



Survey of The Effect of Tax Reporting Variables on Financial Reporting Quality

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Abstract

Financial statements users are interested on receiving clear and trustable financial information. To achieve this goal some users tried to affect regulator bodies and change rules and some governments for solving this problem and complying governmental needs, tried to regulate accounting environments. Governmental regulation caused changes in reporting environment and financial information quality that companies prepare and render to different users. Some regulator bodies and researchers have forecasted tax reporting will increase financial statements quality. In this survey different variables that can cause tax accounting affect financial reporting are examined. The results of this survey have shown one of the most important advantages of tax reporting is increasing financial statements clarity and quality. Thus investors and other users are interested to betterment and making a powerful tax reporting because they believe powerful tax reporting will increase clarity and quality of financial reporting. In this survey by using questionnaire the data required was gathered and analyzed by Likert's Spectrum and Z-test and for questionnaire reliability Cronbach's Alpha model used.

Key words: *tax reporting, reporting quality, information clarity, regulator bodies, tax rules.*

1. INTRODUCTION

Empirical research about tax evasion and the informal economy has exploded in the past few decades, seeking to shed light on the magnitude and (especially policy) determinants of these phenomena. Quantitative information informs the analysis of policy choices, enables the testing of hypotheses about determinants of this phenomenon, and can help with the accurate construction of national income accounts. Even as empirical analysis has burgeoned, some have expressed doubts about the quality and usefulness of some prominent measures. The fact that high-quality data is elusive is neither surprising nor a coincidence. The defining characteristic of tax evasion and informal economic activity—that they are generally illegal—



often renders unreliable standard data collection methods such as surveys. Unlike invisible phenomena in the natural sciences, these invisible social science phenomena are hard to measure because of choices made by individuals. Analysis of tax evasion and the informal economy must proceed even in the absence of the direct observability of key variables, and theory should guide the construction and interpretation of evidence of the “invisible” (Slemrod & Weber). Accounting information is one of the most important tools for decision making by users. When financial statements credibility increase the possibility of making a mistake in decision making will be decreased.

Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The Framework for the Preparation and Presentation of Financial Statements states in paragraph 25 that ‘users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.’ Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions (IAS No.1).

2. LITERATURE REVIEW

In Iran not using International Accounting Standard 12 Income Taxes will cause financial information and EPS and some ratios like P/E be distorted. And so matching principle and other principles of accounting won't be regarded and this will have a negative effect on financial reporting transparency. This happens in the environment that IAS is trying to increase the quality and transparency of financial information. As researchers has shown now in Iran there is no tax accounting standards and the only rule for tax is the Iran's rule No. 272 and is not done base on IAS.

Tax reporting role has become so much important since the year 2001 after that society understood, scandals about moral hazards of not having transparent reporting in Worldcom, Telecom, Xerox and Enron is true. Because one of the most important reasons about their acts was that they didn't want to pay the real amount of tax for income, for this purpose they tried to do some acts that it may cause financial information be distorted and these information weren't transparent. At this time SEC and US Treasury Department has become more interested about financial information transparency. For a long time this financial immorality was argued at news and scientific journals to observe the reasons. Thus financial reporting transparency has become more and more important.



The role of governmental agencies as one of the most important groups of users of financial information has become an important subject for standard setters.. Earnings management undermines financial markets by reducing their transparency, along with shareholders' ability to monitor managers. Tax sheltering reduces the efficiency and equity of the tax system. The joint rise of these two problems, beginning in the 1990s and apparently persisting even as the pendulum swung back towards more cautious managerial behavior, reflects, at a minimum, elements of joint causation. Both phenomena reflect the impact of financial innovation, which has created new tools and opportunities for nuanced and aggressive planning in both areas. Both seem to have reflected as well the rise of greater competitive pressures on corporate management, along with enhanced competition and entrepreneurialism in the markets for legal and accounting services (shivaro, 2008).

The key to FASB's relative independence from industry-specific and managerial influence is a fortuitous alignment between (1) the grounds on which it can most persuasively claim professional expertise, and (2) the interests of investors. Its stance as a nonpolitical expert decider could not easily be squared with the instrumental accounting-style exercise of balancing interests and evaluating competing social objectives (Bratton, 2007). Instead, the claim to an expert stance invites purporting to apply "neutral accounting principles" that seek to embody the underlying concept of economic income (Mundstock, 2003). This, in turn, is best rationalized by reference to informing investors, the protection of whom also jibes with the SEC's institutional mission (Bratton, 2007). FASB identified investor protection as its core mission early on, issuing a "Conceptual Framework" that "broke with past accounting theory to raise external transparency – 'decision usefulness' for the users – over internal control [by the managers] as the system's goal (Shaviro, 2004)."

