranting attention.

Earnings management is the result of companies proactively choosing accounting policies that benefit their interests. Earnings information is a critical measure of a company's profitability and is essential for investors making investment decisions. However, opportunistic behaviors by corporate managers, such as manipulating financial statements through accounting techniques or altering financial conditions by arranging specific transactions, lead to severe distortion of earnings information. This not only misleads investors in their decision-making but also negatively impacts the stable development of the capital market.

In response to these issues, China has actively promoted the disclosure of ESG (Environmental, Social, and Governance) information in recent years. With the active support of the government, ESG information disclosure has become an important supplement to address the issues of earnings information distortion in China’s capital market. Therefore, the potential impact of ESG information on earnings management deserves our attention. This study selects listed companies in China's A-share market from 2012 to 2023 as the research sample and constructs a multiple regression model to empirically analyze the impact of ESG ratings on real earnings management activities of companies.

2. Theoretical Analysis and Research Hypotheses

ESG performance emphasizes that companies should possess strong governance capabilities, as good corporate governance is a critical guarantee for sustainable development [17]. It not only promotes stable growth and enhances the stability of both internal and external business environments but also improves a company's sustainable development capabilities, operational conditions, and reduces financial risk. Additionally, good corporate governance can boost investor confidence, lower financing costs, and significantly suppress management's motives for earnings management. In contrast, management is more inclined to fully utilize company resources to achieve corporate value, including efforts to enhance overall competitiveness, increase investment in research and innovation, and optimize the internal governance structure—all aimed at serving the company's long-term development goals. Therefore, the motivation for earnings manipulation is weakened, leading to a reduction in the level of earnings management. Companies with strong ESG performance can gain the trust and support of stakeholders during their operations, acquire the necessary resources for sustainable development, and significantly improve operational efficiency, thereby reducing the motivation for earnings management.

Stakeholder theory suggests that companies should not only focus on their own interests but also be accountable to a broad range of external stakeholders, balancing relationships with various stakeholders in their operations [19]. As companies grow, the prominence of material capital within them gradually diminishes, and the normal survival and operation of a company also require the support of various stakeholders. Government agencies and employees, as stakeholders, pay more attention to the benefits and welfare the company provides to society and its workforce. ESG practices help establish a positive image for the company, meeting the expectations of shareholders, creditors, employees, suppliers, local governments, non-profit organizations, media, and other stakeholders, thus garnering comprehensive support for the company.

By collaborating and achieving mutual benefits with stakeholders, companies can acquire more resources, enhance operational efficiency and profitability, achieve economic, social, and environmental benefits, and strengthen their potential for long-term sustainable development, thereby reducing the motivation for earnings manipulation.

According to sustainable development theory, ESG can improve a company's environmental risk management capabilities, raise management's awareness of environmental protection, enforce compliance with relevant laws and regulations, and reduce the occurrence of environmental incidents and uncertainties regarding future profits. Previous academic studies have shown that companies that prioritize environmental performance often hold competitive advantages in the market, enhancing their competitiveness. As noted in Yang Dongning's 2004 research, focusing on environmental protection and sustainable development effectively enhances a company's market position and industry competitiveness. Moreover, research by Tong Donghua and Xu Dongyan in 2020 found that companies emphasizing environmental performance could significantly improve their operational performance, thereby maintaining a leading position in intense market competition. Managers with high professional integrity are likely to maintain lower levels of earnings management within the company.

However, ESG, as a non-operational initiative, may serve as a shield for management's earnings management activities. Agency theory suggests that agency problems exist within companies, where managers may choose not to disclose negative information during information disclosure to increase personal compensation or enhance their reputation. On the other hand, based on information asymmetry theory, managers, as the advantaged party in possessing information, may use positive performance to conceal potential unethical behaviors when disclosing ESG information [3]. Since external parties cannot access authentic information, selective ESG disclosure becomes a way for companies to meet the ESG standards set by third-party agencies, masking short-term profit-driven behaviors of management that exploit company funds. This often exacerbates the company's earnings management situation and prevents the company from genuinely addressing existing issues.

From the perspective of the trade-off theory, companies often face resource allocation challenges in the pursuit of profit maximization [11]. For companies with limited resources, excessive investment in non-productive activities such as environmental and social responsibilities may incur unnecessary costs and risks. In a constrained resource environment, overemphasizing non-financial goals may weaken the company's strength, putting it at a disadvantage in market competition.

