Discussion on the Rationality of "Accounting Standard for Business Enterprises No. 3 - Investment Real Estate"

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Abstract. "Accounting Standard for Business Enterprises No. 3 - Investment Real Estate" has made a relatively specific statement on the definition of "investment real estate" accounting subjects, but a part of it is not reasonable in a way. This paper will analyze the accounting treatment of "investment real estate" subject with the combination of "Accounting Standard for Business Enterprises No. 3 - Investment Real Estate", point out the unreasonable situation, and put forward relevant suggestions for the improvement of contents of the unreasonable criteria.

Background and Significance of the "Investment Real Estate" Subjects

The Background of the "Investment Real Estate" Subjects

With the gradual development of social economy and the continuous expansion of the scale of enterprises, assets are often not all used in production out of enterprises’ strategic considerations or the business environment changes, so enterprises have idle assets. Idle real estate can be used for rental or capital appreciation to earn income. The changes of the concept of financial management prompt to turn enterprises’ real estate earning into an important investment tool [1]. Because the use of real estate is different, and the value of real estate is very high, it is convenient for enterprises to make classification of such assets to analyze the business situation and it is helpful for accounting information users to understand the operation of the enterprise. In China, the real estate industry is one of the fastest growing industries since the 21st century, which not only has become a pillar industry in China, but also leads to development of many industries. The development of the industry also makes the measurement of real estate more accurate. In this regard, in 2006, the Ministry of Finance issued the "Accounting Standards for Business Enterprises No. 3 - Investment Real Estate". In this standard, real estate that is used to earn rent or capital appreciation or both is categorized as investment real estate. Moreover, this standard provides the relevant accounting treatment on investment real estate.

The Significance of the "Investment Real Estate" Subjects

To Simplify Accounting So That Asset Classification Is More Specific.

Before the issuance of investment real estate standards, the accounting did not separate the investment real estate from the various types of real estate and the accounting treatment provisions of investment real estate scattered in other accounting standards. Specifically, the land use rights that have been leased and the land use rights transferred and prepared for value-added are accounted for
the "intangible assets" subject by the Accounting Standards for Business Enterprises - Intangible Assets. For the buildings that have been leased, the division of their accounting treatment is relatively complex, real estate belonging to fixed assets, is accounted for by the "Accounting Standards for Business Enterprises - Fixed Assets" provisions in the "fixed assets" account. Enterprises’ own real estate belonging to the inventory which is built for external rental, should be put into "rental development products" level subjects which can be classified into two detailed subjects: the "rental products" and "rental products amortization", respectively accounting for the cost of such assets and stalls pin. Dealing with investment real estate according to above not only is complicated and hard to understand, but also makes financial information not fully reflect the different uses of corporate assets, thus not easy to conduct financial analysis. Therefore, "investment real estate" accounting subjects is of great significance to simplify accounting, rationalize the classification of assets.

To Truly Reflect the Business Situation, So That Financial Information Is More Relevant To Enterprise.

With the socio-economic development, the community's demand for information is growing, and the quality of information requirements are getting higher and higher. Financial information is essential for enterprises or stakeholders, both to see their own business conditions, timely adjusting business or production strategy, and to allow business stakeholders to estimate the development prospects of enterprises to maximize their own interests. The Investment property reflects the financial information. In particular, the nature of investment real estate is idle assets, which is not to meet the production and operation. Companies can understand the efficiency of the use of assets and timely make adjustment of asset use strategy by a separate accounting. In addition, companies can respectively understand the contribution of the investment real estate and the main business to the profitability of enterprises, which can be used to analyze profit components. Companies can also make the relevant stakeholders understand the real business situation by deducting the impact of investment real estate. The fair value of investment real estate used in capital appreciation is the more realistic reflection of asset value, which is beneficial to the improvement of financial information relevance.

Reducing the Profit Manipulation of Space to a Certain Extent.

