

IMPACT OF THE NEW ACCOUNTING STANDARDS ON LISTED COMPANY

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Abstract: The new accounting standards have been put into effect first in listed companies. It introduces new concepts as well as different processing methods which absolutely will have a great effect on listed companies' performance. This effect includes three directions: (a) it will affect items on listed companies' income statement in a direct way;(b) it will affect investors' judgements of listed companies' performance; (c) it will introduce some other methods of controlling earnings of managers. This paper analyzes these effects and at last comes to the conclusion that the new accounting standards is much more precise than the last one in formulation, and covers more to details, which will restricts accounting control of earnings more effectively.

Key words: The new accounting standards, Performance of listed companies, Financial indicators, Control of earnings

1. INTRODUCTION

The new accounting standards have been the focus. Discussions about its impact on listed companies center mainly on processing changes. Few except ZhangXiping and ShenLie (the New Accounting Standards and Earnings Control, 2007,2) talks about its impact on earnings control. They think the new standards restrict and provide new space for earnings control. A fat lot discusses its impact on financial indicators. This paper discusses the processing changes, its impact on earnings control and financial indicators.

2. THE NEW ACCOUNTING STANDARDS' DIRECT IMPACT TO LISTED COMPANIES' INCOME STATEMENT

2.1 Fair value is thought to be the brightest spot of the new accounting standards. Several assets can be measured on fair value basis, including real estate investments, biological assets, trading securities and available-for-sale securities. No depreciation should be recorded for these assets which are measured on fair value basis. Meanwhile, allowance for these assets can be recorded only in some certain situations

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and cannot be switched back later once it is recorded. So, if fair value of an asset that is measured on fair value basis does not change for a certain period, depreciation should be accounted for according to the former accounting standards which will reduce the company's current profit while according to the new one current profit does not change.

2.2 The new accounting standards made some revisions and replenishments in the revenue standard. It makes clear the concept of revenue and sphere of application of the new revenue standard, etc. There is a big change that may affect a company's performance shown in the income statement. In an installment sale, current receivables should be accounted for as current revenue when sale is actually realized, the new revenue standard stipulates, while the total cost of goods is debited to installment merchandise and credited to merchandise inventory when the transaction comes into being. Therefore, the new revenue standard delays the time when revenue is recorded for the short run which respectively decreases current income.

2.3 The new accounting standards also made some revisions about processing methods of intangible assets. It allows costs in the development process to be accounted as capital expenditure if it satisfies certain conditions. These costs should be accounted as current profit or loss, which leads to current income decrease. That's to say, the new standards may cause more income in earlier stage and less in the future because it delays time when expenditure is accounted as current loss. Loan fee standard has similar impact on income statement.

2.4 It is thought that the new accounting standards does not leads to stock price change because changes in processing methods only change a company's profit in the distribution during an account period but will not change the real cash flow of the company. However, income tax should be taken into account. Those direct effects of the new accounting standards on the items on a company's income statement may change current income tax during a certain period, which then actually change the company's cash flow. That's to say, the new accounting standards is very much possible to change a company's stock price.

3. THE NEW ACCOUNTING STANDARDS' IMPACT TO INVESTORS' JUDGEMENTS OF LISTED COMPANIES' PERFORMANCE

It is said that the new accounting standards does not influence roles of financial ratios like price-earnings ratio and price-net asset ratio; it does not increase a company's operating risk; it does not add tax burden to a company. However, these can not change an investor's judgement of a company's performance because every investor is an economic human being who has personal preference.

3.1 The new accounting standards impress investors with a fluctuating income statement

For example, fair value of assets that are measured on fair value basis should be totaled every period and shortage or overage of the assets should be accounted for as fair value change profit or loss. Since the new accounting standards allow fair value change profit or loss to be shown in the income statement, a big change of an asset's fair value during a certain period may cause a big change of a listed company's operating profit, which makes investors think the company's assets and profits are fluctuating.

3.2 The new accounting standards affect methods of measuring a listed company's profitability

For example, according to the former accounting standards, rate of return on sales which is sales revenue divided by net profit is a very important ratio to measure a listed company's profitability. Yet, according to the new accounting standards, profitability measured in the same way may be not accurate. For the one hand, denominator of the ratio has been changed. Investors can only know a listed company's performance by financial statement. The new accounting standards no longer classifies revenue as operating income and non-operating income but calls both of the two incomes and other incomes together as operating income. And operating expenses, non-operating expenses and other expenses are collectively referred to as operating expense. In this way, investors can no longer get information about a company's main operation through the new financial statement. What's more, results gained by this method may give investors an unstable impression because non-operating incomes as well as other incomes are not usual items, which makes operating income change a lot. For the other hand, fair value focuses mainly on financial assets and financial debts but not on non-financial assets or debts. Therefore, fair value change profit or loss should not be taken into account when measuring a listed company's performance because it comes from financial assets or financial debts. Someone proposes that we should change the idea of incomes by strengthening the idea of the balance sheet, desalinizing the idea of income statement in order to weaken the foundation of earnings control. This might be a good way because a shortcoming of the traditional idea is that it is likely to magnify the role of earnings by focusing on income.

