FINANCIAL REPORTING AND TAX ISSUES IN NIGERIA

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Abstract
The purpose of this study is to examine the relationship between financial reporting and tax issues in Nigeria. The objective of the study is to examine the relationship between deferred taxation, tax planning and financial reporting in Nigeria. The study adopts a longitudinal research design for the collection of secondary data for the period of 2012 to 2016 where thirty-two (32) quoted non-service company are randomly selected and employs Logistic regression for the empirical analysis. The empirical evidence shows that deferred taxation has a positive and a significant relationship with financial reporting at 1% level of significant across the models (Probit, Logit and Extreme value regressions), tax planning measured by cash effective tax rate has a positive and insignificant relationship with financial reporting even at 10% level of significant across the models (Probit, Logit and Extreme value regressions). And tax planning measured by income effective tax rate has a negative and insignificant relationship with financial reporting even at 10% level of significant across the models (Probit, Logit and Extreme value regressions). The study therefore recommends that financial managers and accountants should consolidate deferred tax liabilities for the intended purpose because it help to generate more cash flow to the organization for meeting operation activities. The study also suggests that management of quoted firms in Nigeria should employ stringent tax measures to cushion the incidence of cash effective tax rate and income effective tax rate.

Keywords: *Financial Reporting, Deferred Taxation, Tax Planning, Logit Regressions.*

INTRODUCTION

The Nigerian tax system has undergone series of reforms and amendments geared towards enhancing tax collection and administration with minimal enforcement cost and high level of tax compliance from tax payers in Nigeria (Adedeji & Oboh, 2012). Ezeoha and Ogamba (2010:5), "argue that the Nigerian tax system has an inherent delinquent that has been a major impediment to economic growth, where tax evasion and avoidance are the means employed by tax payers not to comply with the payment of tax". Torgler (2007) argues that taxpayers are willing to cooperate with the tax authority will increase, if they sees itself as a service institution and provides a quality service and meets the taxpayers expectation. This shows that taxpayers are willing to cooperate with the tax authority leads to credible financial reporting. The quality of financial reporting has to be maintained in order to ensure good measure of credibility on the information disclosed to the general public of the financial health of the companies at the end of the financial period (Adeyemi, Okpala &Dabor, 2012). Financial reporting credibility is reflected in the confidence of users in audited financial reports (Watkins, Hillison & Morecroft, 2004).

Tax administration is a very crucial and bases for any economic development of many nations and society over a long period of time (Gurama & Mansor, 2015). However, this fundamental and basic source of capacity and economic building is related with various problems which need urgent attention by the stakeholders and policy makers in maintaining quality financial reporting. Muhrtala and Ogundeji (2013:35), "are of the view that factors that influence sharp practices in the tax system include the presence of high tax burden, non-availability of comprehensive tax payers database, lack of accountability for tax revenue, lack of clarity and fairness on taxation powers of government, lack of skilled manpower and inadequate funding, aggressive and unorthodox tax collection methods, non-refund of excess taxes paid by economic agents, non-review of tax legislations guiding the operation of taxes in Nigeria". In addition, the corruption is paramount among tax officials in a society where there is poor tax policy and weak tax administration. This issue has led to poor financial reporting quality in public and private sector of the Nigerian economy. In order to fill the gap in knowledge, this study tried to find out the tax issues that influence credible financial reporting. The study contributed to the body of knowledge the possible effect of deferred taxation and tax planning on financial reporting in Nigeria.

Objective of the Study

The broad objective of this study is to examine the relationship between financial reporting quality and tax issues in Nigeria. The specific objective is:

(i) to examine the relationship between deferred taxation and financial reporting quality in Nigeria.

