PSYCHOLOGY AND EDUCATION (2021) 58(4): 1917-1923
Article Received: 08th October, 2020; Article Revised: 15th February, 2021; Article Accepted: 20th March, 2021

The effect of the information disclosure to earning management and firm performance of the listed companies on the Stock Exchange of Thailand

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ABSTRACT

The information disclosure is greatly beneficial for the investors to help them making the decisions on the investment in their business. The objectives of this research were to study the impact of information disclosure on earning management and performance and to study the impacts of earning managing and firm performance of the listed companies on the Stock Exchange of Thailand. The data was collected from the sample of 314 listed companies on the Stock Exchange of Thailand. The research variables consisted of the tax disclosure and cash flow disclosure. The dependent variables were profit management and operational performance. The data analysis was conducted using the descriptive and inferential statistics including the path analysis to analyze the model built to verify the model. The hypotheses were tested at the level of significance of 0.05. The research results revealed that tax disclosure and information disclosure on cash flow affected the earning management. The earning management affected the operational performance based on the indicators of economic added value. The tax information disclosure and cash flow information disclosure affected the earning management and the firm performance of the listed companies in the Stock Exchange of Thailand

Keywords
Taxation; Cash Flow; Earning Management; Firm Performance

Article Received: 10 August 2020, Revised: 25 October 2020, Accepted: 18 November 2020

Introduction

As the most important goal of an organization is to create value and increase shareholder wealth, it is necessary to find reliable indicators to reasonably measure the performance of the organization. The free cash flow can create value for the managers. It is expected that businesses with a high positive free cash flow can create shareholder values by investing in new investment projects. The Free Cash Flow (FCF) is the cash balance after the adjustment of cash flow from operating activities (CFO). The managers can use resources effectively under ownership to invest free cash flows in projects that have a positive Net Present Value (NPV) and able to increase the value of the organization. The free cash flow is an indicator of an organization’s ability of debt repayment, dividend payment, stock sale and buyback. It can accelerate the growth of the organizations. All of these are important for the investors (Maham et al., 2008).

The management has the duties and responsibilities in preparing the financial reports to be presented to the entity’s stakeholders) Brown, Beeks & Verhoeven, 2011). If the management uses the discretion to adjust or modify the accounting structure, the financial statements can be presented in the direction that the management wants. This is known as the realization of earning management channel to change or modify the financial statements aiming at enabling investors and stakeholders to understand financial reports in the direction desired by the management. The earning management is therefore an intervention in the financial reporting process that must be presented to third parties with the intention to create significant benefits to the organization.

Apart from exercising the management’s discretion in managing the organization’s earning or avoiding the corporate income tax, the reduction of corporate income tax is another option to increase the value of shareholders. The executives of the organizations try to do their best in minimizing the corporate taxes (Christensen & Murphy, 2004). However, the tax evasion and the tax reduction also allow the executives to generate benefits for themselves (Desai & Dharmapala, 2009). Although the management can reduce the corporate tax burden, it creates a beneficial effect on the shareholders as it will allow the shareholders to receive higher dividends as well. Thus, the separation between shareholders and corporate executives allows executives to make decisions about corporate income tax management without affecting the management’s interests (Hanlon & Heitzman, 2010). Consequently, this inspires the earning management by avoiding corporate income tax (Ball & Shivakumar, 2004). There is also the support from shareholders because the avoidance of corporate income tax is also a transfer of expenses to be paid to the government to the shareholder value (Christensen & Murphy, 2004).

In measuring the firm’s performance, apart from the profits or losses shown in the income statement, there are also some indices that are used to measure a company’s performance in the form of financial ratios. The information from financial statements is used in accordance with generally accepted accounting principles. This requires that corporate financial statements to be prepared for presenting to third parties or stakeholders of the organizations (Wang, Jiang, Liu & Wang, 2015). In addition, the information in some companies’ financial statements possibly requires the selection of various accounting policies in order to keep the performance of the companies in good criteria and in the direction desired by the management of the companies. Therefore, other forms are used in measuring the performance to reflect the true value of the enterprise.

Based on the above information, the researchers are interested in studying the impacts from the disclosure of tax information and free cash flow affecting the earning management and the firm performance of the listed companies on the Stock Exchange of Thailand. This will make the investors or other stakeholders cautious in using the information in the financial statements that affect the future decisions of the stakeholders or investors.

