

Standards Reform, Manipulation of Financial Statements and Debt Financing Based on the Perspective of Subsidiaries' Dividends Under Dual-Disclosure System

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Abstract: In 2006, China published new Chinese Accounting Standards (CAS), and required Chinese companies to apply it since 2007. One big change made in new CAS is the method account for long-term equity investments, which provide opportunities for the parent company to manipulate its parent earning through transferring more dividends from subsidiaries. Based on the background, this paper investigates the effect of changes in accounting standards on corporate's behaviors for Chinese listed companies. We find that subsidiaries of Chinese listed firms make huge payments of cash dividends to their parent companies to avoid losses or decline in earnings of parent companies after adoption of new accounting standards. In further, we find that cash dividend payments by subsidiaries significantly increase debt financing of the parent company. Overall, our study shed lights on how accounting standards reform trigger changes in corporate behaviors.

Keywords: Accounting Standards; Earnings Management; Debt Financing

1. Introduction

With the rapid development of global trade, it is necessary to apply more convergent standards. As the results, countries like Japan and member countries in European Union, adopt International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB). Some other countries like China publish new accounting standards which is convergent to IFRS.

Since 1978, China has conducted the economic reform from a centrally planned to a market-based economy, and experiences rapid developments in economy and society. The economic reform was designed to prompt the

modernization of Chinese economy, enhance the communication with international markets and attract foreign capital ^[1]. Thus, accounting reform followed by the economic reform was needed ^[2]. The introduction of new Chinese Accounting Standards (CAS) in 2006 was regarded as a substantial step for Chinese accounting system to achieve convergence with IFRS, as they cover nearly all of the topics under IFRS or make progressive changes to conform to China's unique institutional, economic and social environments. The new standards incorporate accounting principles familiar to investors worldwide. Thus, numerous studies have conducted to argue whether the compulsory adoption of IFRS-convergent accounting standard in China increase accounting quality ^[3,4]. However, the inherent flexibility in principles-based standards (i.e. IFRS) could increase firms' opportunity to manage earnings ^[5,6].

One big change made in new CAS is the method account for long-term equity investments. Different from United States, China employ a "double-disclosure" system. Chinese companies are required to report both the consolidated and parent financial statements. Specifically, company applies cost method to recognize and record long-term equity investments in the parent financial statements and the equity method in consolidated financial statements. New standards related to long-term equity provide managers higher flexibility to manage earnings reported in financial statements of parent company. Under the cost method, the parent company reports the gain on investments in the parent financial statements only when it actually received cash dividends from subsidiaries. As parent company has the dominant power over subsidiary's dividend policy ^[7], parent company has the opportunity

to manipulate reported parent earnings by transferring discretionary amounts of profits from subsidiaries. Therefore, this study aims to explore whether companies will employ such opportunity to management earnings with the changes in standards.

Our research sample consists of A-share listed companies on the Shanghai and Shenzhen stock markets from 1999 to 2017, which divide the duration into the pre-adoption periods from 1999 to 2006 and the post-adoption periods from 2007 to 2017. Our results show that companies would manage the reported earnings upward in the parent financial statements to avoid losses or declines through transferring more dividends from its subsidiary companies during the post-adoption periods. When preparing consolidated financial reports, information about both parent company and its subsidiaries is aggregated. As the rights for claims are based on the legal entity (i.e. parent company) not the economic entity, debt holders pay more attention on accounting information in the financial statements of parent company. Thus, we find parent companies' ability of debt financing are significantly associated with the profits shifted from subsidiaries during the new CAS periods of 2007 - 2017.

Our study contributes to existing literatures about economic effects of adoption IFRS-convergent standards in countries with different institutional environments and financial systems ^[5,8], especially in the emerging markets. In addition, our results support that higher standards flexibility resulting from new CAS provide an opportunity for listed firms to manage the earnings reported in parent financial statements ^[9]. Our results also provide evidence that the financial statement of parent company is useful for debt holders in a "double-disclosure" accounting system.