In the fiercely competitive market environment, many companies may prefer to allocate resources to activities that directly generate economic value rather than to non-productive activities like environmental and social responsibilities. However, this approach does not always align with the expectations of society and investors. Nowadays, investors and consumers increasingly focus on companies' environmental and social responsibility performances, so corporate actions should not only seek economic benefits but also take on social and environmental responsibilities [7]. Consequently, to attract more external funding, companies may resort to embellishing their financial statements to conceal their negligence of environmental and social responsibilities, presenting a positive image to external investors and encouraging favorable investment decisions. Therefore, while companies may proactively implement ESG-related initiatives, they may not necessarily provide accurate and reliable information. In reality, they may use ESG actions as a façade, aiming only to present a positive image externally. In the pursuit of satisfactory ESG performance, companies may even exacerbate earnings management behaviors. While this approach might yield short-term economic benefits, it could harm the company's reputation in the long term, leading to a loss of trust from investors and consumers.

Based on the above analysis, this paper proposes the following competing hypotheses:

Hypothesis H1a: ESG performance reduces the level of earnings management in companies.

Hypothesis H1b: ESG performance increases the level of earnings management in companies.

3. Research Design

3.1. Sample Selection and Data Sources

This study selects listed companies on the Shanghai and Shenzhen A-share markets in China from 2009 to 2020 as the research sample. ESG performance data is sourced from the Wind database, while other financial data is obtained from the CSMAR database. The raw data underwent the following processing steps:

1. Excluded financial companies and companies without ESG rating information.
2. Removed specially treated companies (ST and *ST).
3. Eliminated companies with incomplete financial data.
4. Winsorized continuous variables at the 1% and 99% levels to minimize the influence of outliers.

After the above processing, 15,645 valid observations were obtained for analysis.

3.2. Variable Definitions

1. Dependent Variable: Earnings Management Level, which includes Accrual-Based Earnings Management (DA) and Real Earnings Management (REM) as indicators. AEM is measured using the modified Jones model, with the specific regression model as follows:

$$\frac{TA_{i,t}}{A_{i,t-1}} = \partial_0 \frac{1}{A_{i,t-1}} + \partial_1 \frac{\Delta REV_{i,t}}{A_{i,t-1}} + \partial_2 \frac{PPE_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t} \tag{1}$$

$$NDA_{i,t} = \partial_0 \frac{1}{A_{i,t-1}} + \partial_1 \frac{\Delta REV_{i,t} - \Delta REC_{i,t}}{A_{i,t-1}} + \partial_2 \frac{PPE_{i,t}}{A_{i,t-1}} \tag{2}$$

TA represents total accruals, $\Delta REV_{i,t}$ measures the change in operating revenue during the period, $\Delta REC_{i,t}$ indicates the change in accounts receivable during the period, $PPE_{i,t}$ records the net fixed assets for the period, $A_{i,t-1}$ represents total assets at the beginning of the period, and $NDA_{i,t}$ denotes non-discretionary accruals obtained by substituting regression coefficients from the industry and annual regression analysis into model (2). In the regression analysis, the residual values from models (1) and (2) are used as indicators of accrual-based earnings management, reflecting the quality of earnings. A larger absolute value of the residual indicates stronger earnings management.

Additionally, the Roy-Chowdhury model is adopted to assess the real earnings management level of companies. This model focuses on production, expenses, and sales aspects, examining specific operational techniques used by firms in real earnings management:

$$\frac{CFO_{i,t}}{A_{i,t-1}} = \alpha_0 + \alpha_1 \frac{1}{A_{i,t-1}} + \alpha_2 \frac{REV_{i,t}}{A_{i,t-1}} + \alpha_3 \frac{\Delta REV_{i,t}}{A_{i,t-1}} + \varepsilon_{i,t} \tag{3}$$

$$\frac{PROD}{A_{i,t-1}} = \alpha_0 + \alpha_1 \frac{1}{A_{i,t-1}} + \alpha_2 \frac{REV_{i,t}}{A_{i,t-1}} + \alpha_3 \frac{\Delta REV_{i,t}}{A_{i,t-1}} + \alpha_3 \frac{\Delta REV_{i,t-1}}{A_{i,t-1}} + \varepsilon_{i,t} \tag{4}$$

$$\frac{DISEXP_{i,t}}{A_{i,t-1}} = \alpha_0 + \alpha_1 \frac{1}{A_{i,t-1}} + \alpha_2 \frac{REV_{i,t-1}}{A_{i,t-1}} + \varepsilon_{i,t} \tag{5}$$

Based on Gao Yanyan's research [5], we first apply an industry- and year-based regression analysis method to calculate the residuals for abnormal operating cash flow (Ab_CFO), abnormal production costs (Ab_PROD), and abnormal discretionary expenses (Ab_DISEXP). Subsequently, using a widely accepted procedure in academia, model (1) is utilized to determine a composite index for evaluating a company's real earnings management level. An increase in this index indicates intensified real earnings management behavior by the company.

