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The Alignment of Tax Accounting with Financial Accounting: An Analytical Study of the Impact of Tax Policies on Financial Reporting

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ABSTRACT

This study examines the relation between tax accounting and financial accounting and analyzes the effect of tax policies and financial reports prepared by companies. The study aims to understand the extent of overlap or discrepancy between the two accounting systems, and the impact of tax and financial accounting on the financial reports adopted in the preparation of financial statements. This paper utilised a sample of 116 companies listed on the stock market and used the Stata program to analyze secondary data. This study found a important and positive association among tax accounting and financial accounting, with tax policies and financial reporting. Tax policies directly impact on the content and credibility of financial reports, as some companies tend to manipulate estimates to reduce their tax burden. The existence of significant variation among the results of tax accounting and financial accounting leads to a decrease in transparency for investors.

Keywords: Tax accounting, financial accounting, tax policies, financial reporting

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INTRODUCTION

The impact of tax policy and financial accounting on the financial reporting of Malaysian is a highly firms' topic that combines regulatory and financial aspects of the business environment. Many companies face difficulties in aligning financial reporting requirements with international accounting standards (Lau & Ooi, 2016 & Fakile et al., 2013). Local tax legislation, for example, leads to permanent and temporary differences in business results. For example, the impact of tax policy on financial reporting is the definition of taxable profit. Malaysian tax policy determines how taxable income is calculated. This forces companies to make adjustments to accounting profits to align with taxable profits, resulting in discrepancies between accounting profits and taxable profits, including tax incentives and exemptions. The Malaysian government offers tax incentives to specific sectors (such as technology, renewable energy, and small and medium-sized enterprises). These incentives directly impact financial reporting by reducing tax expenditures, thereby increasing reported net income (Zainal et al., 2020; Lau & Ooi, 2016 & Braden & Brian, 2021). Deferred taxes result from differences between accounting and tax rules in recording revenue and expenses.

Malaysian companies are required to disclose deferred tax assets and liabilities in accordance with Malaysian Accounting Standards (MAS), such as the Financial Reporting Standards (FRS). Malaysia follows the MFRS, which enhances transparency and comparability in financial reporting between local and international companies (Zainal et al., 2020 & Lau & Ooi, 2016).

Measurement and recognition methods and company's accounting policies affect how assets, liabilities, and revenue are valued, which is reflected in financial reports. For example, using the cost method versus the fair value method results in different financial results. Disclosure and transparency: its requires disclosure of a company's tax policies, significant accounting policies, and any significant changes thereto. This enables investors and other users to better understand the risks and opportunities associated with the company (Elizabeth, 2018). The interaction between tax policy and financial accounting means that companies may adopt accounting tax planning strategies to reduce their tax burden through accounting changes. Legitimate. Both tax policy and financial accounting directly and indirectly impact the quality and accuracy of Malaysian companies' financial reporting. A transparent and fair tax system, coupled with strict application of accounting standards, helps enhance confidence in financial statements and attract domestic and foreign investment (Vokshi, 2018).

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LITERATURE REVIEW

The impact of tax accounting and financial accounting on financial reporting is an important topic that addresses how the two accounting systems interact with each other, and how this impacts the accuracy and transparency of financial reports presented to various users (such as investors, creditors, and regulatory authorities) (Muslim, 2024). The impact of tax policy and financial accounting on the financial reporting of Malaysian firms is a topic of high interest. Many companies face difficulties in aligning financial reporting requirements with international accounting standards. Local tax legislation, for example, leads to permanent and temporary differences in business results. For example, the impact of tax policy on financial reporting is the determination of taxable profits. Malaysian tax policy determines how taxable income is calculated (Christos, 2006, & Lau & Ooi, 2016).

The study found that significant differences between accounting income and tax income can indicate poor earnings quality and are often associated with earnings management or tax evasion. Hanlon, M. (2005). The tax orientation in financial reporting affects the credibility of financial statements for investors. Results: Firms seeking to reduce their tax burden using aggressive strategies may distort financial reporting by manipulating accounting information. Desai, M. A., & Dharmapala, D. (2006). Tax accounting may reduce transparency and clarity in financial reporting.