2. Literature Review and Research Hypothesis

2.1 Literature Review

As to support the growing international shareholding and trade, International Accounting Standards Board (IASB) establishes an internationally acceptable set of financial standards, simply known as IFRS for International Financial Reporting Standards. IFRS is developed for the aim of increasing the

comparability, understandability and transparency of financial statements for companies around the world. Many researches have been conducted to investigate the effects of IFRS adoption and standards convergence, especially focusing on whether the internationally acceptable standards are associated with high degree of accounting quality as it expected. However, previous studies show mixed results.

Firms in countries which apply International Accounting Standards show less earnings management, more timely loss recognition, and more value relevance ^[5]. In order to investigate the effect of adoption IFRS on accounting qualities for firms in member countries in European Union, Chen et al. ^[10] found that companies' accounting qualities were improved after the adoption of IFRS. Some more studies also found positive effects of IFRS adoption ^[11,12]. However, some studies find different results about the application of IFRS on accounting quality. Based on the larger sample of firms from 20 IFRS- adoption countries, Ahmed ^[8] conducted the difference-in-difference research method with the sample of matched firms to compare the effects of IFRS adoption. Interestingly, they find an increase in income smoothing and aggressive reporting of accruals and a decrease in timeline of loss recognition for the firms in IFRS adoption countries relative to benchmark countries. The possible explanation for the reduction in accounting quality after IFRS adoption is the inherent flexibility in the principles-based accounting standards ^[5,8].

The lack of detailed implementation in standards increases the flexibility of managerial discretion over accounting decisions. Comparing to the rules-based standards like Generally Accepted Accounting Principles (GAAP), IFRS are more microeconomic and principles-based standards. Dye ^[6] investigates the possibility of classification manipulation conducted by firms due to the existence of conventional binary classification in GAAP and GAAS. With the equilibrium model analysis, they find that more firms conduct classification manipulation in order to receive favorable accounting classification. In other words, the flexibility in accounting standards contributes to the management on reported earnings. The empirical analysis conducted by Dechow et al. ^[13] suggests that managers can

achieve the income smoothing through the fair value accounting in standards, as managers have more discretion over accounting estimation. Dye and Sridhar, ^[9] proceed with a comparison between the rigid accounting standards and flexible accounting standards under a competitive capital market setting and an imperfectly capital market setting. They find that the flexible accounting standards perform better than rigid accounting standards when the financial reporting environment changes. When the cost of earnings management is high, flexible accounting standards perform better.

Besides the countries choose to completely adopt IFRS, some other countries like China make conversion plans to IFRS. The convergence of IFRS is also a controversial issue. For example, Liu et al. ^[3] find that following the adoption of IFRS-convergent standards, the quality of accounting reporting for Chinese listed firms is improved with a decrease in earnings management and an increase in value relevance. He et al. ^[14] finds that the fair value accounting for trading securities, which was also introduced by new CAS, benefit investors by providing relevant information. However, managers' incentives to meet the regulatory earnings targets lead to the unintended effects of IFRS adoption in China. Cang et al. ^[4] also show that the new IFRS-convergent standards in China does increase the possibilities of companies to conduct earnings management.

2.2 Research Hypothesis

As mentioned earlier, Chinese Accounting Standards require listed companies to disclose both the consolidated and parent financial statements, like Japan and Spain. Several studies are conducted to investigate the associate between the dual disclosure systems and its impact on accounting quality. For example, Shuto ^[15] finds that Japanese listed firms manage the parent earnings at a greater extent than consolidated earnings during the period of 1980-1999 for the purpose of avoiding earnings decline. Compared to the persistence of parent-only earnings levels, Herrmann et al. ^[16] find that the persistence of subsidiary earnings levels is proved to be similar or greater in explaining the year-ahead consolidated earnings levels. That is to say, they provide evidence to support the usefulness of subsidiary earnings. Thomas et al. ^[7]

discover that Japanese listed firms use the earnings distribution approach to manage parent earnings through affiliated transactions in order to avoid losses, earnings decreases, and negative forecast errors.

