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INFLUENCE OF RULES FOR COMPUTING CORPORATE INCOME TAX ON THE ACCURACY OF FINANCIAL STATEMENTS OF LITHUANIAN COMPANIES

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Abstract

Companies in Lithuania have to follow Business Accounting Standards (BAS) when preparing their financial statements. Recording financial transactions according to BAS ensures that the information a company shares with potential lenders and investors gives a true and fair view of its business situation. However, the tax law prescribes its own set of accounting rules, which can result in a difference between what a business shows in financial statements and what it reports on its tax returns. This paper examines whether Lithuanian companies predominantly use tax accounting principles that migrate into their financial statements to create an inaccurate picture of business performance. The method of experts' evaluation was chosen for that purpose. The results indicate that Lithuanian companies tend to heavily rely on accounting principles prescribed in corporate income tax law thus distorting information contained in financial statements. The paper contributes to the scarce literature on this issue of high relevance to both academics and practitioners.

Keywords: accounting principles, financial statements, corporate income tax, Lithuanian companies

JEL classification: M41, M4, H32

1. INTRODUCTION

Under the planned command economy, companies in Lithuania used two sets of accounting rules, one for financial statements and one for tax calculations. Those accounting rules were different, thus making financial statements different from calculation, declaration, and payments of corporate income taxes.

During transition to a free market economy businesses had to adjust to a global market competition. One change was the need to shift to internationally accepted accounting

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standards. But this created a new problem because accounting and taxation are regulated by different sets of laws. Business Accounting Standards (BAS) govern accounting (book-keeping) and the information in financial statements. The Law on Corporate Income Tax (Law on CIT) governs calculation and remittance of tax liability. The distinctive change of the new system is that tax will be calculated from profits reported on the Profit and Loss Statement. Profit, income before taxes, is the starting point for the corporate income tax return, now possible because the provisions of the Law on CIT prescribe the usage of data from financial accounting (on the books) for tax computation. Book income equals taxable income except for provisions in the Law that establish a difference between income recognition from financial accounts and income for tax reporting. There are similar rules that create a difference between expense recognition for the Law on CIT and financial accounting.

The new accounting provisions have significantly simplified the computation and declaration of CIT but at the same time created new problems. A trend to further CIT simplification is apparent. Lithuanian companies simplify in two ways. One approach is to adjust financial accounting rules to tax accounting rules as much as possible so CIT calculation requires minimal adjustments. The second approach is to ignore rules that allow reducing the corporate income tax payable or deferring its payment. Either approach is harmful. With the first approach, the company fails to produce a true and fair view of its financial situation and business results. With the second approach, the company's effort to prevent any misunderstandings with tax administrators may lead to paying more tax than is owed or paying sooner than required by the CIT Law.

The approaches harm different sets of stakeholders. Losers from the first approach include those making decisions from information contained in financial statements. These include decisions by lending financial institutions, acquisition decisions by investors, government decisions on financial incentives to companies, decisions on the evaluation of financial capabilities of companies to bid for contracts; decisions to provide financial support for companies from European funds; company owner decisions on continuation of business operations; customer decisions on the ability of a company to fulfill supply contracts, and other decisions that depend upon financial statement accuracy and reliability.

Companies themselves are the losers from the second approach. Overpayment of tax may cause the company to be short of working capital, may force the company to borrow needlessly, or may cause the company to give up or postpone investment opportunities. Company owners may face lower dividends or lower share prices. If this happens the company fails to achieve its primary goal of increasing shareholder value.

There is no systematic research on the extent of distortion of financial statements in Lithuania caused by improper reconciliation of financial and tax accounting rules and reasons for such distortions. There has been no research to determine the extent of tax law impact on companies' accounting policies and there is no evidence on why companies have not made full use of the ability to defer taxes to later periods.

This research examines accounting policies of Lithuanian companies to determine whether companies predominantly use tax accounting rules that migrate into their financial statements to create an inaccurate picture about their business performance. The results indicate that companies when confronted with the choice between financial accounting standards (BAS) or taxation rules often choose the latter. Results also provide evidence that the most significant distortions in financial statements are related to tangible assets. Most experts also agree that the treatment of financial assets may lead to misleading information about the company. Shares, bonds or other securities in company's possession are often recorded in the accounts at acquisition cost. In the event such assets lose value, a majority of companies do not revalue and do not record reduction in investments' value in financial statements. As a result the balance sheet of the company overstates the value of investments. Experts also agree that the size of doubtful receivables is determined and inventory prices and losses in inventory value are recorded with CIT in mind. Such practices lead to inaccurate and often misleading information in companies' financial statements. In experts' opinion there are enough guidelines and rules to guide accountants to record deferred taxes in financial statements. According to experts laws on accounting and taxation are not overwhelmingly complicated therefore the working on this task or to the deliberate decision of accountants to follow tax accounting rules rather than financial accounting rules.