3.3 The new accounting standards have some new concepts like operating assets, operating debts, net operating assets, financial assets, financial debts, net liabilities and net leverage. By introducing these concepts, measurement of a company's rate of return on equity according to adjustive balance sheet and income statement is different. According to the new accounting standards, rate of return on equity = rate of return on net operating assets (net profits/ net operating assets) + contribution leverage ratio (net liabilities/ equity) = rate of return on net operating assets + (rate of return on net operating assets- net interest rate) * net financial leverage. Result gained from this formula is the same as that gained by the old way.

4. THE NEW ACCOUNTING STANDARDS' IMPACT ON METHODS OF CONTROLLING EARNINGS

4.1 The new accounting standards forbid allowance for asset reduction to be recovered, which effectively confines managers to control earnings by recovering allowance for asset reduction. Revision of regulations on non-monetary assets transaction and enterprises consolidation standard take the same role in limiting earnings control.

4.2 According to the new accounting standards, there are three ways in general to determine fair value: (a) market price of the same asset or debt; (b) adjustive market price of similar asset or debt; (c) price assessed by some techniques when there is no same or similar asset or debt at all. From this principle, we can see that these ways except the first one, to a great extent, rely on personal judgement. Although the new accounting standards have many restrictions on how and when fair value can be used, there are still space for earnings control. And the space is caused by uncertainty of the standards' languages which can not be eliminated at all. Such space includes: (a) the new accounting standards allow expenditure in the development process to be accounted as capital expenditure if it satisfies certain conditions while the boardline between development process and research process is hard to determine; (b) how to recognize asset group; and (c) how to measure receivable salvage.

4.3 Fair value of many assets in the new accounting standards involves issue of cash flow discount. Take income standards as an example, it regulates that fair value should be accounted at present value of the amount specified in the contract or agreement if installment sales have a financing character. The difference between fair value and the amount specified in the contract or agreement should be amortized over the contract period and write off financial cost. Same is lease standards. Take installment sales as an example, when calculating present value of the amount specified in the contract or agreement, choice of discount rate and estimation of future cash flows make different figures that should be accounted for as operating revenue when the sale is actually realized and finance cost reduced in a later stage. Those listed companies who is about to be in the red deficit in the near future possibly would make current revenue increased and meantime reduce financial cost in the future by choosing a lower cash flow discount rate or a properly overstating cash flow, which then will bring a sustainable profit situation.

4.4 As the new accounting standards emphasize that a debt reorganization is acknowledged only when a creditor gives up, this restricts listed companies from the possibilities of earnings control by debt reorganization between irreverent companies. It also regulates the debtor must report the way and evidence of acknowledgement of fair values in the process of debt reorganization in notes to the financial statement. As for per this point, the new accounting standards is binding to those listed companies who may use correlative transaction to control profit. But when income tax rates balance between listed company and its related companies is huge, there still is space for earnings control in debt reorganization. For example, a listed company has 20% income tax rate, while one of its 2 million creditor related companies has 50%. Then by debt reorganizing, the latter gives up 1 million of its creditor's right, which can be accounted for as operating revenue by the former while the latter records the loss from reorganization of 1 million as current loss. Considering income tax, the listed company's after-tax income is 80 million, related company's after-tax loss is 50 million, a their joint net income is 30 million.

5. CONCLUSION

Obviously, the new accounting standards affect listed companies' performance. However, as to how much, that depends. The introducing of fair value is the fatal factor to listed company's performance. However, Appliance of fair value is strongly constrained, additionally; fair value appliance regulated in the new accounting standards of our country is comparably more reserved than that in international accounting standards. In fact, most companies do not prefer to the appliance of fair value to assess their assets of debts. Generally, in the long term, the new accounting standards will benefit the development of capital market, furtherly. This benefit does not mean that the new accounting standards provide very favourable conditions for managers to control earnings and support stock price, in stead it brings about fresh spirit to enterprise's business atmosphere by demanding exposure of the financial information which highly enhances the constraint to accounting control behaviors.

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