(ii) to examine the relationship between tax planning and financial reporting quality in Nigeria.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Financial Reporting Quality

The financial reporting is an important element necessary for corporate governance system to function effectively, that is, it provide quality information about a business entity that is useful to a wide range of users (i.e., Creditors, Shareholders, Financial Institutions, e.t.c) to make economic decisions about their resources (Osisioma & Enahoro, 2006; Appah & Emeh, 2013). According to Ogbaisi, Izedonmi, and Dabor (2016:75), "financial statements is aimed to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions". Financial statements should be understandable, relevant, reliable and comparable. The need for credible financial reporting has become imperative due to the increasing exposure of Nigerian business organizations to international capital markets and the adoption of International Financial Reporting Standards (IFRS). Adeyemi (2016) states that IFRS concept is bases on establishing a set of accounting standards issued by the International Accounting Standards Board (IASB) which was established to achieve the objective of developing a single set of high quality globally accepted accounting standards based upon clearly articulated principles. Adzis, Tripe and Dunmore (2012) add that the general overview of International Financial Reporting Standards (IFRS) is to establish a common set of accounting standards to promote the comparability of financial statements around the globe. In addition, the adoption of IFRS was expected to improve the quality of financial reporting, increase the transparency of financial information due to increased disclosure requirements, and increase access to international capital markets.

Tax Issues in Nigeria

Taxation has been a concern of global significance as it affects every economy irrespective of national differences. Therefore, an efficient and robust tax system is the cornerstone to attaining the Nigeria's ambition of becoming one of the most rapidly developing economies of the world (Adedeji & Oboh, 2012). Total tax expense reflects the tax expenses over the tax benefits that are attributable to pre-tax book income but that are not reflected in current tax expense of the period (Astrid, 2011). "The purpose of deferred tax accounting is to inform about future tax benefits and future tax liabilities, an analysis of the relation of currently disclosed deferred taxes to actual future tax cash flow is crucial for assessing whether deferred tax accounting actually meets its intended purpose," (Beechy, 2007:221). Deferred tax accounting is the recognition of the tax consequences of an item reported within the financial statements in the same accounting period as the item itself.

Tax Planning

Tax planning is an arrangement of the financial affairs in such a way that without violating in any way the legal provisions, full advantage is taken of all tax exemptions, rebates, allowances and other reliefs or benefits permitted under the Act for improved financial reporting (Taylor, & Richardson, 2014). Hence, "tax planning is seen as the methods employed by a tax payer to reduce the burden of taxes in a legal manner. Avoidance is normally employed to minimize tax liability" (Cowell, 1990b:231). However, avoidance is encouraged by legislation granting favourable tax treatment to specific activities in contrast to general taxation principles. As far as economic function is concerned, however, evasion and avoidance obviously have very strong similarities; sometimes, indeed, they can hardly be distinguished (Cowell, 1990b). "Tax avoidance is a cost benefit to the company becauseplanning of tax costs implies higher cash flows and net income for the firm and residually for its shareholders"(Blouin, 2014:875).

Effective tax rate is used as a measure of tax planning because both effective tax rate and tax savings figures yield the same result since statutory tax rate is constant over the years of the study, Taylor and Richardson (2014:1), "carried out an empirical study on incentives for corporate tax planning and reporting". The study made use of 200 publicly listed Australian firms for the period of 2006 to 2010 period for the empirical analysis. "The study revealed that reported uncertainty of a firm's tax position, the tax expertise of its directors, and the performance-based remuneration incentives of key management personnel had significantly positively associated with tax avoidance while tax-related affiliation was significantly negatively associated with tax avoidance".

Deferred Tax Asset

Tax on extraordinary item and prior year adjustment should be deducted or added to the related item and disclosed by way of notes. Deferred tax should be shown separately from the items and disclosed by way of note. Tax should be recognized as expense or income, and included in the profit and loss account of the period, as a separate line item (SAS 19). In addition, the changes in deferred tax assets are based on income tax expense which directly affecting net income; deferred tax assets may be an attractive account to manageearnings. Therefore, "research on recognition of deferred tax assets has primarily focused onwhether discretion in recognition is used for earnings management purposes," (Christensen, Paik & Stice, 2008: 601). According to Zee, Stotsky and Ley (2002:1497), "investment tax credit as a recognized measured of deferred tax asset in a new manufacturing plant and equipment purchased for first-time use in manufacturing or processing". Therefore, "the companies earn 10% non-refundable tax credit which can be applied against company income tax in the year earned, with unused credits usually available for either 10-year carry forward or 3-year carry backward". Gugl and Zodrow (2006:167), "add that investment tax credit as a recognized measured of deferred tax asset is only earned in the year that the property was actually acquired, and only applies to new properties in a company".

