International Journal of Business and Management Invention (IJBMI)
ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X
www.ijbmi.org || Volume 8 Issue 07 Series. IV || July 2019 || PP 54-55

Research on manipulation of book performance through equity incentive

Ma, Bao-Chun
Shantou University

ABSTRACT :*As an incentive mechanism to alleviate the principal-agent problem, equity incentive has been increasingly implemented by listed companies in recent years. Since the equity incentive plan of listed companies usually contains performance conditions, when the actual operating performance fails to meet the performance conditions of equity incentive, managers will have the motivation to manipulate the book performance. Through the case of BD, this paper analyzes the process of manipulating performance through equity incentive. Put forward Suggestions on the supervision of China Securities Regulatory Commissionand the process norm of enterprise equity incentive.*

Date of Submission: 03-08-2019 Date of acceptance: 14-08-2019

I. INTRODUCTION OF CASE

According to the provisions of the restricted stock incentive plan (phase ii)(draft revision) of A-share restricted stock incentive plan of BD co., LTD., which was deliberated and adopted by the first interim general meeting of shareholders in 2014 held on December 5, 2014. On December 9, 2014, the company implemented the restricted stock incentive plan for 206 middle and senior managers in the form of private placement.According to the plan, the vesting of 6,167,630 shares of restricted stock at a price of 10.50 yuan per share is valid for 5 years. Lock-up periods of 2 years, 3 years and 4 years are set in batches, all counting from the date of grant, and 3 years from the next day after the expiration of the lock-up period of the first batch of restricted stock is the unlocking period of restricted stock. If the unlocking conditions of restricted shares specified in the scheme are met, the incentive subject may apply for an unlocking limit of 40%, 30% and 30% of the number of shares granted under the scheme on the three unlocking days (the next day after the expiry of the lock-up period and the first and second anniversary of that date respectively).

According to the announcement on the grant results of the a-share restricted stock incentive plan (phase ii) of BD: The conditions of grant are as follows:

(1) the total operating income in 2013 is no less than 15.842 billion yuan
(2) 2013 annual net profit shall not be less than 360 million yuan;
(3) the weighted average return on equity in 2013 is no less than 8%.

The performance assessment conditions for each unlocking period are based on the 2013 annual performance, as follows:

(1) The first unlocking period (2016) : the compound growth rate of operating revenue in 2015 shall not be less than 15%, and the compound growth rate of net profit shall not be less than 12%; 2015 annual return on equity is no less than 8.1%.

(2) The second unlocking period (2017) : the compound growth rate of operating revenue in 2016 shall not be less than 15%, and the compound growth rate of net profit shall not be less than 12%;2016 annual return on equity is no less than 8.2%;

(3) The third unlocking period (2018) : the compound growth rate of operating revenue in 2017 shall not be less than 15%, and the compound growth rate of net profit shall not be less than 12%;2017 annual return on equity is no less than 8.3%.

II. CASE ANALYSIS

The impact of the incentive plan on performance is calculated as follows:

According to the announcement of the grant result of the restricted stock incentive plan for A shares (phase ii), the cost of the equity incentive is estimated to be about $65.934 million.The cost will be amortized during the waiting period of the incentive plan. The estimated annual apportioned cost and actual annual accrued expense are shown in the table (there is no change in the shares granted to incentive objects from 2014 to 2017, which are 6,167,630 shares) :

Table 5:annual estimated apportionment cost and actual annual expense of equity incentive of BD

Unit:yuan	In 2014	In 2015,	In 2016,	In 2017,	In 2018,
annual estimated apportionment cost	14,423,000	24,725,000	17,031,000	7694000	2061000
actual annual expense of equity incentive	340,000	5,821,472	5,634,577	-7,404,220	

Since there is no change in the shares granted to incentive objects from 2014 to 2017, according to the company's accounting treatment method, the management expenses related to equity incentive actually recognized each year should be consistent with the estimated Shared costs in each year.However, we can see that the estimated allocation cost of the equity incentive in each year is far from the actual management expense recognized by the company.In 2014, it is expected to allocate 14.42 million yuan, but the company only allocated 340,000 yuan.Similarly, in 2015, the company set aside only 5.82 million yuan of the estimated 24.72 million yuan contribution.Since 2015 is the first year of performance evaluation, the company may deliberately reduce the costs and expenses of the year in order to avoid the impact of various performance evaluation indexes.By 2017, due to the unlocking failure, the company wrote down the previously confirmed administrative expenses, so that the company's administrative expenses were negative in that year.To sum up, the company did not calculate and withdraw the management expense of the equity incentive truthfully, thus operating the performance assessment index, making the enterprise's profit significantly inflated.

III. SUGGESTION

(1) In order to ensure the standardization of equity incentive mechanism, China securities regulatory commission should clearly stipulate the information disclosure system of the equity record mechanism of listed companies in China, strengthen the supervision of enterprise equity incentive, and prevent enterprises from forging the relevant accounting treatment of equity incentive, so as to manipulate profits.At the same time, more strict requirements should be set for accounting firms and asset appraisal institutions, and more severe penalties should be imposed for violations of discipline and rules.

(2) Improve the enterprise internal audit system, prevent managers to operate accounting profit and accounting treatment interference.

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Ma, Bao-Chun" Research on manipulation of book performance through equity incentive" International Journal of Business and Management Invention (IJBMI), vol. 08, no. 07, 2019, pp 54-55