Effect of defects and flaws on tax financial statement, announced and specified differences Firms registered in the Stock Exchange of Tehran

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Abstract

The tax related revenues of judiciary individual is of a significant origin of tax revenue integrations, and since these persons maintain for papers, books and reliable documentation to the making of financial statements as compared with judiciary individual and it is obligatory that the ways of calculation and specification and gathering of taxes to be regarded; however it make difference between announced taxable income and tax paying decisive income of judicial person; and these distinctions are, in addition growing discontent of the people, making delays and lingering of tax imbursement and spend a while to resolving by the tax managing that would ultimately heighten costs of collection. Present investigation tried to scrutinize the relation between financial and legal disturbances and the tax policies of the firms registered in the Stock Exchange of Tehran. Around 120 corporations were investigated from the firms registered in Tehran Stock Exchange for a period of six years since 2005 to 2012. The obtained results suggest the firms with higher financial, legal, tax and other distortions, the difference between the announced tax and diagnostic tax goes up. The results indicate important distortions in escaping and exempting from tax.

Key words: *legal distortions, tax distortions, financial distortions, the difference between the declared tax and tax diagnostic.*

Introduction

Increasing firms' expansion, development of communication and conflict of interest create regulatory requirements. The issue of economic globalization and the information revolution make the control outside even the state. The circumstances get the audit filed to have gradually tried to keep pace with technological changes and remain behind in the move to community needs. In this environment, users have to make a decision about the business information such as forms' financial information they need. Financial statements are considered as for the most important financial information set. But the important thing is the uncertainty about the reliability of aforementioned information that stems from a conflict of interest.

In addition to conflict of interest, other issues such as lack of direct access to the information by users have led to demands for an independent audit services. Indeed, the role of the audit is to assess the quality of information to users (Sajjad and Naseh, 2003). Recent trends in tax reforms insist on minimizing the distorted effects of tax policies in order to maintain the competitiveness of the economy. It has been considered new approaches of tax reform programs including reduction in diversification of tax rates in order to reduce unwanted distortions in relative prices, according to the horizontal justice rather than vertical, tax simplification, expansion of the tax bases, lowering tax rates and reducing a variety of rates and limiting the role of taxes. Simplification of the tax system is one of the key goals of tax reform programs in various countries. This is not only due to the effects the system complexity has on the costs of compliance and tax evasion but also the income tax system will be considered a big obstacle to fairness and efficiency (Wayne Thirsk, 1991).

Theoretical assumption

Dependent variable

Tax differences between declaration and diagnosis

Companies based on their managers' per se knowledge and perceptions of tax laws engage to setting out the tax declaration and measuring cost and the tax debt and report on the profit and loss statement and balance sheet, but the investigation conducted by IRS auditors based on their own perception and understanding of tax laws and tax circulars the financial managers may even be unaware of determines taxes to companies. In most companies, these two digits related to the amount of expenses of the company's financial debt differ every year, when comparing to each other. Both of the differences are mentioned as a difference between the declared tax and diagnostic tax. This information is disclosed from the company's stored financial records (Safari, 2006).

Independent variables

Defining independent variables operationally, the statutory audit's reports and audit's reports of the companies were used. Definition and how to measure each of the variables are the following:

Financial distortions

In the study, the financial distortions mean the companies' deviations from standards of accounting and financial. As mentioned standard accounting distortions in the audit report and given its importance, the independent audit report is used. If the auditor's report refers to the deviation of accounting standards and if considering its importance the conditional or reprobate statement is issued, 1 will be set for this value, otherwise zero.

Legal distortions

One of the tasks the company's independent auditor and legal inspector in particular do is to review the status of compliance with laws and regulations (including business law, check law, etc.) in a country that if deviated, the auditor or legal inspector is required to submit a report non-compliance with regulations and laws to the board of directors and the General Assembly. To define this variable operationally, an artificial variable would be used such that if there is non-compliance with the laws (law deviation) of audit report and legal inspection, value 1 is given and otherwise 0.

Tax distortions

In this study, the purpose of tax distortions is non-compliance with tax laws and regulations are mainly related to tax evaders, concealment of income, and more. The most major source in gathering information on tax distortions would be companies' audit reports. So if the audit reports contain provisions on corporate tax distortions within the company, the value 1, otherwise the value 0 for this variable is given.

Other distortions

If there is in the audit reports and or the company's legal inspector's report some cases related to other distortions (except distortions in financial, tax and legal), for this variable the value of 1 is given and otherwise 0, to the research model.

