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ABSTRACT

The selection and weighting of performance indicators are of vital importance for an effective compensation contract. We examine the effect of the reclassification of income statement items, caused by China's new Accounting Standards for Business Enterprises (ASBE) in 2007 on the weight adjustment of compensation performance indicators. The results show that the sensitivity of executive pay and investment income increases significantly after ASBE moves investment income in the income statement from below-the-line of operating income to above-the-line, which indicates that the disclosure position of income statement items is directly related to the weight of compensation performance indicators. We also find that the earnings persistence of investment income increases significantly after ASBE, which implies that the reclassification of investment income conforms to business practice and also performs well. However, the increased sensitivity of executive pay and investment income may induce management's opportunistic investment in financial assets.

1. Introduction

Executive compensation contracts play a crucial role in modern firms to align the interests of shareholders to those of management and thus to solve the agency problem (Jensen & Meckling, 1976; Jensen & Murphy, 1990). However, information asymmetry makes it either impossible or excessively costly for shareholders to obtain the complete information of management's efforts. Therefore, performance-based compensation contracts which link executive compensation to firm performance become a suboptimal solution (Holmstrom, 1979). In executive compensation contracts, performance indicators not only convey corporate business objectives (Angelis & Grinstein, 2015; Balsam et al., 2011), but also affect management's behaviour (Huang et al., 2014; Marquardt & Wiedman, 2005; Young & Yang, 2011). Hence, the key to an ideal compensation contract lies in proper selection and weighting of performance indicators. Specifically, performance indicators with high information content should be included, and a corresponding weight should be given according to their sensitivity to management's efforts (Bushman et al., 1996; Holmstrom & Milgrom, 1991). For example, as an aggregate item in the income statement, operating

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income reflects corporate recurring production and operation outcome directly related to management's efforts (Lu & Jiang, 2012). And that is why operating income is often included and given a high weight in executive compensation contracts (Holmstrom & Milgrom, 1991).

However, with the continuous change of economic environment, the economic connotation of performance indicators is constantly evolving. At the early stage of China's capital market, corporate production and operation activities were relatively simple. Internal physical investment was the main operation model of firms. Only a small amount of external equity investment was made for short-term financing purposes. In this case, the resulting investment income could not reflect corporate recurring operation results and thus was excluded from operating income. However, with the development of a market economy, listed firms are becoming increasingly diversified. More and more listed firms make long-term equity investment to expand their business and obtain capital gain, therefore investment income is increasingly not distinct from core operating income in nature. Taking *Huaqiaocheng-A* (000069), a cultural tourism and real estate firm, as an example, it made a net profit of 580.88 million RMB in 2006, of which its major subsidiary, *Beijing Overseas Chinese Town* (29.28% stake), made 137.19 million RMB, accounting for about 20%. As a comparison, *Huaqiaocheng-A* directly acquired investment income of 297.05 million RMB from its joint-operated company *Overseas Chinese Town Real Estate* (40% stake) in 2006, which exceeded 50% of its total net profit of that year. However, under China's old ASBE before 2007, the net profit from subsidiaries could be classified as consolidated operating income, while the investment income from joint-operated companies could not be classified as consolidated operating income, which was obviously contrary to the firm's actual strategies. Furthermore, *Huaqiaocheng-A* could use the proportional consolidation method to incorporate its joint ventures, *Shenzhen World Window* and *Jinxiu Zhonghua* (49% stake for both), into its consolidated statements before 2007, but the *ASBE No. 33-Consolidated Financial Statements (2006)* specifies in its guidance that a proportional consolidation method is replaced by an equity method when listed firms incorporate joint ventures into their consolidated statements. In such conditions, the income statement could not reflect firm operation results properly if investment income were not reclassified accordingly.

Based on such background, one of the important changes in China's new ASBE in 2007 is reclassifying items in the income statement, and moving investment income from below the line of operating income to above the line. Operating income is the most important and stable profit for firms as it is obtained in recurring production and operation activities. Only if operating income truly reflects management's efforts is it viewed as an effective indicator in an executive compensation contract. The reason why investment income is not included in operating income under old ASBE is that the value driver behind investment income is quite different from that behind traditional operating income. Investment income is less persistent. As business practice changes, external equity investment has gradually become an important way for firms to expand, diversify and transform strategically. After the reclassification of income statement items, all of the equity investment income for business strategies except for short-term spreads is regarded as operating income, which not only conforms to the asset-liability view, but also embodies the substance-over-form principle. If the reclassification of income statement items really reflects the actual demand, we can predict that the rational board of

directors will increase the weight of investment income in a compensation contract. Even if the board of directors fails to know the underlying cause of the reclassification of income statement items, the natural dependence on operating income may lead to the weight adjustment of performance indicators in the compensation contract.

We construct a sample of listed firms in China from 2001 to 2017. We find that the sensitivity of executive compensation and investment income increases significantly after 2007, suggesting that firms adjust the weight of compensation performance indicators in response to the reclassification of income statement items in the new ASBE. Further tests show that this relationship is more pronounced in firms with higher accounting sensitivity and in private firms. If the new ASBE does meet the actual demand and affects the design of a compensation contract, management would exert more efforts in external investment activities and improve the quality of investment income. In this way, the difference between the value relevance of investment income and that of traditional operating income would be reduced. Consistent with our prediction, the persistence of investment income is significantly improved. More specifically, the persistence of investment income is significantly lower than that of traditional operating income before 2007, but the difference between them becomes statistically insignificant after 2007. The above evidence indicates that the weight adjustment of compensation performance indicators is a proper response to the changes in value driver of profits.

We conduct a further test to explore how the weight adjustment of compensation performance indicators affects management's behaviour. As the sensitivity of executive compensation and investment income increases, management has to pay more attention to investment forms. By investment objectives, investment can be divided into long-term equity investment and financial asset investment, in which the former aims at controlling or significantly impacting with a longer holding period and higher holding cost, while the latter aims to obtain short-term profits with a shorter holding period and lower holding cost. Therefore, self-interested management may invest more in financial assets to obtain higher pay. Consistent with the prediction, we find that financial asset investment increases significantly after 2007. We also find that financial asset investment has a limited effect on firm value, which may indicate that the management's investment in financial assets is not for the purpose of improving firm value, but more for compensation manipulation.

This article makes three major contributions. First, ASBE is of great significance in standardising corporate accounting and management practice and in improving the effectiveness of the capital market. Therefore, the economic consequence of changes in accounting standards has been a typical topic in accounting and corporate governance research. For example, Lou et al. (2010) find that the new ASBE decreases the explanatory power of accounting earnings to cash dividends. Zhang et al. (2013) find that fair value gain/loss has no significant explanatory power to executive compensation. Jia and Zhang (2016) find that the sensitivity of net profit and executive compensation decreases while the sensitivity of net asset and executive compensation increases significantly after the new ASBE change from an income-expense view to an asset-liability view. The above research mainly focuses on the economic consequences of changes in the information content of financial statements, while this article examines the impact of changes in the disclosure format of financial statements. We also complement the work of Luo et al.

(2018), which examines how investors react to a reclassification of income statement items.

Second, proper accounting information disclosure of listed firms is the basis on which the capital market can operate in an orderly and efficient manner. In recent years, many more scholars have paid attention to the impact of the corporate disclosure format. For example, Hirst and Hopkins (1998), Maines and McDaniel (2000), and Lee et al. (2006) focus on the different effect of income statement disclosure and equity statement disclosure. Riedl and Srinivasan (2010) and Chen and Schoderbek (2000) examine the different effects of statement disclosure and notes disclosure. And Luo et al. (2018) examine the effect of the reclassification of investment income. Unlike the above studies, which focus on how investors react to changes in disclosure format, we study the reaction of insiders, the board of directors, especially when making compensation contracts. Our results indicate that changes in the information disclosure format will alter corporate governance practice, which has important implications for regulators.