One of the substantial changes made in new CAS is related to the measurements of long-term equity investments. Under the old CAS (regarded as the standards applicable before the issuance of 2006 CAS), the long-term equity investments are account for using equity method, when the enterprise has the control, joint control or significant influence over the investee. In contrast, new CAS states that when the enterprise has the control over the investee (that is enterprise's subsidiary), the cost method is applied to account for the long-term equity investment in the separate financial statements of the parent company. With the equity method applied in old CAS, the enterprise could recognize the share of profit from profitable subsidiary as the gain on investments. Under the cost method, the parent company reports the gain on investments in the parent financial statements only when it actually received cash dividends from subsidiaries.

The changes in accounting standards talked above may create new opportunity for the parent company to manipulate the earnings reported in the parent financial statements, because the parent company has the dominant power over subsidiary's dividend policy ^[7]. When the parent company gets loss or suffers a decline in earnings, managers could make affiliated subsidiary companies to shift more profits from the subsidiary to the parent company through dividend payment, and finally report an upward earnings.

Based on the above analysis, we propose our first hypothesis:

Hypothesis 1: With the application of new accounting standards in China, subsidiaries of listed firms pay more cash dividends to their parent company to avoid losses or earnings declines reported in parent financial statements. What is the motivation for Chinese listed companies to engage in management of the parent earnings? Previous studies have found that debt contracting is one of the primary determinants of managers' accounting method choices ^[17]. In order to reduce the debt contracting cost ^[18] or avoid default in debt covenants ^[19], companies have the motive to

engage in earnings management. Meanwhile, creditors would supervise the debtors' financial situation based on the financial information provided by debtors to prevent loan defaults. However, the rights for claims are based on the legal entity not the economic entity. Therefore, creditors could pay more attention on the information from the parent financial statements. China employs a double-disclosure system, so Chinese listed companies are required to report both the consolidated financial statements and parent financial statements, which enable the creditor to analysis the debtor's financial conditions through the parent financial statements. Thus, the companies have greater incentives to manipulate the earnings reported in the parent financial statements. When managers shift profits from subsidiaries to parent company via cash dividends, the seemingly better financial performance can help company raise more moneys. Therefore, we propose our second hypothesis.

Hypothesis 2: With the application of new accounting standards in China, cash dividend payments distributed from subsidiaries can improve debt financing of parent companies.

3. Research Design

3.1 Sample Selection and Data Sources

Our initial sample consists of A-share listed companies on the Shanghai and Shenzhen stock markets in China from 1999 to 2017. In addition, the sample was processed as follows: (1) excluding data from financial and insurance companies; (2) excluding specially treated companies (with "ST" tags); (3) excluding companies with missing data for variable calculations. Finally, we obtain a sample of 11,509 firm-year observations for testing hypothesis 1 and a sample of 14,643 firm-year observations for testing hypothesis 2. All financial data needed in this study was obtained from RESSET database and CSMAR database. A 1% Winsorization was conducted for all continuous variables to eliminate the interference of outliers. Clustered standard errors at the company level were also performed due to the use of panel data with a large number of cross-sectional samples.

3.2 Model Specifications

3.2.1. Tobit Model for Hypothesis 1

To test Hypothesis 1, we develop the following tobit model:

$$sDividend = \alpha_0 + \alpha_1 LOSS(Dec) + \alpha_2 CAS + \alpha_3 CAS * LOSS(CAS * Dec) + \alpha_4 pLev + \alpha_5 pGrowth + \alpha_6 pCfo + \alpha_7 sRoa + \alpha_8 sSize + \alpha_9 sLev + \alpha_{10} sGrowth + \alpha_{11} sCfo + \varepsilon \quad (1)$$