2. Independent Variable: ESG Performance. The independent variable is measured using the China Securities Index ESG rating, which ranks companies into nine levels from low to high: C, CC, CCC, B, BB, BBB, A, AA, AAA. This study assigns values from 1 to 100 accordingly.

3. Control Variables: This study selects control variables from two perspectives: company characteristics and corporate governance characteristics. These include the fixed asset ratio (Fix), cash net content of operating revenue (Cash), operating revenue growth rate (Grow), debt ratio (Lev), ownership separation ratio (Sep), shareholding ratio of controlling shareholders (Shareholding), equity balance degree (Ebd), institutional investor shareholding ratio (INST), CEO duality (Dual), management shareholding ratio (Sen), industry (Industry), and time (Year). The definitions of these variables are listed in Table 1.

3.3. Model Construction

To test H1 and H2, the following model is constructed:

$$AEM_{i,t} \ / \ REM_{i,t} = \beta_0 + \beta_1 ESG_{i,t} + \sum Controls_{i,t} + \sum Year + \sum Ind + \varepsilon_{i,t} \quad (6)$$

Where REM and AEM represent the dependent variables, indicating real earnings management and accrual-based earnings management, respectively. The independent variable, ESGi,t denotes the ESG rating of company i in period t. Covarites include the selected control variables, Year represents dummy variables for the year, Industry indicates dummy variables for the industry, and E denotes the random error term.

Table 1. Variable Definitions

Variable Type	Variable Name	Variable Symbol	Variable Definition
Explained Variable	Accrual-based Earnings Management	AEM	Strategic adjustment and control of earnings through accounting methods by the firm
		REM	Manipulation of earnings through actual operational activities by the firm
	Real Earnings Management	Ab_CF0	Real Earnings Management through Sales Manipulation
		Ab_PR0D	Real Earnings Management through Production Manipulation
		Ab_DISEXP	Real Earnings Management through Expense Manipulation
Explanatory Variable	ESG Performance	ESG	Huazheng ESG Rating, assigned values from 1 to 9
Control Variable	Fixed Asset Ratio	Fix	Net Value of Fixed Assets / Original Value of Fixed Assets
	Net Cash Content of Operating Income	Cash	Cash Inflow from Operating Activities / Operating Income
	Operating Income Growth Rate	Grow	(Current Year Operating Income - Previous Year Operating Income) / Previous Year Operating Income * 100%
	Debt-to-Asset Ratio	Lev	Total Liabilities / Total Assets
	Separation of Rights Ratio	Sep	(Owner’s Equity/Total Equity)×100%
	Proportion of Shareholding by Controlling Shareholder	Shareholding	(Shares Held by Shareholder/Total Shares of the Company)×100%
	Degree of Equity Balance	Ebd	Sum of Shareholding Proportions of the Second to Fifth Major Shareho lders+Proportion of the First Major Shareholder
	Proportion of Institutional Investor Holdings	INST	(Total Shares Held by Institutional Investors/Total Shares of the Listed Company)×100%
	Dual Role	Dual	If the roles of Chairman and General Manager are combined, assign 1; otherwise, assign 0
	Proportion of Holdings by Management	Sen	(Total Number of Shares Held by Senior Management at Year-End/Total Shares)×100%
	Proportion of Independent Directors	Ds	(Number of Independent Directors/Total Number of Directors)×100%
	Industry	Industry	Industry Dummy Variable
	Time	Year	Annual Dummy Variable

4. Empirical Analysis

4.1. Descriptive Statistics Analysis

Table 2 provides the descriptive statistics of the variables used in this study. The data shows that the average ESG score of the sample companies is 73.71, with a median of 74.08, a minimum value of 57.12, and a maximum value of 84.05. The average and median ESG scores are close and approach the maximum value, indicating that the sample companies generally exhibit a high level of ESG performance. The mean value of real earnings management (REM) is -0.0133, with a median of 0.0137, a minimum of -0.809, and a maximum of 0.613, reflecting significant variability in real earnings management among the sample companies. The mean value of accrual-based earnings management (AEM) is 1.26, with a minimum of -26.47, a maximum of 26.00, and a standard deviation of 18.80, indicating a wide range of differences in accrual-based earnings management among the sample companies.