The paper is organized in the following way. Section two reviews the literature concerning the interaction between accounting and tax systems. Section three describes the research method used in the paper. The results of the experts' survey are presented and discussed in section four. Finally, the concluding section provides recommendations.

2. LITERATURE REVIEW

There are numerous studies on the interaction between accounting and tax systems. When financial accounting rules are adapted to the tax system, the goal of a true and fair view of the company's financial condition and operating results may be compromised. Beaver and Dukes (1972) are among the first to pioneer a study proposing that deferred tax items may be value relevant for investors. Some studies examine the relevance of the timing of the reversal of differences between accounting and taxation regulations that give rise to deferred taxes (Amir *et al.*, 1997; Barth, 2000;Citron, 2001; Chaney and Jeter, 1994;Chang *et al.*, 2009;Guenther and Sansing, 2000, 2004; Lynn *et al.*, 2008; Wong *et al.*, 2011; Hanlon *et al.*, 2014; Hennig *et al.*, 2010, 2013).

Amir *et al.* (1997) classify deferred tax components into seven categories: depreciation and amortization; losses and credits carried forward; restructuring charges; environmental charges; employee benefits; valuation allowance required; and all other components. They find that separating deferred taxes into components provides value relevant information. The value relevance of deferred tax has been a popular topic in the literature (Dhaliwal *et al.*, 2013; Graham *et al.*, 2012). What makes this interesting is the complexity of the estimation of income taxes, which sheds light on likely information content for stock prices. Therefore, income tax implications for financial statement users are less likely to prevail. Hanlon, Navissi and Soepriyanto (2014) examined the incremental value relevance of the balance sheet approach to accounting for deferred taxes relative to the income statement approach and whether such incremental value relevance (if any) is attributable to the deferred tax consequences of asset revaluations.

Enhanced asset values increase firms' future tax commitments, as the enhanced value is recovered through the asset's continued use as an income-producing asset (triggering income tax payable) or its disposal as an appreciated asset (triggering capital gains tax payable). Asset revaluations reflect forthcoming tax payments that, consequently, investors will perceive as real liabilities (Hanlon *et al.*, 2014). Upward asset revaluations reflect their enhanced estimated value (Aboody *et al.*, 1999), recoverable through the asset's use or disposal (Barth and Clinch, 1998; Barth, 2000).

Entities make interperiod allocations of the income tax expense because financial accounting and tax systems use different definitions of income and expenses and/or different rules for the period that these are reported (Sonnier *et al.*, 2012). If book income includes book tax differences that will never reverse (permanent differences), then such amounts affect both the book tax expense and the tax liability. This balance sheet approach in accounting for income taxes requires that an asset or liability be created when a tax amount relating to current book income will be recognized in a future period.

The vast majority of income and deduction items encountered by a business enterprise are treated identically for financial reporting and tax purposes. But items that are treated differently are known as book tax differences and are classified as either permanent or temporary (Sonnier *et al.*, 2012).Permanent differences are book items that never affect the taxable income computation, or vice versa. The tax effects of temporary differences are summarized and accounted for on the balance sheet as deferred tax assets or liabilities. When these items reverse in a future period, the corresponding deferred tax asset/liability account will be reduced. An income/expense book tax difference that will decrease the net amount of taxable income that will be recognized in the future is known as a deductible temporary difference creating a deferred tax asset. Temporary differences are classified as either current or noncurrent for purposes of their placement on the balance sheet (Sonnier *et al.*, 2012). A deferred asset/liability is current if it relates to a deferral concerning a current asset or liability, and noncurrent if it relates to a noncurrent asset or liability. Temporary differences are usually recorded in one period and reverse in some future period.

In order to discover the effects of corporate income tax rate change on valuation it is necessary to pay attention to the tax loss carry forward allowances as well as net changes in the deferred tax liabilities, which appear on the equity account and in financial statements (Kubota and Takehara, 2010). Kubota and Takehara (2010) find that the changes in corporate tax rate can boost stock prices in majority of the cases, while there are cases in which there are no effects or even damaging for firm values. They demonstrate that these different results are caused by the mixed effects of the current provisions that allow firms to carry their tax loss forward and the net balance of tax deferred accounts of each firm.