Lastly, this paper finds that a weight adjustment of performance indicators leads to management's opportunistic behaviour, which reminds shareholders and the board of directors to pay close attention to the economic essence of performance indicators and to be vigilant regarding management's compensation manipulation. In addition, our research indicates that accounting standards will alter management's decision-making, which has implications for policymakers when making and evaluating regulations.

The remainder of the paper proceeds as follows. Section 2 reviews the literature and develops the hypotheses. Section 3 describes our sample and research design. Sections 4, 5 and 6 report the empirical results, and Section 7 concludes.

2. Literature review and research hypotheses

2.1. Accounting information and executive compensation contracts

A firm is a nexus of contracts. Accounting information, as a comprehensive reflection of operating results and financial conditions, plays an important role in the formulation, implementation and supervision of contracts (Jensen & Meckling, 1976; Watts & Zimmerman, 1986). The contractual usefulness of accounting information has always been a classic topic in financial accounting, corporate governance and capital market research (Jensen & Murphy, 1990; Lu et al., 2008; Sun et al., 2006). Among all corporate contracts, the executive compensation contract is the main governance mechanism to align the goal of shareholders and management and reduce the principal–agent cost. However, the information asymmetry makes it either impossible or excessively costly for shareholders to observe management's efforts. Therefore, corporate performance is used as a signal to convey the information about management's efforts in executive compensation contracts (Du & Wang, 2007; Fang, 2009; Holmstrom, 1979; Murphy, 1985; Sloan, 1993). Corporate performance indicators with a high signal-to-noise ratio are often selected in compensation contracts so that they can convey more information with lower noise (Banker & Datar, 1989). Therefore, the ideal compensation contract has to strike a balance between relevance and reliability when choosing and weighting performance indicators.

Accounting information is reliable, accurate and comparable, and is most widely used in executive compensation contracts (Angelis & Grinstein, 2015; Li et al., 2013). Since accounting information is relatively less noisy, whether or not to select an accounting performance indicator depends on how much information it delivers. Earlier studies find that net profit is an aggregate indicator with high information content (Ball & Brown, 1968; Beaver, 1968) and is most commonly used in executive compensation contracts (Li et al., 2013). However, later studies state that it is not enough to focus only on the aggregate earnings. Each component of earnings contains a different piece of information, and the sum of components provides incremental information than the aggregate earnings (Fairfield et al., 1996; Lipe, 1986; Ohlson & Penman, 1992; Strong & Walker, 1993). In practice, firms often use a variety of accounting indicators. Li et al. (2013) collected 228 compensation contracts in China from 2004 to 2010, and found that each compensation contract contains 4.5 performance indicators, among which the most commonly used accounting indicators are profit, operating income, ROE, etc. The statistics of firms in the UK and US also suggest that earnings indicators are most frequently used, such as EPS, net profit, operating income, etc. (Angelis & Grinstein, 2015; Conyon et al., 2000; Ittner et al., 1997).

Furthermore, performance indicators are given weight according to their sensitivity to executive behaviour, which is usually measured by pay–performance sensitivity in empirical research. The existing studies basically find that there is a significant positive correlation between executive compensation and corporate performance (Leone et al., 2006; Murphy, 1985). And the pay–performance sensitivity gradually increases as China's executive compensation contracts become more market-oriented. For example, Fang (2009) finds that there is a significant positive correlation between executive compensation and net profit, and that executive compensation is asymmetrically sticky. Wan (2014) further finds that the stickiness between executive compensation and operating income is weak, whereas the stickiness between executive compensation and non-operating income is strong. Zou et al. (2010) find that after fair value is introduced into the new ASBE, the pay of CFOs, other than that of CEOs and chairmen, is correlated with fair value gain/loss.

To sum up, performance indicators are selected and given weight based on the extent that they reflect management's efforts. In particular, operating income is one of the most important indicators in compensation contracts since it is generated from firms' regular production and operation (Lu & Jiang, 2012; Murphy, 2001). On the contrary, the non-operating income is given less weight as it is greatly affected by an external environment and contingency factors.

2.2. Accounting standards changes and accounting information function

Valuation and contracting, which are two basic functions of accounting information, require different information quality. These two functions are revolutionarily impacted by China's new ASBE in 2007, which converges to IFRS (International Financial Reporting Standards). In terms of valuation function, Zhu et al. (2009) find that the introduction of fair value in the new ASBE does not improve the value relevance of accounting earnings. Zhang et al. (2013) also find that fair value gain/loss has no explanatory power to stock returns. Lu and Zhang (2009) find that after the new ASBE, the difference between the net profit of consolidated statements and parent company statements can provide additional

information beyond that of consolidated statements only. Bu and Ye (2009) find that the value relevance of asset impairment improves after the new ASBE.

In terms of the contractual function, on the one hand, the new ASBE reduces the space of earnings management and improves the reliability of accounting information. On the other hand, its introduction of fair value may weaken the contractual usefulness of accounting information (Chen, 2014). Yuan et al. (2013) find that when the new ASBE shifts focus from contractual function to valuation function, accounting earnings are less reliable and thus poorly explain the obtaining of bank loans. Chen (2014) finds that since the new ASBE makes accounting information less reliable, accounting performance indicators are partly replaced by market performance indicators in compensation contracts. On the contrary, Luo and Pang (2014) find that the new ASBE improves the quality of accounting information and increases the sensitivity of executive pay and accounting performance. Jia and Zhang (2016) find that with the new ASBE shifts from the income-expense view to the asset-liability view, the sensitivity of net profit and compensation decreases significantly, while the sensitivity of net assets and compensation increases significantly. Zhang et al. (2013) find that the adjusted fair value gain/loss has no explanatory power on executive compensation.

In addition, the new ASBE also revises the way financial statements report, such as the repositioning of investment income, minority shareholders' equity and minority shareholders' gain/loss. Previous studies demonstrated that the repositioning of accounting items may affect their valuation function. For example, Zhang and Zhang (2008) find that the repositioning of minority shareholders' equity and minority shareholders' gain/loss makes consolidated financial statements more informational. Bartov and Mohanram (2014) find that gain/loss from early debt extinguishments is taken into account by investors after it is moved from below to above the line. Luo et al. (2018) find that investment income is used for earnings management after it is moved from below to above the line, but investors can't see through it. In spite of considerable evidence about how format changes in financial statements affect their valuation function, the impact of format changes in financial statements on their contractual function remains to be studied.

2.3. Hypothesis development

In 2006, *the ASBE No. 30 – Presentation of Financial Statements* issued by the Ministry of Finance of People's Republic of China revised the presentation format of the income statement. First, the new ASBE no longer distinguishes between the primary operating income and non-primary operating income, but combines them as 'operating income'. The underlying reason is that as firms are constantly expanding and increasingly diversifying, the boundary between primary operating income and non-primary operating income is gradually blurring. Second, the fair value gain/loss is added, and the investment income is moved from below the line of operating income to above it. Since external equity investment is becoming a regular way for firms to expand, part of capital income is recognised as operating income in line with the asset-liability view. Finally, the earnings per share is added to help investors and other information users to evaluate firms' profitability and growth potential. This article focuses on whether insiders, the board of directors, adjust the weight of compensation performance indicators when income

statement items are reclassified. As fair value gain/loss is not available in the pre-regulation period, we consider investment income which is both available before and after the new ASBE.