Deferred Tax Liability

Tax consequences of business transactions are recognized in that period when they are recognized by tax authorities, which may be before or after the period when the event itself is recognized in the financial statements. It violates the relationship between accounting income and income tax expense in the income statement and leads to distortions in net profit after tax. Therefore, deferred tax liability is not recognized for the initial recognition of the assets in a transaction that is not a business combination and that affects neither accounting or taxable profit or loss and differences relating to investment in subsidiaries, jointly controlled entities and goodwill to the extent that it is probable that they will not reverse in the foreseeable future (Haskins & Simko, 2011). Meanwhile, deferred tax liability is measured at the tax rates that are expected to be applied to temporary differences when they reverse based on the laws that have been enacted or substantively enacted by the reporting date. A deferred tax liability is the estimated future tax increase related to book income. It is created when an expense is deductible for tax purposes in the current period but is not deductible for book income until some future period, or when revenue is includible for book purposes but not for taxable income until a future period. Therefore, deferred tax liabilities include book-tax depreciation differences (accelerated for tax purposes), installment sales, and undistributed or reinvested foreign earnings (Poterba, Rao & Seidman, 2007). Astrid (2011) argued that the informative value of deferred taxes is only low due to highly uncertain cash flow implications. Meanwhile, the major part of deferred taxes is not expected to be realized in the near future as a consequence of arising from operating and, therefore, periodically recurring activities, which results in an effectively permanent deferral of the associated tax cash flow. In other words, the lack of relevance of deferred tax information is seen as a consequence of lacking cash flow implications would challenge the usefulness of deferred tax accounting in a given reporting entity. Chludek (2011:1), "conducted a study on the impact of deferred tax on firm value". The study showed that deferred taxes are not significantly related to actual tax cash flow of 67.25 percent of the sample firms. Also, "firms with significant deferred tax information tend to perform poorly based on the average value, less growth (of sales, operating cash flow, and total assets), lower

ROA, and significantly less multinational activity (as measured by percent of foreign to total pre-tax income) as compared to the total sample".

METHODOLOGY

The study employed longitudinal research design in the collection of data. The population of this study consists of all non-financial quoted and non-service firms in Nigeria Stock Exchange for the period of 2012 to 2016. The population is made up of companies whose shares are quoted on the floor of the Nigerian Stock Exchange and must have finished its obligation in delivery annual reports for the year ended 2016. The sampled firms were simple randomly from the following sectors, Agriculture, Breweries, Building/ Materials, Health Care, Industrial and Domestic products, Food/Breverages and Tobacco, Petroleum marketing companies etc. In considering sample size, Saunders, Lewis and Thornhill (2003) suggested that a minimum number of thirty (30) for statistical analyses provide a useful rule of thumb. However, the study used thirty-two (32) sampled non-service firms in the Nigerian Stock Exchange. The estimations were carried out with the aid of E-views version 8.0.

Model Specification and Measurement

In the light of the above methodology and theoretical framework deduced to adequately capture and empirically analyze the financial reporting and tax issues in Nigeria. A logistic regression econometric model specified in equation (ll) will be employed for model. This assumption is that, the dependent variable is a dummy variable. The model below is adapted from McFadden Logistic Regression Model (1974) as measured in recent prior study (Adeniye & Mieseigha, 2013). It is express as:

$$FRP = F(DTL, TPL) \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

The binary regressions with error term (et) is express in equation (2)

$$FRP = \alpha_0 + \alpha_1 DTL + \alpha_2 TPL + \varepsilon \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2)$$

Where;
FRP = Financial reporting
TPL = Tax planning
DTA = Deferred tax asset
ε = error term

Dependent Variable

Financial reporting is measured by a dummy variable: "1" Big 4 or otherwise "0"

Independent Variable

Tax planning is proxy by cash effective tax rate (CTR) and income effective tax rate (ITR) which is measured by corporate income tax expense (excluding deferred tax expense)/ profit before tax) **(**Kawor & Kportorgbi, 2014).