Colley, Rue and Volkan (2006) have studied the impact of eliminating deferred taxes and adjusting the liability and stockholders equity balances on the debt-to-equity (DTE) ratio. Their study argues that the income tax accounting issue should be viewed from an aggregate perspective and concludes that the flow-through method of accounting for income taxes should be adopted. Results of regression analysis done by Taylor and Richardson (2012) indicate that there are several practices Australian firms use to aggressively reduce their tax liabilities (Taylor and Richardson, 2012). Specifically, they find that thin capitalization, transfer pricing, income shifting is used.

Raskolnikov (2008) offers an economic analysis of different risks and considers two responses to the relational tax planning problem. The analysis suggests that from a welfares' perspective, business risk is a superior deterrent compared to both market and counterparty risks. Counterparty risk is the most complex. Article is about one unpleasant consequence that taxpayers must often accept as a price of lowering their tax bills, that is risk. Tax law is full of risk-based rules - provisions that grant tax benefits only to those who accept a certain amount of risk.

Chludek (2011) produced one of the first studies to examine the value relevance of deferred tax items under the International Financial Reporting Standards and indicated that deferred tax items do not possess any information content for market prices. The study also revealed that a large part of deferred tax items tend to reverse.

Laux (2013) finds that investors seem to value only the information content of specific items of deferred tax; he empirically examines whether deferred taxes provide incremental information about future tax payments and explores whether the relationship is affected by whether and when the deferred tax accounts reverse. His analysis provides evidence that while deferred taxes do provide incremental information about future tax payments, the magnitude of the information is small. Further, consistent with theoretical predictions analysis done by Guenther and Sansing (2000,2004), he demonstrates there is an asymmetrical association between deferred taxes and future tax payments. The analysis provides evidence that growth in the deferred tax balances does not defer future tax payments (Laux, 2013). Hanlon, Navissi and Soepriyanto (2014) suggest that the increment to deferred tax balances upon adopting the balance sheet approach has value relevance, with such value relevance driven by the deferred taxes on certain asset revaluations (Hanlon *et al.*, 2014).

The tax effects of temporary differences are summarized and accounted for on the balance sheet as deferred tax assets or liabilities. Temporary differences can be used to postpone a part, sometimes a significant part, of income tax payment to a later date without distorting the accounting data. The changes in corporate tax rate can enhance stock prices in majority of the cases.

Numerous authors have explored effects of different approaches to the same phenomena used for financial reporting and for profits tax computation. There has been no examination of Lithuanian companies to determine whether the information presented in the financial statements is distorted when accounting and tax requirements are combined, and for what reasons such distortions may occur. There also has been no systematic study for what reasons companies have not taken advantage of a full-scale income tax rescheduling opportunities. The current paper fills this gap.

3. METHODS

The aim of the research is to establish whether information provided in financial statements is distorted by improper adaptation of financial accounting rules to tax accounting rules and what are the reasons behind such distortions. The method of experts' evaluation, a qualitative research approach, has been chosen for this research. The choice of this method has been prompted by the fact that most citizens are not familiar with accounting and taxation rules and their application in practice. Only specialists such as experienced auditors deal with such issues on a daily basis and are in a position to provide an authoritative opinion.

The method of experts' evaluation can be described as a procedure to produce a generalized experts' opinion from their knowledge, experience, and intuition. The experts' evaluation is a method that allows us to consolidate the opinions of separate experts and draw a common conclusion (Rudzkiene, 2005).The representative sample is not a relevant requirement for the proper application of expert's evaluation. Instead a sample is drawn based on the non-probabilistic selection method. "The reliability of the expert's evaluation method depends upon the selection of experts. Selected experts must be competent persons, have specialized expertise in the area directly related to the research object" (Tidikis, 2003, p. 517). The size of the group (number of experts) also depends upon the competency of experts (Rudzkiene and Augustinaitis, 2009). In order to ensure the validity and reliability of experts' evaluation the size of the group should not be less than five experts. However, sometimes the number of experts may reach 30 or 40. The optimal recommended size of the group is from 8 to 10 experts (Rudzkiene and Augustinaitis, 2009). For this research experienced auditors were chosen to answer questions on the application of accounting standards.

Auditors are the best experts for this research because their work requires that they get to know accounting systems used in numerous companies. In addition, an audit requires that the auditor learn the accounting policy of a specific company and determine whether it is appropriate and can achieve its purpose to provide information that would produce a true and fair view of company's financial situation and business results. Accountants (financial officers) could not serve as experts in this research because they focus on the situation in one company for which they work and may know the intricacies of accounting methods used in one company but would be unable to draw more general conclusions based on the accounting practices of a large number of companies**.** In order to select competent respondents the following requirements were applied: the expert's educational attainment could be no less than a college degree, and have no less than five years experience in financial auditing.

