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Earnings Manipulation and Prior Period Adjustment on Tax Aggressiveness

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ABSTRACT: The purpose of this research is to study the relationship and impact of the effective factors on Tax aggressiveness and Tax diagnostic difference decrease. The study is based on the analysis of samples include 113 companies listed in Tehran Stock Exchange for the time period from 2009- 2013. The samples are selected through the Systematic Elimination Method. The applied statistical methods include the multivariate regression test and F statistics as well as step by step method. In this research, income smoothing, independent auditor reporting tax paragraph, prior period adjustments have been studied, among factors which could be effective on tax assertiveness and tax diagnostic difference. The results indicate that prior year's adjustments just have been effective on the tax assertiveness and tax diagnostic difference. In fact there is a significant relationship between the prior year's adjustments and tax assertiveness and tax diagnostic dereference in the companies.
Keywords: Earnings Manipulation, Prior Period Adjustments, Tax Aggressiveness

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INTRODUCTION

Income tax expense is one of the most important expense of firms .Firms usually make an effort to reduce it to pay less tax the government and less liquidity make exit the firm (Khastoo, 2012). In this regard, often this decision is taken by the executive's management (Specialized Research Centre of Accounting and Auditing, 2011). in accordance with the Agency theory, executives management always follow the their personal benefit that necessarily it is not according to the benefit of all beneficiaries (including, shareholders and government) and they maybe have tax policies which could lead to imposing of expenses on the shareholders and government. For example they can manipulate the amount of calculable income and expense for the tax determination in different years in order to transfer of tax expense to future periods. The earnings are managed via accounting policy selection and are estimated by executives and decisions related to the resources allocation are affected (Linck et al., 2006). The main justification of management for makes use of Prior years' Adjustments is better reflected of changes in the operating environment and investment (Azad and Kazemi, 2011). Prior year's Adjustments reduce Consistency in financial reporting and ability to users of financial Statements in the accrued assessment of firm Performance (Holthausen and Leftwich, 1983). Executives apply Personal judgment in financial reporting and they make Changes in financial structure. This changes Mislead Beneficiaries about firm Performance (Healy and Wahlen, 1999).

Tax is the factor of influence on financial information. From long ago tax was common in human societies and since the governments are responsible against their significant duties, Tax issues are the most effective tool in the hands of any government (Molaee Motlagh, 2003). Legal entities and corporate income tax are the major sources of income tax (Poor zamani et al., 2009). Because financial information required to calculate the tax, provided with legal and financial statements prepared in accordance with accepted accounting standards, it is expected that calculated accounting income and taxable income should match with each other, but in practice we observe that between accounting income by the taxpayer and diagnostic taxable income by auditors of tax are different. Policies to reduce taxable income arose in the financial reporting from late 1990 to early 2000. Managers are trying to reduce the amount of tax payable by manipulating the balance, with the result that it is caused the gap between declared income (book income) and taxable income. Cross sectional analysis Show that tax policies arose for distortion of financial reporting. Results of empirical research also prove this topic (Lennox Tyre et al., 2012).

Pour-Heydar and Aphlatuni (2007) in their paper investigated managers' incentives form(of) income Smoothing using the discretionary accruals (items), results indicated that the prime mover (the main motivation) for income smoothing using the discretionary accruals (items) are incentives such as income tax and deviation in operating activities. (Pour-Heydari and Aphlatuni, 2007).

Sartori (2008) has studied the issue of effects of strategic tax behaviors on corporate governance .He showed that strategic tax policies have a negative impact on corporate governance, because they tend to increase agency costs, transaction costs and they have a negative impact on transparency (Sartori, 2008).

Balakrishnan et al. (2011) investigated in his research whether aggressive tax planning firms have less transparent information environments .they found that managers increase the volume of disclosure in an attempt to mitigate these transparency problems. Overall, their results suggested that firms face a trade-off between financial transparency and aggressive tax planning thereby potentially explaining why some firms appear to engage in more conservative tax planning than would otherwise be optimal (Balakris et al., 2011).

