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## Reflections on Resumption and Improvement of Enterprise Statement of Profit Distribution

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### Abstract

The enterprise profit distribution and its disclosure problem are analyzed to demonstrate why resumption and improvement of the enterprise statement of profit distribution are needed. It is noted that a limit should be set between disclosures of profit formation and distribution. Resumption of the enterprise statement of profit distribution discloses the conditions of profit distribution in a better way while an improvement helps improve the disclosure of the participation of human capital in enterprise profit distribution. The participation of stakeholders in enterprise profit statement of profit distribution is kept in a “white box” to analyze and study whether the contribution of production factors matches its participation in distribution.

**Key words:** Statement of profit distribution; Profit distribution; Resumption; Improvement

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### INTRODUCTION

Great concerns have been paid by all walks of life in China to enterprise profit distribution. Yi (2006) analyzed the factors affecting the level of company profit distribution. He proposed that an improvement of the mandatory dividend policy and intensified disclosure of the reason for the fact that the company gained profits but failed to prepare a cash dividend plan. Zhang (2007) believed that employees who have made partial human capital specific investment should have access to a partial of the surplus of enterprises. Cui, Jin, and Qu (2009) held the idea that an enterprise system where labor-force direct usufruct was recognized should be set up so that they could participate in profit sharing. Xu (2010) summarized the progress of study on state-owned enterprise (“SOE”) profit distribution and attached importance to participation of human capital in SOE profit distribution. Pi (2010) noted that profit distribution of listed companies in China came with the issues that distribution or profit sharing was not given; there was high stock dividend; high cash dividend was provided while refinancing with enormous amount was maintained. Chai (2011) also studied the profit distribution of listed companies in China. Wang (2012) believed that improvement of the profit sharing system was necessary for the system of enterprise profit distribution in China was imperfect and in a lack of both stability and sustainability. Luo and Liu (2012) believed that the relationship between SOEs and the government turned from opposition to mutual benefit and that the inherent defects of SOE profit distribution system, SOE’s self-interest and the lack of influence of public on policy prevented the profit distribution system from a reform. Li and Li (2013) believed that the basis of existing enterprise profit distribution was insufficiently clear, which resulted in a lack of drive for company profit sharing. Tang, Liu, and Zhang (2013) figured out the

influence of the progress of production technology on both enterprise profit distribution and national economic development by studying on micro enterprise's decision-making behavior. Zhang (2015) pointed out that the profit distribution of listed companies in China were subject to weak consciousness of profit distribution, unfair profit distribution, moral hazard, etc. Despite fruitful results of these studies on profit distribution, less attention is paid to study on disclosure of profit distribution. In particular, this paper proposed resumption and improvement of the enterprise statement of profit statement and gave the reasons by analyzing the problems in enterprise profit distribution and its disclosure in the setting that the Accounting Standard for Business Enterprises 2006 ("ASBE") cancelled the enterprise statement of profit distribution and the consolidated statements of profit distribution was insufficiently demonstrated on a theoretical basis and that its consequence was underestimated in order to achieve a more clear and more "white box-based" enterprise profit distribution in China.

## **1. ANALYSIS OF PROBLEMS IN ENTERPRISE PROFIT DISTRIBUTION AND ITS DISCLOSURE**

### **1.1 Problems in Enterprise Profit Distribution**

#### **1.1.1 Profit Distribution is Unfair**

With the pursuit of "giving priority to efficiency with due consideration to fairness" in the primary distribution in China, unfair distribution between human capital and non-human capital have existed for long time and is not properly settled. Such unfair distribution receives no correction in the secondary distribution, which intensifies to a certain extent unfairness of distribution and thus leads to serious polarization of wealth distribution. The Gini coefficient in China released by the National Bureau of Statistics for 2014 is up to 0.469.

#### **1.1.2 Participation of Human Capital in Distribution is Insufficient**

It is stressed in the Report of the Eighteen National Congress of the Communist Party of China that the primary distribution mechanism where labor, capital, technology and managerial expertise should be allowed to have due share of distribution according to their respective contribution should be improved. However, it is not achieved in the process that the "spirit" of the Party's and the Government's document is converted from "institutional" arrangement. The distribution mechanism implemented is imperfect and has no an arrangement with respect to the legal system (Wu & Zhang, 2015). The employee compensation has a weaker incentive effect on the staff than that of participation in surplus value distribution by the staff. There is less motive of human capital to expand surplus value than that of non-human capital. Insufficiently effective incentive of human capital

under the knowledge and information society leads to failure to realize a win-win situation for stakeholders. Actual conditions of existing enterprise profit distribution are: the mechanism of collective consultation on wages is imperfect; the subject of surplus value is still subject to "distribution by capital"; non-human capital participates in distribution of surplus value (shareholders receive dividends and creditors receive interests), and; human capital does not or less participate in distribution of surplus value. In other words, part of the technicians participates in distribution of certain surplus value with the technology acting as intangible assets. A small number of senior management in the enterprise participates in distribution of surplus value with the annual pay or stock options. However, a majority of general staff do not or less participates in distribution of surplus value.