DATA PRESENTATION AND DISCUSSION OF RESULTS

To study examined the relationship between financial reporting and tax issues in Nigeria. The study employed Correlation Matrix, Logistic Regression; Table 1 shows the correlation matrix result which measures the degree of linear relationship between the given variables for the study. The result of the correlation coefficient revealed that deferred tax liability (DTL) was positive and moderately correlated with financial reporting (FRP =0.2191). Tax planning (TPL) measured by cash effective tax rate (CTR) was negative and weakly correlated with financial reporting (FRP =-0.1063). Also, tax planning (TPL) measured by income effective tax rate (ITR) was negative and weakly correlated with financial reporting (FRP =-0.0035). This means that there is the absence of multicolinearity problem in our model. Multicollinearity between explanatory variables may result to wrong signs or implausible magnitudes, in the estimated model coefficients, and the bias of the standard errors of the coefficients. The correlation result is presented in table 1 below;

Table 1: Correlations Result

Variable	FRP	DTL	CTR	ITR
FRP	1			
DTL	0.2191	1		
CRR	-0.1063	-0.0013	1	
ITR	-0.0035	-0.0027	0.1220	1

Source: Author's Computation (2018)

The study employed Logistic regression techniques to examine the relationship between the financial reporting and tax issues and to test the formulated hypotheses. The regression results obtained were presented in table 2 below.

Table 2: Logistic Regression Results

	PROBIT	LOGIT	EXTREME VALUE
C	0.19	0.24	0.53
	(0.10)	(0.77)	(2.25)
	[0.30]	[0.44]	[0.02]**
DTL	9.48	1.88	1.76
	(2.55)	(2.37)	(2.33)
	[0.01]*	[0.01]*	[0.01]*
CTR	0.007	0.01	0.009
	(1.61)	(1.55)	(0.60)
	[0.11]	[0.11]	[0.11]
ITR	-0.0008	-0.001	-0.001
	(-0.62)	(-0.75)	(-0.82)
	[0.52]	[0.44]	[0.41]
McFaden R2	0.096648	0.099873	0.101768
LR statistic	14.81	15.31	15.60
Prob (LR-Stat)	0.001981	0.001569	0.001369

Note: (1) Parentheses ( ) are z-statistic while bracket [ ] are p-values

(2) *, and ** were, 1% and 5% level of significance respectively.

It would be revealed from the above that the study employed a dummy measure for the dependent variables to proxy financial reporting. The Logistic regression showed that the McFadden R2 value Probit regression (0.096648), Logit regression (0.099873) and Extreme value regression (0.101768) and its associated probability values of 0.001 across the models showed about 10% of the chances in variation of financial reporting (FRP) was jointly explained by the independent variables (deferred taxation, and tax planning). Therefore, that the model on overall is statistically significant. The LR-statistic value of 14.81, 15.31 and 15.60 showed that the model on overall was statistically significant. This means that there exists a significant linear relationship between the dependent variable and the independent variables.

Following the results in the table above, deferred taxation (DTL) had a positive and a significant relationship with financial reporting (FRP) at 1% level of significant across the models (Probit, Logit and Extreme value regressions). This means that presence of quality financial reporting has the tendency of increasing deferred taxation in the Balance Sheet of the companies. Tax planning measured by cash effective tax rate (CTR) has a positive and insignificant relationship with financial reporting (FRP) even at 10% level of significant across the models (Probit, Logit and Extreme value regressions). This means that presence of quality financial reporting has the tendency of increasing tax planning issues but was statistically insignificant. More so, Tax planning measured by income effective tax rate (ITR) has a negative and insignificant relationship with financial reporting (FRP) even at 10% level of significant across the models (Probit, Logit and Extreme value regressions). This means that presence of quality financial reporting has the tendency of decreasing tax planning issues but was statistically insignificant.

CONCLUSION AND RECOMMENDATIONS

Tax system is one of the most effective means of mobilizing resources for any given country and creating an environment conducive to the promotion of business organizations that would enhance economic growth. Taxation might change the ranking of different alternatives, i.e. it is relevant for decision-making. Business managers might increase post-tax performance by considering different levels of taxation on different decision alternatives for improve financial reporting quality. The study therefore recommends that:

(i) Financial managers and accountants should consolidate deferred tax liabilities for the intended purpose because it helps to generate more cash flow to the organization for meeting operation activities.