Profit is not only the main basis for evaluating the results of business operations, but also an important reference for assessing the value of the enterprise. Operating profit, total profit, net profit is the three main indicators of profit. Total profit after deducting accidental income (non-operating income, non-operating expenses) is the operating profit, and total profit after deducting income tax is net profit. By research and analysis of these three indicators, the contribution of each component of the profit can be clearly understood, and the main factors of profit can also be concluded. The current investment real estate standards limit the business manipulation of profits mainly from two aspects. On the one hand, to limit the enterprise conversion of the measurement model, that is, only allowed the cost model to the fair value model, not allowed the fair value model to cost mode. On the other hand, when business for real estate is changed to investment real estate (in fair value model), part of the fair value greater than the book value can only be included in “other comprehensive income”, the owner equity subjects, rather than "gains and losses on changes in fair value" account.
The Irrationality of "Investment Real Estate" Criteria

Due to the above background and significance, the Ministry of Finance issued the Accounting Standard for Business Enterprises No. 3 - Investment Real Estate, which made a relatively specific statement on the definition and accounting application of "investment real estate" accounting subjects. This paper will combine the relevant provisions of the guidelines to give a specific analysis of its unreasonable points and to lay the foundation for specific recommendations as follows.

Brief Description of the Subject

Accounting standards explain the definition of investment real estate through the list of the content and use of investment real estate, that is, in order to earn rent, or capital appreciation, or both purposes for the holdings. Real estate is the general term for real estate and land. China is a socialist country, thus the property can be owned by individuals or businesses, but land can only be owned by the state or collectively, which means that businesses can only have the right to use. Therefore, there are three types of investment real estate: land use rights that have been leased; holding and preparation of value-added of land use rights; rented buildings. The accounting treatment of investment real estate mainly includes two modes and two kinds of conversion. Two modes include the cost model and the fair value model, and the two kinds of conversion are the mode conversion and the use conversion. Mode conversion is the cost mode to the fair value model (Fair value model cannot be converted to cost model), and the use conversion is the mutual conversion of business use or inventory of real estate and investment real estate. Compared with most of the criteria, the investment real estate standard is relatively simple. It is because the "investment real estate" subject research is not sufficient that article has important theoretical and practical significance on the study of the guidelines.

The Application of "Investment Real Estate" Guidelines is Unreasonable Purpose for Holding Investment Real Estate Is Not Obvious.

Investment real estate holders have these purposes: to earn rent, capital appreciation, or both. The accounting treatment of investment real estate should be different when the purpose of holding is different. If the use of different investment real estate is not distinct, the enterprise will not have rigid supervision and measurement is not reasonable. For investment real estate used to earn rent, companies need reliable accounting information compared to information relevance. Enterprises do not have to estimate the value of real estate at any time based on changes in fair value, which reduces the cost of asset valuation and regulatory costs [2]. In a word, cost model measurement is more reliable than fair value for investment real estate used to earn rent. For investment real estate used in capital appreciation, accounting information relevance is more important. Companies need to pay more attention to the fair value of real estate, which means that the fair value model is more suitable for capital appreciation. For multi-purpose investment real estate, if the fair value of technology is mature, the use of fair value model can better reflect the true value of assets. The current guidelines do not focus on the distinction between investment real estate using, making the investment real estate accounting treatment not be accurately reflected in the use of assets.
The Corporate Income Tax Deduction of Business Hospitality and Advertising Fee Increases, Reducing the Amount of Corporate Income Tax.

It is mainly reflected in the disposal of investment real estate. The accounting treatment is as follows. On the one hand, in the fair value model, the sales income of investment real estate should be included in other operating income; the book value of the investment property should be included in other operating costs, and the amount of "gains and losses changes in fair value" and "other comprehensive income" will be transferred to other business costs. The purpose of accounting treatment above is to adjust the cost of investment real estate to the original cost. On the other hand, in the cost mode, the disposal of income is also included "Other operating income". Except as provided by the Ministry of Finance and the State Administration of Taxation, the business income tax deduction shall be deducted by 60% of the amount, but the maximum not exceeding 0.5% of the sales (business) income of the year. The eligible pre-tax deduction of the advertising expenses and business publicity expenses shall not exceed 15% of the sales revenue of the year, but the excess can be allowed to be deducted in the subsequent tax year. For example, the profit and loss of disposal is included in the "non-operating income" or "non-operating expenses" account, and it is not the deduction base for business hospitality and advertising expenses expense. However, after the conversion to investment real estate, the disposal income is included in the "other business income" as a business hospitality and advertising expenses tax deduction base, and the amount of income is often larger, so that the deduction base expands, which leads to a substantial reduction in corporate income tax burden, reduce the country's fiscal revenue, and the serious effect.