The dependent variable *sDividend* is defined as the cash dividends paid by subsidiaries to their parent companies, scaled by the end-of-year parent total assets. *CAS* is a dummy variable and equals to 1 if the observation is during the periods when the new *CAS* is applied (2007-2017) and equals to 0 if it is during the pre-adoption periods (1999-2006). We define the variable *LOSS* as 1 when the company gets losses in the parent-own earnings but reports non-negative profits in the parent income statement, and 0 otherwise. The parent-own earnings represent the amounts of profits earned by the parent company itself, excluding the effects of investment incomes on the parent earnings. When the parent-own earnings are negative, managers have strong incentive to manage the parent earnings up and report non-negative profits in annual reports. Similarly, *Dec* equals to 1 if the company suffers declines in the parent-own earnings but reports profits increase in the parent financial statement, and zero otherwise.

According to our Hypothesis 1, we expect a significantly positive coefficient (α_3) on the variable of *CAS*LOSS*, indicating that a listed firm with negative parent-own earnings will increase cash dividends distributed from subsidiaries during the post-adoption periods, for the purpose of reporting positive earnings of parent company. Similarly, a significantly positive coefficient on the variable of *CAS*Dec* is also expected, representing as transfer more cash dividends from subsidiaries to their parent company to avoid a decline reporting in the parent earnings.

As to control the impacts of the firm characteristics of the parent company and its subsidiaries. For example, *pLev* represents the leverage ratio of the parent company. The *pGrowth* represents the growth rate of sales revenues of the parent company. *pCfo* controls the net cash flows from operating activities of the parent company. *sSize* represents subsidiaries' firm size. *sLev* stands for the average leverage of subsidiary companies. *sRoa* is the average return on assets for all subsidiaries of a listed firm. *sCfo* is subsidiaries' net cash flows from operating activities scaled by the end-of-year subsidiary

total assets. sGrowth is measured as the growth rate in the subsidiary total assets. We also include industry dummy variables to control for industry fixed effects.

3.2.2 Regression Model for Hypothesis 2

To test Hypothesis 2, the regression model is constructed as following:

$$\Delta \text{Loan} = \beta_0 + \beta_1 \text{sDividend} + \beta_2 \text{CAS} + \beta_3 \text{CAS} * \text{sDividend} + \beta_4 \text{pDRoa} + \beta_5 \text{pSize} + \beta_6 \text{pLev} + \beta_7 \text{pCfo} + \beta_8 \text{pGrowth} + \beta_9 \text{pFcf} + \beta_{10} \text{pAm} + \varepsilon \quad (2)$$

ΔLoan is defined as the changes in the total amounts of loans borrowed by parent company divided by beginning-of-year parent total assets. sDividend represents cash dividends distributed by subsidiaries divided by beginning-of-year parent total assets. CAS is a dummy variable and equals to one if the observation is during the periods when the new CAS is applied (2007-2017) and equals to zero if it is during the pre-adoption periods (1999-2006). The interaction variable of CAS*sDividend estimates the impacts of subsidiaries' cash dividends on loan borrowings of the parent company before and after the adoption of new accounting standards. According to our analysis, we expect a significantly positive

coefficient on the variable of CAS*sDividend, suggesting that cash dividends distributed from subsidiaries help improve debt financing of parent company during post-adoption period. pDRoa is the ratio of a parent company's net income excluding the cash dividends distributed from subsidiaries to the beginning-of-period total assets.

A series of variables are applied to control the effects of parent company's firm characteristics on debt financing. pSIZE is defined as the natural log of the total assets reported in financial statements of parent company. pLEV is the beginning-of-year total liabilities divided by beginning-of-year total assets of the parent company. pCFO is the net cash flows from the operating activities reported in the parent financial statements divided by the beginning-of-year parent total assets. pGrowth estimates the growth rate of sales revenues of the parent company. pFcf is the free cash flows and the pAm define as the ratio of parent company's fixed assets to its total assets. Detailed definitions and calculations for those variables are presented in Table 1.