#### **1.1.3 The Basis of Enterprise Profit Distribution is Unclear**

The basis of profit distribution of business enterprises and even the parent and subsidiary companies of an enterprise differs. It is shown in the fact whether profit distribution of the company should be based on the profit to be distributed of the company or that included in the consolidated statements, which remains with undefined basis.

#### **1.1.4 There is an Extremely Low "Profit and Cash Dividend Rate" of Business Enterprises**

According to Pi (2010) and Chai (2011), it is commonly seen in listed companies in China that: no distribution is given and investors receive no returns; profit sharing is not given and stock dividend acts as a substitute of return on investment; high profit distribution occurs, which turns the capital of listed companies to the dividend of major shareholders, or; high cash dividend is provided while refinancing with enormous amount is maintained.

### **1.2 Problem in Disclosure of Enterprise Profit Distribution**

#### **1.2.1 There is Undefined Disclosure Limit of Profit Formation and Distribution**

For the definition of profit under Chinese ASBE, profit is essentially the net profit with the interest and income tax deducted. According to the theory of stakeholders, interest should be the benefit sharing of creditors while income tax should be the benefit sharing of the government. It falls in the scope of profit distribution with respect to its nature. An "income distribution view" other than an "expense view" should be maintained. For this reason, profit formation cannot be confused with its distribution. These items of profit distribution are disclosed in the income statement, which leads to an unclear limit. The disclosure should be adjusted.

#### **1.2.2 Much Importance is Attached to the Report of Profit Formation While Less Stress is Attached to the Report of Profit Distribution**

Chinese ASBE keeps the income statement but cancels the enterprise statement of profit distribution and the

consolidated statements of profit distribution with consideration that the statement of change in owner's equity can be a substitute of the statement of profit distribution, which means that much importance is attached to the report of profit formation and of the change in owner's equity while less stress is attached to the report of profit distribution and of profit distribution to other stakeholders. The statement of change in owner's equity only discloses the information with respect to participation in profit sharing of the owner. However, as a major item of corporate management, profit distribution is the profit distribution to all stakeholders other than the owners. It should disclose the information with respect to the information of participation in profit sharing of all stakeholders in details.

### **1.2.3 The Disclosure is Neither True Nor Standard**

Some company management intentionally sugars up the operating conditions to maintain its benefits. They use nonstandard accounting treatment methods willfully in profit distribution and mislead the information users, leading to damages to legitimate interests of other stakeholders.

### **1.2.4 The Disclosure is Not Made on a Sufficient and Timely Basis**

Most business enterprises especially listed enterprises fail to achieve accurate disclosure of the enterprise's distribution information and specific conditions of profit distribution. A detailed description is seldom seen in such as where the enterprise profit comes from or for what purpose the profit to be distributed will be used.

## **2. REASON FOR RESUMPTION OF ENTERPRISE STATEMENT OF PROFIT DISTRIBUTION**

### **2.1 Cancellation of the Statement of Profit Distribution is Insufficiently Demonstrated**

It is shown in the research literature and learning materials under ASBE that cancellation of the statement of profit distribution is provided with insufficient theoretical analysis and feasibility study. Instead, the statement of profit distribution and the consolidated statements of profit distribution are cancelled considering the convergence with the international accounting standards according to the International Accounting Standards 1 – Presentation of Financial Statements. The negative effect of cancellation of the statement of profit distribution is underestimated. The understanding of its importance is insufficient. The participation of factors such as labor, capital, technology and managerial expertise is not fully disclosed. The fact that socialism with Chinese characteristics requests for the people being the masters of the country and taking the road to common prosperity,

which goes against the principles of openness, fairness and impartiality. The “institutional” arrangement and disclosure mechanism where human capital participates in surplus value distribution should be established. On this basis, cancellation of the statement of profit distribution was not prudent enough.

