RESEARCH ARTICLE

The Impact of Tax Compliance, Earnings Quality, and Financial Performance on Future Earnings Response Coefficient: Evidence From Indonesia and Thailand

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This study was conducted to examine the impact of tax compliance and earnings quality, in addition to current financial performance, in predicting future earnings. Generally, future earnings are predicted using current earnings and their interactions with stock prices. The future earnings response coefficient is used by investors to measure it. Several previous studies have found different results on the effect of financial performance on future earnings, so further research is needed to develop any factors that affect future earnings. A total of 332 panel data were sourced from annual reports and historical stock prices from 83 manufacturing companies listed on the Indonesian Stock Exchange and the Thai Stock Exchange from 2014 to 2017. We use a quantitative approach with STATA 16 to analyze available data. The results indicate that earnings quality has a strong effect on future earnings, whereas tax compliance and financial performance are weak. These results have very important implications for entities that produce quality financial reports that help investors predict future earnings.

Keywords: future earnings, FERC, tax compliance, earnings quality, financial performance

JEL Classifications: H25, L22

Since the industrial revolution in the 18th century, industrial growth has increased, including in countries in ASEAN. This is influenced by many factors, one of which is the stock market (Regan, 2017; Nordin & Nordin, 2016). There are currently six stock exchanges in ASEAN, namely the Indonesian Stock Exchange (IDX), the Stock Exchange of Singapore (SES), the Stock Exchange of Thailand (SET), the Malaysian Stock Exchange (MYX), the Philippine Stock Exchange (PSE), and the Ho Chi Minh Stock Exchange (HOSE), which with increased capitalization is able to improve the economy in the country and other ASEAN countries.

Increased capitalization of investors is inseparable from market analysis of the entity's past and future performance because investors must predict how much future earnings are related to the expected return. Some studies found a strong impact on the entities' financial performance on future earnings (Anwaar, 2016; Macharia & Gatuhi, 2013), but other studies did not find it (Puspitaningtyas, 2017). The inadequacy of financial statement information in predicting future earnings is thought to be due to poor quality, so further research is needed to prove it.

In addition to financial information, many studies analyze various factors that affect the company's financial performance and earnings quality, such as management characteristics (Salehi & Moghadam, 2019), managerial change (Salehi et al., 2021), ownership (Tarmidi et al., 2023) and its impact on stock markets (Faysal et al., 2020). Meanwhile, many studies found the effect of audit quality (Williem & Aryati, 2017; Murwaningsari, 2014) and ownership structure (Henny, 2017; Murwaningsari, 2014) on future earnings, but there has been little analysis of the level of company compliance on future earnings, specifically tax compliance. Taxes are coercive, which, if not compliant, can lead to penalties that burden the company in the future. Corporate compliance information helps investors predict how compliance costs incurred in the future can reduce future earnings (Lev & Nissim, 2004). Several studies have found the adverse effect of tax non-compliance on stock prices (Ling et al., 2018; Chen et al., 2014; Brooks et al., 2016), which has an impact on high firm value (Akbari et al., 2019), although sometimes there is no reaction from the stock price on the entity's tax avoidance information (Blaufus et al., 2019). However, there is very little research on tax compliance in predicting future earnings. The measurement of tax compliance is allegedly limited in the research conducted. Generally, tax compliance research is related to the personality of the taxpayer, such as knowledge about taxes (Mbilla et al., 2020; Permatasari & Mutoharoh, 2021), personality of tax staff or tax authorities such as fraud and corruption of tax auditors (Farrar & King, 2023; Mawani & Trivedi, 2021), to corporate financial ratios such as debt (Salehi & Salimi, 2020), managerial (Salehi & Salimi, 2017), or ownership (Tarmidi, et al., 2022).

