An Analysis of the Influence of New Guidelines for Government Subsidies on China's New Energy Automobile Industry--A Case Study of BYD

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Abstract. In May 2017, the Ministry of Finance promulgated a new guideline for government subsidies. This paper compares the changes of the new and old criteria of government subsidy, and sums up the accounting methods of government subsidy and financial discount under the new criteria. At the same time, this paper takes BYD, one of the leaders in the new energy automobile industry, as the analysis object, analyzing BYD's balance sheet, profit statement and financial indicators according to the new government subsidy standards, and putting forward relevant suggestions for listed companies.

1. Introduction
In order to standardize the accounting treatment of government subsidies and improve the information quality of financial statements to meet the principle that substance is more important than form, the Ministry of Finance issued the new criteria for government subsidies on May 10, 2017. The revised criteria will come into effect on June 12, 2017. The new criterion of government subsidy revises and perfects the relevant accounting treatment problems: First, it defines the characteristics of government subsidy in more detail, and can better distinguish the nature and scope of the subsidy according to the definition; Second, it makes significant adjustments in accounting to make the accounting treatment of enterprises more practical and relevant accounting indicators more accurate; Third, the accounting treatment of the policy-based preferential loan discount provides different ways to better standardize the practical operation; Fourth, adding other income items to account for government subsidies that are related to daily business activities but do not incur costs.

2. The comparison of the old and new criteria
The revised guidelines for government subsidies in 2017 consist of 5 chapters and 20 articles, which are 2 chapters and 10 articles more than the old guidelines in 2006. The formulation of reserved contents has also been greatly adjusted.

2.1. Increase the characteristics of government subsidies and clarify its definition and scope
Fiscal funds allocated by the government to enterprises can be divided into three categories: the first is that government investments in enterprises can be accounted for as paid-in capital (equity) or capital reserve, and the government plays the role of shareholders; The second is the products of government purchasing enterprises, including the government purchasing the products needed by itself or the
government undertaking the partial consideration of public purchasing products, such as the
government's financial subsidies for home appliances to the countryside and new energy vehicles, the
government plays the role of consumers. The first two cases do not meet the gratuitous requirement of
government subsidy, because in the first case the government can take equity in the enterprise, and in
the second case the government (or the public) can obtain goods or services. Because of the
requirements of the old criteria, most enterprises in practice will receive financial subsidies as non-
operating income treatment, which is not in line with the economic essence, is not conducive to the
accuracy of accounting information accounting and disclosure, the new criteria can be a good
improvement.

2.2. Great adjustment has been made in accounting, and net method has been introduced
The old criterion restricts the enterprise to adopt the total amount method for accounting treatment,
while the new criterion introduces the net amount method, the enterprise can choose which accounting
treatment method to use. The so-called net amount method is to use government subsidies to offset the
related costs, such as the book value of fixed assets, sales costs, management costs and so on. The
introduction of the net amount method in the new criterion is based on the principle that substance is
more important than form. In order to make the enterprises reflect the book value of assets,
depreciation and amortization, the cost and interest rate of period expenses and loans more truly, and
improve the quality of accounting information, it is helpful for the stakeholders to make accurate
judgment and evaluation of the situation of enterprises.

2.3. Making specific provisions for the treatment of discounted interest accounts of preferential loans
is conducive to better standardizing the practical operation
In order to standardize the accounting treatment of financial discounts and to converge with the
International Accounting Standards (IAS), Articles 12 to 14 of the new Standards have added new
accounting treatment provisions for financial discounts. The new standards classify the financial
discounts obtained by enterprises from the government into the following two situations: (1) The
discounted funds are directly allocated to the banks where the enterprises obtain loans; (2) Discount
funds are allocated to beneficial enterprises. This provision is conducive to better standardize practical
operations and improve the accuracy of fiscal discount accounting.

2.4. Adding other income items to account for government subsidies that are related to daily business
activities but do not incur costs
Compared with the old standard, Article 11 of the new standard adds the new accounting subject
"other income", that is, according to the essence of economic business, the profit and loss caused by
the receipt of financial subsidies can be divided into two categories related to or unrelated to daily
activities. According to the new criteria, enterprises should add a new line of "other income" above the
operating profit items in the profit statement to account for government subsidies related to daily
activities but without incurring related costs; and government subsidies related to daily activities and
incurred or pending costs should offset related costs. This regulation is conducive to enterprises in
accordance with the requirements of the basic criteria, the correct distinction between income,
expenses, and profits, improve the transparency of accounting information.

3. The impact of new Government Subsidy Guidelines on new energy automotive industry
report items and financial indicators
The new guidelines will have a great impact on listed companies, especially in the new energy
automotive industry, electronic equipment manufacturing industry and some chemical industries.

