

# The Rent-Seeking Behavior of the Fair Value under the New Accounting Standards—Based on the Theory of Accounting for Rent-Seeking

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## Abstract

With the development of market economy, accounting for rent-seeking has become the new research directions in the field of accounting. Under the background of international convergence and equivalent of accounting standards, introduction of fair value measurement also becomes a hot topic. In recent years, accounting rent-seeking behavior makes the use of fair value frequently, causing serious damage to the orderly and healthy operation of the market. Based on the accounting rent-seeking theory, the paper carries out the research on background, reason and pathway of rent-seeking behavior of the fair value, combined with fair value measurement attribute, and making specific countermeasures and suggestions to suppress rent-seeking of fair value in the accounting, to improve the quality of accounting information, to protect the interests of investors, as well as the stability of the market order.

## Keywords

New Standards, Rent-Seeking of Accounting, The Fair Value

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## 1. Rent-Seeking and Accounting Rent-Seeking

Economic rent is part of the category of political economy; it means that part of income that income of all elements minus part of income of the elements will not affect the total supply of factor income, which is equal to the difference between income of the elements and its opportunity cost. American economist J. Buchanan [1] (1980) suggested that the rent is the benefit that is paid to the resource owner's earnings exceeding the resulting

alternative use of resources, which is revenue over opportunity cost; as long as the owner of resources wants to get more, rent-seeking is to seek another profits.

Accounting seeking is rent-seeking reflected in the accounting field. Lei Guangyong, Liu Jinwen [2] *et al.* (2001) proposed the term “accounting rent-seeking”; the domestic scholars began to combine the theory of rent-seeking with China’s accounting standards and accounting system to develop and implement research. The presence of accounting seeking is derived from the pursuit of “rent”. For listed companies, the stock market-related policies, laws, regulations, controls are based on accounting data and accounting indicators (*i.e.* solvency, profitability indicators), such as listing threshold, refinancing control, delisting control and so on. Shenzhen Stock Exchange in 2012 issued on the improvement and perfection of the Shenzhen Stock Exchange main board, small and medium enterprises board listing corporation delisting system program, added and changed seven delisting criteria. Among them, the new delisting conditions include: as a result of consecutive losses, the net assets are negative; operating income is less than 10 million yuan or annual audit report is the negative opinions or unable to express an opinion; listed companies shares listing was suspended. After its stock has been suspended from listing, its first annual report is not disclosed within the statutory time limit, and its shares will be terminated. Listed companies manipulate accounting data and inflate profits to get rent which is only the virtual rent reflected on the book; the real rent is based on the financing because of securities market regulation, which is the expectation to listed companies from investors on the capital market exceeding the value of its real part. Yan Min [3] (2004) defined the accounting rent-seeking: under the premise that the total wealth in the society and enterprise’s real performance level (that is, economic benefits) do not change, the transfer of wealth and the inappropriate allocation of resources by changing the accounting information (*i.e.* financial reporting earnings number) are unproductive profit-seeking activities which cause the harm to interest of other social stakeholders [2].

## 2. Guidelines for the Interpretation of Fair Value Measurement

Due to the rapid development of financial instruments and derivative financial instruments in the United States, the society put forward higher requirements to the accounting measurement, simultaneously, the fair value measurement began to be mentioned, US accounting theorists have made new demands on the research of the fair value. After a series of meetings to discuss research, SFAS NO.157 issued by the US Financial Accounting Standards Board (FASB) defined fair value as follows: that is the price selling an asset or the expenditure transferring a liability among an orderly transaction during participants in the market where entity resides. FASB also provides a theoretical framework for the unified guidance of fair value measurement, clarifies the confirmation, objectives, scope, measurement, disclosure, effective dates and transition period of fair value measurement etc., apart from this, made a detailed specification about the definition of fair value, the use of assets and liabilities, the main market or most advantageous market, initial recognition and subsequent confirmation, valuation techniques, technical parameters of valuation, the fair value hierarchy, and make a more comprehensive and clear exposition to realize the fair value measurement.

Under the background of economic globalization, the Accounting Standards has become the common business language of international trade and investment, thus achieving international convergence of China accounting standards, the same as accounting standards in Hong Kong, the United States, the European Union. The new accounting standards issued by Ministry of Finance in February 15, 2006 reintroduce the fair value measurement attribute and give its definition: at fair value, in accordance with the arm’s length transaction, assets and liabilities are measured as the two sides familiar with the situation of the transaction will be voluntary to exchange assets or settle the amount of debts. However, compared with the FASB, China’s new accounting standards has nothing to do with uniform guidelines on fair value measurement, the measurement of the fair value spread only in seventeen specific accounting standards. At the same time, as a technology, broadening the use of the fair value is also easier for listing corporation to distort accounting information, consciously using the fair value to contribute to accounting rent-seeking.