Taxes, in addition to being a corporate obligation to the state, are also a burden on companies whose records are regulated by International Accounting Standards 12 (IAS 12). Companies can calculate current and deferred taxes to provide information to stakeholders about the amount of tax that must be paid now and in the future. The policy helps management manipulate earnings using taxation information (Kasipillai & Mahenthiran, 2013) associated with high earnings management (He et al., 2020). In the end, the financial statements cannot help investors predict future earnings because of their poor quality. The high quality of earnings has an impact on the prediction of future earnings (Al-Attar & Maali, 2017), although in some sectors and other times, it cannot be done (Cheng et al., 2014), thus getting a positive reaction from investors (Tarmidi et al., 2022). This study develops earnings quality measurements by adding tax elements in calculating the company's earnings quality, namely, performance adjustment accrual include tax (PAiT).

Based on the phenomenon, literature, and gap in the previous studies, this has a motivation for analysis of corporate compliance impact, especially tax compliance and earnings quality, and corporate financial performance on future earnings response coefficient as future earnings predictability that an investor needs.

Literature Review

Market Efficiency Theory

Fama (1970), in market efficiency theory, explained that the securities market is efficient if the information available is reflected in the stock price. This means that when the information published by an entity can reflect the situation or analysis of the stock prices in the future, the market is efficient. Similarly, Beaver (1989) explained that market efficiency theory is the relationship between published information and the stock price.

In this study, connected to the financial statement information, the high quality of earnings reflects real earnings or minimal manipulation. With qualified earnings information, the investor's analysis of future earnings will be more valid. Furthermore, with the formation of market efficiency, the investors seem to always observe information on every stock price and react to every movement of information published by the entities. Conversely, in reality, it is a bit difficult to create a perfect market as not all existing information is responded to by the investors. However, with the

efficiency of the semi-market, a variety of company information affects investors' reactions differently because of various measuring tools or influencing factors.

Future Earnings Response Coefficient

The future earnings response coefficient (FERC) is an approach developed by Collins et al. (1994) to examine the amount of information about future earnings that is reflected in changes in current earnings, including shares. The coefficient of response to future earnings is often used to predict future earnings or what is commonly referred to as surprise earnings in the future.

The coefficient of future earnings response is the development of the earnings response coefficient (ERC), which has been widely used before in calculating corporate earnings response by comparing abnormal returns with company profits in a 3-year period of current year earnings, previous year's earnings, and earnings afterward.

The coefficient of future earnings response has been used in several previous studies (Choi et al., 2019; Wang & Zheng, 2018; Bisheh & Kangarlouei, 2018; Lee, 2018; Lin et al., 2017; Haw et al., 2016; Murwaningsari, 2014) by analyzing various factors that influence it as well as the impact of the FERC both from the internal company (such as company performance, operating profit, audit quality, compliance policies as well as company external information) to the macroeconomy.

Hypotheses Development

Compliant taxpayers are those who carry out their tax obligations in accordance with applicable regulations. This is reflected in the tax burden of a company, which is paid according to the tax rate. Although the tax burden is a matter of reducing corporate profits and also dividends on investors, with the company's adherence to the tax provisions, concerns over future tax penalties can be overcome. With the minimal possibility of future tax fines or penalties, the level of corporate tax compliance can strengthen the future earnings response.

Tax information is useful for investors in predicting future earnings (Lev & Nissim, 2004). Furthermore, Brooks et al. (2016), in their research in the United Kingdom, concluded that companies that pay less tax than the applicable tax rate have a low return value.

Conversely, tax-compliant companies have a low investment risk and uncertainty, especially because the future tax burden is more accurate, so the future earnings response coefficient is positive.

> H1: Tax compliance influences a good future earnings response coefficient.

Earnings quality is a condition where company information is free from earnings management factors, in the sense that published earnings information is accurate or describes actual earnings. Profit is an important indicator that illustrates the company's performance, which is generally a concern for investors, but the value of earnings reflected in financial statements can be a problem if it has low quality. The purpose of investors analyzing earnings is to predict future earnings, so the information must be of high quality so that it reflects the accuracy of future earnings that can be measured by the coefficient of future earnings response.

Information from financial statements is very important for investors because it involves funding decisions to be made by investors, and the quality of earnings plays an important role in helping investors calculate the coefficient of future earnings response (Salehi et al., 2018; Sunder, 2017). On the other hand, earnings management is precisely disturbing for investors because of information that deviates from measuring the coefficient of future earnings response (Lento & Yeung, 2017; Kousenidis et al., 2014).