3.1. Case selection
BYD (1211.HK, 002594.SZ) was founded in February 1995, is the world's new energy vehicle
research and development and application of pioneers. As can be seen from table 1. Below, BYD
receives large government subsidies annually, the lowest in 2014 at $301 million and the highest in 2014 at $798 million. Government subsidies account for a higher proportion of net profit, with more than 100% in 2012 and 2014, suggesting that without government subsidies in these years, companies would have been facing losses. Especially in 2012, the profitability of the enterprises was poor, the government subsidies accounted for 258.53% of the net profit of the enterprises, indicating that the government invested 550 million yuan in financial subsidies in return for BYD 213 million yuan of profit. That is to say, all the book profits come from the government’s “blood transfusion” rather than the self-earning of enterprises.

Table 1. BYD 2011-2016 annual government subsidy and net profit. Unit: 10000 yuan

| Year | Government Subsidy | Net Profit | Percent |
|------|--------------------|------------|---------|
| 2011 | 30,122.10          | 159,507.60 | 18.88%  |
| 2012 | 55,038.70          | 21,289.00  | 258.53% |
| 2013 | 67,712.10          | 77,586.60  | 87.27%  |
| 2014 | 79,844.60          | 73,987.00  | 107.92% |
| 2015 | 58,117.70          | 313,819.60 | 18.52%  |
| 2016 | 71,093.90          | 548,001.20 | 12.97%  |

3.2. Hypothesis

Since BYD only disclosed the information of the government subsidy in the notes to the financial statements, it did not disclose the full text of the government subsidy document. In addition, part of the government subsidy is issued in the form of confidential documents, it is difficult to query through information, so this paper makes relevant assumptions in case analysis. The financial statements and annotations disclosed in BYD 2015 and 2016 are the data sources.

First, suppose that BYD started to adopt the new Government Subsidy Guidelines in December 31, 2015 to prepare financial statements. Second, assume that assets are depreciated by line method, with no net residual value. Third, office and transportation equipment for 5 years and less, machinery and equipment for 5-10 years, housing and buildings for 10-50 years. To facilitate calculation, the assumption of depreciation is unified for 10 years.

3.3. The impact of the implementation of the new guidelines on the new energy vehicle industry

As mentioned above, one of the highlights of the new government subsidy criteria is the introduction of the net method. Therefore, in the following analysis, this article will take the net method as an example to analyze the financial impact of the implementation of the new government subsidy criteria on the new energy industry.

3.3.1. The impact on the balance sheet.

According to the information on government subsidies disclosed in the BYD financial statements and notes for the year 2015, the end-of-term balance of deferred income related to government subsidies at 31 December 2015 amounted to 1,546.11 million (of which 1,382.56 million was related to assets and 163.55 million was related to liabilities). If the net method was adopted, the capital should be invested. Production related deferred income reduces the book value of assets in full. The new asset-related deferred income in 2016 was 18.33 million, so the book value of the assets was reduced by 1,400.89 million. As can be seen from table 2. Below, the adoption of the new criteria for government subsidies will affect both assets and owner's equity and lead to a slight decline in assets and owner's equity.

3.3.2. The impact on the profit statement.

Among the government subsidies originally included in non-operating income, 13 were related to assets and 5 were related to income, totalling 710.94 million. The former should write off the book value of the assets at the time of actual receipt under the net amount method, so the off-business income of 204.90 million disclosed in the notes on off-business income should be reduced. The latter should be dealt with separately as related to Nissan activities and unrelated to daily activities. Specifically, the value-added tax returned to the enterprise is 33.44 million, which is related to daily business activities but does not incur cost, and should be transferred from non-operating income to other income. The allowance of 32.07 million is related to the daily
activities of the enterprise and the related expenses have occurred this year. The allowance should be transferred from the non-operating income to the management expenses. The subsidy for basic research expenditure of Changsha Motor City Project, which is 213.95 million, is related to the daily activities of the enterprise and the related expenses have occurred this year, should be transferred from the off-business income to the management expenses. The Luhe production base received a one-time incentive of 50.38 million for R&D innovation, which was unrelated to daily activities and did not incur any expenditure, and was still accrued as non-operating income unchanged. There is another cost associated with revenue, but the nature of the subsidy is not disclosed in the notes. It is impossible to determine whether adjustments are needed and it is still included in the non-operating income. As can be seen from table 3. Below, the new criteria have the greatest impact on the non-operating income items in the profit statement. In order to be more in line with the actual production and operation of the enterprise, the subsidies included in the non-operating income are transferred to other income or write off the book value of the assets and the related costs, resulting in a 57.37% reduction in the non-operating income. Because the book value of the assets is adjusted by the net amount method, the depreciation and amortization of the enterprises also have great changes, down by 10.42%. The adjustment according to the new criteria of government subsidy will also affect the total operating costs, sales and management costs, operating profits and total profits in the profit statement. The adjustment is not very large. This article will not elaborate on this.

