

The Protective Effect of Accounting Conservatism on Creditors

Lin Li¹, Tao Zhang¹

¹Heilongjiang Bayi Agricultural University, Daqing, 163319, China.

Abstract

As financing in China's capital market and bond market is not yet universal, most companies obtain funds for their operations by borrowing from creditors. Strengthening the protection of creditors' interests can directly improve the company's ability to indirect financing, so protecting the interests of creditors is of great significance to the company. From the perspective of the impact of the quality of accounting information on the creditor's decision, this article explores the role of accounting conservatism in the protection of creditors. Accounting conservatism is an important indicator for measuring the quality of accounting information, which can actively and effectively promote the signing of debt contracts. Therefore, in order to better protect the interests of creditors and promote the vigorous development of a socialist market economy with Chinese characteristics, it is necessary to further improve the corresponding laws and regulations, strengthen the construction of a good market financial regulatory environment, and continuously regulate the current status of China's credit market operation.

Keywords

Accounting Conservatism; Creditor Protection; Debt Contract.

1. INTRODUCTION

As China's capital market is still in its infancy, it is difficult for most companies to choose to raise funds through the capital market. Enterprises have a single fund raising channel, and more choices of loans and other means to obtain funds required for operations. Therefore, the degree of protection of the interests of creditors is very important. Most of the previous studies have analyzed from the perspective of strengthening the construction of the legal system, and few have studied the impact of creditor protection decisions from the perspective of the quality of accounting information. The managers of an enterprise may have the tendency to overestimate accounting income and assets to whitewash financial statements for motivation of performance appraisal linked to salary or for the purpose of successfully signing a debt contract. If the company's public financial report fails to reflect the true situation of the company's operations, it means that there is a certain information asymmetry between the manager and the creditor, which will cause professional ethics risks and adverse selection of creditors, and damage the interests of creditors. Therefore, accounting stability is adopted to avoid the above problems and protect the interests of creditors to the greatest extent. The above views have been recognized by many scholars. Some scholars have shown through research that the stability of creditors and shareholders has a certain degree of mitigation, and that the stability can reduce the information uncertainty of creditors and improve the secondary market for bonds. Transaction efficiency. In addition, some scholars have suggested that the principle of sound accounting conservatism is conducive to obtaining more effective funding channels and credit ratings in the creditor financing process.

2. BRIEF INTRODUCTION TO RELATED THEORIES

2.1. Robustness Principle

The principle of conservatism is an important principle used in corporate accounting. The principle of conservatism, also known as the principle of prudence, means that one should be cautious when dealing with uncertain economic business of an enterprise. The "Accounting Standards for Business Enterprises-Basic Standards" of the Ministry of Finance of the People's Republic of China states: "Enterprises should maintain due diligence in accounting confirmation, measurement and reporting of transactions or events. cost". In other words, all foreseeable losses and expenses should be recorded and recognized, while income without full confidence cannot be recognized and accounted for. Under the conditions of a market economy, enterprises will inevitably encounter risks. Implementing the principle of prudence can resolve risks before they actually occur and prevent them, which is conducive to making correct business decisions and protecting owners and creditors To improve the competitiveness of enterprises in the market.

2.2. Classification of Accounting Conservatism

A series of practical analysis shows that accounting conservatism is divided into conditional conservatism and unconditional conservatism. The biggest difference between the two is whether new information is used. Conditional robustness uses new information, so it happens after the fact. So conditional robustness is also named after-the-fact robustness, non-independent robustness, or income statement robustness. Unconditional robustness is that when an enterprise obtains creditor's investment beforehand, it overestimates its own property or plan, and then has a certain impact on the interests of creditors. Robust accounting refers to the phenomenon that the market value of net assets is higher than its book value for a long time. The concept of balance sheet robustness is roughly the same as accounting conservatism. The income statement robustness and the balance sheet robustness are in reverse, and a large part of this situation is due to the fact that the source needs to be measured. The usefulness of unconditional robustness in making decisions that increase or decrease returns is a matter of debate.