Earnings management by companies has a low response coefficient for future earnings (Sari & Febriyanto, 2019; Cheng et al., 2014), whereas earnings quality affects the high value of the future earnings response coefficient (Shahzad et al., 2019).

> H2: Earnings quality influences good future earnings response coefficient.

However, financial performance is the result of past and current hard work done by management and can be considered in subsequent policies. The company's current financial performance is an indicator commonly used in predicting future earnings.

Several studies have found that financial performance with indicators positively impacts the coefficient of future earnings response (Macharia & Gatuhi, 2013; Anwaar, 2016). Specifically, Shin et al.

(2019) found that operating profit has a positive impact on the future earnings response coefficient.

H3: Financial performance influences good future earnings response coefficient.

Research Methodology

This is the quantitative study with pooled last square regression for the hypothesis test. The data analyzed were taken from investing.co.id and yahoo.finance.com websites, the Indonesia Stock Exchange, and the Stock Exchange of Thailand website. There are 332 firm-year observations in the sample from the 108 firms listed on the Indonesia Stock Exchange (IDX) and Stock Exchange of Thailand (SET) from the 2014–2017 period. The details of the sample selection are presented in Table 1.

Dependent Variables

The dependent variable is the future earnings response coefficient (FERC), which is information on future earnings reflected in changes in current earnings, developed by Collins et al. (1994).

FERC is measured by the regression of stock returns this year from the results of the distribution of earnings per share the previous year, earnings per share this year, and earnings per share next year with the stock price at the beginning of the year. The coefficient value of the division of earnings per share next year with the stock price at the beginning of the year is used as FERC. This measurement is consistent with previous studies, such as that of Choi et al. (2019), Williem & Aryati (2017), and Murwaningsari (2014).

Independent Variables

There are three dependent variables in this study. The first is tax compliance (TC), we developed a tax compliance ratio for taxpayers based on the measurement commonly used by previous research, namely the effective tax rate or cash/current effective tax rate. An effective tax rate is widely used to measure tax planning and tax avoidance by dividing tax costs with profit before tax (Zeng, 2019; Oktavia et al., 2019; Thanjunpong & Awirothananon, 2019; Kovermann, 2018; López, 2017; Tandean & Winnie, 2016). Tax costs in the annual report consist of current tax costs and deferred tax costs; therefore, only current tax costs should be used. Similarly, profit before tax and fiscal reconciliation should be fixed, and the time difference should be noted; therefore, it should be measured as fiscal profit. The tax compliance ratio is measured by dividing current tax costs by fiscal profits multiplied by the tax rate. Companies are said to be compliant when calculating taxes according to applicable regulations.

The second variable is earnings quality (EQ), which in this study uses a new measurement of performance adjusted accrual include tax (PAiT), which is a development of performance adjusted discretionary accruals (PAccr; Yasser et al., 2016; Chen et al., 2015; Kothari et al., 2005). PAiT is measured by regressing revenue increases divided by total assets, PPE, ROA, and deferred tax assets divided by total assets on total accruals. On the other hand, total accruals are calculated by reducing current assets without bank cash with current debt without bank loans and minus PPE. The residual value of the regression results is multiplied by minus 1 to get the value of earnings quality.

The third independent variable is financial performance (FP), which is measured using return on capital employed (ROCE), which is achieved by dividing operating income with equity. ROCE is one measurement of financial performance used in this study because it measures the financial performance of operating income. ROCE measurements are consistent

Table 1. *Sampling Procedure*

	Total
The number of manufacturing industries listed on the Indonesia Stock Exchange and the Stock Exchange of Thailand from 2014–2017 (284 x 4 years)	1,136
Newly listed or delisted companies on the exchange in 2014–2017	(264)
Firms with incomplete data	(540)
Total sample	**332**

with previous studies, such as Maqbool and Bakr (2019), Prasad et al. (2018), Ganvir and Dwivedi (2017), Afrifa and Padachi (2016), Anwar & Hasnu (2016), Bhatt and Bhattacharya (2015), and Oyewobi, et al. (2015).