Lisowsky(2008) the variable of great interest to the IRS is the actual tax burden of a firm. Quantifying and understanding the empirical relationship between actual tax liability, on the one hand, and current U.S. tax expense, tax benefit from stock options, tax cushion, intraperiod tax allocation, and consolidation book-tax differences, on the other hand, can assist IRS auditors in estimating compliance risk or tax aggressive-ness. Specifically, Gleason and Mills (2002) find a positive relationship between the tax cushion and IRS audit adjustments. Separately, Dyreng et al. (2008) use cash taxes paid as a proxy for short- and long-run tax avoidance. To the extent this study successfully identifies proxies for items that may be related to U.S. tax liability, the IRS and tax researchers may more directly assess audit risk by understanding which items, such as stock options, tax cushion, or firm (consolidation) structure warrant further scrutiny.



The extant academic research suggests that financial statement disclosures of tax information provide, at best, cloudy estimates of a firm's tax liability. Although investors and analysts treat these disclosures as relevant, they appear to be unsure of their magnitude, as book-tax differences are systematically associated with future earnings, stock returns, and forecast errors. Finally, the IRS and tax researchers are interested in understanding the differences between current U.S. tax expense and Total Tax in order to supplement their models of tax aggressiveness or tax avoidance (Lisowsky, 2008).

Scholes, Wilson, and Wolfson (1990) conclude that banks are willing to pay substantial income taxes related to gains from sales of securities in order to boost their book income and regulatory capital, consistent with financial reporting incentives dominating tax reporting incentives with respect to choices made by regulated industries. On the other hand, Guenther, Maydew, and Nutter (1997) find that a sample of firms that experienced an increase in book-tax conformity after the Tax Reform Act of 1986 deferred income recognition, thereby incurring financial reporting costs to avoid explicit tax costs. Other studies examining trade-offs between financial and tax reporting decisions include Johnson and Dhaliwal 1988; Matsunaga, Shevlin, and Shores 1992; Guenther 1994; Hunt, Moyer, and Shevlin 1996; Jenkins and Pincus 1998; Maydew 1997; Engel, Erickson, and Maydew 1999. See Shackelford and Shevlin 2001 for a thorough review of the trade-off literature (Frank, J. Lynch, Rego, 2008).

To address these issues, this study now tries to develop and illustrate tax reporting variables effects on financial reporting quality.

3. HYPOTHESIS

In order to investigate the relationship between tax reporting variables and financial reporting quality, our study specifies the following hypothesis:

3.1.Hypothesis 1

H₀: Regulating tax reporting has a significant effect on financial reporting credibility.

3.2.Hypothesis 2

H₀: Regulating tax reporting has a significant effect on financial reporting quality.

3.3.Hypothesis 3

H₀: Tax reporting clarity has a significant effect on financial reporting quality.



3.4. Hypothesis 4

H₀: Regulating tax reporting has a significant effect on decreasing expectation gap between different groups of users of financial statements.

4. METHODOLOGY

4.1 Data and Sampling Design

Data of this study were collected by a comprehensive questionnaire from different groups of users of financial statements like Iranian CPA's, professors in accounting, finance, business, economic and Iran Tax Organization and investors. Because number of these groups member was unknown we selected 30 members from these groups of users as primary sample. The variance of this sample was about 34 and the whole sample is calculated as follow:

$$n = \frac{s^2 * Z_{\alpha/2}^2}{d^2} = \frac{34^2 * 1.96^2}{5^2} \cong 178$$

S²= sample variance
α=95%

As we sent the questionnaire to 5 different groups of users of financial statements we divided whole this sample between these groups of users equally as follow:

$$n_i = \frac{n}{NG} = \frac{178}{5} \cong 36$$

n= whole sample calculated above.

NG= Number of Groups that questionnaire sent to them to answer.

n_i= number of sample that questionnaire has been sent to from each group.

Then we sent them the questionnaire and guide letter and requested them to complete it. The questionnaire contained 37 questions (5 general questions and 32 questions related to hypothesis).

5. ANALYSIS OF RESULTS

This study for measuring data gathered by questionnaire employed Likert's Spectrum and t-student and Correlation-test has been done by spss software, and for questionnaire reliability Cronbach's Alpha model used. The result of Cronbach's Alpha model is as follow:



Table 1: The result of Cronbach's Alpha model

Reliability Statistics	
N of items	Cronbach's Alpha
32	.835

Table 2 presents the minimum, maximum, mean, standard deviation, variance, standard deviation for whole questions of questionnaire base on answers measured by a 5 part Likert's Spectrum.