2.3. Asymmetric Information Theory

The information asymmetry theory means that in market economic activities, various types of personnel have different understandings of relevant information; those who have sufficient information are often in a better position, while those who lack information are in a disadvantage. status. The theory is that the seller in the market knows more about various kinds of information about the goods than the buyer; the party who has more information can benefit from the market by passing reliable information to the information-poor party; the buyer and seller have less information. Efforts will be made to obtain information from the other party; market signals show that to some extent, the problem of information asymmetry can be compensated.

3. ANALYSIS OF ACCOUNTING ROBUSTNESS AND CREDITOR PROTECTION

3.1. The Protection of Accounting Conservatism on Creditors

On the one hand, accounting conservatism plays a role in protecting the interests of creditors in regulating risks. Information asymmetry exists widely between enterprises and creditors. Information asymmetry can also lead to adverse selections beforehand and moral hazards afterwards. Therefore, it is easy for companies and creditors to cause conflicts of mutual interests. Often, creditors who are the disadvantaged parties of information are seriously damaged. Legitimate interest. The unreliability of financial reports will affect creditors'

judgments on corporate decisions and make wrong choices, which will lead to the damage of creditors' interests. The robustness of accounting makes the financial reports more authentic and avoids the occurrence of events where creditors' interests are damaged due to untrue financial reports. When the debt contract is signed, the creditor may not be able to understand all the manager's investment and operating behaviors in the use of funds due to the excessive cost of supervision or the absence of supervision. And managers themselves tend to overestimate returns and assets, especially when managers' salaries and performance are linked, they tend to over-invest, leading to excessive risks for the interests of creditors, making creditors unable to prevent risks well. As an information governance mechanism, accounting conservatism can achieve the purpose of protecting the interests of creditors by reducing the asymmetry of information before and after the event, and inhibiting the occurrence of adverse selection and moral hazard.

On the other hand, accounting conservatism plays a role in protecting the interests of creditors when signing a debt contract. In the debt contract, the creditor provides early development funds for the development of the enterprise, and the enterprise manager acts as the processor of the funds and allocates the use of the funds. At the same time, the enterprise manager also controls the true financial report. Generally speaking, enterprises manage the concept of venture capital, and creditors need to predict the risk of investment through financial reports, but once there is a divergence between the two, managers will adopt a stance of reporting good news and not worrying about the financial report, misleading the judgment of creditors. Making creditors' interests at high risk. Provisions to restrict management's opportunistic behavior are not enough. Because creditors can only compensate for the risks they face by reducing the amount of loans or demanding higher interest rates, this will eventually lead to the shrinking of the credit market and long-term inefficiency. Therefore, a single ex post clause is not conducive to protecting the long-term interests of creditors. Accounting conservatism requires that companies' financial reports be realistic, and that they both report good news and do not conceal their disadvantages. This is also an inherent requirement of conservatism. Therefore, accounting conservatism can, to a certain extent, have the effect of restricting clauses on debts.

3.2. Issues in Accounting Conservation in Protecting Creditors

Firstly, the related laws are incomplete. China's capital market does not pay much attention to the governance of creditors, and it has not effectively protected creditors in terms of policies, laws and regulations, and the corresponding laws and regulations are still very scarce. The judicial department has imposed restrictions for the formulation of detailed laws and regulations. The law enforcement departments of unscrupulous elements are not yet in place. China's status quo in this regard is still very chaotic; secondly, the supervision of relevant departments is insufficient. Under the socialist market economy, the degree of protection provided by state macro-controls to state-owned enterprises is still very high. Although the restructuring of state-owned enterprises is underway, the pace is relatively slow. State-owned enterprises are less conscious. The financing methods of SMEs are single, the state's support is small, and the internal monitoring system of SMEs is not strict enough. The bank loan approval system is not perfect, and the state has less supervision over banks. Finally, there is a lack of a sound institutional constraint mechanism. Under the influence of special background, the accounting soundness of China's state-owned enterprises is low, and it is obviously lower than that of private enterprises. In other words, the government background of state-owned enterprises will affect creditors' choice of soundness. Their creditors trust the government, but such trust is not suitable for the sound development of state-owned enterprises. Over time, more and more problems will occur. As a result, state-owned enterprises will face huge changes when they lose trust; their internal governance mechanisms are also unreasonable and their

operations do not meet market requirements. A more complete supervision mechanism should be established within the enterprise. As the largest debtor in China's capital market, banks often require greater corporate soundness than ordinary creditors. However, its inadequate loan review system has led to the reduction of banks' restrictions on enterprises.