**Table 2.** Comparison of balance sheet information. Unit: 10000 yuan

|            | Original number | Adjustment | Adjusted data | Adjustment range |
|------------|-----------------|------------|---------------|-----------------|
| Assets     | 11,548,575.50   | -138,255.70| 11,410,319.80 | -1.20%          |
| Liabilities| 7,945,651.40    |            | 7,945,651.40  |                 |
| Owner's equity | 3,602,924.10   | -138,255.70| 3,464,668.40  | -3.84%          |

|            | Original number | Adjustment | Adjusted data | Adjustment range |
|------------|-----------------|------------|---------------|-----------------|
| Assets     | 14,507,077.80   | -140,088.90| 14,366,988.90 | -0.97%          |
| Liabilities| 8,966,141.50    |            | 8,966,141.50  |                 |
| Owner's equity | 5,540,936.30   | -140,088.90| 5,6400,847.40 | -2.53%          |

**Table 3.** 2016 comparison of profit tables. Unit: 10000 yuan

|                  | Original data   | Adjustment | Adjusted data | Range  |
|------------------|-----------------|------------|---------------|--------|
| Total operating income | 10,346,999.70  |            | 10,346,999.7  |        |
| Other benefits    | 3,343.70        | 3,343.70   | 3,343.70      |        |
| Total operating cost | 9,673,951.20   | -38,427.07 | 9,635,524.10  | -0.40% |
| Among: Sales and management costs (no depreciation and amortization) | 971,162.50 | -24,601.50 | 946,561.00 | -2.53% |
| Depreciation and amortization | 132,735.00 | -13,825.57 | 118,909.43 | -10.42% |
| Operating profit | 598,625.10      | 41,770.70  | 640,395.90    | 6.98%  |
| Non-operating income | 84,432.80      | -48,435.10 | 35,997.70     | -57.37% |
| Total profit      | 656,841.00      | -6,664.33  | 650,176.70    | -1.01% |

3.3.3. Impact on financial indicators. Because the book value of assets is offset by the net amount method, while the book value of liabilities remains unchanged, the ratio of assets to liabilities of enterprises increases, indicating that the solvency of enterprises is weakened and the financial risk of enterprises increases. Property ratio has also risen, reflecting the same problem, that is, the long-term solvency of enterprises has weakened, but the impact is small. Total assets turnover rate slightly increased, indicating that enterprise assets turnover accelerated, resource utilization increased, sales
capacity is strong. Generally speaking, the issuance of new government subsidy standards has little impact on financial indicators, weakens the long-term solvency of enterprises, and improves their operational capacity.

**Table 4.** Comparison of financial indicators. Unit: 10000 yuan

| Items             | Asset liability ratio | Equity ratio | Turnover of total assets |
|-------------------|-----------------------|--------------|--------------------------|
| Original number   | 61.81%                | 161.82%      | 89.60%                   |
| Adjusted data     | 62.41%                | 166.01%      | 90.68%                   |

4. **Suggestions for listed companies to adapt to the new criteria**

4.1. *Strengthen the knowledge training of Accountants in Enterprises*

With the constant change of market economy, the deepening understanding of accounting theory knowledge and the need of accounting information standardization, it is imperative to reform the government subsidy standards and converge with international accounting standards. This requires the practitioners of financial direction in China to constantly pay attention to new accounting policies and learn new accounting knowledge. Enterprises should also provide timely training for financial personnel accordingly, so as to make the accounting treatment of enterprises more in line with the norms, and provide more accurate financial information for enterprises and investors.

4.2. *Develop sustainable strategic planning and enhance overall competitiveness.*

Enterprises should formulate sustainable strategic planning for their own development, grasp the international situation and market dynamics, and constantly adjust and improve. Enterprises should strive to develop new products, expand new markets, develop new customers, and have a good risk response mechanism, improve the main business income and net profit. Enterprises should constantly enhance their comprehensive competitiveness, and should not rely too much on government subsidies, so as to lose the ability of independent development, "hematopoietic function" decline.

4.3. *Strengthen the transparency and transparency of government subsidy information.*

From the perspective of enterprises, enterprises should improve the disclosure of government subsidies in their financial statements. According to the types and use of government subsidies, enterprises can also disclose financial indicators such as the proportion of government subsidies to net profit of the year, so that investors can understand the true profitability of enterprises. If there is a return of government subsidies, we should also disclose the reasons and specific accounting treatments. At the same time, the government should also strengthen the transparency of subsidies information, make the public understand the object and basis of financial subsidies, establish and improve laws and regulations on government subsidies, criticize and punish enterprises that use subsidies irregularly, and strengthen the external supervision of investors and stakeholders.

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