Literature Review

1. Effects of the tax information disclosure to earning management

The tax information disclosure is required by law. If the company is operating and generates profits, it is necessary to calculate corporate income tax in order to pay government taxes. Taxation is the duty of an organization that profits from its operations. However, many organizations try to avoid paying taxes by using tax strategies. In some organizations, the management may not cooperate in corporate tax evasion (Rego & Wilson, 2012). Thus, the shareholders or stakeholders must use incentives mechanisms to enable the management to join. It is argued that the corporate executives may not participate in tax evasion actions as it adds value to shareholders or stakeholders unless doing so would benefit the management. Scott (2003) said that the corporate income tax was the most obvious reason for companies to manage the profits. In addition, tax expenses are what contribute to the management of profits. The executives are also profit managers. It is difficult to assess tax expenses for large corporations because of the complicated information. The company's financial policy also affects the relationship between corporate income tax avoidance (CTA) and earning management (EM) (Amidu & Yorke, 2017).

2. Effects of the cash flow information disclosure to earning management

For the excessive free cash flow in the company, if it is not used or invested to increase wealth or interests to shareholders, it will create management and shareholder problems. According to the agent theory, the management may choose to invest in the projects that are not profitable. This is because taking into account their own interests, the company may grow slowly. If the shareholders or the stakeholders do not closely monitor the operation of the management, the executives may conceal information about operations in the company. Being the stakeholders, the investors do not have access to inside information. The management may disclose only part of the cash flow of their investment to investors. As the information received by investors is without the awareness of the opportunities, advantages, or disadvantages of the investment project, it may lead to a loss of opportunity to increase the security of investors (Chung et al., 2005).

There are some studies on the relationship of free cash flow and earning management and they are found to be significantly correlated (Mehdi et al., 2016). It is also found to have the positive correlation stating that the free cash flow of companies will be able to encourage earning management (Bhundia, 2012). Apart from the fact that the free cash flow and earning management have the relationship, it is additionally found that the company executives with excessive free cash flow are incentivized to participate in the earning management.

3. Effects of the earning management on performance

Iatridis et al (2009) said that the earning management resulted in higher returns for the executives and represented efficient management in compliance with the terms of contracts agreed with the creditors. It is for adding the value to the securities going to be released. This can create the incentives for investors and will result in better reporting of financial status or creating business value. Therefore, it will yield positive impact on the operational performance. Moreover, the earning management also signals future managerial competence or operational performance. This is in correspondence with Bowen et al (2008) who studied the influence of accounting discretion on corporate governance and operational performance. Such operational performance is measured from future operating cash flows, Return on Asset (ROA), and Return on Securities. In Pakistan, the earning management was found to have a negative correlation to corporate performance.

Methods

Population and sample groups

The research population consisted of 314 companies listed on the Stock Exchange of Thailand. The data was collected from the financial statements and disclosed in the financial statements for a period of 5 years (2014-2018).

Data analysis

Once the variables were obtained, all the obtained data were analyzed by using statistical techniques with computer software packages, path analysis (with statistical packages) to analyze the created model for confirming the model and study the influence of the variables according to the hypothesis testing at the level of significance of 0.05.

For the research on the effects of the information disclosure to earning management and firm performance of the listed companies on the Stock Exchange of Thailand, there are variables used for studying and measuring as follows.

Independent Variables consist of:

Tax information disclosure

considered the use of tax disclosure measures to be divided into the following indicators:

1. Calculation on the true corporate income tax rate based on generally accepted accounting principles (ETR1) = Total corporate tax expenses / Income before taxes

2. Calculation on the true corporate income tax rate based on the cash (ETR2) =)Total corporate tax expenses- Deferred tax expenses) / Income before taxes

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3. Book-Tax Differences (BTD)=Pre-tax income - Taxable income

Information disclosure on the cash flow

The cash flow disclosures used in this study consisted of free cash flow and surplus free cash flow.
1. Free Cash Flow (FCF) = Operating cash flows - capital expenditures
2. Surplus Free Cash Flow (SFCF)
Measuring the Surplus Free Cash Flow (SFCF), the free cash flow must be used together with the price-to-book value ratio as follows.
-If the company's free cash flow is higher than the mean of the sample group and the company's price-to-book value ratio is lower than the mean of the sample group, it will equal to 1.
- If the company's free cash flow is lower than the mean of the sample group and the company's price-to-book value ratio is higher than the mean of the sample group, it will equal to 0. **Dependent Variables** used in this study consisted of:
1. The earning management of the company will use the measuring model of Modified Jone Model, Dechow, Sloan & Sweeney (1995), and measurement of Yoon Model using Yoon et al. (2006) Model.
2. The performance will use the measuring model of Tobin's Q (Chung & Pruitt, 1994) which is the indicator of market performance and economic value added (EVA) to add the True Profits to the organizations.