Financial accounting aims to provide useful information to investors and stakeholders for making economic decisions and adheres to international accounting standards. Tax accounting aims to determine tax liabilities and is depend on local tax laws and regulations. Studies such as Hanlon (2005) have shown that large variation among accounting income and tax income may indicate earnings management or tax avoidance. The presence of large differences may undermine the reliability of financial reporting, raising questions about earnings quality. Some studies, such as Mills & Newberry (2001), have tested the extent of overlap among tax and financial accounting in countries with a unified or highly integrated accounting system, for example Germany. Nevertheless, in countries for example the United States, there is a important separation among the two systems, allowing for greater tax manipulation. Previous studies highlight the ongoing tension between financial accounting and tax accounting, and the extent to which this tension impacts the credibility of financial reporting. The gap among the two systems may lead to risks link to the quality of financial information, but coordination among them-through policies and disclosures – can support the transparency and stability of financial reporting.

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Blaylock, Shevlin, Ryan, Wilson. (2012)find in the study there are a large differences between tax income and accounting income are typically less able to maintain consistent earnings, which reduces the reliability of financial reporting. Studies on the impact of financial accounting on financial reporting. Results: Financial accounting designed according to international standards helps improve transparency and increase comparability across companies. Financial accounting is an essential tool in improving the quality of financial reporting for investors and markets. The quality of financial accounting is affected. The legal and tax system of a country, and tax accounting may have a negative impact if it overshadows financial objectives. Impact Separating tax and financial accounting enhances the quality of financial reporting. Studies linking tax and financial accounting: Atwood, T. J., Drake, M. S., & Myers, J. N. (2010) the results showed that a high degree of overlap between accounting income and tax income may weaken the predictive power of earnings. The presence of a moderate discrepancy between financial and tax accounting is beneficial to the quality of financial reporting. Tang, T. Y., & Firth, M. (2011) the results: In weak regulatory environments, differences among the financial and the tax accounting are used as a means of managing earnings and avoiding taxes. These differences can weaken the credibility of financial reporting unless there is effective oversight. The overlap between tax and financial accounting may lead to conflicting objectives (profit generation vs. tax minimization). Differences between accounting directly impacts the credibility and transparency of financial information. Adopting clear financial standards that are independent of tax objectives enhances the quality of reporting.

This research present the “model” which is with the relation among tax accounting with financial accounting on the tax policies and financial reporting. The “regression” of this model below mention the relation.

$$TP, FA =_{it} \beta 0 + \beta 1\, TAit + \beta 2FAit + \beta 3FSIZEit \; + \beta 3FAGEit \; + \varepsilon$$

RESEARCH METHODS

This research relies on the analytical-statistical approach, which aims to study and analyze the effect of both financial accounting and tax accounting on the content of financial policies and financial reports. This is achieved by reviewing the practical framework and applying analytical tools to relevant accounting data. The study adopted the analytical approach by analyzing the financial data from 116 company listed on the Malaysian stock exchange. The analytical-statistical approach was used to achieve the study's objectives. This approach allows

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for a description of the phenomenon under study (financial reports) and an analysis of the factors influencing them, particularly tax accounting and financial accounting. This is achieved by analyzing financial data and comparing it to what is required by international accounting standards and what is required by local tax systems. Secondary data was obtained through a database and annual reports from 2020 to 2023. Hypotheses were tested using the statistical program STATA related to tax accounting, financial accounting, tax policies, and financial reports. A sample consisting of a number of companies operating in various sectors was selected, focusing on their financial and accounting departments. These variables were measured in different ways, as present in the table 1.