Table 1. Definitions and Calculations

Variables	Definitions and calculations
Dependent variables:	
sDividend	The amount of cash dividends distributed from subsidiaries to parent company (SCD), scaled by parent total assets, where: SCD = cash received from investment return reported in cash flow statements of parent company – cash received from investment return reported in consolidated cash flow statements
ΔLOAN	The changes in the total amounts of loan borrowed by parent company (PLoan), scaled by beginning-of-year parent total assets, where: PLoan = (short-term loans + long-term liabilities due within one year + long-term loans + bond payable, year t) – (short-term loans + long-term liabilities due within one year + long-term loans + bond payable, year t-1)
Independent variables:	
CAS	Indicator variable that takes the value of 1 if the firm-year is after year 2007, and 0 otherwise.
Loss	Indicator variable that takes the value of 1 if the firm has negative parent-own earnings but reports non-negative net profits in the financial statements of parent company, and 0 otherwise.
Dec	Indicator variable that takes the value of 1 if the firm gets decline in the parent-own earnings but reports profits increase in the financial statements of parent company, and 0 otherwise.
Parent-own earnings	The amounts of profits earned by the parent company itself, excluding the effects of investment incomes on the parent earnings. Parent-own earnings = net profits reported in parent financial statements – (investments income reported in parent financial statements – investments income reported in consolidated financial statements)
pDRoa	The difference between the parent company net profits and cash dividends from subsidiaries (SCD), scaled by beginning-of-year parent company total assets.
Control variables:	
sSize	The natural log of subsidiaries' total assets, where: subsidiaries' total assets = (the consolidated total assets – the parent company total assets) + (the long-term investments reported in the parent company financial statements – long-term investments from the consolidated financial statements)
sLev	The ratio of end-of-year subsidiaries total liabilities to end-of-year subsidiaries total assets, where: subsidiaries total liabilities = the consolidated total liabilities – the parent company total liabilities
sRoa	Subsidiaries' return of earnings on assets, where: subsidiaries earnings = the reported net profits belonging to parent company in consolidated financial statements – the calculated parent-own earnings
sCFO	Subsidiaries' net cash flows from operating activities, scaled by the end-of-year subsidiaries total assets, where: subsidiaries net cash flows from operating activities = the consolidated net cash flows from operating activities – the parent company net cash flows from operating activities
sGROWTH	The growth rate in subsidiaries total assets.
pSIZE	The natural log of parent company total assets.
pLEV	The ratio of the end-of-year parent total liabilities to the end-of-year parent total assets.
pCFO	Parent company's net cash flows from operating activities, scaled by beginning-of-year parent total assets.
pGrowth	The growth rate of sales revenues reported in the parent financial statements for the parent company
pFcf	The Ratio of parent company's net cash flows from operating activities + net cash flows from investment activities, scaled by beginning-of-year parent total assets
pAm	The ratio of parent fixed assets divided by beginning-of-year parent total assets

4. Empirical Results

4.1 Results for Hypothesis 1

4.1.1 Descriptive Statistics

Table 2. shows the descriptive statistics for the test of hypothesis 1. Panel A reports the descriptive statistics for the full sample. Panel B reports the results of a t-test to compare whether the main variables are significantly different before and after the adoption of new CAS.

Table 2. Descriptive Statistics for Test of Hypothesis 1

Panel A: descriptive statistic results for the full sample						
Variables	Sample Size	Mean	Standard deviation	Minimum	Medium	Maximum
sDividend	11509	0.0200	0.0500	0	0	0.320
CAS	11509	0.720	0.450	0	1	1
Loss	11509	0.220	0.410	0	0	1
Dec	11509	0.480	0.500	0	0	1
pLev	11509	0.410	0.210	0.0100	0.410	1.190
pGrowth	11509	0.200	0.980	-0.990	0.0700	7.620
pCfo	11509	0.0300	0.0800	-0.240	0.0300	0.280
sSize	11509	20.69	1.880	14.35	20.71	25.33
sRoa	11509	0.0300	0.110	-0.530	0.0200	0.640
sLev	11509	0.420	0.380	-1.820	0.460	1.660
sGrowth	11509	0.630	2.580	-1	0.130	23.35
sCfo	11509	0.0500	0.200	-0.910	0.0500	0.950
Panel B: Results of t-test						
	Pre-adoption		Post-adoption		Test of means	
	Mean		Mean			
zgsDividend	0.0100		0.0220		-0.012***	
Loss	0.238		0.208		0.030***	
Dec	0.522		0.450		0.073***	