After the reclassification of income statement items, the board of directors may adjust the weight of compensation performance indicators actively or passively. On the one hand, the board of directors is not only familiar with business practice, but also has a keen insight into the policy intention. The board of directors may realise that investment income is becoming an important part of operating income and conveys more incremental information about management's efforts. Therefore, it will increase the weight of investment income in the compensation contract. On the other hand, even if the board of directors is not aware of the motivation of reclassifying investment income, it may also increase the weight of investment income due to the functional fixation to operating income. We expect that the weight given to income investment is significantly increased after the new ASBE. The hypothesis is proposed as follows:

H1. Ceteris paribus, the sensitivity of executive compensation and investment income significantly increases after the implementation of the new ASBE in 2007.

3. Research design

3.1. Model specification

Following prior literature (Fang, 2009; Leone et al., 2006), this article uses the change model to test the sensitivity of ΔPAY and $\Delta PERFORMANCE$. The specific model is as follows:

$$
\begin{aligned}
PAY\_CH_t = {} & \alpha + \beta_1 \times SALE_t + \beta_2 \times SALE^2{}_t + \beta_3 \times LEV_t + \beta_4 \times BM_t + \beta_5 \times BH_t + \beta_6 \\
& \times PRIVATE_t + \beta_7 \times AGE_t + \beta_8 \times MINDEX_t + \beta_9 \times RETURN_t + \beta_{10} \\
& \times CORE\_CH_t + \beta_{11} \times INVESTINCOME\_CH_t + \beta_{12} \times OTHERINCOME\_CH_t \\
& + \beta_{13} \times POST2007_t + \beta_{14} \times RETURN_t \times POST2007_t + \beta_{15} \times CORE\_CH_t \\
& \times POST2007_t + \beta_{16} \times INVESTINCOME\_CH_t \times POST2007_t + \beta_{17} \\
& \times OTHERINCOMR\_CH_t \times POST2007_t + \gamma + \eta + \varepsilon
\end{aligned}
\tag{1}
$$

where *PAY* is executive compensation, defined as the natural logarithm of the mean value of 'total compensation of top three executives' disclosed in annual reports. *PERFORMANCE* refers to corporate performance and is divided into three components that are core income (*CORE*), investment income (*INVESTINCOME*) and other income (*OTHERINCOME*), respectively. *INVESTINCOME* was presented below operating income before 2007, but above operating income after 2007. *CORE* refers to operating income prior to 2007 and operating income excluding investment income and fair value gain/loss after 2007. *OTHERINCOME* is derived from total profit less core income and investment income. All of the performance indicators are standardised by total assets. In particular, the above variables are suffixed with '_CH' in the change model, indicating the difference between the current value and the previous value. In addition, the model includes the capital market performance (*RETURN*), which is the annual stock return.

Table 1. Variable definition.

Variable	Definition
PAY	The logarithm of mean value of total compensation of top three executives
CORE	Current core income divided by total assets
INVESTINCOME	Current investment income divided by total assets
OTHERINCOME	Current other income divided by total assets
POST2007	A dummy variable that equals to 1 in 2007 and beyond, otherwise 0
SIZE	The logarithm of total assets
SALE	The logarithm of operating income
SALE^2	The square of logarithm of operating income
LEV	Current liabilities divided by total assets
ROA	Net profit divided by total assets
OCF	Operating cash flow divided by total assets
BM	Book value divided by market value
BH	A dummy variable equals to 1 if a firm issue A and B share simultaneously or A and H share simultaneously, otherwise 0
ATURN	Total asset turnover
PRIVATE	A dummy variable that equals to 1 for private firms, otherwise 0
OWNERSHIP	Largest shareholder ownership
AGE	The logarithm of firm age
MINDEX	Regional marketisation index – Wang et al. (2017)
RETURN	Annual stock return
FIN_ASSET	Financial assets investment divided by total assets
GDP	The logarithm of GDP
M2	Broad money supply

We control financial characteristics, equity characteristics, market environment and other firm characteristics. Definitions of control variables are presented in Table 1. We also control for the year fixed effect (γ) and the industry fixed effect (η). *POST2007* is a dummy variable which equals 1 in the post-2007 period, otherwise 0. Our primary variable of interest is the interactive term of *INVESTINCOME_CH$_t$* and *POST*2007$_t$. We expect its coefficient to be significantly positive, which indicates that the sensitivity of executive compensation and investment income is significantly increased after 2007.

3.2. Data source and descriptive statistics

We collected listed firms in A-share, B-share and the growth-enterprise market from 2001 to 2017 whose stock return and financial data are obtained from CSMAR (China Stock Market & Accounting Research) databases. After excluding financial firms and observations with missing values, our final sample consists of 26,705 firm-year observations. All continuous variables are winsorised at 1% and 99%.

Table 2 provides descriptive statistics of variables. The mean (median) value of *PAY* is 0.125 (0.068) with the standard deviation 0.409, which indicates a highly-dispersed and right-skewed distribution of executive compensation. The mean value of *POST2007* is 0.761, indicating that there are more observations in post-2007 period. The mean (median) value of *RETURN* is 0.057 (−0.031), and the standard deviation is 0.503, which indicates that stock return is highly heterogeneous and right-skewed. In addition, the skewness of *CORE, INVESTINCOME* and *OTHERINCOME* is relatively low since they are change variables. Table 3 tabulates the correlation matrix of the variables. *CORE, INVESTINCOME* and *OTHERINCOME* are significantly positively correlated. The coefficients on all performance indicators and *PAY* are significantly positive, indicating that there is significant sensitivity of executive compensation and each component of corporate performance.

Table 2. Descriptive statistics.

Variable	N	Mean	SD	P25	P50	P75
PAY_CH	26,705	0.125	0.409	−0.026	0.068	0.253
POST2007	26,705	0.761	0.426	1	1	1
SALE	26,705	21.080	1.531	20.140	21.030	21.970
LEV	26,705	0.074	0.102	0	0.026	0.112
BM	26,705	0.439	0.473	0.212	0.354	0.559
BH	26,705	0.089	0.285	0	0	0
PRIVATE	26,705	0.474	0.499	0	0	1
AGE	26,705	2.208	0.593	1.792	2.303	2.708
MINDEX	26,705	0.710	0.294	0.556	0.778	1
RETURN	26,705	0.057	0.503	−0.217	−0.031	0.221
CORE_CH	26,705	0.006	0.059	−0.014	0.004	0.021
INVESTINCOME_CH	26,705	0.001	0.019	−0.001	0	0.003
OTHERINCOME_CH	26,705	0.002	0.034	−0.003	0.001	0.006

4. Main empirical results

4.1. Baseline empirical results

Table 4 reports the baseline regression results. Column 1 shows that the coefficients on *RETURN* and *CORE_CH* are significantly positive at the 1% level, while the coefficients on *INVESTINCOME_CH* and *OTHERINCOME_CH* are not significant. In columns 2 and 3 we present the results of subsamples of pre- and post-2007 periods respectively. It turns out that the coefficient on *INVESTINCOME_CH* is negative and not significant before 2007, and significantly positive at the 1% level after 2007. In column 4, we add the interaction variables between *POST2007$_t$* and each performance indicator to differ between pre- and post-2007 periods. We find that while the coefficients on *CORE_CH$_t$* *POST2007$_t$*, *OTHERINCOME_CH$_t$*POST2007$_t$* and *RETURN$_t$*POST2007$_t$* are insignificant or significantly negative, the coefficient on *INVESTINCOME_CH$_t$*POST2007$_t$* is significantly positive. In column 5, we use a consistent sample that only contains firms listed before 2000, and we find that the sensitivity of executive compensation and market performance, core income and other income has no difference between the pre- and post-2007 periods, while the sensitivity of compensation and investment income significantly improves, which is consistent with our prediction. Other income is treated as a comparison since it is below the line in both the pre- and post-2007 periods. It is noted that there is no significant correlation between *OTHERINCOME_CH$_t$* and *PAY_CH$_t$* in columns 1 through 3, and the coefficient on *OTHERINCOME_CH*POST2007* is not statistically significant in columns 4 and 5, which further excludes the possible explanation that our findings are the result of changes in the economic environment.