Literature

Logit regression results of Lanis and Richardson's research (2011) when investigating the effects of a board of directors' arrangement on tax bold policies examined reducing the tax and tax reductive. For example, a sample selected form 32 companies, including 16 companies with bold actions and 16 without, shows that there is a high share of foreign members of the board that cuts down the bold action probability and tax reductive. Least squares of regression representing the sensitivity of the cross-sectional analysis of 401 companies approve major results of the board arrangement and tax bold actions. Steijver and Niskanen (2011) who investigated the impact of governance and ownership of senior executives (board of directors arrangement) on tax bold decisions and actions of 600 small and medium joint-stock and non-joint-stock firms in 2000-2005 concluded that private joint-stock firms take lower into bold and tax reductive actions than non-joint-stock.

Methodology

This study was an applied one in terms of objective, and a correlated one in terms of the method of data collection; the hypotheses are as follows:

- In companies involving in higher tax distortions, the tax difference is higher in declared and diagnostic.
- In companies involving in greater financial distortions, the tax difference is higher in declared and diagnostic.
- In companies involving in greater distortions in the legal, the tax difference is higher in declared and diagnostic.
- In companies involving in other distortions, the tax difference is higher in declared and diagnostic.

Research models and variables

In this study, to investigate the effects of distortions may be in the financial, tax, legal etc. on the companies' financial policies, the following logistic regression model (with respect to the nature of being independent binary (0 and 1) variables) will be used.

Tax aggre = $\alpha_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3$ + Contro Var + $\acute{\varepsilon}$

Tax aggre: differences between declared and diagnostic tax
X: distortion of legal, tax, financial, and other distortions
Contro Var: control variables

Experimental Results

The results of inferential statistics

The first hypothesis examines the relationship between high financial distortions of companies and difference in declared and diagnostic taxes

H_0: $\mu_1 = \mu_2$

H_1: $\mu_1 \neq \mu_2$

Table 1: results of independent t-test to the difference between declared and diagnostic tax

Variable	Financial distortion	Number	Mean	t-statistic value	Significance level	Confidence level		Result of test
						Upper limit	Lower limit	
Financial distortion	No	41	7.719	-2.154	0.023	-0.061	-1.437	Being different
	Yes	79	8.468					Rejecting H_0

The second hypothesis examines the relationship between the high tax distortions of the companies and difference in declared and diagnostic taxes

H_0: $\mu_1 = \mu_2$

H_1: $\mu_1 \neq \mu_2$

Table 2: results of independent t-test to the difference between declared and diagnostic tax

Variable	Financial distortion	Number	Mean	t-statistic value	Significance level	Confidence level		Result of test
						Upper limit	Lower limit	
Tax distortion	No	86	7.831	-4.557	0.000	-1.761	-1.935	Being different
	Yes	79	8.178					Rejecting H_0

According to the results of the t-test table, significance level for t-statistic value is less than 5% (sig =0.000), so we confirm the hypothesis H_1 but reject H_0. Thus we reject H_0 but confirm H_1 at %95 confidence level, that is, we approve the assertion that on average companies with higher tax distortions (9.178) present more difference between declared and diagnostic tax than those with lower tax distortions (7.831). Also, due to negative upper and lower limits of both universes, the means will be less than zero among both universes, i.e. the mean to the difference in companies with higher tax distortion is greater than those with lower financial distortion; it can be also seen the results in the companies' means.The third hypothesis examines the relationship between the high legal distortions of the companies and difference in declared and diagnostic taxes

H_0: $\mu_1 = \mu_2$

H_1: $\mu_1 \neq \mu_2$

Table 3: results of independent t-test to the difference between declared and diagnostic tax

Variable	Financial distortion	Number	Mean	t-statistic value	Significance level	Confidence level		Result of test
						Upper limit	Lower limit	
Legal distortion	No	20	7.117	-3.025	0.003	-0.454	-2.174	Being different
	Yes	120	8.431					Rejecting H_0

According to the results of table 4-8, significance level for t-statistic value is less than 5%, at 5% error level (sig =0.003), so we confirm the hypothesis H_1 but reject H_0 which is on the difference in the legal distortion companies is equal to without. Thus we reject H_0 but confirm H_1 at %95 confidence level, that is, we approve the assertion that on average companies with legal distortions (8.431) present more difference between declared and diagnostic tax than those without (7.117). Also, due to negative upper and lower limits of both universes, the mean difference will be less than zero among the universes, i.e. the mean to the difference in companies with legal distortion is greater than those with lower legal distortion; it can be also seen the results in the companies' means.