Table 3 shows Pearson correlation matrix of main variables. Those independent variables CAS, Loss, CAS*Loss, Dec, and CAS*Dec are

As is shown in Panel A, the mean of sDividend is 0.02 percent for the full sample. However, there is significant difference between the mean of sDividend during the pre-adoption period and the mean of sDividend during the after-adoption period. That is to say, on average, subsidiary companies distribute a larger amount of cash dividends to their parent company after adoption of new CAS. During the post-adoption periods, there are less companies report a loss or decline in the parent-own earnings for the parent company.

significantly correlated with the dependent variable sDividend.

Table 3. Pearson Correlation Results for Variables in Model (1)

	sDividend	Loss	CAS	CAS*Loss	Dec
sDividend	1				
Loss	0.108***	1			
CAS	0.119***	-0.018**	1		
CAS*Loss	0.138***	0.810***	0.263***	1	
Dec	0.026***	0.329***	-0.049***	0.265***	1
CAS*Dec	0.088***	0.249***	0.440***	0.411***	0.740***

Note: ***, **, * respectively indicate passing the test at significance levels of 1%, 5%, and 10%.

4.1.2. Regression Analysis

We present our regression results for the test of whether the changes in standards as for the long-term equity investments provide a new opportunity for managers to manage up the earnings in the parent financial statements to avoid losses or declines in earnings through subsidiary dividend policy.

In Column (1) of Table 4, the coefficient on the variable of CAS*Loss is 0.008 (p-value<0.05), supporting our Hypothesis 1. In other word, when the parent-own earning is negative, parent company will receive a larger amount of cash dividends from its subsidiaries to avoid

loss during the post-adoption periods. Similarly, the coefficient on the variable of CAS*Dec is 0.006 (p-value<0.1), as shown in column (2) of Table 4. This result supports that parent companies also receive a larger amount of cash dividends from subsidiaries after new CAS adoption, as to avoid a decline reporting in the parent-own earnings. In addition, both the coefficients on the variable of Loss and on the variable of Dec are significant, suggesting that there is no significant relationship between earnings management of parent company and distribution of the subsidiaries' dividends during the pre-adoption periods.

Table 4. Regression Results of Test of Hypothesis 1

	(1)	(2)
	sDividend	sDividend
CAS	0.002 (0.78)	0.000 (0.17)
Loss	0.002 (0.50)	
CAS*Loss	0.008** (2.13)	
Dec		-0.001 (-0.35)
CAS*Dec		0.006* (1.71)
mgsLev	0.010*** (10.54)	0.011*** (11.46)
mgsGrowth	-0.000 (-0.68)	-0.000 (-0.61)
mgsCfo	0.016*** (2.62)	0.014** (2.37)
zgsSize	0.192*** (25.74)	0.194*** (25.95)
zgsRoa	0.014*** (29.18)	0.014*** (29.07)
zgsLev	0.002*** (8.65)	0.003*** (9.14)
zgsGrowth	-0.001* (-1.80)	-0.001* (-1.95)
zgsCFO	0.049*** (11.76)	0.049*** (11.81)
constant	-0.334*** (-30.90)	-0.332*** (-30.45)
Industry	Controlled	Controlled
N	11509	11509
Pseudo R ²	-0.369	-0.367

Notes: The coefficients are estimated using the Tobit model. ***, **, * respectively indicate passing the test at significance levels of 1%, 5%, and 10%. The T values are in the brackets.