In this research the experts' evaluation was conducted with the use of a survey. A questionnaire was designed and sent to the experts. This method allows data to be gathered in a time-saving manner. The questionnaire uses close-ended (multiple choice and ranking) questions as well as some open-ended (comment box) questions. Ranking questions employ a Likert scale with five possible answers using a 1-to-5 rating scale where "1" means "strongly agree" to the notion and "5" means "strongly disagree" of the notion. The questionnaire contains 17 questions. Each question is designed to achieve certain goals as reflected in Table no. 1.

Table no. 1 – Research goals and corresponding questions in the questionnaire

Goals	**Questions**
Disclose for what reasons deferred taxes are not shown in the accounts (financial statements**)** when this should be done	1
Disclose experts' opinion about the treatment of long-term tangible assets in financial statements	2, 3, 4, 5, 6
Disclose experts' opinion about the treatment of financial assets, inventory, receivables, and expenses in financial statements	7,8,9,10,11,12
Evaluate the competence of experts	13, 14,15
Provide information about audited companies	16, 17

Source: Authors

In total 11 questionnaires were filled out. Seven respondents had a Master's degree and four had a Bachelor's degree. Their experience in financial auditing ranged from 5 years to over 20 years; six auditors had a job experience from 5 to 10 years, three had experience from 10 to 20 years, and two auditors' experience was longer than 20 years. The number of audited companies by individual auditors in the last three years ranged from 9 to 150. In total the auditors had audited 421 companies of various size engaged in various industrial fields, commerce, and services.

This method requires formal testing of the compatibility of experts' evaluations. The compatibility of the expert evaluations was tested using Kendall's *W (*Kendall's coefficient of concordance). Kendall's coefficient of concordance for ranks (*W*) calculates agreements between experts as they rank a number of items according to particular characteristics. If the test statistic *W* is 1, then all the survey respondents have been unanimous, and each respondent has assigned the same order to the list of items. If *W* is 0, then there is no overall trend of agreement among the respondents, and their responses may be regarded as essentially random. The following hypotheses are formed:

H_0: *The expert evaluations are conflicting (*Kendall's *W is equal to zero);*

H_A: *The expert evaluations are similar (*Kendall's *W is not equal to zero).*

Kendall's coefficient of concordance is calculated according to the following formula:

$$W = \frac{12S^2}{m^2(k^3 - k) - m\sum_{l=1}^{r} T_l} \tag{1}$$

where:

W is the coefficient of concordance

S^2 is the sum of squared deviations

m is the number of experts

k is the number of alternatives

r is the number of rows that contain coinciding ranking

T_l is the number of coinciding rankings in the first row of ranks

For the survey data, Kendall's *W* has been calculated using statistical package SPSS (version 13). Results are presented in Table no. 2.

Table no. 2 – Test statistics for expert compatibility

Kendall's Coefficient of Concordance	0.573
Chi-Square	25.219
Degrees of Freedom	4
Number of Experts	11
Asymp. Significance.	0.000

Source: (Authors' calculations)

The responses to ranking question 1 that are summarized in Figure no. 1 below were used to test the compatibility of experts' evaluations. The calculated Kendall's coefficient of concordance of 0.573 indicates a high level of agreement among experts in evaluating proposed items. We can reject the null hypothesis that the experts' evaluations are conflicting at the 0.00 level of statistical significance. The test statistics indicate that results obtained through the chosen methodology are robust.

4. RESEARCH RESULTS AND ANALYSIS

The first question seeks to reveal the reasons behind the failure to include deferred taxes in financial statements. The question is important for two reasons. First, it concerns the external stakeholders who have financials links to the company and who have an interest to see a true and fair view of business operations reflected in company's financial statements. If due to the different interpretation of specific operating facts in accounting and tax system deferred taxes should be recorded but are ignored the information presented in financial statements is misleading. Management decisions made based on such information will be unsound and may produce substantial financial losses. Second, companies can lawfully make use of the provisions in corporate income tax calculation rules and defer the payment of CIT for quite a long time. In such a way companies receive an interest-free loan or subsidy from the government instead of borrowing from financial institutions and paying interest. It should be noted that deferral of tax payment is completely within the discretion of the company. In other words, no other party - apart from the company itself - has an interest that taxes should be paid later rather than sooner. The law provides for such a possibility. However it is up to the company to take advantage of this possibility.