### **2.2 The statement of Change in Owner's (Shareholder's) Equity Should Not Serve As a Substitute of the Statement of Profit Distribution**

The statement of change in owner's (shareholder's) equity reflects the change in current increase or decrease of the owner's equity components. The profit distribution information provided therein is incomplete. It cannot serve as a substitute of the statement of profit distribution as it more discloses the information as required by the owners other than based on the perspective of all stakeholders. Despite the presentation of partial matters with respect to profit distribution, the information presented is far from details of the statement of profit distribution and is the disclosure with much importance attached to the owner's sharing information and less stress on the sharing information of other stakeholders. In addition, the owner's profit distribution is not disclosed in details, such as dividend payable on preferred stock and dividend payable on common stock.

### **2.3 Profit Formation and Distribution Should be Separately Disclosed**

The income statement is only a reflection of profit formation while the statement of profit distribution reflects profit distribution. The report of profit distribution and formation should be equally treated other than overlapped and request for separate disclosure. The term profit under ASBE is essentially the net profit with the interest and income tax deducted. Interest and income tax fall in the scope of profit distribution and should be presented in the statement of profit distribution. Convergence with the international practice should be not made blindly (subject to consistency with international practices). Foreign income statements are copied to reflect EBIT (profit and loss before interest and tax) and net profits. The statement of profit distribution is cancelled without consideration that the fact human capital is excluded from profit sharing in foreign countries may be a way of covering up exploitation by capitalists, which is followed by us. Therefore, we recommend a modification of the definition of profit under ASBE. It is the profit (without interests and income taxes deducted) other than net profit. Resumption and improvement of the enterprise statement of profit distribution place participation of stakeholders in enterprise profit distribution under a “white box” status where participation of the dividend, interest, tax, human capital (labor, technology and managerial expertise) in after-tax profit sharing amount are included in the statement of profit distribution for disclosure.

### 3. IMPROVEMENT OF ENTERPRISE STATEMENT OF PROFIT DISTRIBUTION AND REASONS

#### 3.1 Improved Statement Format of Enterprise Profit Distribution

With the analysis above, the format we believe for an improved statement of profit distribution is shown in Table 1. This format can be directly used as the primary sheet of accounting statements or remain an attached sheet of the income statement.

**Table 1**  
**Statement of Profit Distribution**

Item	Line No.	Current year actual	Prior year actual (omitted)
<b>I Total profit (or referred to as EBIT)</b>	1		
Less: Interest sharing	2		
Income tax sharing	3		
<b>II Net profit</b>	6		
Add: Undistributed profit at the beginning	7		
Other transfer-ins	8		
<b>III Profit to be distributed</b>	11		
Less: Appropriation of statutory surplus reserve	12		
Appropriation of discretionary surplus reserve	13		
Labor factor sharing	14		
Technology factor sharing	15		
Managerial expertise sharing	16		
Or appropriation of employee welfare and bonus fund	17		
Appropriation of reserve fund	18		
Appropriation of enterprise expansion fund	19		
Profit capitalized on return on investment	20		
<b>IV Profit to be distributed to investors</b>	23		
Less: Dividend payable on preferred stock	24		
Dividend payable on common stock	25		
Common stock dividend converted into capital (or share capital)	26		
<b>V Undistributed profit</b>	29		
<b>VI Earnings per share</b>	30		
a) Basic earnings per share	31		
b) Diluted earnings per share	32		

#### 3.2 Reason for Improvement of Enterprise Statement of Profit Distribution

##### 3.2.1 A Clear Disclosure Limit Can be Developed Between Profit Formation and Distribution

Western countries presents the interests and income taxes as the deduction item of profit and loss after calculating EBIT (profit and loss before income and tax) in the profit and loss statement to reflect the net profit and loss, leading to unclear disclosure limit between profit formation and distribution. Chinese income statement is different from that of western countries in terms of the meaning and orders of relevant items. However, disclosure has been provided in the items “financial expense” and “income tax expense” for long periods according to the “interest expense view” and the “income tax expense view”. Considering that the economic interpretation of interest and income tax falls in the scope of distribution of surplus value, we believe that it should be presented in the items “interest sharing” and “income tax sharing” under the statement of profit distribution other than disclosed in the income statement. Accordingly, the accounting item “financial expense” should be cancelled. Overheads including transfer commission should be included in the item “overhead”. A separate “interest sharing” item should be provided to calculate non-capitalized interest expense. The item “income tax expense” should be turned to be the item “income tax sharing”.