4.2 Results for Hypothesis 2

4.2.1 Descriptive Statistics

We present descriptive statistics of regression sample for testing hypothesis 2 in Table 5. The

mean of Δ LOAN during the pre-adoption periods is 0.04. The mean for the variable of sDividend is 0.02. And, the mean of pDRoa is 0.03.

Table 5. Descriptive Statistics for Test of Hypothesis 2

Variables:	Sample	Mean	SD	Minimum	Medium	Maximum
Debt	14643	0.0400	0.160	-0.420	0	0.780
sDividend	14643	0.0200	0.0400	0	0	0.320
CAS	14643	0.7806	0.4138	0	1	1
pDRoa	14643	0.0300	0.0800	-0.320	0.0300	0.360
pSize	14643	21.38	1.180	18.21	21.25	24.82
pLev	14643	0.960	0.750	0.0400	0.790	5.570
pCfo	14643	0.0400	0.110	-0.410	0.0400	0.440
pGrowth	14643	0.200	1.020	-0.990	0.0600	8.140
pFcf	14643	-0.0300	0.190	-0.950	-0.0100	0.460
pAm	14643	0.190	0.180	0	0.150	0.740

Table 6 reports the Pearson correlation matrix of main variables of regression model (2). As we seen, the variable CAS*sDividend is

significantly correlated with the changes in the total loan borrowed by parent company.

Table 6. Pearson Correlation Results

	Debt	sDividend	CAS	CAS*sDividend
sDividend	0.039***	1		
CAS	0.023**	0.109***	1	
CAS*sDividend	0.045***	0.960***	0.194***	1
pDRoa	0.090***	-0.098***	0.0130	-0.095***

Note: ***, **, * respectively indicate passing the test at significance levels of 1%, 5%, and 10%.

4.2.2 Regression Analysis

For test of hypothesis 1, we already find a

significantly positive association between subsidiaries' cash dividends and management

of parent earnings after adoption of new CAS. To explore the possible reasons for the management of parent earnings, we conduct the regression analysis and report the results in **Table 7**. As predicted by Hypothesis 2, the coefficient on the variable CAS*sDividend is significantly positive, which indicates that after new CAS adoption the amount of cash dividends distributed from subsidiaries significantly improve loan borrowing power for the parent company. However, the coefficient on the variable of sDividend is insignificant. Thus, there is no significant relationship between cash dividends from subsidiaries and change in loans borrowings by parent company before the adoption of new CAS. The parent return of earnings on asset, excluding subsidiaries' dividends, is significantly associated with changes in the parent debt financing, supporting that firms of higher profitability can raise more money from banks. Furthermore, the coefficients on variables of pSize and pLev are also significant. In a word, a positive relationship between cash dividends distributed from subsidiaries and changes in parent debt financing is found after new CAS adoption, which suggests the underlying motivation for the parent company to manipulate the parent earnings is for obtaining more loans.

Table 7. Regression Results for test of Hypothesis 2

	Debt
sDividend	0.012 (0.11)
CAS	-0.003 (-0.87)
CAS*sDividend	0.216* (1.95)
pDRoa	0.225*** (13.62)
pSize	0.004*** (3.15)
pLev	0.006*** (3.15)
pCfo	0.074*** (5.81)
pGrowth	0.007*** (6.05)
pFcf	-0.159*** (-20.24)
pAm	0.002 (0.19)
constant	-0.057** (-2.19)
industry	Controlled
N	14643
Adj.R ²	0.056

Notes: The coefficients are estimated using the regression model. ***, **, * respectively

indicate passing the test at significance levels of 1%, 5%, and 10%. The T values are in the brackets.