Table 1: *Measures of Variables*

Terms of Variable	**Terms Measures**
Tax Accounting	Tax Accounting measured by using the disclosure, when the company disclose on the information refer to 1 and when the company no disclose any information about tax accounting refer to 0.
Financial Accounting	Financial accounting can be measured using several methods, including measuring assets, liabilities, and equity, as well as measuring revenues and expenses. These measurements are used to determine a company's financial position and operating results.
Tax Policies	Tax policies can be measured by several key indicators, such as changes in GDP.
Financial Reporting	Financial reports can be measured through several methods, including financial ratio analysis through liquidity analysis and profit analysis.
Control Variables	
Firm size	“The natural logarithm of the total assets at the date of the private placements firms”.

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Firm age	The age of the company is tested by employing the log of the number for the years since the establishment.

RESULTS

Tax policies directly impact on the content and reliability of financial reports, as some companies tend to manipulate estimates to reduce their tax burden. Significant differences between tax and financial accounting results lead to a decrease in transparency for investors. Using international standards in preparing financial statements, while taxation relies on local rules, creates temporary differences that are recorded in deferred tax items. Financial accounting is concerned with recording financial transactions and modify financial statements in giving with mostly recognized accounting principles. Its primary objective is to give useful information to decision makers (Vokshi, 2018). The most important impact is improving transparency. Financial accounting leads to the preparation of standardized, transparent, and reliable financial reports. It increases comparability by following international accounting standards, making reports comparable across companies and industries. It enhances investor confidence. Accurate and audited financial reports increase the confidence of investors and stakeholders.

Tax accounting aims to determine taxable income according to local tax laws and regulations, which often differ from financial accounting principles Hanlon & Heitzman, 2010): An American study showed that deviation among accounting income and tax income can be an indicator of earnings quality and the potential for manipulation. It showed that the widening gap among tax and financial accounting reduces the effectiveness of financial reporting and increases audit risk. Both financial and tax accounting affect financial reporting, but in different ways. Convergence or convergence between the two systems contributes to increased quality and reliability. Significant differences between the two systems may lead to difficulties in interpreting financial statements by investors. The results of the study are shown below.

Descriptive Statistics Test

This research presents in the table 2 the “descriptive” analysis investigation in the “sample” of 116 in “the Malaysian companies om annual reports and DataStream” from 2020 to 2023. The Tax accounting shows a mean with 12.918, Financial accounting shows 60.652, tax policies

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show 12.918, and financial reporting shows 3.054. The control variables show the firm size with mean 12.264 and firm age with mean16.948.

Table 2: *Descriptive test*

Variable	Obs	Mean	Std. Dev.	Min	Max
Tax accounting	116	12.918	37.283	9.396	16.886
Financial accounting	116	60.652	63.743	7.000	27.700
Tax policies	116	12.918	37.283	9.396	16.886
Financial reporting	116	3.054	30.681	2.870	9.478
Firm size	116	12.264	1.697	8.614	17.432
Firm age	116	16.948	13.582	1.000	8.800

Correlation test

This paper showed in Table 3, the tax policies, firm size, and firm age has appositive correlation with tax accounting. The financial accounting and financial reporting shows a negative correlation with tax accounting.

Table 3: *Correlation test*

Variables	Tax accounting	Financial accounting	Tax policies	Financial reporting	Firm size	Firm age
Tax accounting	1.000					
Financial accounting	-0.450***	1.0000				
Tax policies	0.100	0.441***	1.000			

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Financial reporting	-0.018	-0.195*	-0.136	1.000		
Firm size	0.111	0.944***	0.191*	0.426***	1.000	
Firm age	0.182*	0.154	0.182*	0.521***	0.346***	1.0000

The results for the "model" displays in the Table 4 release the results link to tax accounting which display that has "positivlly" related with financial reporting (t=0.810, p-value=0.042). The financial accounting which shows that has "positivlly" related with financial reporting (t=0.711, p-value=0.031). The tax policies which shows that has "positivlly" related with financial reporting (t=9.396, p-value=0.016). The firm age have a "positive" and important link with financial reporting but the firm size has important and a negative link with financial reporting. "Developing markets regulators" could development from these findings in their effort to attain growing process on. Moreover, the results of this paper can too be utilized to define present financial reporting.

