Journal of
Empirical Research In Accounting

Alzahra University, Faculty of Social Sciences and Economics
Empirical Research in Accounting, Fall 2022, V. 12, No. 45, pp.27-30

The Impact of Different Audit Quality Measures on Tax Risk Criteria with Emphasis on Horizontal and Vertical agency Costs[1]

Fatemeh Hadelvand[2], Seyede Mahboobeh Jafari[3], Mohammadreza Mehrabanpoor[4]

Received: 2022/03/14
Accepted: 2022/08/18

Research Paper

INTRODUCTION

The purpose of this study is to investigate the impact of different audit quality measures on tax risk. Since the tax risk is the result of the tax decisions of the companies and their management, previous research has considered the characteristics of the company level as well as the managerial and administrative characteristics as drivers of the tax risk of the companies. Among the different characteristics of the companies that previous researchers have considered as drivers of tax risk, we can refer to things such as performance, size, operational costs, financial leverage, growth, international performance scale, industry index, and also the costs spent on financial services. At the executive level, annual bonuses, stock-based incentives, and compensation for the services of financial and tax managers are among the factors affecting tax risk, and research results have shown that these factors intensify tax avoidance in companies and reduce tax risk. They increase.

In addition, the personality characteristics of managers also affect the tax planning of companies. The review of the research literature shows that the effect of these factors on the effective tax rate has not always been the same. For example, the contracts and incentives of the company's employees, unlike other factors, have less effect on the effective tax rate and a cash payment of taxes, but they have been effective in reducing taxes anyway.

---

1. DOI: 10.22051/JERA.2022.34216.2771
2. Department of Accounting, Kish International Branch, Islamic Azad University, Kish Island, Iran. (fereshtehhadelvand@gmail.com).
3. Assistant Professor, Department of Accounting, South Tehran Branch, Islamic Azad University, Tehran, Iran. (Corresponding Author). (Jafari.mahboobeh@gmail.com).
4. Assistant Professor, Department of Accounting, Tehran University, Tehran, Iran. (mehrabanpour@ut.ac.ir).

Tax risk and its effect on business units are considered new topics in accounting research. Studies conducted in the field of taxation indicate that tax risk is a type of business unit risk that is managed by companies. The use of strategies by companies that lead to tax risk can affect operational decisions and the future performance of companies.

The effect of audit quality on risk or tax evasion can be different depending on the type of cultural and legal environment of different countries. Therefore, it is not possible to generalize the findings obtained from research that has been carried out in developed countries such as America and Europe to developing countries such as Iran. Things like the level of protection of investors' interests, the level of litigation risk, the audit environment, and capital market pressure are among the factors that can affect the relationship between audit quality and tax risk in different countries. For example, in cases where corporate governance mechanisms are weak, audit quality can be used as a substitute for corporate governance mechanisms to support the interests of shareholders.

MATERIALS AND METHODS

This research is correlational in nature and content and practical in terms of purpose. Conducting research is done in the framework of deductive-inductive arguments, which means that the theoretical foundations and background of the research are done through the library, magazines, and other authoritative sites in a deductive way, and data collection is done inductively to confirm and reject the hypotheses. Also, considering that the data used in the current research is real and historical information, it can be classified as post-event type.

Due to the type of data studied, the simultaneous comparison of cross-sectional and longitudinal data using the method of combined data patterns (panel data) has been used to estimate coefficients and test hypotheses. First, Chow's test was used to determine the method of using combined data and to determine whether they are homogeneous or heterogeneous. In this test, the null hypothesis is that the data is homogenous, and if it is confirmed, all the data should be combined and parameters should be estimated using a classical regression, otherwise, the data should be considered as panel data. If the results of this test based on the use of data are panel data, one of the fixed effects or random effects models should be used to estimate the research model. To choose one of the two models, the Hausman test must be performed. The null hypothesis of the Hausman test is that the random effects model is suitable for estimating panel data regression models.

RESULTS AND DISCUSSION

In many types of research, the difference between express and diagnostic taxes has been used as a measure of tax avoidance or risk, and independent audit work hours for each company have also been considered as a criterion for determining audit quality. In this context, we refer to studies such as Dolly Wall and colleagues (2011), McGuire and colleagues (2012), Desai and Dharampala (2006), Hope and colleagues (2009), Choi and colleagues (2010), and finally Hu Bayi (2017).), can be mentioned. The horizontal agency costs that may be created among the shareholders have affected the tax risk related to the companies, but the high quality of the audit can lead to the reduction of these costs. The horizontal conflict of interest caused by agency costs shows the difference of interests between different managers, while the vertical conflict of interest caused by agency costs is related to the conflict of interests between managers and other stakeholders.

The purpose of this research was to investigate the impact of different audit quality criteria on tax risk. In many types of research, the difference between express and diagnostic taxes has been used as a measure of tax avoidance or risk, and independent audit work hours for each company have also been considered as a criterion for determining audit quality. The current research was conducted to assess tax risk using audit quality and vertical and horizontal agency costs. In this regard, tax risk (annual effective rate, average effective rate, gap rate, expected risk rate, and effective cash flow rate) has been used as a dependent variable. In addition, audit quality, horizontal agency costs, and vertical agency costs have been used as independent variables. Finally, company size, financial risk, profitability, operational cash flow, growth opportunities, government ownership, and liquidity of assets have been used as company-level characteristics and in other words control variables.

CONCLUSION

The analysis of the relationship between tax risk and the factors affecting it showed that: 1) audit quality based on seven criteria has a negative and significant effect on tax risk. 2) Horizontal agency costs have a positive and significant effect on tax risk in terms of ownership concentration and managerial ownership. 3) Representation costs have a negative and significant effect on the tax risk in terms of the activity level of the board of directors and the activity of the audit committee. The results showed that the activity level of the audit committee, as one of the measures of horizontal agency costs, had a negative and significant effect on the effective tax rate, and regardless of any of the audit quality measures, this effect was found to be objective. In other words, it is expected that the audit committee, by playing a better supervisory role through holding more meetings and controlling the process of the company's reporting activities, will increase the quality of the company's audit, and as a result, on the one hand, reduce the information asymmetry between the company's top management and the stakeholders. The other includes shareholders,

potential investors, creditors, regulatory bodies, and legal institutions, and on the other hand, it leads to their ability to rely on effective information in financial decisions related to the company.

Keyword: Tax Risk proxies, Audit Quality proxies, Horizontal and Vertical agency costs.

JEL Classification: M41, M42.