This study also uses five control variables. Institutional ownership is measured by dividing the number of shares owned by the institution by the total number of company shares (Murwaningsari, 2014; Fauzyyah & Rachmawati, 2018). Book-to-market value is measured by comparing the book value of shares with the market value of shares (Choi et al., 2019). Asset growth is measured by dividing the increase in assets by the assets of the previous period (Haw et al., 2016; Shin et al., 2019). Audit quality is measured by dummy 1 for non-Big Four auditors and 2 for Big Four auditors (Williem & Aryati, 2017). Growth opportunities are measured by dividing sales increases by sales of the previous period (Henny, 2017).

We tested the research hypothesis with the following regression estimates:

$$FERC = \beta_0 + \beta_1 TC + \beta_2 EQ + \beta_3 FP + \beta_4 INS + \beta_5 BMV + \beta_6 ASGRO + \beta_7 AUD + \beta_8 GROP + \varepsilon$$

with,

FERC	= future earnings response coefficient
TC	= tax compliance
EQ	= earnings quality
FP	= financial performance
INS	= institutional ownership
BMV	= book-to-market value
ASGRO	= asset growth
AUD	= audit quality
GROPP	= growth opportunity

We use panel regression in STATA software version 16 to test hypotheses. Before entering the panel data regression test, we chose suitable model estimates: pooled least square, fixed-effect models, and random effect models. By conducting a Chow test (choosing a pooled least square and fixed effect model), LM test (for selecting a pooled least square and random effect model), and Hausman test (for choosing a fixed-effect model and a random effect model), we found that pooled least square is a suitable model. We also test assumptions to ensure that the data is the best linear unbiased estimator assumption. The assumption tests include the normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test. The results show that the data are normal and free from multicollinearity, as well as the best results on heteroscedasticity and autocorrelation tests.

Table 2 shows all variable's descriptive statistics. The FERC's mean amount is 5.3368, which explains that the value of current earnings can reflect future earnings by 5.3368. These results indicate that future earnings can be measured by current financial statement information, so it is important to analyze

Table 2. *Descriptive Statistics*

Variable	Mean	Std Dev	Min	Max
FERC	5.3368	12.4591	-37.3530	47.6380
TC	1.8475	13.4778	-87.4167	201.3542
EQ	0.0742	2.5468	-2.1229	29.8884
FP	0.1641	0.2174	-0.7874	2.0700
INS	0.5584	0.2744	0.0000	0.9818
BMV	1.5389	2.3148	0.0024	18.7260
ASSGRO	0.0468	0.1514	-0.9738	1.1353
AUD	1.5663	0.4963	1.0000	2.0000
GROPP	0.0279	0.1437	-0.4323	0.6223

FERC = future earnings response coefficient, TC = tax compliance, EQ = earnings quality, FP = financial performance, INS = institutional ownership, BMV = book to market value, ASGRO = asset growth, AUD = audit quality, GROPP = growth opportunity

Table 3. *Regression Result*

Independent Variable	Expected	Coefficient	Prob.
TC	+	-0.01716	0.612
EQ	+	0.37165	0.038**
FP	+	1.93033	0.370
INS	+	-0.70084	0.678
BMV	+	-0.33049	0.100
ASSGRO	+	-4.40892	0.168
AUD	+	1.76377	0.068*
GROPP	+	9.57867	0.005***
N	332		
Adj. R	0.0438		
Prob. F-Statistics	0.0040		

FERC = future earnings response coefficient, TC = tax compliance, EQ = earnings quality, FP = financial performance, INS = institutional ownership, BMV = book to market value, ASGRO = asset growth, AUD = audit quality, GROPP = growth opportunity

*** *significant at α = 1%, ** significant at α = 5%, * significant at α =10%*

other factors at this time that can help investors predict future earnings.

Regression Result

Table 3 shows the regression analysis result. In general, only one variable (outside the control variable) has a significant positive effect on FERC, namely earnings quality.