4. MEASURES TO IMPROVE THE PROTECTION OF CREDITORS BY ACCOUNTING CONSERVATISM

4.1. Improve the Legal Environment for Creditor Protection

China has special national conditions and complex economic market components. If we want to develop a socialist market economy with Chinese characteristics, it is necessary to improve China's protection measures for investors, namely creditors, continuously refine various laws and regulations, improve the legal system, improve the effectiveness of law enforcement, and improve the judicial system. Fundamentally administering the problem and effectively implementing laws and regulations are conducive to protecting the interests of creditors. Only in this way can China's socialist market economy develop. In order to develop China's capital economy market, the national judicial department should attach great importance to laws and regulations to safeguard the interests of debtors, improve the judicial system, and strengthen the enforcement of law enforcement, so that law can be consulted, violations must be investigated, and enforcement must be strict. In order to avoid the use of loopholes by criminals, the already unstable capital market is destroyed, leading to various types of credit crises. In addition, it is necessary to reform the current financing situation to avoid relational financing and affect the judgment of other creditors.

4.2. Improving the Regulatory Environment for Financial Reporting

Practical research shows that the corporate regulatory environment has a greater impact on accounting conservatism. Once a company's regulatory environment deteriorates, the trust of investors in the company will decline, which will greatly affect the financing ability of the company. The results of practical surveys show that the quality of information supervision by most companies is good, but there are still a few listed companies with very poor information supervision. To sum up, enterprises can establish a sound supervision system, enhance supervision, improve the authenticity of financial reports, proceed from reality, maintain creditors' right to know property reports, and maintain the foundation of trust between enterprises and creditors to ensure that creditors Make the right choice before financial reporting. In addition, corporate regulators can also improve the property estimation system so that various types of special property can be correctly estimated, avoiding adverse effects on the choice of creditors.

4.3. Strengthening the Institutional Construction of the Credit Market

First of all, the monopoly status of state-owned commercial banks should be gradually removed, the current situation of soft debt constraints between state-owned banks and state-owned enterprises should be broken, and the price of funds should be closer to the real situation in the market. Second, regulate the bad status quo of the credit market. On the one hand, we are actively looking for ways to solve the problem of difficult loans for small and medium-sized enterprises; on the other hand, we have carried out in-depth reform of the property rights system of state-owned enterprises and separated management and management rights. Third, actively improve the system, enhance corporate trust, and develop a distinctive credit market.

5. CONCLUSION

The robustness of accounting has a strong protective effect on the interests of creditors. Accounting robustness can improve the accuracy of credit decisions made by creditors using accounting information, thereby protecting the interests of creditors. Specifically, accounting conservatism is to underestimate assets and income, and overestimate liabilities and losses to improve the value of the company 's solvency and profitability information, effectively control the occurrence of credit default risks, and improve creditors' use of accounting information The right decision. Effective accounting robustness urges companies to provide more realistic information to debtors in financial reports, reduces the information asymmetry between the two parties, thereby strengthening trust between the two, and reducing the probability of adverse selection by creditors. For corporate development , Accounting soundness can also enable companies to get more capital injection when developing themselves; on the other hand, accounting soundness effectively predicts debt risk and timely confirms bad news, so that creditors can see credit risk in advance and effectively Giving play to the signal transmission function of accounting information, so that creditors can avoid risks in advance, which is an extremely effective measure for protecting the interests of creditors.

ACKNOWLEDGEMENTS

This paper is one of the achievement of the program supported by Heilongjiang Bayi Agricultural University (No.:RRCPY201901).

REFERENCES

- [1] Ball, R, A, Robin, J, S, Wu. Incentives Versus Standards: Properties of Accounting Income in four East Asian Countries ,2013,(36):235-270.
- [2] Basu, Sudipta. The Conservatism Principle and the Asymmetric Timeliness of Earnings[J]. Journal of Accounting&Economics ,2013, 24 (1):3-37.
- [3] Beatty, A, J, Weber, J, J, Yu. 2008. Conservatism and Debt[J]. Journal of Accounting and Economics ,2008, (45): 154-174.