Results

The disclosure of tax information of the true corporate income tax rate based on generally accepted accounting principles (ETR1), the true corporate income tax rate based on the cash (ETR2), and the difference between accounting principles and tax rules (BTD) affects the modeled earning management of the Modified Jones Model (EMJ) modeled earning management (EMJ), and the Yoon Model (EMY) modeled earning management. This corresponds to the value-built model with Chi-Square = 0.00 P-value = 1.000 and RMSEA = 0.000 as shown in Figure 1, Figure 2, Table 1, and Table 2.

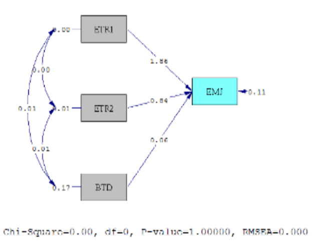

Figure 1 Model of the disclosure of tax information affecting the earning management following the EMJ model

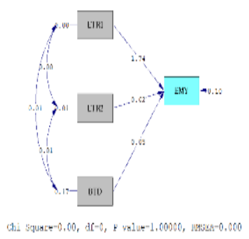

Figure 2 Model of the disclosure of tax information affecting the earning management following the EMY model

Table 1 Analysis on the model of the disclosure of tax information affecting the earning management following the EMJ model

Variables	Statistical value				
	Coefficients	**SE**	**t**	**Value**	**R^2**
ETR1	1.86	0.19	9.78	0.30	0.23
ETR2	0.84	0.13	6.47	0.19	
BTD	0.058	0.023	2.50	0.06	

Chi-Square = 0, df = 0, p = 1.00, RMSEA = 0.000

From Table 1, it is found that tax disclosure can explain the change in earning management in the model of EMJ for 23.0%. The tax disclosure on all 3 areas has a significant positive influence of 0.05 on the EMJ model-based earning management with influences of 1.86, 0.84, and 0.058, respectively.

Table 2 Analysis on the model of the disclosure of tax information affecting the earning management following the EMY model

Variables	Statistical value				
	Coefficients	**SE**	**t**	**Value**	**R^2**
ETR1	1.74	0.18	9.54	0.30	0.20
ETR2	0.62	0.12	4.98	0.15	
BTD	0.054	0.022	2.39	0.06	

Chi-Square = 0, df = 0, p = 1.00, RMSEA = 0.000

From Table 2, it is found that tax disclosure can explain the change in earning management in the model of EMY for 20.0%. The tax disclosure on all 3 areas has a significant positive influence of 0.05 for the earning management with the influences of 1.74, 0.62, and 0.054, respectively.
Disclosure of free cash flow information and surplus free cash flow influences the modeled earning management of The Modified Jones Model (EMJ) and the Yoon Model (EMY) model earning management. This is consistent with the model created with Chi-Square value = 0.00 P. -value = 1.000 and RMSEA = 0.000 as in Figure 3, Figure 4, Table 3, and Table 4.

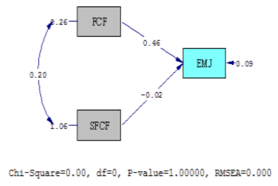

Figure 4 Model of the disclosure of cash flow information affecting the earning management

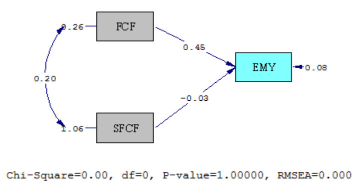

Figure 5 Model of the disclosure of cash flow information affecting the earning management

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following the EMJ model   following the EMY model

Table 3 Analysis on the model of the disclosure of cash flow information affecting the earning management following the EMJ model

Variables	Statistical value				
	Coefficients	**SE**	**t**	**Value**	R^2
FCF	0.46	0.016	28.60	0.63	0.37
SFCF	- 0.023	0.0080	-2.88	-0.06	
Chi-Square = 0, df = 0, p = 1.00, RMSEA = 0.000					

From Table 3, it is found that the cash flow disclosure can explain the change in earning management in the model of EMJ for 37.0%. The cash flow disclosure of free cash flow (FCF) has a significant positive influence of 0.05 for the earning management with the influences of 0.46. For the surplus free cash flow (SFCF), it has the negative influence at the significant level of 0.05 for the earning management with the influence value of -0.023.

Table 4 Analysis on the model of the cash flow disclosure affecting the earning management following the EMY model

Variables	Statistical value				
	Coefficients	**SE**	**t**	**Value**	R^2
FCF	0.45	0.015	30.81	0.66	0.40
SFCF	-0.026	0.0074	-3.50	-0.07	
Chi-Square = 0, df = 0, p = 1.00, RMSEA = 0.000					

From Table 3, it is found that the cash flow disclosure can explain the change in earning management in the model of EMY for 40.0. The cash flow disclosure of free cash flow (FCF) has a significant positive influence of 0.05 for the earning management with the influences 0.45. For the surplus free cash flow (SFCF), it has the negative influence at the significant level of 0.05 for the earning management with the influence value of -0.026.