Steijvers and Niskanen (2011) examined the tax aggressiveness of private family firms, relative to their non-family counterparts. They found that private family firms appear to be less tax aggressive than private non family firms. Results showed that firms with a higher CEO ownership stake are less eager to engage in tax aggressive behavior, while CEOs with a lower ownership share are more eager to engage in tax aggressive behavior (Steijver and Niskanen, 2011)

Babajani and Abdi (2009) have found out that there isn't significant difference between average of difference percentage of taxable income assertiveness and conclusive in companies that have criteria of corporate governance in comparison with companies that do not have criteria of corporate governance, whereas in both groups is significant difference between average of difference percentage of taxable income assertiveness and conclusive.

Khastoo (2012) indicated that there is significant relationship between dual chairman-CEO role and out director's ratio on tax aggressive behavior (Freise et al., 2008). Zemzem and Ftouhi (2013) studied the effects of Board of Directors' Characteristics on tax aggressiveness. Results indicated that the board size and the percentage of women in the board, affect the activity of tax aggressiveness. Return on assets and size of the firm are significantly and positively associated (Zemzem and Ftouhi, 2013).

MATERIALS AND METHODS

This study is an applied research in terms of the objectives and is an analytical-descriptive research in terms of approach. This study is also a causal research because it applies precedent data. The statistical population of this research includes the companies listed in Tehran Stock Exchange which are adjusted according to the following limitations:

1- Due to different nature, they should not be included among the financial investment and brokering companies.

2- They should be listed in stock exchange during the period 2009-2013.

3- The end of their fiscal year is mid of March.

Sectional regression and synthetic data are used for data analysis. Due to using synthetic data, before running the main regression model, one of the fixed, common, or random effects models is selected using Chow test and Hausman test and then the main regression model is accordingly estimated. Calculations and data extraction are done in Excel and data analysis and hypothesis testing are done in EViews. Finally, the research hypotheses are tested through regression analysis, F-statistic, and coefficient of determination (R^2) at 95% confidence interval.

RESULTS

Statistical attributes are given in Table 1. The results of descriptive statistics of variables indicate that mean of the tax paragraph is .77 and mean of the income smoothing is .32. Therefore, most of the surveyed companies have tax paragraph and they are not income smoothing. Because the coefficient of skewness of dependent variable is 4.102, thus the distribution is almost symmetric and Skewness has the right.

Table 1. Descriptive statistics

	Y:ΔTi,t	X1:CY	X2: Tax paragraph	X3: PPA
Valid	123	123	123	123
Missing	0	0	0	0
Mean	9403.23	0.32	0.77	14560.10
Median	3253.00	0.00	1.00	4298.00
Std. Deviation	17733.779	0.467	0.421	29912.313
Variance	314486909.030	0.218	0.177	894746483.154
Skewness	4.102	0.796	-1.315	4.216
Std. Error of Skewness	0.218	0.218	0.218	0.218

The results of research hypotheses testing is summarized in Table 2.

The table results of the statistical summary shows that multiple correlation between the dependent variable is the linear combination of all independent variables. The coefficient of determination) R2) is .265. The digit of Durbin-Watson is obtained 2.107. (Since the Numbers between 1.5 to 2.5 is accepted) Data independence is so appropriate.

Since the F is significant in the error level of 5%, therefore with a confidence level of 95%, assumption of linear regression model is confirmed. The results show the independent of variables well able to explain the changes and the variance in the dependent variable. In other words, the regression model is a good model to study.

