



The Effect of Accounting Conservatism on Income Tax Litigation

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Abstract

This study investigates the relationship of accounting conservatism and income tax litigation. Furthermore this study also examines whether accounting conservatism become the drive to income tax litigation. We use financial ratios that generate tax litigation for understanding the accounting conservatism and income tax litigation relationship. The research sample is manufacturing industry listed at Indonesian Stock Exchange (IDX) within 2004-2008 periods.

Based on financial ratios, i.e. account receivable/account payable, cash receipt/cash disbursement, and sales/operating expenses, and using Ordinary Least Square (OLS) regressions, this study has empirical support the relationship of accounting conservatism and income tax litigation. This examination also approve that accounting conservatism drives income tax litigation. The implication from this research is that accounting standard board must consider the practice of firms accounting conservatism level when they prepare accounting standards.

Key notes: *accounting conservatism, income tax litigation*

INTRODUCTION

Watts (2003a) states in contracting explanation conservative accounting can decrease *moral hazard* caused by parties inside companies which have: information asymmetry, asymmetric salary, limited horizon, and limited obligation. Conservatism limits the managerial opportunistic behavior and erase the managerial bias with its asymmetric variability requirement. The relation between taxation and financial reporting can cause conservatism in financial reporting. Asymmetric recognition from income/profit and expenses/loss make the company manager profitable to save recent value of tax and raise the company value. To postpone recognition from income and fasten recognition from expenses can decrease the taxable income, then running a conservative accounting practices may delay tax payment.

Alleged accounting conservatism with its asymmetric recognition can lead to conflict between the companies with the tax authorities which regard as a result of income corporate tax determination is too low, due to accounting conservatism produces earnings figures and assets tend to be lower and the figures expenses and debts tend to be high. After checking calculations done by the fiscus, this can lead to less pay and then can be the start of the incidence of income tax disputes. This



research will test empirically the relationship between accounting conservatism and income tax litigation. More information can be hypothesized that (1) companies that use more conservative accounting tend to be more susceptible to a tax litigation, and (2) the higher level of accounting conservatism can lead to income tax litigation.

Companies always try to minimize their income tax payment (Guenther et al. 1997). The Methods to calculate taxable profits is related to profit calculation reported in the external financial report. Manager tried to find ways to manage both accounting profit and taxable profit in dealing with *trade-off* to achieve two purposes with *mutually exclusive* characteristics, that is to maximize the accounting profit by minimizing the tax payment. The financial reporting management for external party and financial reporting management for tax purpose is not independent. Both things are consistently dominate the considerations in decision making of accounting method selection. (Shackelford and Shevlin, 2001).

Zarowin (1997) stated that ratio between accounting profit before tax on taxable profit can be used as accounting conservatism measurement. Taxable profit is a very conservative performance measurement, because companies tried to minimize their tax payment. Accounting conservatism caused accounting profit bias low (Chen et al. 2006). This thing resulting in net assets and cumulative profit also set lower which result the financial report users, including investors and creditors, make the inference not correct because of uncertainty of the bias. (SFAC No. 2). Therefore, the *Financial Accounting Standard Board* (FASB) has consistently opposed accounting conservatism (LaFond and Watts, 2008). FASB responded question: *What is the role of conservatism? Does it conflict with neutrality? If not, why not? Why keep it?* With answer as follow:

Financial information needs to be neutral – free from bias intended to influence a decision or outcome. To that end, the common conceptual framework should not include conservatism or prudence among the desirable qualitative characteristics of accounting information. However, the framework should note the continuing need to be careful in the face of uncertainty.

Therefore, the research about accounting conservatism influence on the income tax litigation are interesting to do.