Table 2: The results of descriptive analysis for questions of questionnaire

Question No.	Max	Min	Mean	Variance	Question No.	Max	Min	Mean	Variance
1.	5	2	4.4	.41	17.	5	2	3.9	.42
2.	5	2	4.2	.43	18.	5	2	4.1	.41
3.	5	2	4.2	.47	19.	5	2	4.4	.43
4.	4	2	3.8	.38	20.	5	2	3.9	.32
5.	5	3	4.1	.40	21.	5	2	4.1	.43
6.	5	2	3.9	.36	22.	5	2	4.0	.46
7.	5	2	4.8	.42	23.	5	3	4.6	.26
8.	5	2	4.0	.51	24.	4	2	3.3	.43
9.	5	2	3.8	.43	25.	5	2	3.9	.37
10.	5	2	4.1	.44	26.	5	2	4.2	.48
11.	5	2	3.7	.31	27.	5	3	4.6	.29
12.	5	2	4.1	.41	28.	5	2	4.1	.46
13.	5	2	3.9	.47	29.	5	2	4.2	.41
14.	5	4	4.9	.16	30.	4	2	3.6	.36
15.	3	1	2.6	.25	31.	5	3	4.3	.32
16.	5	2	3.8	.17	32.	5	2	4.1	.44

H1: Regulating tax reporting has a significant effect on financial reporting credibility.

To examine this hypothesis we designed 9 questions and polling from 180 persons scoring by Likert's Spectrum. The results of t-student for first hypothesis are shown in table 3 as follow.

Table 3: the results of t-student for H1

One-Sample Test

Test Value = 3						
95% Confidence Interval of the Difference						
Upper	Lower	Mean Difference	Sig. (2-tailed)	df	t	
1.2657	1.1651	1.21541	.000	179	47.608	H1



To survey above hypothesis we used t-student method.

$H_0: \mu \leq 3$

$H_1: \mu > 3$

Regarding the T value in table 1 this hypothesis have been verified; thus
"Regulating tax reporting has a significant effect on financial reporting credibility."

H2: Regulating tax reporting has a significant effect on financial reporting quality.

To examine this hypothesis we designed 10 questions and poling from 180 persons scoring by Likert's Spectrum. The results of t-student for first hypothesis are shown in table 4 as follow:

Table 4: the results of t-student for H2

One-Sample Test

95% Confidence Interval of the Difference		Mean Difference	Sig. (2-tailed)	df	t	H2
Upper	Lower					
1.3773	1.2477	1.31247	.000	179	39.886	

To survey above hypothesis we used t-student method.

$H_0: \mu \leq 3$

$H_1: \mu > 3$

Regarding the T value in table 1 this hypothesis have been verified; thus
"Regulating tax reporting has a significant effect on financial reporting quality."

H3: Tax reporting clarity has a significant effect on financial reporting quality.

To examine this hypothesis we designed 6 questions and poling from 180 persons scoring by Likert's Spectrum. The results of t-student for first hypothesis are shown in table 5 as follow:

Table 5: the results of t-student for H3

One-Sample Test

95% Confidence Interval of the Difference		Mean Difference	Sig. (2-tailed)	df	t	H3
Upper	Lower					
1.2189	1.0704	1.14466	.000	179	30.369	



To survey above hypothesis we used t-student method.

$H_0: \mu \leq 3$

$H_1: \mu > 3$

Regarding the T value in table 1 this hypothesis have been verified; thus
"Tax reporting clarity has a significant effect on financial reporting quality."

H4: Regulating tax reporting has a significant effect on decreasing expectation gap between different groups of users of financial statements.

To examine this hypothesis we designed 7 questions and poling from 180 persons scoring by Likert's Spectrum. The results of t-student for first hypothesis are shown in table 6 as follow:

Table 6: the results of t-student for H4

One-Sample Test

95% Confidence Interval of the Difference		Mean Difference	Sig. (2-tailed)	df	t	H4
Upper	Lower					
1.3203	1.2095	1.26490	.000	179	44.955	H4

To survey above hypothesis we used t-student method.

$H_0: \mu \leq 3$

$H_1: \mu > 3$

Regarding the T value in table 1 this hypothesis have been verified; thus
"Regulating tax reporting has a significant effect on decreasing expectation gap between different groups of users of financial statements."

6. CONCLUSION

Based on analytical methods that described above:

First, the credibility of financial statements by different groups of users of financial information is increasingly dependent to tax reporting regulating; almost all groups of users believe that a group of comprehensive rules for tax reporting will cause financial reporting become well and the credibility of financial information increase.

Second, different groups of users of financial statements believe that the quality of financial information is really affected by a lot of factors, one of the most important factors is tax reporting rules and users believe that comprehensive rules that force companies to report their tax in a clear method will cause financial information quality increase.



Third, the expectation gap between different groups of users of financial information is one of the oldest problems that different groups of regulators and standard setters tried to solve. For solving this problem different suggestions are rendered by different groups. One of the most advantages methods for decreasing expectation gap between different groups of users is regulating financial information reporting and tax reporting.

7. REFERENCES

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