ISSN 2616-5902 Vol. 4, Issue 12: 37-42, DOI: 10.25236/AJBM.2022.041207

The Impact of Financial Assets on Accounting Robustness-Based on the Perspective of Macro-Monetary Policy Changes

Chen Yanfang[1,a], Zhou Fuping[1,b]

[1]*College of Accounting, Guangzhou College of Technology and Business, Foshan, China*
[a]*1030135419@qq.com*, [b]*272173540@qq.com*

Abstract: *Accounting robustness is not only affected by micro business activities such as accounting policy changes, accounting treatments, and management profit manipulation, but also by changes in monetary policies in the broader environment in which firms operate. This paper examines the impact of financial asset price fluctuations on accounting soundness from the perspectives of investment return, discounted stock value, the purchasing power of money, company performance, and market follow-through effect, and concludes that a loose monetary environment will overestimate the value of financial assets and reduce accounting soundness; a tight monetary policy will underestimate the value of financial assets and improve accounting soundness.*

Keywords: *Monetary policy changes; Financial assets; Accounting robustness*

1. Introduction

Changes in monetary policy not only affect the cost of corporate financing, but also affect the price fluctuations of financial assets in the capital market. Financial assets measured at fair value are vulnerable to changes in the macroeconomic environment, and changes in monetary policy can increase the price volatility of financial assets, which affects the robustness of financial information. Therefore, this paper examines the impact of financial asset price volatility on accounting robustness in the context of monetary policy changes.

Fair value measurement can truly reflect the value of assets, but fair value measurement will change with changes in the macro environment and business activities of micro entities, especially in the context of today's macroeconomic environment and increased uncertainty of macroeconomic policies, and financial asset prices are more volatile. The monetary policy regulates the production and operation activities of the real economy as a means to influence the direction of market capital flows and the financing costs of different industries. Will monetary policy changes increase the volatility of financial asset values? What are the transmission channels through which changes in monetary policy affect changes in the value of financial assets? Does a change in monetary policy affect accounting soundness through the transmission channel of the value of financial assets, as soundness is an important principle of accounting?

The principle of accounting soundness states that a company cannot overestimate the company assets and earnings and underestimate the company liabilities and expenses, and that the earnings on the company's assets should be recognized with care. Soundness is one of the important principles of accounting. It arises in the process of contracting the debt obligations of borrowers and lenders. An enterprise's overestimation of earnings on assets can disguise an increase in the company's solvency and the amount it raises, but this can harm the interests of creditors. This is because creditors are not concerned about the future performance and development potential of the company, but whether the company will be able to repay the principal and interest on time under the most unfavorable and conservative operating conditions. Therefore, to ensure the safety of capital, creditors will require enterprises to prudently recognize, measure, and disclose accounting information, to meet the basic conditions for recognition of assets, liabilities, costs, and expenses, to avoid including good news that can only be realized in the future, but must recognize bad news that can only be realized even in the future in advance, and can postpone the recognition of revenue, profit, and asset appreciation, but cannot recognize costs and expenses and asset impairment in advance, which is the accounting This is the fundamental characteristic of accounting robustness.

ISSN 2616-5902 Vol. 4, Issue 12: 37-42, DOI: 10.25236/AJBM.2022.041207

Most previous studies on accounting robustness have focused on the firm level (Beatty et., 2008; Zhang, 2008) or comparative studies between countries (Bushman and Piotroski, 2006). Monetary policy changes, a macroeconomic policy that plays a regulatory role, first affect micro-individual economic activities, which adjust their business activities in response to changes in the external policy environment, and the sum of economic activities among micro-individuals, such as customers, suppliers, and producers, forms the macroeconomic activity aggregate. Therefore, the study of the impact of monetary policy changes on economic aggregates should focus on the production and operation activities of enterprises and explore the internal mechanisms and channels through which monetary policy changes affect the robustness of accounting. There are significant breakthroughs in monetary policy, macroeconomic policy, corporate accounting robustness, and bank loans, such as (Rao, Pingui, and Jiang, 2011) [1] when monetary policy enters a tightening period, corporate accounting policy is found to become more robust and easier to obtain bank loans. This paper focuses on the impact of monetary policy changes on the value of financial assets and the impact of the interrelationship between the two on accounting robustness. This paper includes two major parts: theories related to monetary policy changes, financial assets and accounting robustness, and micromechanisms of monetary policy changes affecting accounting stability.