(ii) The study also suggests that management of quoted firms in Nigeria should employ stringent tax measures to cushion the incidence of cash effective tax rate and income effective tax rate.

REFERENCES

Adedeji, T. O & Oboh, C.S. (2012). An empirical analysis of tax leakages and economic

APPENDIX: RESULTS

CORRELATION MATRIX

	FRP	DTL	CTR	ITR
FRP	1.000000	0.219183	0.106380	-0.003595
DTL	0.219183	1.000000	-0.001356	-0.002794
CTR	0.106380	-0.001356	1.000000	0.122068
ITR	-0.003595	-0.002794	0.122068	1.000000

Dependent Variable: FRP
Method: ML - Binary Probit (Quadratic hill climbing)
Date: 06/19/18 Time: 10:18
Sample: 1 134
Included observations: 133
Convergence achieved after 10 iterations
Covariance matrix computed using second derivatives

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	0.190355	0.185418	1.026625	0.3046
DTL	9.48E-08	3.71E-08	2.557221	0.0106
CTR	0.007461	0.004632	1.610862	0.1072
ITR	-0.000834	0.001324	-0.629836	0.5288

McFadden R-squared	0.096646	Mean dependent var	0.736842
S.D. dependent var	0.442012	S.E. of regression	0.423670
Akaike info criterion	1.101418	Sum squared resid	23.15501
Schwarz criterion	1.188346	Log likelihood	-69.24431
Hannan-Quinn criter.	1.136742	Deviance	138.4886
Restr. deviance	153.3049	Restr. log likelihood	-76.65244
LR statistic	14.81625	Avg. log likelihood	-0.520634
Prob(LR statistic)	0.001981		
Obs with Dep=0	35	Total obs	133
Obs with Dep=1	98		

Dependent Variable: FRP
Method: ML - Binary Logit (Quadratic hill climbing)
Date: 06/19/18 Time: 10:19
Sample: 1 134
Included observations: 133
Convergence achieved after 10 iterations
Covariance matrix computed using second derivatives

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	0.243071	0.315310	0.770896	0.4408
DTL	1.88E-07	7.93E-08	2.375709	0.0175
CTR	0.013110	0.008421	1.556755	0.1195
ITR	-0.001660	0.002194	-0.756658	0.4493

McFadden R-squared	0.099877	Mean dependent var	0.736842
S.D. dependent var	0.442012	S.E. of regression	0.421999
Akaike info criterion	1.097694	Sum squared resid	22.97276
Schwarz criterion	1.184622	Log likelihood	-68.99666
Hannan-Quinn criter.	1.133018	Deviance	137.9933
Restr. deviance	153.3049	Restr. log likelihood	-76.65244
LR statistic	15.31156	Avg. log likelihood	-0.518772
Prob(LR statistic)	0.001569		
Obs with Dep=0	35	Total obs	133
Obs with Dep=1	98		

Dependent Variable: FRP
Method: ML - Binary Extreme Value (Quadratic hill climbing)
Date: 06/19/18 Time: 10:19
Sample: 1 134
Included observations: 133
Convergence achieved after 9 iterations
Covariance matrix computed using second derivatives

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	0.531832	0.235393	2.259333	0.0239
DTL	1.76E-07	7.54E-08	2.334940	0.0195
CTR	0.009941	0.006188	1.606500	0.1082
ITR	-0.001437	0.001745	-0.823514	0.4102

McFadden R-squared	0.101768	Mean dependent var	0.736842
S.D. dependent var	0.442012	S.E. of regression	0.421207
Akaike info criterion	1.095514	Sum squared resid	22.88655
Schwarz criterion	1.182442	Log likelihood	-68.85168
Hannan-Quinn criter.	1.130838	Deviance	137.7034
Restr. deviance	153.3049	Restr. log likelihood	-76.65244
LR statistic	15.60151	Avg. log likelihood	-0.517682
Prob(LR statistic)	0.001369		
Obs with Dep=0	35	Total obs	133
Obs with Dep=1	98		