RESEARCH ON THE INFLUENCE OF ASSETS IMPAIRMENT CRITERION ON ENTERPRISE EARNINGS MANAGEMENT

Su Peirong

Department of Accounting, Nanjing University of Science and Technology Xiaolingwei No.200, Xuanwu, Nanjing, China.

*Corresponding Author Email: 536767971@qq.com

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ABSTRACT

Provision for impairment of assets is helpful to reflect the real value of assets objectively, but the accounting information is easy to be distorted to a certain extent because of the arbitrariness of asset impairment preparations' reversion. And this characteristic of asset impairment preparation is usually grasped by management and uses it to control earnings management. In February 2006, the Ministry of Finance of China promulgated the Accounting Standard for Enterprises No. 8-impairment of assets, which clearly stipulates that once the loss of impairment of assets is confirmed, it will not be allowed to return in the subsequent accounting period. The guidelines were formally implemented on January 1st, 2007. This paper analyzes the financial data of Wuliangye Group Co., Ltd from 2001 to 2013, and probes into the influence of the asset impairment criterion formally implemented on 2007 on the earnings management behavior in Wuliangye Company.

KEYWORDS

Asset impairment, control of earnings, Accounting Standards for Business Enterprises.

1. INTRODUCTION

In February 2006, China's Ministry of Finance issued a set of new accounting standards, which includes a basic standard and 38 specific standards. The measurement of recoverable amount of assets, the test and treatment of impairment of goodwill, the judgment of signs of impairment of assets, etc [1]. Once the impairment loss is recognized, the asset will not be reinstated in the subsequent accounting period.

Asset impairment has always been one of the methods used by listed companies to carry out earnings management. Managers often choose to make substantial provision for impairment of assets when the company is making more profits, in order to increase the impairment losses of assets in this year [2]. Reduce profits for the current year; in turn, when the company's profits fall, prepare to shift the impairment back to increase profits, this behavior no doubt makes the accounting information much less truthful. The standards issued in 2006 did, to some extent, contain the impairment preparation [3]. The space for managers to manipulate earnings management through asset impairment reserve is thus reduced. But it is undeniable that the emergence of this criterion has virtually promoted the growth of other earnings management methods.

This paper takes Wuliangye Group Co., Ltd. as a case study to explore the impact of the impairment criteria of assets issued in 2006 on the management earnings management of its management. The investigation of Wuliangye by the Securities Regulatory Commission found that, The Zhongke Securities, which it invested in, was administratively cleaned up in 2006 because of the outbreak of risks [4]. The following year, Zhongke Securities was declared bankrupt. Therefore, Wuliangye was given 4.5881 million yuan of debt in 2008. However, according to the financial report of 2006-08, it was found that the above debts were only reflected as normal monetary funds, and that no provision had been made for the impairment of the value that should be taken into account. This makes Wuliangye Group Co., Ltd. suspected of false increase in profits.

2. CASE ANALYSIS

The following table is the case of Wuliangye Group Co., Ltd. From 2001 to 2013 according to the enterprise accounting preparation for impairment, at the same time combined with the analysis of the net profit of the enterprise.

Figure 1: Assets impairment reserve balance

From Figure 1 we can find that between the change and the enterprise assets impairment to the balance of the net profit is closely linked [5]. While net profit compared to last year a larger fluctuation in the table, the balance also showed the same change, indicating that the impairment of assets, the enterprise profit smoothing behavior exists.

After 2002, 2006, 2007, 2008, the balance of impairment reserve was

significantly lower than that of other years. At the same time, the regulatory authorities have been increasing the management of enterprises to abuse assets impairment provisions, Wuliangye in 2006 after the decline in net profits is bound to be related to it [6]. Through the overall analysis of assets impairment preparation from 2001 to 2013, we can already see that Wuliangye really has anomalies in impairment preparation.

Table 1: Asset impairment turnover and net profit

Year	Total turnover of asset impairment	Net profit (¥)	Net profit growth (%)	The growth rate of Asset impairment reversal (%)
2001	220,593.04	811,407,817.88	0.00%	0.00%
2002	5,440,300.00	613,234,637.84	-24.42%	2366.22%
2003	461,792.91	702,974,477.92	14.63%	-91.51%
2004	1,703,804.36	827,997,151.42	17.78%	268.95%
2005	12,113,802.79	791,348,797.04	-4.43%	610.99%
2006	7,073,781.61	1,170,117,537.30	47.86%	-41.61%

Combined with Table 1, we can find that except in 2004, all the other five years are consistent with the law of the decline in net profit, the increase in the number of asset impairment reversals, the increase in net profit and the decrease in the number of asset impairment reversals. Separately, the first profit in 2002 declined, as can be seen from Table 1. This year, the enterprise turned back 10 times the amount of bad debt reserves in 2001 and returned to the 3 million reserves for the fall in inventory price. Net profit fell by 4.43% in 2004. The short-term investment reserve for this

year has returned to four times the amount in 2003. At the same time, on the premise of not turning back the reserve for falling inventory prices in 2003, in 2004 Wuliangye Group again began to reverse the reserve for falling inventory prices [7]. It is not difficult to find that the amount of reversal of assets impairment actually adjusts with the change of net profit. Play a role in smoothing profits. Let's take a look at what changes have taken place in Wuliangye's asset impairment preparation after the implementation of the current asset impairment criteria?