Among control variables, the coefficient on *SALE^2* is significantly negative, and the coefficient on *SALE* is significantly positive, which indicates that there is an inverted U-shaped relationship between firm size and executive compensation. The coefficient on *PRIVATE* is significantly positive, especially after 2007, which reveals that executive compensation in private firms is growing faster than that in state-owned firms given the policy of limiting executive pay in state-owned firms. The coefficient on *BM* is significantly negative, which means that firm growth is significantly positively related to executive compensation growth. The coefficient on *AGE* is significantly positive, indicating that the older the firm is, the faster executive compensation grows.

Table 3. Correlation matrix of variables.

	PAY_CH	POST2007	SALE	LEV	BM	BH	PRIVATE
PAY_CH	1						
POST2007	−0.076*	1					
SALE	−0.006	0.234*	1				
LEV	−0.005	0.039*	0.220*	1			
BM	−0.030*	−0.119*	0.249*	0.162*	1		
BH	−0.004	−0.043*	0.1628*	0.079*	0.272*	1	
PRIVATE	−0.015*	0.176*	−0.2497*	−0.178*	−0.178*	−0.161*	1
AGE	−0.005	0.227*	0.1747*	0.167*	0.044*	0.159*	−0.239*
MINDEX	−0.014*	0.044*	0.084*	−0.110*	0.017*	0.136*	0.124*
RETURN	0.066*	0.148*	0.008	−0.009	−0.166*	−0.014*	0.043*
CORE CH	0.121*	0.005	0.025*	−0.036*	−0.070*	0.003	0.029*
INVESTINCOME_CH	0.020*	0.026*	−0.004	−0.009	−0.021*	0.004	0.007
OTHERINCOME_CH	0.015*	0.039*	−0.013*	−0.015*	−0.026*	0.006	0.009

	AGE	MINDEX	RETURN	CORE_CH	INVESTINCOME_CH	OTHERINCOME_CH
AGE	1					
MINDEX	−0.066*	1				
RETURN	−0.002	0.004	1			
CORE_CH	0.022*	0.004	0.159*	1		
INVESTINCOME_CH	0.019*	0.014*	0.053*	0.131*	1	
OTHERINCOME_CH	0.007	0.008	0.061*	0.112*	0.538*	1

Table 4. Regression of income statement item reclassification on pay-performance-sensitivity.

Variable	(1) PAY_CH_t Full sample	(2) PAY_CH_t Pre-2007 period	(3) PAY_CH_t Post-2007 period	(4) PAY_CH_t Full sample	(5) PAY_CH_t Consistent sample
$SALE_t$	0.160***	0.150*	0.073**	0.156***	0.138***
	(6.251)	(1.921)	(2.481)	(6.090)	(4.024)
$SALE^2{}_t$	−0.004***	−0.003	−0.002**	−0.003***	−0.003***
	(−5.926)	(−1.511)	(−2.295)	(−5.776)	(−3.781)
LEV_t	−0.025	−0.082	0.020	−0.021	−0.021
	(−1.103)	(−1.307)	(0.823)	(−0.954)	(−0.680)
BM_t	−0.018***	−0.001	−0.029***	−0.018***	−0.010*
	(−3.134)	(−0.151)	(−3.780)	(−3.116)	(−1.814)
BH_t	−0.011*	−0.009	−0.018***	−0.010*	−0.011
	(−1.780)	(−0.546)	(−2.811)	(−1.704)	(−1.580)
$PRIVATE_t$	0.022***	−0.016	0.034***	0.021***	0.019***
	(5.476)	(−1.355)	(7.559)	(5.325)	(3.089)
AGE_t	0.020***	0.023*	0.023***	0.020***	0.019
	(6.502)	(1.842)	(6.980)	(6.308)	(1.002)
$MINDEX_t$	−0.022***	−0.017	−0.027***	−0.022***	−0.030***
	(−3.822)	(−1.000)	(−3.910)	(−3.738)	(−3.486)
$RETURN_t$	0.025***	0.037***	0.015**	0.040***	0.037**
	(3.837)	(3.229)	(2.021)	(3.467)	(2.574)
$CORE\_CH_t$	0.775***	0.642***	0.884***	0.663***	0.603***
	(12.830)	(4.708)	(12.819)	(4.874)	(3.960)
$INVESTINCOME\_CH_t$	0.219	−0.510	0.602***	−0.565	−0.625
	(1.099)	(−1.120)	(2.659)	(−1.242)	(−1.270)
$OTHERINCOME\_CH_t$	−0.094	−0.211	−0.164	−0.221	−0.258
	(−0.766)	(−0.744)	(−1.202)	(−0.783)	(−0.856)
$RETURN_t*POST2007_t$				−0.023*	−0.025
				(−1.743)	(−1.269)
$CORE\_CH_t*POST2007_t$				0.225	0.248
				(1.496)	(1.397)
$INVESTINCOME\_CH_t*POST2007_t$				1.156**	1.309**
				(2.288)	(2.291)
$OTHERINCOME\_CH_t*POST2007_t$				0.067	−0.171
				(0.217)	(−0.507)
$CONSTANT$	−1.499***	−1.574*	−0.800**	−1.453***	−1.266***
	(−5.418)	(−1.941)	(−2.515)	(−5.254)	(−3.435)
YEAR	YES	YES	YES	YES	YES
INDUSTRY	YES	YES	YES	YES	YES
adj. R^2	0.042	0.037	0.042	0.042	0.037
Obs	26,705	63,80	20,325	26,705	13,703

*, ** and *** denote significance at the 10%, 5%, and 1% levels, respectively. Robust t-statistics are in parentheses.

4.2. Robustness tests

4.2.1. Firm fixed effect

We introduce the firm fixed effect to model (1) to get rid of the impact of firm heterogeneity. The results are displayed in Table 5 are consistent with Table 4

4.2.2. Partition by investment income

It is concerning that the above findings are caused by the growing proportion of investment income after the basic completion of Non-tradable Shares Reform in 2007, but not the new ASBE as we stated. In that way, our results can only be found in firms with a high proportion of investment income. We partition our sample into two groups via the median value of *INVESTINCOME* in 2001–2006. As tabulated in Table 6, the coefficients on *INVESTINCOME_CH*POST2007* are both significantly positive in two groups, while the

Table 5. Regression of firm fixed effect model.

Variable	(1) PAY_CH_t	(2) PAY_CH_t	(3) PAY_CH_t	(4) PAY_CH_t	(5) PAY_CH_t
	Full sample	Pre-2007 period	Post-2007 period	Full sample	Consistent sample
$RETURN_t$	0.021***	0.033**	0.010	0.038***	0.035**
	(3.101)	(2.466)	(1.236)	(3.176)	(2.280)
$CORE\_CH_t$	0.762***	0.519***	0.848***	0.660***	0.603***
	(12.213)	(3.445)	(12.084)	(4.650)	(3.791)
$INVESTINCOME\_CH_t$	0.235	−0.325	0.637***	−0.521	−0.595
	(1.159)	(−0.664)	(2.760)	(−1.099)	(−1.159)
$OTHERINCOME\_CH_t$	−0.105	−0.135	−0.214	−0.194	−0.240
	(−0.837)	(−0.457)	(−1.540)	(−0.664)	(−0.770)
$RETURN_t*POST2007_t$				−0.026*	−0.027
				(−1.884)	(−1.363)
$CORE\_CH_t*POST2007_t$				0.208	0.245
				(1.324)	(1.337)
$INVESTINCOME\_CH_t*POST2007_t$				1.117**	1.279**
				(2.122)	(2.154)
$OTHERINCOME\_CH_t*POST2007_t$				0.020	−0.198
				(0.064)	(−0.564)
$CONSTANT$	−2.795***	−7.295***	0.266	−2.701***	−2.912***
	(−4.341)	(−2.959)	(0.280)	(−4.185)	(−3.692)
FIRM	YES	YES	YES	YES	YES
YEAR	YES	YES	YES	YES	YES
adj. R^2	0.037	0.030	0.036	0.038	0.038
Obs	26,705	63,80	20,325	26,705	13,703

*, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Robust t-statistics are in parentheses.