From Table 3, it was found that there was no significant effect on future earnings of companies that have a high level of tax compliance. These findings imply that future earnings are not reflected in the tax compliance costs arising from current tax compliance measures. Therefore, hypothesis 1 is rejected. This indicates that corporate tax compliance measures cannot ascertain the amount of future tax compliance costs, so they cannot help investors assess future earnings.

This is allegedly due to tax uncertainties in Indonesia and Thailand, in accordance with the provisions in force that the tax collection expiration is 5 to 10 years so that even if the company complies with current tax regulations, it cannot ensure that the company is free from future tax penalties.

In line with previous expectations, there is a significant positive effect on earnings quality on future earnings. This result is in line with Salehi et al.

(2018), Lento and Yeung (2017), Sunder (2017), and Kousenidis et al. (2014), who discovered the effect of earnings quality on future earnings response coefficient and get a positive reaction from investors (Tarmidi et al., 2021). These results explain that quality financial statement information more accurately reflects future earnings. These results provide input for companies to produce quality financial information that can help investors predict future earnings. Therefore, H2 is accepted.

As an indicator that is often used in research, financial performance does not have a significant impact on future earnings. These results are in line with Puspitaningtyas (2017), who concluded that financial performance ratios such as profitability, liquidity, and sales growth were not reflected in stock prices. Thus, it can be concluded that H3 is rejected. This result is contrary to the significant effect of earnings quality on the future earnings response coefficient, which reinforces that only quality financial information can reflect future earnings compared to general financial performance information.

Additional Result

We conducted additional regression tests to increase the understanding of the effect of tax compliance and earnings quality on future earnings response coefficient

Table 4. *Additional Tests Results*

Independent Variable	Expected	Direct Effect		Indirect Effect	
		Coefficient	Prob.	Coefficient	Prob.
FP	+	1.93033	0.362		
TC	+	-0.17168	0.607	-0.00291	0.415
EQ	+	0.37165	0.034**	-0.00085	0.919
INS	+	-0.70084	0.674		
BMV	+	-0.33049	0.095*		
ASSGRO	+	-4.40892	0.161		
AUD	+	1.76377	0.063*		
GROPP	+	9.57867	0.004***		

FERC = future earnings response coefficient, TC = tax compliance, EQ = earnings quality, FP = financial performance, INS = institutional ownership, BMV = book to market value, ASGRO = asset growth, AUD = audit quality, GROPP = growth opportunity

*** significant at α = 1%, ** significant at α = 5%, * significant at α = 10%*

with financial performance as an intervening variable. Structural equation models were used for this test, and Table 4 shows that earnings quality has a good influence on future earnings response coefficient directly rather than through financial performance. In this study, corporate financial performance cannot mediate impact of earnings quality and tax compliance on future earnings response coefficient.

Conclusion

Conclusion of the Study

Based on the analysis, the study did not find a significant effect of tax compliance and financial performance on the future earnings response coefficient, whereas earnings quality reflected in financial information affects the future earnings response coefficient, which means that it can reflect future earnings because earnings information is protected from earnings manipulation including tax policy.

This study also did not find the intervening role of financial performance on the effect of tax compliance and earnings quality on the future earnings response coefficient, which means that financial information in the analysis unit does not help investors predict future earnings.

Implications

The results can provide important implications for corporate management in the process of preparing financial statements to provide quality financial information. Although this implication may be contrary to the manager's personal goals, the impact of earnings quality can ultimately increase the corporate value because investors believe in the entity's financial information.

Limitations and Recommendations for Future Research

There are several limitations in this study. First, not all companies recorded Deferred Tax Asset even though it was explained in IAS 12, so it had to be eliminated in this study. Likewise, there are some share prices that have not been published by our data sources, so they must be eliminated. This result only explains manufacturing companies in Indonesia and Thailand; future studies can use a variety of industries or other countries to analyze the impact of industry characteristics and other factors that might have an impact on the results of the analysis.

Furthermore, financial performance in this study was measured using ROCE, which was used little in analyzing future earnings. Future studies can use ROA and ROI, which are more commonly used, so the results of the study may be different.

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