2. Review of Literature

2.1. Impact of financial asset value changes on accounting robustness

Accounting has developed the principle of robustness for four main reasons. The first reason for the principle of robustness is that it promotes efficient contracting between creditors and debtors to avoid companies overestimating asset returns and damaging creditors' interests by failing to repay debts on time; the second reason is that managerial compensation is closely related to the company's economic performance, and the principle of accounting robustness avoids executives overstating profits to complete performance appraisals to the detriment of shareholders' interests; the third reason is that by overstating company profits or assets, the company The third reason is that if the company's profits or assets are overstated, the company's share price will rise accordingly, which damages the interests of investors, who are more likely to sue the company and damage the company's reputation in the capital market, thus accounting robustness also protects the company. Accounting robustness prevents managers from exaggerating asset returns, and corporate information disclosure is more cautious and conservative, which helps reduce information asymmetry between companies and creditors, and investors. By overstating the value of corporate assets, companies may not be able to repay their debts in the worst-case scenario, and the safety of creditors' assets is not guaranteed. On the other hand, share prices change as the company's financial condition and profitability fluctuate, and overstating the value of assets can mislead shareholders and potential investors about the true valuation of the company's value. Therefore, the principle of accounting soundness can protect creditors' interests by safeguarding the recovery of interest on borrowings on the one hand, and reducing investment risks by protecting investors' interests on the other. Overall, previous scholarly research on accounting robustness and financial asset value changes has focused more on managers' access to debt financing and capital market financing through manipulation of assets and profits, but this has greatly reduced accounting robustness. Previous studies have not considered the impact of macro context on accounting robustness. This paper studies the impact of financial assets on accounting robustness from the perspective of monetary policy changes.

2.2. The impact of monetary policy changes on the value of financial assets

Monetary policy is one of the most important tools for governments to regulate macroeconomics. When the economy is down, central banks stimulate the economy by increasing the money supply and lowering interest rates to regulate the production and operation activities of micro-entities; when the economy is overheated, they reduce the money supply and raise interest rates to tighten excessive investment by enterprises. The equity capital market is more vulnerable to macroeconomic policies, while the fairness and instability of the value of financial assets can have a significant impact on the value of a company's assets and profits. Changes in fair value can best reflect changes in the market environment promptly. When monetary policy is loose, people are optimistic about the market outlook, market transactions are active, the price of financial assets in the capital market rises, and gains from changes in fair value further push up the value of financial assets; when monetary policy is tightened, the money supply decreases, loan interest rates fall, enterprises will invest less, market sentiment declines, stock prices fall, and fair value Changes in gold gains and losses are credited to assets, and the book value of financial assets decreases, which easily causes asset prices to be undervalued (Zhang Rongwu

ISSN 2616-5902 Vol. 4, Issue 12: 37-42, DOI: 10.25236/AJBM.2022.041207

and Wu Zhongxin, 2010) [5]. Under the loose monetary policy environment, stimulated by sufficient sources of funds, enterprises will expand production scale and investment, and with the unchanged supply of raw materials and labor and other factors of production, with the need to expand investment, enterprises bid against each other, demand exceeds supply, and the prices of factors of production rise. With the increase in production costs, the price level of goods and stock prices will rise again (Yi and Wang, 2002) [3]. However, in the case of monetary policy changes, tight monetary policy, the value of the capital market falls, companies take impairment on financial assets at market value, company profits fall, stock prices fall, stock market participants increase selling efforts, stock prices fall, and financial assets fall further; in the loose monetary policy environment, people are optimistic about the market outlook, market transactions are active, and the price of financial assets in the capital market rises. The gain from fair value change further pushes up the value of financial assets. So under the change of monetary policy, will it inevitably lead to the decline of accounting robustness?

3. The micromechanism of monetary policy changes affecting accounting stability

Changes in monetary policy will aggravate the volatility of financial assets measured at fair value, and the price volatility of financial assets will affect the stability of accounting, does the change in monetary policy affect the stability of accounting through the mediating variable of financial assets? What is the micro mechanism by which changes in monetary policy affect accounting stability? Does an accommodative monetary policy overestimate the value of financial assets and reduce accounting stability? Does a tight monetary policy undervalue financial assets and improve accounting robustness?

3.1. Loose monetary policy overestimates the value of financial assets and reduces accounting soundness

Changes in interest rates directly affect the stock market through corporate funding channels and funding amounts, money supply, corporate performance, the follow-through effect, and other elements, stimulating stock price increases. During the period of monetary easing, on the one hand, corporate funding channels and funding amounts increase, bank deposit and bond interest rates fall, the yield of bonds is lower than the return on investment in stocks, and bonds lose their attractiveness relative to stock investments, and funds flock to the stock market, pulling up stock prices in the bidding of many stockholders (Qu Qiang, 2004) [4]. Investing in stocks has higher returns, thus market investors prefer stock investments, funds flow to the stock market, stock market transactions are active, and market participants bidding against each other will push stock prices up. With the decrease in market interest rate, the present value of discounted future cash flows of stocks will increase, and the value of stocks will increase, which will also drive up stock prices.