The disclosure of tax information of the true corporate income tax rate based on generally accepted accounting principles (ETR1), the true corporate income tax rate based on the cash (ETR2), and the difference between accounting principles and tax rules (BTD) affects the operation following the Tobin's Q (FPQ) indicators. This is correspondent with the model created with Chi-Square = 0.00 P-value = 1.000, and RMSEA =0.000 as shown in Figure 5, Figure 6, Table 5, and Table 6.

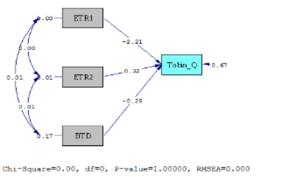

Figure 6 Model of the tax information disclosure affecting the performance following the Tobin's Q (FPQ) indicators

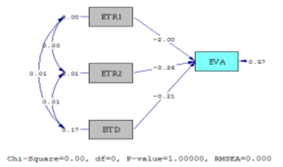

Figure 7 Model of the tax information disclosure affecting the performance following the EVA.

Table 5 Analysis on the model of the tax information disclosure affecting the performance following the Tobin's Q (FPQ) indicators

Variables	Statistical value				
	Coefficients	**SE**	**t**	**Value**	R^2
ETR1	- 2.21	0.47	- 4.70	-0.16	0.056
ETR2	0.32	0.32	1.00	0.03	
BTD	- 0.28	0.058	- 4.82	-0.14	
Chi-Square = 0, df = 0, p = 1.00, RMSEA = 0.000					

From Table 5, it is found that the tax information disclosure can explain the change in the performance following the Tobin's Q (FPQ) indicators for 5.6%. The true corporate income tax rate based on generally accepted accounting principles (ETR 1) and the difference between accounting principles and tax rules (BTD) has the negative influence at the significant level of 0.05 with the influence values of -2.21 and -0.28. Meanwhile, the true corporate income tax rate based on the cash (ETR2) does not have influence on the performance following the Tobin's Q (FPQ) indicators.

Table 6 Analysis on the model of the tax information disclosure affecting the performance following the EVA's indicators

Variables	Element weight				
	Coeffici	**SE**	**t**	**Standard coefficients**	
ETR1	-2.00	0.43	-4.61	0.16-	
ETR2	-0.26	0.30	-0.89	0.03-	
BTD	-0.21	0.053	-3.98	0.11-	
Chi-Square = 0, df = 0, p = 1.00, RMSEA = 0.000					

From Table 6, it is found that the tax information disclosure can explain the change in the performance following the EVA's indicators for 6.3%. The true corporate income tax rate based on generally accepted accounting principles (ETR 1) and the difference between accounting principles and tax rules (BTD) has the negative influence at the significant level of 0.05 with the influence values of -2.00 and -0.21. Meanwhile, the true corporate income tax rate based on the cash (ETR2) does not have influence on the performance following the EVA's indicators.

The cash flow information disclosure on the free cash flow (FCF) and the surplus free cash flow (SFCF) affects the performance following the Tobin's Q (FPQ) indicators and the EVA's indicators. This is consistent with the model created with Chi-Square = 0.00 P-value = 1.000 and RMSEA =0.000 as shown in Figure 7, as Figure 8, Table 7, and Table 8.

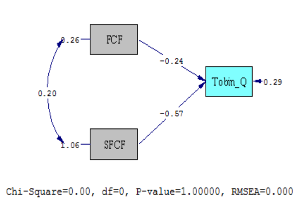

Figure 8 Model of the cash flow information disclosure affecting the performance following the Tobin's Q (FPQ) indicators

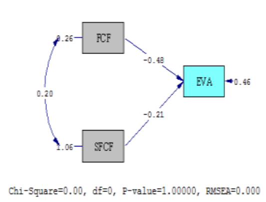

Figure 9 Model of the cash flow information disclosure affecting the performance following the EVA's indicators

Table 7 Analysis on the model of the cash flow information disclosure affecting the performance following the Tobin's Q (FPQ) indicators

Variables	Statistical value				
	Coefficients	**SE**	**t**	**Standard values**	**R^2**
FCF	-0.24	0.029	-8.32	-0.15	0.59
SFCF	- 0.57	0.014	-39.7	-0.70	

Chi-Square = 0, df = 0, p = 1.00, RMSEA = 0.000

From Table 7, it is found that the cash flow information disclosure can explain the change in the performance following the Tobin's Q (FPQ) indicators for 59.0%. Both of the 2 areas have the negative influence at the significant level of 0.05 with the influence values of -0.24 and -0.57.