The development happened shows that accounting conservatism practice increases (Basu, 1997). Givoly and Hayn (2000) gave evident that accounting conservatism practice has been run since 1950s, and there's a tendency of increasing intensity. In a case related to taxation, litigation, political process and regulatory pressure, it has influenced the degree of conservatism in accounting principles which is generally acceptable in the United States. FASB has obligated liabilities recognition which were previously *off-balance sheet*, such as: pension, health insurance benefits



after retirement and environmental obligations, together with its associated costs. FASB also publishes standards for the recognition of asset impairment. This standard is acknowledged to increase accounting conservatism. Valuable contracting and expensive regulatory rationale can explain the importance of conservatism in generally acceptable accounting principles (Watt and Zimmerman, 1986). Therefore, if accounting conservatism is increasing in practice, it can effect the profit to be refractive downward further so that the expected level of accounting conservatism will trigger income tax litigation.

This research has two research question as follows: 1) is accounting conservatism connected to income tax litigation; and 2) is accounting conservatism level can be the booster of income tax litigation. The motivation that triggered this study is: first, this study aims to find empirical evidence about the relationship between accounting conservatism with income tax litigation. Previous studies that examined this relationship empirically, has not been done. Watts (2003a) suggested a link between taxation and financial reporting may also lead to accounting conservatism in financial reporting. Mills (1998) states that the measurement of accounting profit according to the financial accounting method is not independent of the measurement according to tax; thereby allegedly accounting conservatism caused income tax determination by firm is lower than the calculation results according to the tax authorities. This can trigger a tax litigation.

Second, this study wanted to examine if the accounting trend is becoming more conservative (Givoly and Hayn, 2000), the earnings downward bias will also be greater, and the determination of income tax by the company will also be lower. Companies try to reduce the present value of income tax to raise the value of the firm (Watts, 2003a). This causes differences in the calculation of corporate income tax and by the tax authorities are becoming increasingly large. It is expected to trigger a tax dispute further.

This research is expected to contribute to the academics and practitioners, which include: (1) contribution to the financial accounting practices literature on accounting conservatism practice which considered an obstacle in financial reporting, (2) to contribute on the real effects of accounting conservatism, which has a relationship with the incidence of income tax litigation, and (3) this research is expected to contribute to the regulators, particularly the standard board and government, as a consideration in the preparation of financial accounting standards and tax accounting.

The hypothesis testing gives results that there is a relationship between accounting conservatism and income tax litigation. Later in the testing that the level of accounting conservatism triggers income tax litigation, using the accounting



conservatism *lag 1*, the result can be obtained that the level of accounting conservatism become the trigger of income tax litigation.

Described in section II is the theoretical framework underlying why conservatism accounting related to income tax litigation and also the development of hypotheses. Section III presents the research methods used to test hypotheses and discuss the measures to proxy accounting conservatism and income tax litigation. Data and analysis are described in section IV. Finally, section V describes the conclusions, research limitations, and implications.

THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

Definition of accounting conservatism

The researchers have introduced various definitions of accounting conservatism. Accountants have traditionally expressed conservatism with rules to anticipate no profits but anticipate all losses (Bliss, 1924 in Watts, 2003a). This can be interpreted as a tendency of accountants requires a higher degree of verification to recognize good news as gains than to recognize bad news as losses. For example, SFAC 2 (FASB 1980), paragraph 95 states: "... if the two amount estimation e to be received or paid in the future that seemed similar, conservatism recommend using less optimistic estimate."

Basu (1997) defines conservatism as the practice of lowering earnings (and decrease net assets) in response to bad news, but do not raise profits (and increase net assets) in response to good news. The literature assessment is based on accounting; researchers often refer to the characterization of Feltham and Ohlson (1995) from the conservative accounting or "biased" as expectations that reported net assets would be less than market value in the long run. Beaver and Ryan (2000) also classify conservatism (or bias) as a persistent difference between market value and book value as distinguished from temporary differences of economic gains and losses recognized in book value gradually over time.

Accounting conservatism example is to choose between lower of cost or market prices for inventories accounting, or immediately recognize changes in the estimated cost if estimated yield losses in the future on a long term contract, but did not revise if it produces profits increase in the foreseeable future; or physical impairment of assets due to obsolescence (impairments), but does not raise to a higher asset value. So, conservatism generates greater probability of timelines recognition of accounting for bad news than good news.