Under the easy money environment, as the money supply increases, the number of money held by the public increases, the purchasing power of money decreases, and people look for investment channels to preserve and increase the value of their existing assets. With the increase in the number of money flowing into the stock market, more stockholders participate in stock investment, and in mutual bidding, stock prices keep rising. On the other hand, under the loose monetary environment, market interest rates fall, and stimulated by low financing costs, when investment opportunities come, companies are less risk-sensitive and more willing to obtain bank credit funds to participate in investments. Funds will flow to high-profit popular industries, and the stock market and real estate investment keep increasing. (Jiang Guohua and Zhang Ran, 2007) [2]. Under the easy monetary policy environment, as the market real interest rate decreases, the risk premium decreases accordingly, the stock discount rate decreases, and stock prices will rise (Yi and Wang Zhaoge, 2002) [3], and the value of financial assets measured at fair value increases. On the other hand.

As the money supply increases, the population finds itself with more money and feels that it has more wealth than before and will tend to expand its spending to buy stocks. Increased corporate performance stimulates higher stock prices. Balance sheet and income statement performance are good during boom times. Inflation affects consumer prices and factors prices differently in terms of how quickly and to what extent it affects them. Consumer prices are relatively flexible and can react quickly to market changes. The money supply increases, the purchasing power of money relative to consumer goods decreases, and the exchange ratio between money and consumer goods decreases, which means that consumer goods prices increase. However, companies usually sign long-term contracts with owners of production factors (employees, raw material suppliers), and the prices of production factors will remain stable for a longer period time. Consumer goods prices rise before the prices of production factors, and the profit margin

ISSN 2616-5902 Vol. 4, Issue 12: 37-42, DOI: 10.25236/AJBM.2022.041207

between the prices of consumer goods and production factors becomes larger. The information reflected in the income statement is that the profitability of the company becomes stronger and the company's financial position becomes better. With the enhanced performance of the company, stockholders have optimistic expectations about the future development of the company and the stock price will rise. The herd following effect stimulates stock price increase. The stock market is prone to the herd the following effect, and active stock market trading will attract more stockholders to participate in the stock market. The public is very optimistic about the economic outlook of the market, and optimistic expectations will further push up stock prices.

3.2. Tight monetary policy undervalues financial assets and improves accounting robustness

A tight monetary policy will undervalue financial assets and improve accounting robustness. In a tight monetary policy environment, market sentiment is pessimistic and investments will tend to be in low-risk items, with fewer investments in the stock market and lower prices of financial products. Fair value change gains and losses further reduce the price of financial assets, asset prices are easily undervalued, market panic is contagious to each other, there will be a collective stock selling scenario, and stock prices will fall further. (Ge Jiashu, 2009) [6]. What is the micro-mechanism of undervaluing financial assets and improving accounting robustness during a credit crunch?

Overheated investments during the monetary easing period are fully exposed in the monetary tightening period. The expanded project investment by enterprises during the monetary easing period will increase the demand of enterprises for production factors, and with the constant quantity of production factors, the price of production factors will rise as enterprises bid against each other, and the cost of production of enterprises will rise. At the same time, resource owners and labor owners slowly perceive that commodity prices have risen and cannot buy goods of the same size at the original wage level, requiring enterprises to re-sign contractual contracts. Enterprises are forced to increase the wages of employees and the price of resources, and the cost of factors of production of enterprises rises. The market money supply decreases, the market interest rate rises, the company's loans become more difficult to obtain, and the cost of financing rises. As a result, companies' factor costs such as resources, labor, and financing costs rise, the profit margin between companies' factor costs and the selling price of their products shrinks, and items that were expected to be profitable become unprofitable. A period of monetary tightening will liquidate the bad investments made during the period of economic overheating, companies will default, project investment failures or even bankruptcy, the financial statements will reflect inside the company's earnings decline, asset prices will fall, and stock prices will react quickly with the changes in the company's financial position and profitability, stock prices will fall, and financial assets are therefore undervalued in price.

In a period of monetary tightening, the market money supply decreases, market interest rates fall, bank deposit and bond rates rise, and bond investments become attractive. As monetary policy changes, from easing to tightening, companies and individuals face increased environmental uncertainty, and investors seek to hedge risk and preserve the value of their assets. At this time, they seek sound asset preservation over investment appreciation and will prefer bond-based investments. As the stock market becomes less active, investors will shift from equity investments to debt investments. At the same time, the stock market has a herd-following effect that exaggerates market pessimism, and pessimistic expectations about the economic outlook in the capital market are transmitted to each other, which will further reduce the value of stocks.

Robust accounting treatment reduces current period profits while generating surplus reserves for future periods. Investors often do not realize the relationship between lower earnings in the current period and higher earnings in the future, and therefore undervalue the business now. Too much robustness leads to conservatism in current period surpluses, but also inevitably leads to aggressiveness in future surpluses (Yu Yongsheng, 2009) [7]. It can be seen that both decreasing accounting robustness and being too conservative are undesirable.