Table 6. Subsample regression partitioned by investment income.

Variable	(1) PAY_CH_t	(2) PAY_CH_t
	Low investment income	High investment income
$RETURN_t$	0.048***	0.009
	(2.688)	(0.617)
$CORE\_CH_t$	0.817***	0.540***
	(4.179)	(2.785)
$INVESTINCOME\_CH_t$	−1.085	−0.500
	(−1.141)	(−0.908)
$OTHERINCOME\_CH_t$	0.065	−0.463
	(0.142)	(−1.331)
$RETURN_t*POST2007_t$	−0.026	0.005
	(−1.138)	(0.258)
$CORE\_CH_t*POST2007_t$	0.149	0.235
	(0.657)	(1.067)
$INVESTINCOME\_CH_t*POST2007_t$	1.853*	1.098*
	(1.778)	(1.740)
$OTHERINCOME\_CH_t*POST2007_t$	−0.357	0.330
	(−0.729)	(0.836)
$CONSTANT$	−1.623***	−0.904**
	(−3.556)	(−2.063)
YEAR	YES	YES
INDUSTRY	YES	YES
adj. R^2	0.035	0.020
Obs	9816	10,124

*, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Robust t-statistics are in parentheses.

coefficients on *OTHERINCOME_CH*POST2007* are both insignificant. Hence, it is the new ASBE that improves the sensitivity of executive compensation and investment income.

4.2.3. Dynamic effect test

Following Bertrand and Mullainathan (2003), we conduct a dynamic effect test to eliminate the possible interference of the time trend. Specifically, we replace the dummy variable *POST2007* with six dummy variables: *POST1* equals one for the year of 2007 when new ASBE is put into effect, *POST2* equals one for the year of 2008, *POST3* equals one for the year of 2009 and beyond, and *BEFORE1*, *BEFORE2 and BEFORE3* equal one for the years of 2006, 2005 and 2004, respectively. The results are displayed in Table 7. The coefficients on interactive terms between *INVESTINCOME* and *BEFORE1, BEFORE2, BEFORE3* are not statistically significant, while the coefficients on interactive terms between *INVESTINCOME* and *POST2* and *POST3* is significantly positive, which further excludes the influence of the time trend.

4.2.4. Cross-sectional test

To further reveal the conditions in which the above relationship is more pronounced, we conduct several cross-sectional tests.

First, we examine how firm accounting sensitivity affects the above relationship. If the reclassification of income statement items in new ASBE leads to increased sensitivity of executive compensation and investment income, then firms that are more sensitive to changes in accounting standards are expected to react more. For this reason, we calculate firm accounting sensitivity following Yuan et al. (2013), Jia and Zhang (2016). Specifically, in the annual report of 2007, which is the first year of the new ASBE implementation, listed firms are required to disclose net profit of 2006 adjusted in accordance with the new ASBE. The impact of the new ASBE on firm accounting practice can be derived from the

Table 7. Regression of dynamic effect.

Variable	(1) PAY_CH_t
$INVESTINCOME\_CH_t*BEFORE1_t$	0.621
	(0.792)
$INVESTINCOME\_CH_t*BEFORE2_t$	−0.872
	(−1.038)
$INVESTINCOME\_CH_t*BEFORE3_t$	0.656
	(0.729)
$INVESTINCOME\_CH_t*POST1_t$	0.815
	(1.141)
$INVESTINCOME\_CH_t*POST2_t$	2.055***
	(2.644)
$INVESTINCOME\_CH_t*POST3_t$	1.061**
	(1.965)
CONSTANT	−1.348***
	(−4.367)
YEAR	YES
INDUSTRY	YES
adj. R^2	0.044
Obs	26,705

*, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Robust t-statistics are in parentheses.

change value between the retroactively adjusted net profit of 2006 and the original net profit of 2006 in line with the old ASBE. The calculation is presented as formula (2), where NI_{new} is the net profit calculated according to the new ASBE, and NI_{old} is the net profit calculated according to the old ASBE. The larger the value of *SENSITIVITY*, the greater the accounting sensitivity of the firm. We then partition the samples by the median value of accounting sensitivity. Columns 1 and 2 of Table 8 show that the coefficients on *INVESTINCOME_CH*POST2007* are only significantly positive in the subsample with high accounting sensitivity, and the difference of coefficients between groups is significant.

$$SENSITIVITY = \left| \frac{NI_{new} - NI_{old}}{NI_{old}} \right| \tag{2}$$

Next, China's state-owned firms and private firms differ greatly in the business objectives and agency conflicts. They may be influenced by changes in accounting standards in different way. From the traditional point of view, since state-owned firms bear non-economic goals, the correlation between management compensation and firm performance is relatively low. In addition, with the absence of owners, compensation incentive plans are difficult to conduct efficiently. On the other hand, with the executive compensation reform of state-owned firms, the executive compensation system of state-owned firms has been gradually improved (Xin & Tan, 2009). Besides, excessive executive compensation of state-owned firms has drawn wider public concern and stronger social supervision (Fang, 2009), which may prompt state-owned firms to react more to the

Table 8. Subsample regression partitioned by accounting sensitivity.

Variable	(1) PAY_CH_t	(2) PAY_CH_t	(3) PAY_CH_t	(4) PAY_CH_t
	Low accounting sensitivity	High accounting sensitivity	State-owned firms	Private firms
$RETURN_t$	0.029*	0.028	0.020	0.035
	(1.720)	(1.506)	(1.326)	(1.571)
$CORE\_CH_t$	0.359	0.715***	0.786***	0.321
	(1.416)	(3.691)	(4.084)	(1.305)
$INVESTINCOME\_CH_t$	0.410	−1.665***	−0.277	−1.803**
	(0.475)	(−2.652)	(−0.496)	(−1.974)
$OTHERINCOME\_CH_t$	−0.107	0.226	−0.602	0.804*
	(−0.182)	(0.573)	(−1.335)	(1.719)
$RETURN_t*POST2007_t$	−0.010	−0.019	−0.002	−0.025
	(−0.461)	(−0.848)	(−0.130)	(−0.966)
$CORE\_CH_t*POST2007_t$	0.414	0.040	0.108	0.327
	(1.522)	(0.190)	(0.510)	(1.247)
$INVESTINCOME\_CH_t$ $*POST2007_t$	−0.463	2.405***	0.630	2.344**
	(−0.490)	(3.547)	(0.979)	(2.440)
$OTHERINCOME\_CH_t$ $*POST2007_t$	0.375	−0.468	0.675	−0.925*
	(0.594)	(−1.059)	(1.324)	(−1.830)
$CONSTANT$	−1.429***	−1.149***	−1.113**	−0.792
	(−3.319)	(−2.786)	(−2.510)	(−1.361)
$YEAR$	YES	YES	YES	YES
$INDUSTRY$	YES	YES	YES	YES
adj. R^2	0.017	0.028	0.027	0.020
Obs	10,280	10,905	13,040	8145
Difference		2.868**		1.714
		(6.11)		(1.90)

*, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Robust t-statistics are in parentheses.

new ASBE. Therefore, we do not make specific prediction on the results. As columns 3 and 4 of Table 8 show, the coefficient on $INVESTINCOME\_CH* POST2007$ is only significantly positive in the subsample of private firms, but the difference of coefficients between groups is not significant.