In summary, accounting conservatism is the precautionary principle which does not recognize the benefit until credible evidence is obtained, whereas losses should be recognized when it is likely to happen, no need to wait until there is real



evidence. Accounting conservatism causes the figures presented in the Balance Sheet and Income Statement are set lower. Net asset is set lower and cumulative earnings also set lower, on a contrary the debt and the cost is set at the highest value. As an important consequence of the asymmetric treatment of gains and losses conservatism is over the persistent understatement of net asset value. Capital market regulator, standard setter, and academics criticized conservatism for understatement in the current period can lead to the profit *overstatement* in future periods as the cause of *understatement* future costs (Watts, 2003a).

The relevance of accounting profit and taxable profit

There are similarities in the measurement of accounting profits and earnings for fiscal purpose, which is the accrual accounting method (Guenther et al 1997). Nevertheless, there are some specific items from the revenue and expense which must follow fiscal accounting rules that are different from the financial accounting rules, for example: charging of depreciation of fixed assets. The link between taxation and commercial reporting may also lead to conservatism in financial reporting. Asymmetric recognition of gains and losses in accounting conservatism make profitable enterprise managers to reduce the present value of taxes and increase firm value. Defer recognition of revenue and accelerate the recognition of the costs may delay payment of income taxes (Watts, 2003a).

In tax planning (tax planning), companies usually take strategies to minimize corporate tax (tax-minimizing) which produces a lower reported earnings. The selection of accounting, finance, marketing, production, and other business method functions all tend to lower the taxable profit. Although financial accounting and tax accounting often differ in the recognition of income and other critical care, income tax planning often results in lower accounting earnings (Shackelford and Shevlin, 2001). In short, *financial accounting management* and *tax management* are not independent and there is no consistent consideration that dominates the decision-making.

Guenther et al. (1997) provide evidence of tax policy affecting the financial statements. *Tax Reform Act* of 1986 (TRA 86) in the United States requires that companies use the accrual basis. Prior to TRA 86, firms can use the cash basis (except stocks) or accrual basis for calculating taxable profits. Guenther et al. (1997) found that before the change is required, cash basis taxpayers showed a slight tradeoff in tax planning and financial reporting. After required to use accrual basis, the company previously used the cash basis delay income for financial statement purposes. So that the accrual basis, the congruence between accounting profit and fiscal profit directing the company to change the accrual behavior. By delaying income, they lowered their fiscal income and save taxes, despite the cost to lower reported earnings.



Mills (1998) by using confidential data from the *Coordinated Examination Program* from 1982 to 1992, finds that the proposed tax adjustment by the *Internal Revenue Service* (IRS) is increasing in number as the amount of accounting profit exceeds fiscal profit which also increased, the *tradeoff* for the company between: savings current tax, the cost of the tax, and benefits of financial reporting. Thus, the main implications of the research Mills (1998) is that the company could not be without cost to maximize the benefits of financial reporting and tax savings independently, that is to lower the fiscal profit without affecting the accounting profit.

Positive accounting theory which is based on agency theory can be used to explain the impetus for management to defer payment of income tax. Watts and Zimmerman (1986: 200-221) use agency theory to explain and predict the behavior of management with respect to the selection of accounting procedures by managers to achieve certain goals. They make the following three hypotheses: (1) *bonus plan hypothesis: ceteris paribus*, the manager of the company with a bonus plan is more likely to choose accounting procedures that shift reported earnings from periods that will come to the present period, (2) the hypothesis of *debt/equity: ceteris paribus*, the greater the *debt / equity ratio* of the company, the more likely the manager of the company to choose accounting procedures that shift reported earnings from periods that will come to the present period, and (3) *political cost hypothesis: ceteris paribus*, the greater political costs faced by the company, the more likely the firm's managers choose accounting procedures that suspend the reported earnings from today period to periods now to come. Political *political cost* is related to the *size* of the company, if large companies are also very profitable, it will increase its political cost. Therefore, associated with the encouragement of managers to defer tax payment is in accordance with the third hypothesis, that managers are more likely to choose more conservative accounting.