Table 2: Asset Impairment Turnover and Net Profit

Year	Total turnover of asset impairment	Net profit (¥)	Net profit growth (%)	The growth rate of Asset impairment reversal (%)
2006	14,630,176.55	1,170,117,537.30	0.00%	0.00%
2007	1,608,314.27	1,472,784,098.42	25.87%	-89.01%
2008	1,698,808.59	1,829,699,892.55	24.23%	5.63%
2009	683,453.92	3,466,668,431.51	89.47%	-59.77%
2010	6,743,757.63	4,562,056,835.60	31.60%	886.72%
2011	2,258,157.73	6,394,377,214.98	40.16%	-66.51%
2012	2,643,511.18	10,335,733,704.78	61.64%	17.06%
2013	6,873,425.39	8,322,215,360.95	-19.48%	160.01%

In table 2, we can see that the net profit of Wuliangye group has been on the rise from 2006 to 2012. At the same time, we can see that the impairment of assets in that year is 2.6 times that of the previous year. The other year is due to net profit. Run has been rising so it can't see how the impairment changes as net profits fall. But the chart shows that 2009 was the lowest point in the eight years since the impairment returned to total value. This year was also the year of the largest net profit growth rate.

Although after 2007, from the point of view of Wuliangye Group Co., Ltd., the reversal of asset impairment provisions has not had the effect of smoothing profits. But it is undeniable that there is still a link between the amount of return and the change of net profit.

3. IMPACT OF CURRENT ASSET IMPAIRMENT CRITERIA ON WULIANGYE

Figure 2: Preparation for impairment of assets from 2001 to 2013

As can be seen more clearly from figure 2, prior to 2007, the reserves for impairment of assets affected by Wuliangye Group were respectively inventory depreciation reserve, bad debt reserve, and short-term investment depreciation reserve. After 2007, In addition to the long-term investment impairment provisions mentioned earlier, which do not fall

within the scope of the guidelines, Wuliangye's reserve for asset impairment is basically only reserve for inventory price decline. We can clearly see that Wuliangye enterprise's reserve for impairment of assets has become less in kind and quantity than before after the promulgation of the standard in 2006.

Figure 3: Ratio of impairment provision to net profit (%)

Figure 3 clearly shows the change in the ratio of asset impairment reserve to net profit of Wuliangye Group Co., Ltd. between 2001 and 2013, with the largest rate of change in 2006 and a slow decline in the subsequent year. In 2004, The ratio of impairment reserves to net interest rates is even five times that of 2007, It can be seen that the implementation of the asset impairment guidelines issued in 2006 has greatly weakened the correlation between impairment provisions and net profit. This is undoubtedly the most significant significance of the current guidelines. That is to prevent enterprises from making use of asset impairment to make unreal earnings management.

The asset impairment guidelines, which were formally implemented in 2007, stipulate that long-term assets are not allowed to be turned back, but for things like bad debts, these short-term assets, such as inventory reserve, are not prohibited from being reversed. According to the proportion of the provision for impairment of assets in Wuliangye from 2001 to 2013, the provision for bad debts is made every year. There is no provision for a fall in inventory prices in the middle of the year, and the year in which the amount is charged is relatively large, with long-term investment impairment provisions only in the first two years and in 2012, and in 2013. According to figure 3, before the implementation of the current standards, companies have more kinds of impairment provisions. Since 2007, it has focused on short-term asset impairment provisions, which means companies can still manipulate profits from short-term assets such as bad debt provision, inventory depreciation provision, and a large amount of impairment provision for such assets to achieve the same purpose.

4. CONCLUSION

Through the research, it is found that the management of earnings management is contained in the current guidelines, but it is undeniable that there are still some enterprises that can make a large amount of asset impairment provision at one time in a certain fiscal year or return to other assets which are not limited by the criteria, so that it can reduce a large part of the pressure. As the asset impairment criterion does not give a comprehensive consideration to the various possible earnings

management, it can be said that it also has a flaw, and it does not make all the earnings management behaviors that use the impairment of the assets are suppressed, and it has limited effect on the earnings management behavior of the enterprise.

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