5. Additional tests: is the weight adjustment of compensation performance indicators effective?

The above results show that the sensitivity of executive compensation and investment income increases significantly after the implementation of the new ASBE in 2007. The next question is: is the weight adjustment of compensation performance indicators effective? If it is effective, then investment income is supposed to be more persistent after 2007. Based on this, we test the relationship between investment income and future accounting performance and also future operating cash flow.

Table 9 presents the relationship between all performance indicators and firm future performance. In the full sample displayed in column 1, $RETURN_t$, $CORE_t$ and $INVESTINCOME_t$ have a significant positive effect on firm future performance. Next, we present the results of subsamples of the pre- and post-2007 periods in columns 2 and 3, respectively. We find that the coefficients on $RETURN_t$ and $CORE_t$ are both significant in columns 2 and 3, while the coefficient on $INVESTINCOME_t$ is not significant before 2007 and is significantly positive after 2007. We further introduce interactive terms between all performance indicators and the $POST2007$ dummy in column 4. The coefficient on $CORE_t*POST2007_t$ is significantly negative and the coefficient on $INVESTINCOME_t*POST2007_t$ is significantly positive. The above results indicate that core income is less powerful in explaining future firm performance, whereas investment income is more powerful in explaining future firm performance after 2007.

Table 10 shows the impact of all performance indicator on firm future cash flow. In the full sample displayed in column 1, the coefficients on $RETURN_t$ and $CORE_t$ are significantly positive, while the coefficients on $INVESTINCOME_t$ and $OTHERINCOME_t$ are significantly negative. Subsample results presented in columns 2 and 3 show that, although the coefficients on $INVESTINCOME_t$ are both negative, the one after 2007 is, to some extent, larger. To further reveal the effect of the new ASBE, we introduce interactive terms between all performance indicators and the $POST2007$ dummy in column 4. It is found that the coefficient on $INVESTINCOME_t*POST2007_t$ is significantly positive, indicating that investment income is more powerful in explaining future cash flow.

In summary, the earning persistence of investment earnings improves significantly after 2007, indicating that the weight adjustment of compensation performance indicators is in line with the economic essence and market demand.

6. Additional tests: is management opportunistic?

6.1. Compensation incentives and corporate investment

Does the increased sensitivity of executive compensation and investment income lead to management's opportunistic behaviour, that is, to raising compensation by increasing investment income? Investment income comes mainly from financial assets investment

Table 9. Regression of investment income and future performance.

Variable	(1) ROA_{t+1}	(2) ROA_{t+1}	(3) ROA_{t+1}	(4) ROA_{t+1}
	Full sample	Pre-2007 period	Post-2007 period	Full sample
$SIZE_t$	−0.001	−0.002	−0.000	−0.001*
	(−1.465)	(−1.573)	(−0.405)	(−1.778)
LEV_t	−0.006*	−0.001	−0.005	−0.005
	(−1.770)	(−0.109)	(−1.243)	(−1.389)
$ATURN_t$	0.006***	0.007***	0.005***	0.006***
	(5.067)	(2.954)	(3.967)	(4.628)
OCF_t	0.089***	0.096***	0.082***	0.087***
	(11.788)	(6.651)	(9.293)	(11.536)
BH_t	0.001	−0.004	0.003	0.001
	(0.352)	(−1.212)	(1.506)	(0.477)
$PRIVATE_t$	0.000	−0.007***	0.003***	0.000
	(0.316)	(−3.423)	(2.997)	(0.336)
$OWNERSHIP_t$	0.014***	0.020***	0.010***	0.014***
	(4.596)	(3.624)	(2.976)	(4.690)
$MINDEX_t$	0.009***	0.013***	0.007***	0.009***
	(5.428)	(4.517)	(3.476)	(5.570)
$RETURN_t$	0.013***	0.011***	0.014***	0.012***
	(11.788)	(6.677)	(10.187)	(6.907)
$CORE_t$	0.390***	0.424***	0.378***	0.446***
	(37.145)	(21.968)	(28.231)	(26.953)
$INVESTINCOME_t$	0.267***	−0.020	0.375***	−0.045
	(6.076)	(−0.228)	(6.751)	(−0.531)
$OTHERINCOME_t$	0.055	−0.020	−0.009	−0.018
	(1.553)	(−0.233)	(−0.217)	(−0.214)
$RETURN_t*POST2007_t$				0.002
				(1.038)
$CORE_t*POST2007_t$				−0.068***
				(−3.491)
$INVESTINCOME_t*POST2007_t$				0.417***
				(4.156)
$OTHERINCOME_t*POST2007_t$				0.020
				(0.210)
$CONSTANT$	−0.003	0.008	0.012	0.000
	(−0.290)	(0.379)	(0.981)	(0.029)
YEAR	YES	YES	YES	YES
INDUSTRY	YES	YES	YES	YES
adj. R^2	0.283	0.288	0.284	0.285
Obs	20,790	6234	14,556	20,790

*, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Robust t-statistics are in parentheses.

and long-term equity investment. Financial assets investment is an indirect investment to obtain value-added income, which is relatively easier to implement. And long-term equity investment is considered as a direct investment to obtain production and operation profits, of which the implementation cost is relatively higher. Our first step is to examine whether management prefers to invest in financial assets to increase investment income. Specifically, financial assets investment is derived from the sum of trading financial assets, available-for-sale financial assets and held-to-maturity financial assets, and long-term equity investment equals the long-term equity investment in the parent company balance sheet. The above two variables are both normalised by firm total assets.

Panel A of Table 11 show how the implementation of the new ASBE affects firm financial assets investment. It is shown that the coefficients on $INVESTINCOME_t$ are significantly positive, which means that the current investment income will promote

Table 10. Regression of investment income and future cash flow.

Variable	(1)	(2)	(3)	(4)
	OCF_{t+1}	OCF_{t+1}	OCF_{t+1}	OCF_{t+1}
	Full sample	Pre-2007 period	Post-2007 period	Full sample
$SIZE_t$	0.002***	0.003**	0.002***	0.002**
	(2.629)	(2.122)	(2.828)	(2.387)
LEV_t	−0.006*	0.014**	−0.012***	−0.005
	(−1.712)	(2.341)	(−3.310)	(−1.507)
$ATURN_t$	0.005***	0.001	0.007***	0.005***
	(3.188)	(0.388)	(3.608)	(3.118)
OCF_t	0.240***	0.159***	0.266***	0.237***
	(20.967)	(7.417)	(20.594)	(20.684)
BH_t	0.004*	0.007**	0.003	0.004*
	(1.786)	(2.061)	(1.166)	(1.832)
$PRIVATE_t$	0.001	−0.001	0.001	0.000
	(0.576)	(−0.381)	(0.373)	(0.229)
$OWNERSHIP_t$	0.008*	0.015**	0.005	0.007*
	(1.911)	(2.426)	(1.087)	(1.886)
$MINDEX_t$	0.008***	0.007**	0.008***	0.008***
	(3.435)	(2.089)	(3.151)	(3.603)
$RETURN_t$	0.005***	0.006***	0.006***	0.005***
	(4.427)	(3.108)	(3.627)	(3.066)
$CORE_t$	0.136***	0.166***	0.136***	0.116***
	(10.838)	(7.635)	(8.913)	(6.654)
$INVESTINCOME_t$	−0.251***	−0.545***	−0.178***	−0.472***
	(−5.951)	(−7.470)	(−3.310)	(−6.693)
$OTHERINCOME_t$	−0.079**	−0.225***	−0.088**	−0.240***
	(−2.419)	(−3.225)	(−2.182)	(−3.456)
$RETURN_t*POST2007_t$				0.000
				(0.206)
$CORE_t*POST2007_t$				0.043**
				(2.227)
$INVESTINCOME_t*POST2007_t$				0.292***
				(3.371)
$OTHERINCOME_t*POST2007_t$				0.161**
				(2.040)
$CONSTANT$	−0.010	−0.049*	−0.022	−0.005
	(−0.756)	(−1.811)	(−1.477)	(−0.345)
YEAR	YES	YES	YES	YES
INDUSTRY	YES	YES	YES	YES
adj. R^2	0.182	0.137	0.206	0.183
Obs	20,790	6234	14,556	20,790

*, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Robust t-statistics are in parentheses.

the financial asset investment in the next year. The most interesting variable is *POST_2007* in column 4, which is significantly positive, indicating that management invests more in financial asset after 2007. However, the coefficient on the interactive term $INVESTINCOME_t$ *POST_2007 is not significant, indicating that the impact of investment income on future financial asset investment does not change significantly. Columns 1 and 2 also show that core income is negatively related to future financial asset investment, indicating that the higher the core income, the less the firm will invest in financial assets in the future. However, this relationship disappears after 2007, as shown in column 3.

Panel B shows that investment income and future long-term equity investment are significantly positively correlated, indicating that investment income will encourage management to carry out long-term equity investment in the future. However, column 4 shows that *POST_2007* is significantly negative, indicating that long-term equity

Table 11. Regression of new accounting standards implementation on corporate investment.

Panel A Whether to increase financial assets investment

Variable	(1) Full sample	(2) Pre-2007 period	(3) Post-2007 period	(4) Full sample
	FIN_ASSET_{t+1}	FIN_ASSET_{t+1}	FIN_ASSET_{t+1}	FIN_ASSET_{t+1}
$SIZE_t$	1.936***	1.755***	1.918***	2.163***
	(20.916)	(9.784)	(18.646)	(24.636)
LEV_t	−1.495***	−2.556***	−1.218**	−2.322***
	(−3.152)	(−3.354)	(−2.205)	(−4.931)
$ATURN_t$	0.174	−0.182	0.352	0.041
	(0.845)	(−0.504)	(1.561)	(0.200)
$CASHHOLDING_t$	1.431**	8.639***	−0.397	0.752
	(2.016)	(5.958)	(−0.511)	(1.056)
MB_t	−0.013	−0.021	−0.010	0.078***
	(−0.693)	(−0.571)	(−0.471)	(4.313)
GDP_CH_t	-	-	-	−55.731***
	-	-	-	(−13.917)
$M2_t$	-	-	-	−6.510***
	-	-	-	(−9.594)
$R54M_t$	0.907***	1.014***	1.934***	1.556***
	(5.973)	(6.241)	(12.001)	(25.033)
BH_t	0.539	−0.386	1.018**	0.436
	(1.453)	(−0.703)	(2.522)	(1.182)
$PRIVATE_t$	−0.822***	−0.984***	−0.753***	−0.726***
	(−3.864)	(−2.831)	(−3.205)	(−3.429)
$OWNERSHI_t$	−3.121***	−3.786***	−3.174***	−3.546***
	(−5.136)	(−3.727)	(−4.772)	(−5.904)
$MINDEX_t$	1.482***	0.957*	1.740***	1.573***
	(4.215)	(1.790)	(4.494)	(4.472)
$CORE_t$	−2.356*	−6.514***	−1.213	−2.895
	(−1.902)	(−2.967)	(−0.834)	(−1.539)
$INVESTINCOME_t$	39.951***	43.235***	39.093***	44.587***
	(8.892)	(5.052)	(7.569)	(5.056)
$OTHERINCOME_t$	1.816	−3.814	2.692	−0.638
	(0.636)	(−0.610)	(0.789)	(−0.099)
$POST2007_t$				2.949***
				(12.608)
$CORE_t*POST2007_t$				−0.989
				(−0.495)
$INVESTINCOME_t*POST2007_t$				−3.190
				(−0.332)
$OTHERINCOME_t*POST2007_t$				1.504
				(0.206)
$CONSTANT$	−31.173***	−26.740***	−29.192***	−31.380***
	(−15.500)	(−6.958)	(−12.923)	(−15.230)
YEAR	YES	YES	YES	NO
INDUSTRY	YES	YES	YES	YES
adj. R^2	0.278	0.157	0.246	0.255
Obs	25,478	6304	19,174	25,478

Panel B Whether to increase long-term equities investment

Variable	(1) Full sample	(2) Pre-2007 period	(3) Post-2007 period	(4) Full sample
	$LONG\_INVEST_{t+1}$	$LONG\_INVEST_{t+1}$	$LONG\_INVEST_{t+1}$	$LONG\_INVEST_{t+1}$
$SIZE_t$	0.993***	1.036***	0.982***	0.972***
	(35.684)	(23.001)	(32.280)	(37.038)
LEV_t	−0.935***	−0.732***	−1.008***	−0.875***
	(−6.858)	(−3.817)	(−6.336)	(−6.555)
$ATURN_t$	−0.156***	−0.124	−0.177***	−0.147**

(*Continued*)

Table 11. (Continued).

	(−2.582)	(−1.416)	(−2.633)	(−2.437)
$CASHHOLDING_t$	−0.755***	−0.192	−0.883***	−0.741***
	(−3.690)	(−0.583)	(−3.818)	(−3.648)
MB_t	0.019***	0.000	0.025***	0.014**
	(3.237)	(0.017)	(3.656)	(2.542)
GDP_CH_t	-	-	-	2.854***
	-	-	-	(2.789)
$M2\_R_t$	-	-	-	0.595***
	-	-	-	(3.635)
$R54M_t$	−0.165***	−0.201***	0.008	−0.154***
	(−5.452)	(−6.236)	(0.346)	(−10.011)
BH_t	0.181*	−0.081	0.287***	0.195**
	(1.927)	(−0.681)	(2.696)	(2.079)
$PRIVATE_t$	−0.090	−0.132	−0.086	−0.109*
	(−1.516)	(−1.531)	(−1.295)	(−1.855)
$OWNERSHI_t$	−0.333*	−0.741***	−0.164	−0.308*
	(−1.854)	(−3.119)	(−0.808)	(−1.728)
$MINDEX_t$	0.298***	0.358***	0.257**	0.291***
	(3.127)	(2.741)	(2.410)	(3.058)
$CORE_t$	−1.732***	−2.265***	−1.435***	−2.431***
	(−4.932)	(−4.136)	(−3.434)	(−4.724)
$INVESTINCOME_t$	23.836***	24.290***	25.039***	24.167***
	(19.310)	(14.369)	(15.457)	(14.382)
$OTHERINCOME_t$	−1.471*	2.665	−2.353**	2.822*
	(−1.778)	(1.614)	(−2.148)	(1.738)
$POST2007_t$				−0.698***
				(−13.052)
$CORE_t*POST2007_t$				1.089**
				(2.005)
$INVESTINCOME_t*POST2007_t$				0.804
				(0.395)
$OTHERINCOME_t*POST2007_t$				−5.178***
				(−2.631)
CONSTANT	−2.662***	−3.529***	−3.289***	−2.490***
	(−4.544)	(−3.760)	(−4.795)	(−4.161)
YEAR	YES	YES	YES	NO
INDUSTRY	YES	YES	YES	YES
adj. R^2	0.382	0.335	0.397	0.381
Obs	20,697	5808	14,889	20,697

*, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Robust t-statistics are in parentheses.

investment declines significantly after 2007. In addition, the coefficients on *CORE* are significantly negative before and after 2007, indicating that the higher the core income, the less long-term equity investment will be carried out considering its high implementation cost.