The Autonomy of Choice of Enterprises to Measure Is Greater.

The greater autonomy is mainly reflected in two aspects: first, the choice of the initial measurement mode of investment real estate is not limited; second, the criteria don’t make specific provisions on when measurement mode can be converted without. For the first aspect, in the fair value model, the large value and price changes of the real estate make the profit fluctuations significant, leading to the impression of unstable business. And the book value of the investment real estate caused by the price change is the unrealized gains and losses of the enterprise, that is, "floating profit" or "floating loss", and cannot reflect the true business results of the enterprise. In terms of cost model, the financial information reflects on historical information. Although the historical information is reliable, it is of the great lag. For real estate, the price tends to fluctuate in short time, so the information reflected by historical cost is not relevant to stakeholders to make decisions about the enterprise. In general, the choice of measurement mode involves the choice of the relevance and reliability of accounting information. Business decision makers will choose a more suitable model to achieve their business objectives, that is, the profit margins of enterprises to manipulate are larger. In the year when the main business operating loss is large, the enterprise can increase the profit of the enterprise by choosing the fair value mode. In the cost mode, the enterprise can reduce the profit through the amortization to achieve the purpose of tax avoidance. Although the fair value model is likely to beautify the profits, policy makers prefer to use the cost model in special circumstances. Specifically, state-owned enterprises set business objectives that the annual profit required to increase by 10% last year. If the profit has increased by 30% over the previous year, the
profit growth of 10% next year will be much more difficult than this year for the profit base growth, which makes it difficult for the enterprise managers to achieve the business objectives. In this case, managers are more inclined to use the cost model to reduce their own business performance to achieve the appropriate goals. In short, the possibility of manipulating profit for enterprise through the choice of measurement mode is very high.

In addition, when the cost model is converted to the fair value model is not clearly defined by the criteria. For the comparison of the two modes, the enterprise can inflate profits in the fair value model, while the enterprise can reduce the measurement of profits in the cost mode. The criteria clearly stipulate that the cost model can be converted to a fair value model, but the fair value model can no longer be converted to a cost model, which limits the space in which the firm manipulates profits. However, for the cost model to the fair value model, what is the purpose of the enterprise, to reduce the information distortion or to want to manipulate corporate profits and to reduce the payment of corporate income tax? The conversion measurement model has a great influence on the profit and tax burden of the enterprise. If there is no corresponding audit and judgment mechanism to determine the reason for the enterprise conversion measurement mode, it will not guarantee the rationality and reliability of the enterprise financial information.

**Less Supervision for When the Use of Real Estate Can Be Transferred.**

As mentioned above, under the fair value model, turning the self-use real estate to investing real estate has a greater impact on corporate income tax. Similarly, when the investment real estate (fair value model) is converted into its own real estate, the difference between the fair and the original book value shall be recorded into the current profit and loss (changes in fair value). For the fair value model of investment real estate to self-use real estate, when the real estate market prices rise or fall, it will directly bring the value of corporate assets and current profits increase or decrease [3], and this effect is often significant. And for what purpose for the conversion of real estate use, and the authenticity of the transformation need appropriate supervision and approval. However, the status quo is that the conversion regulatory approval is less, leading to the possibility of business manipulation of profits increasing.

**Suggestions**

After analyzing the irrationality of the "investment real estate" criterion, the following suggestions will be put forward for the unreasonable points to provide ideas and directions for further scientific reform.