## 3. Behavior Analysis of the Rent-Seeking of the Fair Value

### 3.1. Background of the Rent-Seeking Behavior of the Fair Value

Accounting rent-seeking behavior exists mainly in the process of execution of accounting standards and ac-

counting standards-setting. The rent-seeking of the fair value generated in the process of implementation of accounting standards, with a certain system background, legal background and theoretical background. With the implementation of new accounting standards in 2007, the dual track mode of accounting standards and accounting system transfer to the single mode of accounting standard. While it is still in a transitional stage of economic transition, this shift reflects a trend the system-oriented accounting standards to guidelines-oriented accounting standards, and will also gradually reduce the possibility that rent-seeking body use policy space caused by the difference in accounting standards to seek rent. From legal level, the current legal system construction of China are still inadequate, the relevant legal and regulatory system is not perfect, as the law does not clearly define the false financial information, accounting standards do not specifically define related measurement methods, thus accounting rent-seekers can take advantage of these laws and institutional blind spots to take accounting rent-seeking, without paying too much rent costs. From the theoretical level, Ge Jiashu, Xu Yue [4] (2006) has showed the fair value is estimated in the current trading price, rather than the actual price of the past formed transaction. As a measurement attribute, fair value still has many shortcomings, mainly reflected in its vague concept, the present valuation technology is not mature and not feasible enough. China is still in economic transition, has not yet to establish a fair, orderly and active capital market, there are the difficulties in confirming the fair value, and fair value measurement is less reliable. Accordingly, dong the research on the precise application of the fair value measurement in financial and accounting practices is important for improving accounting model for the future.

### 3.2. Reasons for the Rent-Seeking Behavior of the Fair Value

According to the theory of rent-seeking, the motivation of rent-seeking is to pursue the securities regulation-based market rent, namely economic consequences of the pursuit of positive market. The accounting rent-seeking will regard accounting as a tool, by selecting the accounting measurement methods and accounting standards, to distort accounting information to achieve the transfer of the social economic resources and wealth. Therefore, the root cause of the emergence of rent-seeking behavior is that rent-seeking accountancy body pursue the maximization of rent and interest. Concerning the specific subject of rent-seeking, the government want to attract investment and stimulate economic development; Enterprises or listed companies want to raise fund and finance; Managers want to seek higher wages; Intermediaries (such as CPA) facing fierce competition in the industry want to make a profit, to become the enterprise or company profit manipulation accomplice, this collusion greatly reduce audit independence, also greatly contribute to the unhealthy practices of accounting rent-seeking.

In addition, the information asymmetry is another reason for accounting rent-seeking, public accounting information can influence stakeholders' decisions. At the same time, accounting earnings can be understood as a product of the information age in the enterprise, its emergence has a cost, there is no doubt it can also generate revenue and value for the enterprise. In the case of listing corporation in the status of information monopoly, you can change the financial reporting income, and accounting earnings information by changing the accounting recognition and measurement methods, thereby affecting the decision of the relevant stakeholders, to achieve accounting rent-seeking purposes.

### 3.3. Pathway of Rent-Seeking of the Fair Value

The introduction of new accounting standards are mainly applied to the fair value recognition and measurement of financial instruments, long-term equity investments, investment property, debt restructuring, non-monetary assets exchange, as well as a business combination under common control, and other aspects. The main body of accounting rent-seeking take advantage of defect of fair value, the loopholes in the system and the choice of accounting policy to manipulate profit space, as mainly the following ways.

Financial tool. In order to improve the usefulness of the accounting decisions, "Accounting Standards for Enterprises No. 22—Financial Instruments Recognition and Measurement" provides that changes in gains and losses of fair value during the holding of trading financial assets should be recorded into the profits and losses of the current period, thus reflected in the accounting earnings information. For available for sale financial assets, changes in profit and loss of fair value during the holding period cannot be recorded into the profits and losses of the current period, but be included in the capital reserve—other capital reserve, which only affects the book value of owners' equity, only the sale of it can be transferred to the investment income. Therefore, listed com-

panies can choose the sale point of securities investment to manage earnings, then manipulate profits, thus affecting the decisions of stakeholders. Derivative financial instruments is accounted in the table, so we can increase the assets or liabilities of enterprises, which also affects the changes in fair value through profit or loss, provides more space for the accounting rent-seeking.

Debt reorganization. “Accounting Standards for Enterprises No. 12—Debt Restructuring” classify gains from debt restructuring as profit or loss, the company make the use of debt relief or debt restructuring to gain the income, counted as current non-operating income reflected in the income statement. Thus, listed companies that carry on the burden of debt can not only relieve debt but also derive revenue, increase profits and improve earnings per share level by debt restructuring. For listed companies that have claims, the controlling shareholder will convert claims to high-quality assets, to improve the company’s operating capacity, bringing cash flows for future years.

Non-monetary assets exchange. According to “Accounting Standards for Enterprises No. 7—the exchange of non-monetary assets”, if there is commercial substance, and the fair value of the buying assets or the selling asset can be measured reliably, it should regard fair value and related taxes payable as the cost of the assets, the difference between the fair value and the book value of the selling assets should be recognized in profit or loss during the current period. At the same time, the difference between the fair value of and its book value of the selling assets is recognized in the income statement. Therefore, when there is the loss in listed companies, controlling shareholders of listed companies is likely to exchange high-quality assets for inferior assets with other listed company, as a non-monetary assets exchange to change profits and losses of the listed company during the current period, so as to increase the accounting profit. Listing corporation can also swap the asset based on the agreed fair value valuation, thus, increase the value of exchanging assets.