Tax Litigation

Every Tax Notification (SPT) entered and accepted by the Tax Office (LTO) in the Taxation General Directorate, Ministry of Finance, Republic of Indonesia, performed analysis and examination by the tax man called *Account Representative* (AR) to check the calculation of total tax liabilities by the taxpayer (WP) which has been paid to the State Treasury. The results of the examination may include: compliance, overpayment or underpayment. Of the three possibilities, the WP (taxpayer) will receive a Tax Assessment Letter (STP) which explains that the WP (taxpayer) has been appropriate, overpayment or underpayment in fulfilling tax obligations.

If WP (taxpayer) is compliance in paying his taxes, then the liability with the tax authorities for the relevant fiscal year has been completed. But if companies pay more



which contains the determination and amount of tax underpayment due date when tax payers have to pay to the State Treasury. WP has received STP and agree with the amount of underpayment included in the STP shall meet the pay less obligation, but if the WP did not agree with the amount of underpayment set forth in STP the tax disputes arise.

The above explanation relates to all kinds of taxes, both value added tax (VAT), Income Tax (VAT), as well as land and building tax (PBB). This study will be linked to the Corporate Income Tax.

Development of hypotheses

The research hypothesis is mainly based on positive accounting theory based on agency theory to explain and predict the selection of certain accounting procedures by the company manager for a particular purpose. There are several accounting methods that affect income tax, for example: LIFO inventory valuation method, the method of accelerated depreciation of fixed assets, and other several different accounting methods. Finally, to reduce duplication of record keeping costs, corporate managers have an incentive to use the same accounting procedures for financial reporting and tax purposes (Watts and Zimmerman, 1986: 233).

Tendency of managers to minimize the amount of income tax in the current year, can be done by selecting the accounting procedures and methods of lowering taxable income. Conservatism accounting principle is to accelerate the recognition of expenses and / or loss and slow the recognition of gains and / or income, so that the corporate profits is lower or downward bias, and also resulted in lower set of assets and higher debt is specified. These circumstances lead to the calculation of corporate income tax lower than the calculations by tax authorities, so that the alleged dispute relating to income tax. Based on the above explanation, the hypothesis is developed as follows:

H₁: Conservatism in accounting relates to income tax litigation.

If the accounting conservatism lead to set lower income associated with income taxes is set lower, then it is suspected if the rate accounting conservatism increases (Givoly and Hayn, 2000) will probably trigger a dispute over taxes. On the basis of these explanations, hypotheses can be proposed as follows:

H₂: The level of accounting conservatism could be impetus for income tax litigation.

RESEARCH METHODOLOGY

Data and study sample

In this study it is used secondary data obtained from the financial statements of listed companies in Indonesia Stock Exchange (BEI) obtained through the IDX Web



address: www.idx.co.id. *Purposive random sampling* is done by a sampling method using the following criteria:

- 1) a company listed on the Stock Exchange during the 2004 to 2008 period;
- 2) types of companies are manufacturing;
- 3) do not suffer loss during the study period.

Sample which met the criteria for testing hypothesis 1 are 507 observations in the time period 2004 to 2008. To test hypothesis 2 obtained 342 observations, with the dependent variable observation period from 2004 to 2007 and the independent variable is the observation period from 2005 to 2008.

Model and measurement variables

1. Accounting conservatism size

This study uses accounting conservatism construct that reflects the cumulative effect of accounting method choice in the company, including accounting estimates and assumptions. There are several sizes to accounting conservatism, including: the coefficient of Basu (Basu, 1997), the ratio of book value / market value of equity (Beaver and Ryan, 2000), a measure on the accruals basis (Givoly and Hayn, 2000).

Givoly and Hayn (2000) focus on the influence of accounting conservatism in the income statement over several periods. They argue that conservative accounting leads to persistently negative accruals, as contrasted with the accrual which will reverse (reversal). A consistent amount of negative accruals in several accounting periods, *ceteris paribus*, is an indicator of accounting conservatism. Because the calculation of tax income related to the figures contained in the income statement, then to measure accounting conservatism used in this study follows the accrual-based measure of Givoly and Hayn (2000) who calculated the following way.

$$\text{Total accruals (before depreciation)} = (\text{net income} + \text{depreciation}) - \text{Operating cash flow} \times -1: \text{total assets.}$$

Givoly and Hayn (2000) excluded accrual depreciation because it is a positive accrual that would reverse when the fixed assets acquired and are not captured in the difference between profit and cash flow. Conservatism size is multiplied by -1, so the larger the positive value of the ratio, it is more conservative.