Table 2. Model Summary [b]

Model	R	R2	R2adj	St.error	Durbin-Watson
1	0.515a	0.265	0.234	15524.332	2.107

a. Predictors: (Constant), X1. CY, X2. Tax paragraph, X3. PPA b. Dependent Variable: Y: ΔTi, t

Table 3. ANOVA[b]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	10169832725.986	5	2033966545.197	8.440	0.000
Residual	28197570175.640	117	241004873.296		
Total	38367402901.626	122			

a. Predictors: (Constant), CY, X2.Tax paragraph, X3. PPA b. Dependent Variable: Y: ΔTi, t

Table 4. Coefficients a

Model	Unst.Coefficients		St.Coefficients	t	Sig.	Co linearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	3827.284	8722.215		.439	0.662		
X1. CY	-3443.411	3018.342	-0.091	-1.141	0.256	0.993	1.007
X2. Tax paragraph	726.168	3409.124	0.017	0.213	0.832	0.959	1.043
X3. PPA	0.297	0.050	0.500	5.965	0.000	0.893	1.120

a. Dependent Variable: Y: ΔTi,t

Therefore, the following equation to predict the dependent variable:

$\Delta Ti,t = 3827/284 - 3443/411\ \mathrm{CY} + 726/168\ \mathrm{Tax\ paragraph} + 0/297.\mathrm{PPA}$

As regards the slope of lines are numbers of far away, therefore to understand the relative importance of these predictors cannot be used. For better Interpretation of model the standard regression model is used (Without writing a) .

Reviews of assumptions of the model indicate that only variable of prior period adjustments has a significant relationship with the tax assertiveness and tax diagnostic difference. In order to identify most of influence of independent variables on the dependent variable, we use the forward method. In this method, all variables are entered in the regression model both the independent and control variables and the variable make the most of effect, it will be selected.

The table results shows among the variables just have remained prior adjustments, financial leverage. Considering that significance level is less than 5 percent in both models, therefore linearity assumption of regression model is confirmed.

Ultimately, regression model equation was formulated by using remaining variables in the model as follows: ΔTi,t = 0/526 PPA - 0/181 FL

In fact, the prior period adjustments variable just has a significant relationship with the dependent variable. Because the significance level of beta coefficient, its F test is less than 5 percent. Most changes of variance in the dependent variable are affected by the prior period adjustments.

Table5. Model Summary [c]

Model	R	R 2	R2adj	St. Error	Durbin-Watson
1	0.506[a]	0.256	0.250	15359.391	2.157
2	0 .537[b]	0.288	0.276	15085.119	

a. Predictors: (Constant), X3:PPA b. Predictors: (Constant), X3:PPA, C1:FL

Table 6. ANOVA [c]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	9822184458.199	1	9822184458.199		
Residual	28545218443.427	121	235910896.227	41.635	0.000[a]
Total	38367402901.626	122			
Regression	11060104155.371	2	5530052077.686		
Residual	27307298746.255	120	227560822.885	24.301	0.000[b]
Total	38367402901.626	122			

a. Predictors: X5:PpA b. Predictors: X5:PPA, C1.FL c. Dependent Variable: Y: ΔTi,t

Table7. Statistical Results

Results	Beta	sig	f	R2	St. Deviation	Mean	Variable	Hypotheses
					17733.779	9403.23	ΔTi,t	
Not confirm	-0.125	0.169	1.914	0.016	0.467	0.32	CY	1
					0.421	0.77	Tax Paragraph	
					17733.779	9403.23	ΔTi,t	
Confirm	0.506	0.000	41.635	0.256	29912.313	14560.1	PPA	2

DISCUSSION

The results indicated that assumptions in relation to the own concentration, out board ratio, income smoothing, auditor reporting tax paragraph have failed to explain the tax assertiveness and tax diagnostic dereference in the multivariate regression. In conclusion, there is no significant difference between the presences or absence of these factors on the tax assertiveness and tax diagnostic dereference. The hypothesis relative to prior period adjustments was accepted .In fact the prior period adjustments has been effective on the tax assertiveness and Tax diagnostic.

The findings show that direct positive relationship there is between the prior period adjustments and the tax assertiveness and Tax diagnostic. Whatever the amount prior period adjustments is much less, the tax assertiveness and tax diagnostic will be decrease. This means that if the changes in the income and expenditure figures decrease for the previous years in this year be expected to tax assertiveness and Tax diagnostic dereference is less effective. Because the items of prior period adjustments have the effect of tax, lead to displacement of distributable income. Therefore it should pay attention to as a sign of tax assertiveness and Tax diagnostic dereference.

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