##### 3.2.2 It is a Requirement of Implementing the Party’s and the Government’s Income Distribution Policy

Chinese residents’ income has gained an overall increase in recent years. However, the proportion to distribution of national income is reduced. The Party and the Government attach great importance to income distribution. It is highlighted in the Report of the Eighteen National Congress of the Communist Party of China that: “A proper balance should be struck between efficiency and fairness in both primary and secondary distribution, with particular emphasis on fairness in secondary distribution.” “We should set up the principles where factors of production such as labor, capital, technology and managerial expertise are allowed for in participation in distribution according to their respective contribution.” and “we should improve the system of income distribution in which distribution according to work is the main form that coexists with other forms of distribution.” The Communiqué of the Fifth Plenary Session of the 18th CPC Central Committee stresses that: “we should develop a reasonable and orderly pattern of income distribution”, enabling it a consensus that we should allow factors of production such as human capital (labor, technology and managerial expertise)” and non-human capital to have their due share of income according to their respective contribution (it should not be limited to due share of labor reward; instead, it should have due share of surplus value especially of after-tax profit). In other words: It is only human capital and non-human



capital that are allowed to have due share of residual Claim of enterprise that can give full play to all sources of social wealth.” Therefore, human capital and non-human capital should be the subjects with equal access to profit (especially after-tax profit) distribution. We should set up and improve the mechanism and procedure (including arrangement with respect to legal system) to allow human capital (labor, technology and managerial expertise) to have due share of after-tax distribution. We should apply it in enterprise practice and put it to the test of practice while emancipating our minds. Resumption of enterprise statement of profit distribution will better disclose the conditions with respect to profit distribution. Improvement of enterprise statement of profit distribution is to better improve the disclosure of participation of human capital in enterprise profit distribution. Participation of stakeholders in enterprise profit distribution is placed under a “white box” status for analysis of and study on the fact whether the contribution of factor matches actual condition of its participation in distribution. This is not only the requirement of implementing the Party’s and the Government’s income distribution policy but also the demand of disclosing the participation of factors of production in enterprise income distribution and also better suits to the full disclosure principle to achieve openness, fairness and impartiality.

### 3.2.3 Profit Distribution Procedure is Further Optimized

Net profit (or known as “net profit and loss”) can be obtained by subtracting share of interest and income tax with total profits of the enterprise realized in current period. The profit to be distributed is the sum of net profit and undistributed profit at the prior year beginning (or unrecovered loss at conclusion of prior year) and the balance of other transfer-ins. Current profit to be distributed of the enterprise can be distributed in the following order:

- Loss from confiscated property, payment of tax delay charge and fine;
- Recovery of after-tax loss of enterprise in prior years;
- Appropriation of statutory surplus reserve in a proportion of 10% of after-tax profit;
- Appropriation of discretionary surplus reserve according to the resolution of the general meeting;
- For general enterprise, presentation of share of factors such as labor, technology and managerial expertise in the principle that factors of production have due share of distribution according to their respective contribution;
- For foreign-funded enterprise, presentation of appropriation of employee welfare and bonus fund, reserve fund, enterprise expansion fund and profit capitalized on return on investment;

- Dividends or profits should be distributed to owners. An incorporated company distributes dividends according to the shareholding ratio of shareholders, including dividend (interest) payable on preferred stock and dividend (bonus) payable on common stock. A limited liability company and an enterprise of other categories distribute profits to shareholders or the owners according to their respective ratio of contributions.

Undistributed profit (or unrecovered loss) of the enterprise is thus generated by such distribution. Undistributed profit may be held for distribution in subsequent years.

### 3.2.4 Other Statements Should be Properly Adjusted

In addition, the cash flow statement should add “cash payable on share of labor, technology and managerial expertise factors” under “cash flow from operating activities” or “cash payable on share of labor, technology and managerial expertise factors” should be combined with the cash payable to and for employee for presentation; the statement of change in owner’s (shareholder’s) equity should accordingly add an item “share of labor, technology and managerial expertise factors” under “profit distribution”; the earnings per share should be transferred from the income statement to the statement of profit distribution for disclosure. Relevant items under the consolidated statements of profit distribution should also be adjusted.

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## CONCLUSION

Profit distribution with openness is subject to detailed disclosure of the process and the result of participation of stakeholders in profit distribution. Fair profit with fairness is to allow both human capital and non-human factor to have due access to profit distribution in terms of qualification and opportunity. Profit distribution with impartiality is to realize that the contribution of factors of production matches with the results of its participation in distribution. This is not only the requirement of socialist market economy but also the goal a majority of stakeholders pursue. Resumption and improvement of enterprise statement of profit distribution that realizes demonstration of both the process and the result of profit distribution on an open, fair, impartial, clear and detailed basis are of strong theoretical significance and practical value.

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