Table 8 Analysis on the model of the cash flow information disclosure affecting the performance following the EVA's indicators

Variables	Statistical value				
	Coefficients	**SE**	**t**	**Standard values**	**R^2**
FCF	- 0.48	0.036	-13.20	-0.32	0.24
SFCF	- 0.21	0.018	-11.26	-0.27	

Chi-Square = 0, df = 0, p = 1.00, RMSEA = 0.000

From Table 8, it is found that the cash flow information disclosure can explain the change in the performance following the EVA's indicators for 24.0%. Both of the 2 areas have the negative influence at the significant level of 0.05 with the influence values of0. - 48, and 0.- 21.

Discussions

The disclosure of tax and cash flow information has the significant positive impact on the earning management of the companies listed on the Stock Exchange of Thailand. The study found that the disclosure of tax and cash flow information affects the earning management following the EMJ and EMY models. The tax expenses are what drives earning management and the executives are also earning managers. The executives who have the earning management are even more likely to protect themselves by tax avoidance. As the tax avoidance enables the companies to pay less taxes, it is beneficial for the shareholders or stakeholders allowing them to continue to support the management further. Amidu et al. (2016) found that corporate income tax avoidance had a positive relationship with earning management. It was found that the corporate income tax avoidance would distort the management's behavior. It is considered that the management is authorized by shareholders or stakeholders to carry out such activities. It also prevents the executives from exploiting their own interests. This is correspondent with Dechow & Ge (2006) stating that free cash flow is a better measure of cash flow than operating cash flow. This is because income includes capital expenditures such as depreciation and amortization that are not included in operating cash flows. Studies on the relationship of free cash flow and profit management were found to be significantly correlated (Mehdi et al., 2016). Besides, the positive correlation was found that the free cash flow of companies would be able to encourage profit management (Bhundia, 2012). The tax and cash flow disclosures have a significant negative impact on the performance of the companies listed on the Stock Exchange of Thailand. The research results revealed that the tax and cash flow disclosures had significant negative influence of 0.05 on results of Tobin's Q metric and economic value added metric performance. It is in line with Pasternak & Rico stating that the corporate income tax avoidance is a financial and economic arrangement that results in less tax payments by using the deduction method for expenses that are permitted by law to be deductible. It agrees with Chung, Firth & Kim (2005) studying the relationship between free cash flow, agent expenses, profit management, and investor audits found to be correlated. There is also the study on the effect of free cash flow on profits. It was found that surplus free cash flow adversely affects corporate profitability and audit mechanisms. This is in accordance with Zhou et al. (2012) studying the effects of free cash flow on the performance of real estate companies listed on the stock exchange in China. It was found that free cash flow and performance had a negative correlation.

Conclusion

The disclosure of tax and cash flow information has the significant positive impact on the earning management of the companies listed on the Stock Exchange of Thailand. In terms of the disclosure of tax information positively affecting the earning management, it is found that the management thinks that small tax payment will give stakeholders the option to let management continue to work in the organization. In addition, less taxation will allow the management to receive the benefits that arise. It is one of the incentives for the executives to use taxes to help managing the company's profits. The disclosure of cash flow information positively affects the earning management. That the company has too much free cash flow makes the stakeholders believe that the company does not invest this money to generate income. Besides, in the free cash flow, capital expenditures are included such as depreciation and amortization. Thus, it facilitates the earning management by using depreciation and amortization as the means to manage the earning. The disclosure of tax and cash flow information has a material adverse effect on the operational performance of the companies listed on the Stock Exchange of Thailand. The fact that corporate stakeholders allow management to take action on reducing profits in order to pay less taxes, the company's executives may increase their own expenses or compensation for working with tax avoidance or savings. Therefore, the cost has increased. As a result, the business has reduced operating performance and has a negative relationship. That the company has too much cash flow without investing in it for returns does not generate cash turnover and may have an impact on the overall economy.

Limitations and Future Studies

The research results show that tax disclosure has a positive impact on earning management and has a negative impact on the performance. This means that the company uses tax information to help managing the company's profits. Besides, the company will use tax information so that the performance of the company has less effect on the tax. Therefore, the Revenue Department should review tax laws in order to amend the laws or regulations to be more concise in order not to allow the companies to use tax gaps to manage profits or improve the operating results to meet their needs. This can maximize the benefits of taxation and tax spending in the country development

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