**Setting Investment Real Estate Details of the Subjects According to the Use, and Introducing Advanced Fair Value Valuation Technology**

It is more manageable that enterprise sets the details of the account according to the purpose of the use of investment real estate which make managers and financial information users more clearly understand the use of investment real estate. Enterprise can divide the "investment real estate" into three details of the subjects: the subject "investment real estate - leasing", "investment real estate - capital appreciation", "investment real estate - mixed". Investment real estate for rental is only allowed to use cost model, and is not allowed to convert model, unless the use of change. Investment real estate for capital appreciation is only
allowed to use fair value model, which requires companies to adopt advanced market valuation technology to make valuation more reliable. Moreover, the relevant departments can give some guidance and limit on the valuation model. At the same time, the research and development of fair value valuation technology should be strengthened so that the fair value valuation model reflects the more relevant accounting information. The fair value measurement model should also be used for mixed purposes (investment real estate used for both earning rents and capital appreciation). Because mixed purposes contain the purpose of capital appreciation, the accounting information can be more relevant only if it is measured at fair value.

**The Calculation of Corporate Income Tax Pre-Tax Deduction Base Should be Removed Due to the Operating Income of Disposing Investment Real Estate**

In the calculation of corporate income tax, the tax pre-tax deduction base of business hospitality and advertising fee should exclude operating income of the disposal of investment real estate. Since the disposal of investment real estate is included in the "other business income", the pre-tax deduction base will be seriously enlarged, compared to the income from the disposal of its own real estate, which is included in "non-operating income" or "non-operating expenses". After deducting the impact, corporate income tax calculation will be more reasonable, and the country's fiscal revenue will not outflow.

**Strengthening the Measurement Mode Conversion Supervision Combined with Investment Real Estate Holding Purpose**

After the use segmentation, the use respectively corresponds to the measurement mode. Therefore it is more clearly for management, and profit manipulation space is narrowed. However, as the premise of which the measurement model is the same is that the management of investment real estate held the same purpose. When holding purpose of the investment real estate changes, it is the time to change measurement mode. In this process, the relevant departments should strengthen supervision, to ensure that the purpose of a real change, and to prevent enterprises to manipulate profits. If the purpose of holding is indeed converted from capital appreciation to earning rents, strong regulatory approvals can also allow the fair value model to be converted to cost mode, which eliminates the restrictions on the measurement mode that conversion can only be unidirectional. Of course, the purpose of holding cannot be arbitrarily changing. There should be a certain cooling period. During the cooling period, enterprises shall not change the measurement model to prevent enterprises to manipulate profits.

**To Strengthen the Use Conversion Approval**

The profit and loss of disposal of self-use real estate that should be included in the "non-operating income" or "non-operating expenses" is included in the "other business income" with the self-use real estate converted into the investment real estate. And "other business expenses", which beautifies the operating profit and expands the tax pre-tax deduction base of the business hospitality and advertising fee, leading to a substantial reduction in corporate income tax. And in fair value model when enterprise turns investment real estate to self-use real estate, with the real estate market prices rise or fall, corporate asset value and current profits will also increase or decrease, which giving the enterprise a chance of profit manipulation and substantial tax avoidance. So the
relevant departments should strengthen the supervision of the conversion of real estate use, achieving a reasonable guide to the management of business results and tax norms.

Conclusion

In short, the development or introduction of fair value valuation technology can improve the relevance of accounting information, the fair value of the investment model can be accurately measured the value of real estate, which is the key point. Effective supervision is supposed to prevent enterprises to have unreasonable purposes for the conversion of asset use and measurement model, and to reduce the profit manipulation of space, which is guarantee. To achieve effective classification related to holding purposes and measurement model can be reasonable in choosing the accounting information between the relevance and reliability, which is the approach. This article discusses the rationality of the "investment real estate" criterion, not only pointing out some unreasonable existence of the "investment real estate" criterion, but also putting forward the improvement suggestion of accounting treatment of the investment real estate, so that our country’s accounting standards system is more reasonable and perfect.

References