Table 4: *Regression test*

<u>Variables</u> **Financial reporting**	**Coef.**	**Std. Err.**	**t.stat**	**sig**
Tax accounting	3.300	4.050	0.810	0.042**
Financial accounting	0.002	.0023	0.711	0.031**
Tax policies	0.045	0.100	9.396	0.016**
Firm size	0.002	0.004	-0.440	0.006**
Firm age	0.611	0.155	3.940	0.000***
Constant	10.234	0.668		
sample	116			
F value	4.640			
P value	0.001			

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R-squatred	0.144			
Adjusted R squared	0.113			

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The findings release the findings relating to tax accounting, financial accounting, tax policies shows that has "positively" related with financial reporting. The firm age have a "positive" and important link with financial reporting but the firm size has important and a negative link with financial reporting.

The study demonstrated that tax accounting aims to calculate the tax base in accordance with legislation, while financial accounting seeks to present a fair picture of an entity's financial position and economic performance. There are differences in the treatment of revenues and expenses, leading to temporary (such as depreciation of assets) and permanent (such as non-deductible penalties) variation among accounting income and taxable income. The impact of tax accounting on management decisions: It was observed that some administrations modify accounting policies for tax purposes, which may affect the quality and transparency of financial reporting.

Temporary variation led to the recognition of deferred tax assets or liabilities, impacting the entity's statement of financial position and profitability. In some countries or accounting environments, there is still overlap or ambiguity in the relationship between tax and financial accounting, which undermines the credibility of financial reporting.

RECOMMENDATIONS

Enhancing coordination between tax authorities and accounting standards to reduce discrepancies. Training accountants to address tax discrepancies in accordance with international standards. Enhancing transparency in the disclosure of tax policies in financial reports. It is preferable to work to reduce discrepancies between tax and financial accounting by harmonizing policies as much as possible, without compromising tax compliance or financial disclosure. Increasing disclosure of discrepancies. Companies should clarify in the notes accompanying financial reports the nature of temporary and permanent discrepancies and their impact on financial results. Enhancing the independence of financial accounting. It is

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important not to influence financial accounting policies as a result of tax pressures, to ensure the quality of financial information and its relevance for decision-making.

The tax authorities should review and update laws in line with developments in international accounting standards to reduce conflicts. Raising the efficiency of accountants and auditors. It is necessary to train accounting personnel to distinguish between the requirements of the two systems and the ability to prepare accurate financial reports that are compliant with regulations. The objectives of tax accounting and financial accounting differ. The first focuses on tax compliance and determining obligations to the state, while the second aims to provide accurate and transparent information to external users. Differences between accounting income and tax income. The application of different rules results in permanent differences (such as expenses not recognized for tax purposes) and temporary differences (such as depreciation of assets), which impact net income and financial reporting.

The impact of tax policies on accounting policies. Some administrations resort to manipulating or modifying accounting treatments to achieve tax savings, which may influence the "credibility of financial statements". Recognizing deferred tax assets and liabilities. Temporary differences in accounting affect financial statements through the recognition of deferred tax, which must be clearly disclosed to users. The need for better integration between the two systems. A gap has been observed among "tax accounting" requirements and "financial accounting" standards, especially in countries that have not fully adopted international standards. Promoting convergence between the accounting and tax systems.

The study recommends working to reduce the gap between the two accounting systems by coordinating policies and updating legislation to align with international standards. To achieve transparency and full disclosure, companies must disclose the nature of variation between accounting income and tax income, and their impact on the financial position and business results. Reporting quality should not be sacrificed for tax purposes. It is important to maintain the independence of accounting treatments in accordance with approved standards and not be subject to pressure to reduce tax liabilities. It is necessary to provide specialized professional training for accountants and auditors on the differences between the two systems and how to deal with them professionally. It is recommended to periodically review tax policies to ensure their compatibility with changes in global accounting standards.

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