2. The size of the income tax litigation

To examine the hypothesis it needs the financial ratio measurement triggering the income tax dispute between the company management as the tax payer with the



tax authorities. The dispute happened when the result of income tax calculation by the tax payer is smaller than the tax authorities' calculation and tax payer is standing with the calculation result. This study was using the measurement which can make a proxy triggering the income tax dispute happened using the measurement used by Guenther et al (1997) which is using the financial ratios measuring the accrual flows and cash flows as below:

1. The ratio of accounts receivable in accounts payable (AR / AP) measure the overall effect of differences in flow pattern recognition of accrual and cash flow.
2. The ratio of cash receipt to the cash disbursement (CR/CD) identifies the cash management by the company, to measure if the company accelerate the cash acceptance and decelerate the cost payment.
3. The ratio of sales to operating expenses (SALES/EXP) to determine if the tax obligation has the different acknowledgement policy sistematically for financial report purpose, which is decelerate income acknowledgement and accelerate cost loading.

For ratios AR/AP and SALES/EXP, the smaller the ratios predicted the more conservative the company is, as for the ratio CR/CD, the more the ratio predicted the more conservative the company is, so it has tendency to make the income tax dispute.

3. Empirical Specification

Before testing the hypothesis, the classical assumption test is performed, i.e. multi-co linearity, autocorrelation, heteroscedasticity, and normality test. To test the first hypothesis (H1) it is used regression with a method of *Ordinary Least Square* (OLS) with regression equation as follows:

$$CON_i = \alpha + \beta_1 AR/AP_i + \beta_2 CR/CD_i + \beta_3 SALES/EXP_i + \beta_4 ROA_i + \beta_5 SIZE_i + \beta_6 SALESROW_i + \varepsilon$$

(1)

Hypothesis 1 predicts that the coefficient of AR/AP (β_1) and coefficient of SALES/EXP (β_3) is negative, while the coefficient of CR/CD (β_2) is positive. Control variable that affects the accounting conservatism it is used variables as in the research of Ahmed et al. (2002), namely: (1) the level of corporate profitability (ROA), (2) the company size (SIZE), and (3) sales growth (SALESROW).

To test the second hypothesis (H2) the regression equations are as follows:

$$CON_{it-1} = \alpha + \beta_1 AR/AP_{it} + \beta_2 CR/CD_{it} + \beta_3 SALES/EXP_{it} + \beta_4 ROA_{it} + \beta_5 SIZE_{it} + \beta_6 SALESROW_{it} + \varepsilon_i$$

(2)



The whole data processing is done with *EViews* programming.

RESEARCH RESULTS

Classical Assumptions Test Results

Table 1
Multi-co linearity Test

Dependent Variable: AR/AP Sample: 507				
Variable	Co-efficient	Std. Error	t-Statistic	Prob.
CR/CD	3,425400	2,028368	1,688746	0,0919
SALES/EXP	0,072299	0,035778	2,020790	0,0438
ROA	-2,083745	7,958425	-0,261829	0,7936
SIZE	-3,71E-07	8,83E-06	-0,041963	0,9665
SALESGROW	-0,212288	1,062173	-0,199862	0,8417
		Multi-co linearity Test		Regression Result
R-squared		0,008469		0,411487
Adjusted R-squared		0,000569		0,404424
Prob(F-statistic)		0,369659		0,000000

Based on the results that appear in table 1 above, there is no multi-co linearity between independent variables. Therefore there is no relationship between the independent variable used in this research. It is seen from the Adjusted R-squared multi-co linearity test results value is smaller than Adjusted R-squared value of the equation regression, namely: 0,000569 much smaller than 0,404424. Likewise, the Prob (F-statistic) multi-co linearity test results value is not significant, amounting to 0,369659