Table 2. Descriptive Statistics Analysis

Variable	Observations	Mean	Median	Min	Max	Std. Dev
ESG	15645	73.71	74.08	57.12	84.05	5.738
AEM	15645	1.260	16.24	-26.47	26.00	18.80
REM	15645	-0.0133	0.0137	-0.809	0.613	0.211
Fix	15645	0.207	0.180	0.00240	0.708	0.150
Cash	15645	0.122	0.107	-0.618	0.684	0.154
Grow	15645	0.342	0.131	-0.714	8.082	0.915
Lev	15645	0.416	0.411	0.0601	0.895	0.187
Sep	15645	4.455	0	0	27.93	7.233
Shareholding	15645	0.356	0.338	0.0840	0.748	0.146
Ebd	15645	0.768	0.614	0.00830	4	0.610
INST	15645	0.423	0.441	0.00350	0.907	0.252
Dual	15645	0.286	0	0	1	0.452
Sen	15645	14.39	1.810	0	66.32	19.45

4.2. Regression Results Analysis

Table 3 shows the regression results of ESG on earnings management. Columns (1) and (2) present the regression results for real earnings management and accrual-based earnings management without control variables. Columns (3) and (4) display the results when control variables are added, and industry and year fixed effects are considered. The regression coefficient between ESG score and real earnings management is -0.0008, and with accrual-based earnings management, it is 0.3767, both significant at the 10% and 1% levels, respectively. This result indicates that an increase in ESG levels reduces real earnings management and increases accrual-based earnings management. Specifically, when a company's ESG level improves by 1%, real earnings management decreases by 0.08, and accrual-based earnings management increases by 37.67. Good ESG performance likely reflects a company's focus on transparency and accountability, reducing the motivation and behavior of real earnings management. Real earnings management involves adjusting actual business activities without violating accounting standards to influence reported earnings. In contrast, companies might use accrual-based earnings management to meet market expectations for ESG by choosing specific accounting policies or modifying accounting estimates within the permissible range of accounting standards.

Table 3. Impact of ESG on Earnings Management

	(1) REM	(2) AEM	(3) REM	(4) AEM
ESG	-0.0025***	0.3612***	-0.0008*	0.3767***
	(-4.8071)	(9.0210)	(-1.7084)	(9.8228)
Fix			0.1027***	-0.2248
			(4.2396)	(-0.1068)
Cash			-0.5086***	-41.5320***
			(-28.9104)	(-27.2622)
Grow			0.0021	0.3547
			(0.5417)	(1.4771)
Lev			0.0745***	-20.2277***
			(4.6523)	(-15.2153)
Sep			-0.0005	0.0749**
			(-1.2738)	(2.2054)
Shareholding			-0.0831***	6.6157***
			(-3.2221)	(3.6322)
Ebd			-0.0098*	0.3045
			(-1.7271)	(0.7441)
Dual			-0.0041	-0.5303
			(-0.6215)	(-1.0486)

Table 3. Continued

Sen			-0.0009***	-0.0026
			(-4.6377)	(-0.1880)
_cons	0.1794***	-27.0481***	0.1129***	-17.6499***
	(4.6700)	(-9.2261)	(3.0785)	(-5.9180)
Industry	Control	Control	Control	Control
Year	Control	Control	Control	Control
N	15645	15645	15645	15645
r2_a	0.1679	0.0482	0.3347	0.1783

Notes: Values in parentheses are t-values; ***, *, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

4.3. Further Analysis

4.3.1. Heterogeneity Analysis

Table 4 presents the analysis of the impact of ESG performance on accrual-based and real earnings management based on ownership type. Columns (1) and (3) show the results for state-owned enterprises (SOEs), while the other columns show results for non-state-owned enterprises (NSOEs). In columns (1) and (2), the regression coefficients of ESG on accrual-based earnings management are 0.2173 and 0.2550, both significant at the 1% level, indicating that ESG significantly increases accrual-based earnings management for both types of ownership. Columns (3) and (4) reveal that the coefficient of ESG on real earnings management for NSOEs is -0.0011, significant at the 5% level, while the impact for SOEs is not significant. These findings suggest that the differences in ownership structure may influence earnings management behavior and strategies. SOEs may improve ESG performance under policy and social responsibility pressures, while NSOEs may do so to meet market and investor expectations.

