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Audit Firms, Deferred Taxation and Financial Reporting:
The Case of The Athens Stock Exchange

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ABSTRACT

The purpose of this paper is the sectoral analysis and evaluation of the external audit reports in relation to the amounts of deferred taxes on the balance sheets of listed companies in the Athens Stock Exchange (ASE). External auditors participate significantly in the preparation of financial reporting, reducing agency problems and aiding acceptance of such information by the users as reliable. The "unqualified" audit reports correspond to more than two thirds of the total, while in the banking sector there is no "unqualified" (ie without even issue of 'emphasis') Audit Report after 2011. More than two thirds of Deferred Tax Assets - including those from Loss Carryforwards - (DTA), Deferred Tax Liabilities (DTL), and Deferred Tax in the Income Statement appear on the Balance Sheets of the companies audited by the Big 5. Audit firms and supervisory authorities do not seem to have made satisfactory evaluation and exploitation of this information.

KEYWORDS

Audit Reports, Deferred Taxation, Financial Statement Analysis, IAS

1. INTRODUCTION

This paper aims at highlighting the role of audit firms as regards the reporting of deferred taxes on the financial statements of listed companies. Ball & Shivakumar (2005) and Burgstahler et al. (2006) support that the adoption of Accounting Standards alone is not enough to produce comparable financial reporting, and highlight the influence of other internal and external factors on the quality of the financial reporting offered. Holthausen (2009) demonstrates that incentives for management, connected with profitability or valuations, internal and external governance structures, and other institutional features of the economy may prove more powerful and prevalent in Accounting Rules.

One of the most complex issues in the preparation of financial statements appears to be that of Deferred Taxes (Eierle & Haller, 2010; Colley et al., 2009). Deferred Tax Assets (DTA) and Liabilities (DTL) on balance sheets incorporate the estimated future tax effects of income taxes arising from temporary differences between Book and Taxable Income (Book-Tax Differences-BTDs). The latter result from the implementation of different laws and rules by calculating the Book vs Taxable income and they are mainly due to Temporary Differences between the Book base and Tax base of assets and liabilities.

According to research by the European Financial Reporting Advisory Group (EFRAG, 2011), projected disclosure on Financial Reports as regards deferred tax integrates important information and needs further improvement. On the agenda of the European Securities and Markets Authority (ESMA,

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2014), the handling of deferred tax assets positions in times of financial crisis and recession is of high priority, while attention is drawn to the recoverability of deferred tax assets from loss carryforwards and emphasis is given to the need for improving the information provided.

The external auditors play an undeniably important role in the preparation of financial reporting, while limiting agency problems (Brown et al., 2011; Watts & Zimmerman, 1983). The quality of external audit seems to be related to the size of the audit firm (De Angelo, 1981; Lennox, 1999a & 1999b; De Fond et al., 2002), while its independence safeguards the interests of shareholders, investors and creditors (Brown et al., 2011). The majority of research in the field of deferred taxes comes from the United States, with reference to the American Accounting Standard "SFAS 109 - Accounting for Income Taxes", and from countries that maintain close "Accounting" ties with this country. The causes of the creation of deferred taxes on the balance sheets of listed companies, and the role of external audit in an economic downturn seem to merit further exploration (Hanlon & Heitzman, 2010, pp. 129; Chytis et al., 2013).

In the Old Continent, since the implementation of the corresponding Accounting Standard "IASB - IAS 12- Income Taxes"[1] a small number of surveys has highlighted the informative value of BTDs and deferred taxes, while few of them focus on the role of Audit Firms. Although the concept of IAS 12 is very close to that of SFAS 109, there is considerable differentiation with regard to the tax and legal background of the countries of Central Europe (Karampinis & Hevas, 2011; Karampinis & Hevas, 2013; La Porta et al., 1997). The question whether the findings of these surveys can be useful and could be interpreted in the same way for countries with different tax and accounting systems does not seem to have been answered adequately.

The purpose of this work is the sectoral analysis and evaluation of the external audit reports in relation to deferred taxes on the balance sheets of companies listed in the Athens Stock Exchange (ASE), focusing on the audit firms that carried out the auditing. The findings show that more than 2/3 of the deferred tax assets from loss carryforwards (DTL_TLC), Liabilities (DTL), and deferred taxes in the income statement are recorded on the Balance Sheets and the profit & loss Statements of the Companies audited by the Big 5.

This research promotes scientific knowledge and supplements the existing literature primarily for the following reasons: It uses hand-collected[2] data from the companies' Annual Reports not available in electronic databases[3], from a representative (FTSE-ASE indices[4]) and stable over time sample[5]. Data are derived from companies that implement the Accounting Standard IAS 12[6], while the majority of existing surveys had drawn figures from the US SFAS 10. It includes companies operating in a highly unstable tax environment[7] amid the financial crisis and economic recession, characterized by insufficient supervision facilities and a low level of investor protection (Karampinis & Hevas 2011). It is unique, as far as we know, in the Greek literature, as it takes into account the role of the factor "Audit Firm" in shaping the financial reporting outcome after the adoption of International Accounting Standards.

2. ACCOUNTING FOR INCOME TAXES: A LITERATURE REVIEW

2.1. "Accounting for Income Taxes" According to IAS 12 and US SFAS 109

Reflection on the need for an interperiod tax allocation of income tax expense in the financial statements has dominated for many years the Anglo-Saxon and American Accounting thought and practice (Black, 1966). The term "interperiod tax allocation" signifies the process whereby the Current and Deferred Tax expenses of a period should be allocated either in the statement of comprehensive income and/or the statement of changes in equity for the period.

In Greece, the reasoning of "deferred tax" is a new concept through IAS/IFRS and until 2014 it was not provided for by any National Accounting Standard (GR GAAP). In 2002 the European Union (EU) required all companies listed in the Stock Exchanges of the 27 Member States to switch

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