The fourth hypothesis examines the relationship between the high legal distortions of the companies and difference in declared and diagnostic taxes

H_0: $\mu_1 = \mu_2$

H_1: $\mu_1 \neq \mu_2$

Table 4: results of independent t-test to the difference between declared and diagnostic tax

Variable	Financial distortion	Number	Mean	t-statistic value	Significance level	Confidence level		Result of test
						Upper limit	Lower limit	
Other distortion	No	36	7.710	-2	0.049	-0.003	-1.431	Being different
	Yes	84	8.427					Rejecting H_0

According to the results of the t-test table, at significance level of 95%, t-statistic value is less than 5% (sig =0.000), so we confirm the hypothesis H_1 but reject H_0 on declared and diagnostic difference to the companies with other distortion is the same as those without. Thus we reject H_0 but confirm H_1 at %95 confidence level, that is, we approve the assertion that on average companies with other distortions (8.427) present more difference between declared and diagnostic tax than those without (7.117). Also, due to negative upper and lower limits of both universes, the means will be less than zero among both universes, i.e. the mean to the difference in companies with other distortion is greater than those without; it can be also seen the results in the companies' means.

Conclusion

The main objective of this study was to examine the relationship between financial, tax, legal distortions and other distortions, respectively. The distortions in the financial statements can arise from fraud or error. Fraud in nature is important. The main point is that regardless of the harm inflicted or will be inflicted in the future, the mere existence of fraud could be a great and serious risk unless they take punitive measures or, at least, preventive measures to be taken. It should be recognized in accordance with accounting guidelines with an attitude to audit risk management, the auditor is required to report the issue to paragraph emphasizing on the particular matter (after the comment) in cases where the financial impact resulting from errors or distortions would be less than important limits, however, according to the auditor, necessary to include it in the report (the cases with qualitative importance). The companies are deviated of principles and standards of accounting and financial, financial distortions occur. However, it can be unintentional or intentional. But it should be expressed in tax discussions many of the companies to pretend to lower their revenues and pay lower tax somehow distort audit and accounting principles and standards and in some cases due to the lack of transparency of these standards, financial distortions occur. To measure financial distortions occurred in the company, the independent audit report is used. So there is a difference between declared tax announced by the company itself and diagnostic tax of Tax Administration. In study on first theory, these results are consistent with a number of researchers' results like Ghanbari (1995) and Shamsizadeh and Zokouri (2008) who stated differences between declared taxable profit and the decisive one and the most important factor in the failing state offices to be non-compliance with law offices writing regulations. In its following, the tax distortion is referring to non-compliance with tax laws and regulations that mainly related to tax evaders, concealment of income, and more. There are in between influential factors such as economic conditions, inflation, psychological and social factors, tax evasion culture etc. in fact, many companies who want to pay less tax distorted tax rules. The reason could be the lack of transparency of tax rules and regulations will open the way for payers and companies to carry out these actions. The major source of information gathering on tax distortions would be audit reports. According to the result of this hypothesis it should be stated that companies with higher tax distortions, i.e. turn around the rules and regulations, their declared tax is so much different to the diagnostic one. Second hypothesis is consistent study by Babaei (2006), which explains the difference between the declared and diagnostic tax induced by financial distortions. Analyzing third hypothesis, it should be stated that one of the tasks of the independent auditor and legal inspector in particular is to review the status of compliance with laws and regulations (including business law, check laws, etc.), of the country that when deviated from, the authorized auditor or inspector is required to submit a non-compliance report to the board of directors and the General Assembly. Legal distortions refer to crosscutting the laws and regulations on financial and constitution, business law and so on that makes a context of difference between declared and diagnostic tax. On this hypothesis it should be expressed many different companies for various reasons and incentives attempt to distort the rules in their favor that in this way, less tax to pay. It should be noted that many factors can contribute to handle organizational goals in this area, but not being transparent or in some cases giving way to escape the laws is the most important factor in making distortion. The result of this hypothesis is consistent relatively with study by Black Reyshen et al (2011) who argue that it increases and the company's environment information uncertainty and the managers disclose further until decrease severity of the transparency issue. Reviewing fourth hypothesis speaks of that there is no significant relationship between co-diffraction variables (auditor quality, kind of the audit opinion, firm age and continuity of operations) and tax difference, declared and diagnostic. Other distortions refer to audit reports, legal inspection reports of the company in which some cases are considered other than financial, tax and legal distortions. Other distortions can arise from relationships of back office, the distortions caused by the culture of tax evasion and generally social and moral deviations of real and judicial persons for tax evasion. The auditor's task in this regard is very important because it can be very crucial role in disclosing those responsible.

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