Table 2
Autocorrelation Test

Dependent Variable: AR/AP Sampel: 507				
Variable	Co-efficient	Std. Error	t-Statistic	Prob.
CR/CD	3.425400	2.028368	1.688746	0.0919
SALES/EXP	0.072299	0.035778	2.020790	0.0438
ROA	-2.083745	7.958425	-0.261829	0.7936
SIZE	-3.71E-07	8.83E-06	-0.041963	0.9665
SALESGROW	-0.212288	1.062173	-0.199862	0.8417
Prob(F-statistic): 0.369659				

Autocorrelation test results can be seen in table 2. It appears that each of the independent variables is not correlated with the values in the past shown by their significant value for all the independent variable is not significant.



Heteroscedasticity Test

Heteroscedasticity test is carried out by *White Heteroscedasticity Tests* (the results can be seen in annex), it is indicated that data from a sample of research there is heteroscedasticity shown by the value of the Prob (F-statistics) which is very significant (0.000000). It is thought to be due to the independent variables in research is a mixture between the form and the natural log ratios, so it can't be avoided that the heteroscedasticity happened.

Normality Test

For normality testing, the data is done with the *Kolmogorov-Smirnov* test. The test results are significant for the entire research variables (the result can be seen in attachment). This shows that all data from a sample of research is distributed normally.

Of the four classical assumptions test made, it can be filled with 3 (three) types of test, namely: multi-co linearity, autocorrelation test, and normality test (d), and there is a test that is not qualified, i.e.: heteroscedasticity test.

Statistical Description

The average value of the proxy conservatism is marked by negative-0.0107, which suggests that companies of the research sample do not hold conservative accounting. The average value of the independent variable are used as proxy tendency causative tax disputes, i.e. the ratio of accounts receivable in accounts payable (AR/AP), the ratio of cash receipts over spending cash (CR/CD), and the ratio of sales, operating expenses were greater than 1 (one). While the average rating for the control variables, namely: ROA, SIZE, and SALES-GROWTH are 0.0737; 23.8882; and 0.2436.

Table 3
Descriptive Statistic

Variable	N	Average	Deviation Standard	Maximum	Minimum
CONS	509	-0,0107	0,11304	0,33	-0,96
AR/AP	508	4,5319	17,42286	213,65	0,00
CR/CD	509	1,0692	0,14743	2,22	0,15
SALES/EXP	509	15,6876	21,17525	216,40	0,00
ROA	509	0,0737	0,09919	1,00	0,00
SIZE	509	23,8882	4,65627	30,38	11,06
SALES-GROW	508	0,2436	0,73361	10,67	-1,00



Hypothesis Testing

By using *Ordinary Least Square* method (OLS), hypothesis testing results are presented in Table 4-1. Hypothesis 1 predicts the relationship between the accounting conservatism with income tax litigation. The ratio of accounting conservatism shows increasingly, the company is more conservative. While income tax dispute is represented by three (3) ratio, i.e. the ratio of accounts receivable against payable business, cash receipt against cash disbursement ratio, and the ratio of sales against operational expenses.

The first ratio which can indicate the cause of the income tax litigation is the account receivable to debt ratio. It is predicted that this ratio has a negative direction because the smaller the ratio means the level of company's accounting conservatism is greater, so that triggers the onset of income tax dispute. As shown in table 4, which is consistent with the predicted direction, this ratio has a negative coefficient of -0,0000975. The second ratio is the ratio of cash receipt from operation activities to cash disbursement. The co-efficient of its prediction marked positive. Consistent with the theory, the coefficient of CR/CD regression results are positive for 0,464449 and very significant.