5. Robustness Checks

Cash dividends of the parent company is a kind of behavior that the enterprise distributes profits to the shareholders, resulting in the reduction of the owner's equity of the enterprise. For the creditors, the owner's equity is the basis and guarantee for them to exercise the "residual claim". Therefore, the distribution of cash dividends of the parent company increases the risk of debt repayment. In addition, the cash dividends reduce the parent company's cash flows. Compared with non-dividend companies, cash dividend companies are more motivated to expand external financing channels and increase external financing capacity. In addition, the main capital expenditures of an enterprise include three kinds of activities: operation, financing and investment. The major investment expenditures of an enterprise often indicate the investment activities of the company, and affect the financing strategy of the enterprise. Therefore, it is necessary to test the robustness of the main regression results after controlling the cash dividend behavior of the parent company and major investment arrangements of the parent company. Therefore, based on the model (1), we add the indicate variable of SEO to measure whether the parent company is willing to distribute cash dividends. In addition, an index "investment_forward" is applied to measure whether the parent company has the willing to conduct significant investment arrangements in the next year. The index is calculated as the sum of four items from the parent company's statements of cash flows, including the cash paid for the construction of fixed assets, intangible assets and other long-term assets, cash paid to obtain subsidiaries and other business units, cash paid for investment and other cash payments related to investment activities, to the total assets of the parent company. The larger the value is, the more likely the enterprise is to meet the criteria for major investment arrangements. **Table 8** shows the relationship between the subsidiary's dividends and the modification of the parent company's statements after controlling the parent company's dividend willingness and major investment arrangements. It can be seen

that the interaction term CAS * loss and CAS * Dec are still significantly positively correlated after adding the two control variables.

Table 8. Robustness Tests

	(1)	(2)
	sDividend	sDividend
CAS	0.002 (0.88)	0.000 (0.18)
Loss	0.002 (0.54)	
CAS*Loss	0.009** (2.24)	
Dec		-0.001 (-0.50)
CAS*Dec		0.006* (1.87)
pLev	0.011*** (11.45)	0.012*** (12.39)
pGrowth	-0.000 (-0.43)	-0.000 (-0.38)
pCfo	0.015** (2.52)	0.014** (2.27)
sSize	0.190*** (25.57)	0.192*** (25.80)
sRoa	0.014*** (28.44)	0.014*** (28.33)
sLev	0.003*** (9.12)	0.003*** (9.60)
sGrowth	-0.000 (-1.56)	-0.001* (-1.72)
sCFO	0.048*** (11.73)	0.049*** (11.77)
Seo	-0.007*** (-4.67)	-0.007*** (-4.56)
Invest forward	0.017*** (4.52)	0.016*** (4.20)
constant	-0.327*** (-30.39)	-0.325*** (-29.92)
Industry	Controlled	Controlled
N	11310	11310
Pseudo R ²	-0.365	-0.363

Notes: ***, **, * respectively indicate passing the test at significance levels of 1%, 5%, and 10%. The T values are in the brackets.

6. Conclusions

Based on the application of new Chinese accounting standards since 2007 and the double-disclosure system, Chinese companies are required to use cost method to recognize and record long-term equity investments in the parent financial statements and the equity method in consolidated financial statements. As the parent company have the dominant power to affect subsidiaries' dividend policy, the change in long-term equity standards may provide new opportunity for the parent company to manipulate parent earnings through profits shifting from subsidiaries to parent company. In addition, this study also aims to figure out the possible reason that urges the parent company to manipulate its parent

earnings.

As the results, this study finds a significantly positive association between the cash dividends distributed by the subsidiary and the management of the earnings reported in the annual accounts of the parent company's financial statements after the application of new accounting standards. After the application of new accounting standards since 2007, the managers shift more cash dividends from the subsidiary to the parent company in order to avoid avoiding losses or suffering declines in earnings reported in the parent financial statements. Besides, the motivation that urges the parent company to manipulates the earnings reported in the parent company's financial statements is related to debt financing. In order to obtain more loans, the company shifts more profits from subsidiaries to the parent company. Thus, a significantly positive relationship between subsidiaries' cash dividends and debt financing is found.

This study brings out new insight into the impacts of adoption of IFRS-convergent standards on earnings management behaviors of Chinese companies, and provides evidence that the financial statement of parent company is useful for debt holders in the "double-disclosure" accounting system.

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