Merge. “Accounting Standards for Enterprises No. 33—Consolidated Financial Statements” convinces that a business combination under the different control use fair value as valuation basis. Due to the complexity to confirm the fair value, maneuverability is strong; moreover, there is no reliable standard when specialized agencies assessed the fair value, which provides listed companies with the opportunity for accounting rent-seeking. In addition, related-party transactions between the parent company and listed companies has become a means of accounting rent-seeking, the case of inflated assets and profit transfer are not uncommon.

#### 4. Countermeasures for Rent-Seeking of the Fair Value

Listed companies seek rent in the accounting at fair value, by manipulating accounting information to grab the interests, to achieve an unfair transfer of wealth and improper configuration of resources, thus causing the harm to other social subjects. This kind of earnings manipulation is a negative economic behavior and an enormous waste of social resources, resulting in dissipation of the value of social and economic resource rent. So how fair value should be avoided to be an accounting tool for enterprise to seek rent is one of difficulties in the theoretical research of the fair value, and is of great significance to standardize China’s accounting standards and seek international equivalence.

1) Strengthen theoretical research of the fair value, theory essence, meaning and measurement technology, and provide a theoretical basis for government accounting regulations. Since the present stage is imperfect, sound system is not standardized, information is opaque, the development of a country and a country’s guidelines are also related to accounting environment and accounting technical. It’s not wise to copy simply the fair value of foreign countries for the pursuit of international standards or national political and economic analysis. In addition, the relevant provisions of confirmation and measurement of accounting standards also need to be constantly improved, it requires a combination of theory and practice. Wu Zhanshi, Luo shaode, Wang Wei [5] (2009) proposed that, after the empirical study of listed companies under the new guidelines, it will be available that available for trading financial assets and trading financial assets are uniformly applied pattern whose changes in fair value are recognized directly in profit or loss, more useful to control earnings management. At the same time, this also reduces the information asymmetry by improving the timeliness and transparency of disclosure of securities investment income [4].

2) Establish an active and orderly market economy environment which adapts to the fair value measurement, and develop the socialist market economy. Ge Jiashu believes that in a market economy, the most representative of fair value is observed market price determined by the market price mechanism. However, at this stage, sound and fair market price mechanism has not been established, the capital market is not mature, so it is difficult to

obtain the information of the fair value of majority of assets. All call for removing further local protectionism, accelerating into circulation of the production elements, building up national agricultural products, industrial products and technology products market, and founding the database of macro industry analysis.

3) Normalize accounting standards setting process and accounting information disclosure system. Laura [6] (2008) argued that the development of guidelines for fair value measurement should go through strictly logical argument, and listen to the opinions and suggestions of practitioners. Not only to regulate the definition of fair value, goals, recognition and measurement range, but also to propose a more detailed specification on technical level such as valuation techniques, parameter information, the fair value hierarchy and disclosure system [5]. Compared with FASB in the US, the development program of China's accounting standards is not precise enough, not perfect, need to establish a professional committee of experts and practitioners who participate in the composition of norm-setting and rigorous argument. Establish and improve the professional evaluation agencies, strengthen research on valuation techniques and methods, in particular derivative financial instruments. At the same time, according to the source of income and changes in related projects segments, strengthen the disclosure of related information of the fair value, providing a more clear and reliable information for stakeholders, to improve the quality of accounting information, to curb the economic waste of resources.

4) Increase the punishment of illegal accounting rent-seeking, so, the income from the rent-seeking behavior cannot make up the cost of rent-seeking. In addition of large fines, prosecuting the listed companies' illegal rent-seeking phenomenon, can also use the suspension of listing vigorously to combat illegal rent-seeking behavior; At the same time, taking advantage of public moral to constraint violations, thus, curbing the occurrence and spread of the phenomenon of accounting rent-seeking behavior from the ideological perspective.

5) Perfecting the accounting supervision system, strengthen the system construction, to curb the accounting rent-seeking behavior of enterprises from the source system. For example, before, a lot of listing Corporation use asset impairment to manipulate profits, this phenomenon is more serious in the ST company, The main means is to provision for impairment in the previous year, and then in second years from a variety of reasons for impairment, resulting in a high profit margins to cover the company's operating difficulties. And after the new guidelines are developed, simply transferred back to the profit increase is no longer effective means. Therefore, through the system construction and innovation, to strengthen the accounting guidance and supervision, reduce the occurrence of accounting rent-seeking behavior.

## 5. Conclusion

From the perspective of fair value to explain, the paper analyzes the background and causes of accounting rent-seeking, and puts forward relevant policy recommendations. This paper argues that the space for speculative elements to make the main use of fair value measurement reliability and other defects to the accounting rent-seeking is very large. So we need to strengthen the research of the fair value theory, and establish the effective mechanism of fair value accounting in order to establish the market economic environment suitable for the fair value measurement and to reduce the occurrence of the accounting rent-seeking behavior.

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