Table 4
Regression Result of Accounting Conservatism and Tax Litigation Relation

$CON_i = \alpha + \beta_1 AR/AP_i + \beta_2 CR/CD_i + \beta_3 SALES/EXP_i + \beta_4 ROA_i + \beta_5 SIZE_i + \beta_6 SALES/GROW_i + \varepsilon$ Dependent Variable: Accounting Conservatism number of observations: 507				
Variable	the Prediction	Co-efficient	t-statistic	p-value
AR/AP	-	-9,75E-05	-0,434723	0,6640
CR/CD	+	0,464449	16,63142	0,0000
SALES/EXP	-	-1,66E-05	-0,087803	0,9301
ROA	-	-0,388919	-9,727540	0,0000
SIZE	-	-8,74E-08	-1,835458	0,0670
SALES/GROW	-	-0,004276	-0,799668	0,4243
constants	?	-4574,065	-13,94633	0,0000
F-statistic: 58,2664				
F-value: 0,0000				

The last indication of the ratio occurrence of the income tax litigation is the expense ratio of the company sales effort. This ratio is the accrual component of CR/CD (Guenther et al. 1997). If the ratio became smaller, the company more conservative. SALES/EXP ratio coefficient is predicted marked negative. Consistent with the predicted regression results showed this ratio amounted to -0.0000166.

The second hypothesis test results reported in Table 5. The dependent variable used is the level of accounting conservatism with *lag 1* (on $t-1$) because of the alleged accounting conservatism period preceding level ($t = -1$) may be the catalyst of income tax dispute agency on the next period ($t=1$). Regression results showed that of the three main variables tested, namely: AR/AP, CR/CD, and SALES/EXP, there is one variable, i.e. SALES/EXP with coefficient not in the prediction direction. But although there is one variable that gives an opposite result with the prediction, overall regression results showed the value of F-statistics of 51,60062 with *F-value* is very significant (0,0000). It is concluded that the level of conservatism can be the force in the wake of income tax litigation, so the hypothesis 2 was supported by data.

Table 5
Regression Result of Accounting Conservatism Level as Income Tax Disputes Booster

$CON_{it-1} = \alpha + \beta_1 AR/AP_{it} + \beta_2 CR/CD_{it} + \beta_3 SALES/EXP_{it} + \beta_4 ROA_{it} + \beta_5 SIZE_{it} + \beta_6 SALES/GROW_{it} + \varepsilon_i$ Dependent Variable: Accounting Conservatism number of observations: 507				
Variable	The Prediction	Coefficient	t-statistic	p-value
AR/AP	-	-0,359313	-7,552372	0,0000
CR/CD	+	-5,64E-05	-0,261737	0,7937
SALES/EXP	-	0,471113	13,65787	0,0000
ROA	-	0,000133	0,587342	0,5574
SIZE	-	-0,451544	-10,41846	0,0000
SALES/GROW	-	-0,005079	-4,998324	0,0000
Konstanta	?	-0,006033	-1,052126	0,2935
F-statistic: 51,61162 F-value: 0,0000				

CONCLUSIONS, LIMITATIONS, AND IMPLICATIONS

This research aims to find empirical evidence about the relationship between the accounting conservatism and income tax litigation. Allegedly company as tax payers are predisposed to save tax or try to report the tax amount paid as low as possible. This one can be done with accounting conservatism principles. With accounting conservatism, company profit to be biased downwards and of course income tax calculations are also biased downward. Based on the regression results



proved that there was a relationship between accounting conservatism and income tax litigation, regression coefficient according to prediction direction and significant with *p-value* of 0,0000 (hypothesis 1 supported).

Hypothesis 2 tried to find relationships that accounting conservatism level can drive the income tax litigation. From the regression results, the evidence is provided that the accounting conservatism in the previous period may encourage the occurrence of tax litigation (sig. 0, 00000). So the hypothesis 2 is supported by the data.

This research has limitations of long period of research which covers only 5 years (2004-2008) and the company sample used also only on manufacture companies, so it has not given maximum results proving to be the *p-value* of each independent variables. So the upcoming research can add the number of samples and extend the period of his research.

The contribution of this research is to provide empirical evidence that there is a relationship between the first accounting conservatism with income tax litigation, so as to provide input to the Standards Board and Government in setting regulations related to the presentation of financial statements for the determination of income tax. Upcoming research can test whether or not the companies facing income tax litigation will practice more conservative accounting compared to companies that do not deal with litigation.

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