Table 4. Ownership Structure Heterogeneity Effects

	(1) AEM	(2) AEM	(3) REM	(4) REM
ESG	0.2173***	0.2550***	-0.0003	-0.0011**
	(2.7617)	(5.2135)	(-0.4049)	(-1.5719)
Fix	6.8594*	-1.6657	-0.0151	0.1582***
	(1.8083)	(-0.6156)	(-0.4578)	(4.2012)
Cash	-47.2955***	-59.9184***	-0.4344***	-0.6018***
	(-19.3080)	(-26.0809)	(-17.8280)	(-21.0292)
Grow	0.2472	0.3226	-0.0014	0.0015
	(0.8179)	(0.8659)	(-0.2335)	(0.2198)
Lev	-18.7263***	-20.1528***	0.1093***	0.0476**
	(-7.6131)	(-11.1778)	(4.5786)	(1.9665)
Sep	0.0284	-0.0028	-0.0003	0.0012**
	(0.5032)	(-0.0623)	(-0.5262)	(2.0071)
Shareholding	-15.8553***	-2.6769	0.1162*	-0.0189
	(-2.5995)	(-1.1065)	(1.7817)	(-0.4699)
Ebd	-3.3408**	-0.1981	0.0358**	-0.0066
	(-2.2723)	(-0.4363)	(2.3562)	(-0.9491)
INST	18.4444***	9.9919***	-0.1053**	-0.1590***
	(4.2385)	(5.7501)	(-2.2121)	(-5.8569)
Dual	1.4112	-0.2178	0.0079	0.0013
	(0.9425)	(-0.3827)	(0.6521)	(0.1603)
Sen	0.4047***	0.0696***	-0.0027**	-0.0017***
	(3.9102)	(3.4455)	(-2.5459)	(-5.5032)
_cons	-4.6642	-6.1398	0.0512	0.1713***
	(-0.7577)	(-1.6415)	(0.9141)	(3.3115)
Industry	Control	Control	Control	Control
Year	Control	Control	Control	Control
N	6282	9363	6282	9363
r2_a	0.2260	0.2312	0.3715	0.3715

4.3.2. Impact of E, S, and G on Real and Accrual-Based Earnings Management

Table 5 displays the results of how environmental (E), social (S), and governance (G) factors impact accrual-based and real earnings management. Columns (1)-(3) show that E, S, and G significantly increase accrual-based earnings management, with coefficients of 0.0486, 0.1197, and 0.1474, respectively. Columns (4)-(6) indicate that S and G significantly reduce real earnings management, with coefficients of -0.0006 and -0.0009, while the coefficient for E is positive but not significant.