4. Research Conclusions and Limitations

Accounting robustness is not only influenced by micro-environmental factors such as accounting policies, accounting treatments, and management profit manipulation, but also by monetary policies through the financial assets channel. Loose monetary policy can overvalue financial assets and reduce accounting soundness through the transmission mechanism of money supply and interest rates as follows. A decrease in interest rates and a lower return on investment in bonds than in stocks stimulates stock prices; a decrease in market interest rates increases the present value of discounted future cash flows from stocks, which also drives stock prices up; an increase in the money supply and a decrease in the purchasing power of money, which stimulates stock prices; an increase in the money supply increases the opportunities for investors to use bank credit for investment activities; monetary policy Easing, the average real interest rate decreases, and stock prices rise; factor prices will remain stable for a longer period time, the profit margin between consumer prices and factor prices becomes larger, the profitability of enterprises becomes stronger company performance increases, which stimulates stock prices; the market follows the trend effect, which stimulates stock prices to rise. A tight monetary policy will undervalue financial assets and improve accounting soundness. Overheated investment in the period of monetary easing will be fully exposed in the period of monetary tightening; the demand of enterprises for production factors will increase, and with the number of production factors remaining unchanged, enterprises will bid against each other, the cost of production factors such as resources, labor, and financing costs of enterprises will rise, the profit margin between the cost of production factors of enterprises and the selling price of products will narrow, and the expected profitable projects will become unprofitable, while stock prices will increase with Stock prices will respond quickly to changes in the company's financial position and profitability, stock prices will fall, and financial assets will be undervalued; the monetary policy will tighten, enterprises and individuals will face increased environmental uncertainty, and investors will prefer bond-based investments to avoid risks and preserve the value of their assets. The stock market has a herd-following effect that exaggerates market pessimism, and pessimistic expectations about the economic outlook in the capital market will be transmitted to each other, which will further reduce the value of stocks.

The limitation of this paper is that the impact of monetary policy changes on accounting stability through the mediating variable of financial assets is studied through logical reasoning, and no data is collected for empirical analysis.

Acknowledgments

Fund Project

1). 2021 Collaborative Education Project of University-Industry Cooperation, Department of Higher Education, Ministry of Education, China (202102394017);

2). 2021 Higher Education Research Project of Guangdong Higher Education Society "14th Five-Year Plan" (21GYB82) Research on the reform and practice of accounting education model based on the "high point" of the Greater Bay Area (21GYB82);

3). 2021 Annual Curriculum Civic Construction Project of Guangdong Higher Education Teaching Management Society "Accounting Information System" (X-KCSZ2021060);

4). 2021 University-level Quality Project of Guangzhou Institute of Technology "Financial Management Teaching and Research Department";

5). 2022 Annual Online Open Course Guidance of Guangdong Undergraduate Universities Research Project of the Steering Committee of Online Open Courses of Undergraduate Universities in Guangdong Province in 2022 (Research on the Construction of Online Open Courses Based on OBE - Taking Accounting Information System as an Example) (2022ZXKC530) ;

6). Joint Laboratory of School and Enterprise of Undergraduate Universities in Guangdong Province "Joint Laboratory of School and Enterprise of Digital Intelligence Accounting"

7). 2022 Guangzhou The Third Round of Key Discipline Construction Project of Guangzhou College of Business (Accounting Discipline);

8). 2022 Annual Planning Project of China Association of Private Education (School Development Category) "Research on Cultivating Talents of Private Applied Undergraduate Financial Management Majors in Digital Economy" (CANFZG22182)

References

[1] Rao, Pingui. Jiang, Guohua. (2011) Monetary policy fluctuations, bank credit, and accounting robustness, Financial Research, 3, 51-71.
[2] Jiang Guohua., Zhang Ran. (2007) Robustness and fair value: A normative analysis based on stock

ISSN 2616-5902 Vol. 4, Issue 12: 37-42, DOI: 10.25236/AJBM.2022.041207

price reaction, Accounting Research, 6, 20-25.
[3] Yi Gang., Wang Zao. (2002) Monetary policy and financial asset prices, Economic Research, 3, 13-20.
[4] Qu Qiang. (2001) Asset prices and monetary policy, Economic Research, 7, 60-67.
[5] Zhang Rongwu., Wu Zhongxin. (2010) Property rights protection, fair value, and accounting robustness, Accounting Research, 1, 28-34.
[6] Ge Jiashu. (2009) Research on fair value accounting - the essential features of financial accounting, Accounting Research, 5, 6-13.
[7] Yu Yongsheng. (2009) Research on fair value accounting in the context of the financial crisis, Accounting Research, 9, 22-28.