6.2. Financial asset investment and firm value

The above results show that management is more willing to invest in financial assets than long-term equity investment after 2007. Is it because financial asset investment can better promote firm value, or just because it is easier to implement? The relationship between financial asset investment and firm value is further studied in the next step.

Panel A of Table 12 tabulates the impact of financial asset investment on firm value. In the full sample regression presented in column 1, the coefficient on *FIN_ASSET* is significantly positive. Columns 2 and 3 present the subsample results of the pre- and post-

Table 12. Regression of financial assets investment on firm value.

Panel A financial assets investment and future performance

	(1)	(2)	(3)	(4)
Variable	Full sample	Pre-2007 period	Post-2007 period	Full sample
	ROA_{t+1}	ROA_{t+1}	ROA_{t+1}	ROA_{t+1}
$SIZE_t$	−0.001	−0.002*	−0.000	−0.001
	(−1.228)	(−1.782)	(−0.217)	(−1.205)
LEV_t	−0.008**	−0.006	−0.006	−0.008**
	(−2.127)	(−0.812)	(−1.470)	(−2.132)
$ATURN_t$	0.006***	0.006**	0.005***	0.006***
	(4.701)	(2.451)	(4.024)	(4.706)
OCF_t	0.087***	0.093***	0.083***	0.087***
	(11.383)	(5.179)	(9.705)	(11.384)
BH_t	0.001	−0.003	0.003	0.001
	(0.627)	(−0.885)	(1.617)	(0.623)
$PRIVATE_t$	0.001	−0.008***	0.004***	0.001
	(1.123)	(−2.892)	(3.400)	(1.127)
$OWNERSHIP_t$	0.015***	0.027***	0.010***	0.015***
	(4.713)	(3.891)	(3.086)	(4.714)
$MINDEX_t$	0.008***	0.014***	0.006***	0.008***
	(4.488)	(3.691)	(3.010)	(4.490)
$RETURN_t$	0.013***	0.011***	0.014***	0.013***
	(11.415)	(6.151)	(10.299)	(11.417)
$CORE_t$	0.386***	0.402***	0.381***	0.386***
	(34.018)	(16.281)	(28.610)	(33.980)
$INVESTINCOME_t$	0.280***	−0.058	0.390***	0.281***
	(5.918)	(−0.568)	(6.764)	(5.919)
$OTHERINCOME_t$	0.039	−0.039	−0.023	0.039
	(1.012)	(−0.380)	(−0.511)	(1.007)
FIN_ASSET_t	0.034***	0.024	0.033***	0.024
	(3.304)	(0.709)	(2.946)	(0.701)
$FIN\_ASSET_t *POST2007_t$				0.012
				(0.342)
CONSTANT	0.017	0.060**	−0.008	0.017
	(1.541)	(2.142)	(−0.726)	(1.520)
YEAR	YES	YES	YES	YES
INDUSTRY	YES	YES	YES	YES
adj. R^2	0.284	0.284	0.290	0.284
Obs	18,871	4550	14,321	18,871

Panel B financial assets investment and future stock return

	(1)	(2)	(3)	(4)
Variable	Full sample	Pre-2007 period	Post-2007 period	Full sample
	$RETURN_{t+1}$	$RETURN_{t+1}$	$RETURN_{t+1}$	$RETURN_{t+1}$
$SIZE_t$	−0.018***	0.002	−0.021***	−0.019***
	(−5.923)	(0.187)	(−7.197)	(−6.059)
LEV_t	0.099***	0.153***	0.092***	0.102***
	(5.128)	(2.694)	(5.094)	(5.220)
$ATURN_t$	0.003	−0.012	0.008	0.002
	(0.376)	(−0.485)	(1.159)	(0.315)
OCF_t	0.201***	0.336**	0.146***	0.200***
	(3.899)	(2.244)	(3.092)	(3.896)
BH_t	−0.034***	−0.129***	−0.003	−0.034***
	(−3.376)	(−4.360)	(−0.377)	(−3.351)
$PRIVATE_t$	0.021***	−0.017	0.028***	0.021***
	(3.103)	(−0.771)	(4.364)	(3.075)
$OWNERSHIP_t$	0.091***	0.013	0.106***	0.091***
	(4.473)	(0.216)	(5.350)	(4.454)
$MINDEX_t$	0.006	−0.030	0.015	0.006

(*Continued*)

Table 12. (Continued).

	(0.560)	(−0.908)	(1.533)	(0.548)
$RETURN_t$	−0.112***	−0.152***	−0.091***	−0.112***
	(−15.853)	(−11.611)	(−11.901)	(−15.934)
$CORE_t$	−0.234***	−0.454***	−0.184***	−0.231***
	(−3.742)	(−2.498)	(−3.065)	(−3.690)
$INVESTINCOME_t$	−0.374	−0.556	0.001	−0.383
	(−1.591)	(−0.968)	(0.003)	(−1.623)
$OTHERINCOME_t$	0.060	0.431	−0.207	0.067
	(0.304)	(0.537)	(−1.117)	(0.341)
FIN_ASSET_t	0.253***	0.981***	0.149**	0.844***
	(3.155)	(2.743)	(2.152)	(2.589)
$FIN\_ASSET_t*POST2007_t$				−0.688**
				(−2.090)
$CONSTANT$	0.230***	0.112	0.421***	0.240***
	(3.405)	(0.444)	(6.992)	(3.541)
YEAR	YES	YES	YES	YES
INDUSTRY	YES	YES	YES	YES
adj. R^2	0.103	0.095	0.125	0.104
Obs	18,871	4550	14,321	18,871

*, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Robust t-statistics are in parentheses.

2007 period. The coefficient on *FIN_ASSET* is not significant before 2007 and significantly positive after 2007. However, the value of the coefficient is 0.000, which is not significant. The coefficient on *FIN_ASSET*POST2007* in column 4 is not statistically significant, which shows that the impact of financial asset investment on future performance does not improve after the new ASBE.

Panel B of Table 12 presents the impact of financial asset investment on firm stock return. In columns 1 through 3, the coefficients on *FIN_ASSET* are all significantly positive, indicating that financial asset investment can significantly promote firm stock return. But the coefficient on *FIN_ASSET*POST2007* in column 4 is significantly negative, which shows that the promotion effect of financial asset investment on stock return declines after 2007. Hence, the increase of financial asset investment may result from management's compensation manipulation.

7. Conclusion

The compensation contract is of great significance in improving corporate governance and alleviating agency problems. This article focuses on the impact of reclassification of income statement items caused by changes in accounting standards on the weight of compensation performance indicators. It is found that after the new ASBE moves investment income from below the line to above it, the sensitivity between executive compensation and investment income increases significantly. Further tests show that the persistence of investment income indeed improves significantly after 2007, which reveals that the reclassification of investment income conforms to the change in business practice. Additional tests examine the real economic consequences of reclassification of investment income. It is found that, after 2007, management increases financial asset investment while firm value is less correlated with financial asset investment, which shows that the weight adjustment of performance indicators twists management behaviour to some extent.

This article examines the economic consequences of the new ASBE, aiming at interpreting the intention and examining the consequences of reclassifying income statement items in the new ASBE. The empirical results have important implications for supervisors to formulate and evaluate changes in accounting standards. At the same time, this article adds to the literature regrading the economic consequences of a change in information disclosure format, increasing the understanding of capital market efficiency. It also helps investors and the board of directors to understand the opportunistic behaviour of management driven by an executive compensation incentive. Finally, with the rise of behavioural finance, research in accounting information has gradually switched from disclosure quality to the pricing and governance functions. This study plays an important role in understanding the irrationality of capital markets.

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