Table 5. Sub-Factor Regression

	(1) AEM	(2) AEM	(3) AEM	(4) REM	(5) REM	(6) REM
E	0.0486*			0.0003		
	(1.7533)			(0.7312)		
S		0.1197***			-0.0006**	
		(5.0408)			(-1.9630)	
G			0.1474***			-0.0009**
			(4.8748)			(-2.3657)
Fix	1.9212	2.1811	1.9237	0.0963***	0.0957***	0.0969***
	(0.8681)	(0.9799)	(0.8726)	(3.6843)	(3.6543)	(3.7043)
Cash	-53.3126***	-53.4902***	-53.6280***	-0.5456***	-0.5446***	-0.5434***
	(-31.6982)	(-31.9243)	(-31.6548)	(-27.3799)	(-27.3243)	(-27.3068)
Grow	0.1576	0.2009	0.1497	0.0019	0.0016	0.0018
	(0.6599)	(0.8440)	(0.6292)	(0.4407)	(0.3604)	(0.4126)
Lev	-19.7403***	-19.8896***	-18.0965***	0.0786***	0.0829***	0.0732***
	(-13.7101)	(-13.8826)	(-12.3327)	(4.2966)	(4.5794)	(4.0724)
Sep	0.0234	0.0256	0.0323	-0.0005	-0.0005	-0.0005
	(0.6800)	(0.7446)	(0.9417)	(-1.3271)	(-1.2884)	(-1.3588)
Shareholding	-4.7535**	-4.5127**	-5.2305**	-0.0796***	-0.0785***	-0.0725***
	(-2.2082)	(-2.1060)	(-2.4497)	(-3.0427)	(-2.9892)	(-2.7558)
Ebd	-0.3984	-0.4756	-0.2893	-0.0100*	-0.0094	-0.0102*
	(-0.9323)	(-1.1184)	(-0.6803)	(-1.6630)	(-1.5668)	(-1.7154)
INST	11.3892***	10.8362***	10.4490***			
	(7.3309)	(6.9901)	(6.7490)			
Dual	0.0804	0.0123	0.0728	-0.0041	-0.0043	-0.0046
	(0.1541)	(0.0237)	(0.1404)	(-0.5901)	(-0.6127)	(-0.6630)
Sen	0.0999***	0.0894***	0.0916***	-0.0009***	-0.0009***	-0.0009***
	(5.2497)	(4.6749)	(4.8459)	(-4.4439)	(-4.3878)	(-4.5347)
_cons	8.1952***	2.3642	-0.4047	0.0349	0.0936***	0.1191***
	(4.0388)	(1.1394)	(-0.1542)	(1.2897)	(3.6788)	(3.8284)
Industry	Control	Control	Control	Control	Control	Control
Year	Control	Control	Control	Control	Control	Control
N	15645	15645	15645	15645	15645	15645
r2_a	0.2147	0.2181	0.2174	0.3386	0.3391	0.3393

5. Research Conclusions and Policy Recommendations

To investigate the impact of ESG performance on corporate earnings management levels, this paper, based on relevant theories and literature, proposes hypotheses for testing. Using data from Chinese A-share listed companies between 2009 and 2020, and employing the Huazheng ESG rating index as a measure of corporate ESG, this study utilizes the modified Jones model to evaluate corporate earnings management levels. The empirical analysis explores the impact of ESG ratings on corporate earnings management.

The research findings indicate the following: (1) Under the condition that other factors remain constant, there is a significant negative correlation between a company's ESG performance and its real earnings management. This suggests that the better the ESG performance, the stronger its inhibitory effect on real earnings management, supporting stakeholder theory.

(2) The impact of ESG performance on accrual-based earnings management is not significant. Companies with better ESG performance may see an increase in accrual-based earnings management. This implies that companies might use accrual-based

earnings management to meet market expectations for ESG, adjusting earnings through the selection of accounting policies and estimation changes within the permissible range of accounting standards. This supports both agency theory and the trade-off theory.

(3) The ownership nature of a company moderates the effect of ESG ratings on real earnings management. Specifically, the impact of ESG on real earnings management is more pronounced in non-state-owned enterprises (NSOEs) compared to state-owned enterprises (SOEs). SOEs may enhance ESG performance driven by policy and social responsibility, whereas NSOEs may be driven by market and investor expectations. The ownership nature of SOEs weakens the suppressive effect of ESG ratings on real earnings management.

Based on these conclusions, the following policy recommendations are proposed:

First, promote the importance of corporate transparency and encourage companies, institutions, and individuals to uphold integrity in information disclosure, ensuring fairness and authority in their disclosures. Companies should enhance the transparency and accuracy of their disclosures to better govern earnings management behaviors, allowing investors and the market to access more comprehensive and accurate information.

Second, to protect investor rights, regulatory authorities must intensify supervision and prevent selective information disclosure by companies. This includes strengthening oversight and review of corporate disclosures to ensure all activities comply with current legal standards, achieving transparency. Furthermore, strict penalties should be enforced on entities violating regulations as a deterrent. Only by ensuring that investors receive complete, accurate, and timely information can their rights and interests in the financial market be effectively safeguarded.

Third, there is a need to improve the internal governance structure of SOEs. Given the complex principal-agent relationships in SOEs that exacerbate agency problems, it is necessary to optimize these mechanisms and strengthen internal controls. This will enable SOEs to play a model role in promoting ESG principles and restricting earnings management.

Fourth, refine the ESG rating system. Whether positive or negative, this paper proves that the correlation between ESG performance and earnings management levels cannot be ignored. Therefore, it is recommended to place more emphasis on the transparency of ESG information for listed companies and consider implementing mandatory ESG disclosures when appropriate to meet stakeholder expectations and foster a more robust capital market. Additionally, there should be more rigorous and detailed guidance for ESG rating agencies.

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