At the same time it should be emphasized that there are rules that require paying CIT before income and expenses are recognized in financial accounting. In this case, keeping to the rules is not discretionary and doesn't depend upon the company's choice. If taxes due are not paid on time damage is done to the government's budget. Therefore those rules are mandatory and enforced by the tax administration including the application of sanctions in case of non-compliance.

As indicated in Figure no. 1 below according to experts the most important reason is low competency of accountants who compile financial statements. However this reason is closely followed in ranking by the opinion that deferred taxes are not reflected in financial statements because instead of following accounting principles accountants give precedence to taxation rules.

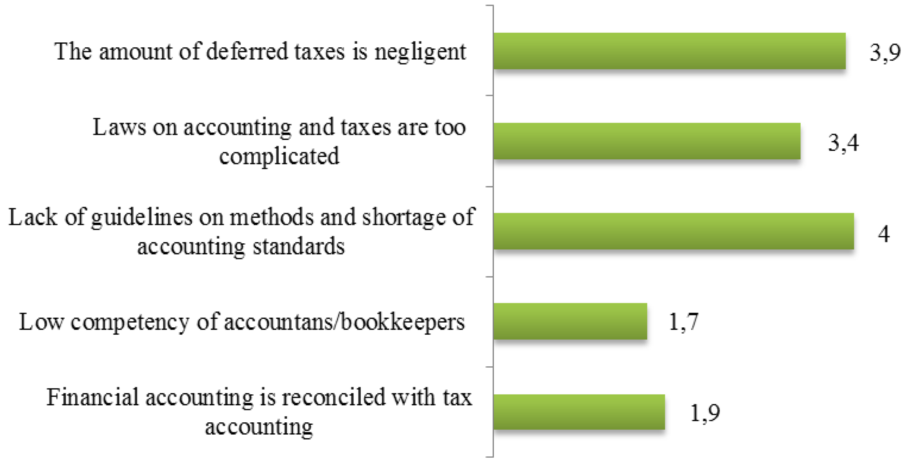

Figure no.1 – For what reasons deferred taxes are not shown in the accounts (financial statements) though it should be done? (evaluate from 1 to 5; 1 meaning "the most important reason", 5 meaning "the least important reason")

Experts indicate that the least important reason is the lack of guidelines on how to compile financial statements or absence of accounting standards. The results show that there are enough guidelines and rules to guide accountants to record deferred taxes in the financial statements. Because the laws on accounting and taxes are not too complicated, the failure to compile financial statements accurately can be ascribed either to the low competency of accountants working on this task or to the deliberate decision of accountants to follow tax accounting rules rather than financial accounting rules.

The next five questions seek to disclose experts' opinion about the treatment of long-term tangible assets in financial statements. Experts were given several statements about the treatment of tangible assets and were asked to assign values from 1 meaning "strongly disagree" to 5 "strongly agree". As shown in Figure no. 2 experts mostly agree with statements that long-term tangible assets are treated to conform to taxation rules rather than to financial accounting standards.

Such results provide evidence that the most significant distortions of information presented in financial statements are related to tangible assets. First, responses to the survey indicate that differences related to various expenditures that could be included in the acquisition cost of long-term assets are often ignored. Second, the responses indicate that the most important factor that contributes to the inaccuracy of financial statements is the depreciation method chosen. Often the depreciation method is chosen not to reflect the useful life time of long-term assets but the shortest period allowable for CIT computation. As a result, costs shown during the initial usage of an asset are magnified, thus reducing profit recorded in Income and Loss Statement. At the same time the value of long-term assets recorded in the balance sheet is understated and the company's financial situation looks worse than it is in reality.

The impact of faster depreciation is also confirmed by the response to the statement that companies have significant quantities of fully depreciated long-term assets at their disposal. As a result, the balance value of such assets is zero. The depreciation costs are also equal to zero. That improves operating results recorded in the Income and Loss Statement (the net profit increases) and all indicators related to the effective usage of long-term assets are unjustifiably enhanced.

The results of the survey also indicate that long-term assets are usually evaluated at acquisition cost, though they could be revalued or evaluated at true value. Therefore, if market value of the assets is growing, these assets continue to be appraised at a smaller than true value because only asset acquisition cost can be used for taxation purposes.

Expert responses also indicate that companies often fail to record the reduction in long-term assets value even if business accounting standards require doing so. This unwillingness to record loss in value can be explained by the fact that reduction in value is not treated as allowable deduction for taxation purposes and therefore does not reduce taxable income. As a consequence an overstated assets' value is recorded in the balance sheet of the company while losses incurred due to the reduction in long-term assets value are not recorded.

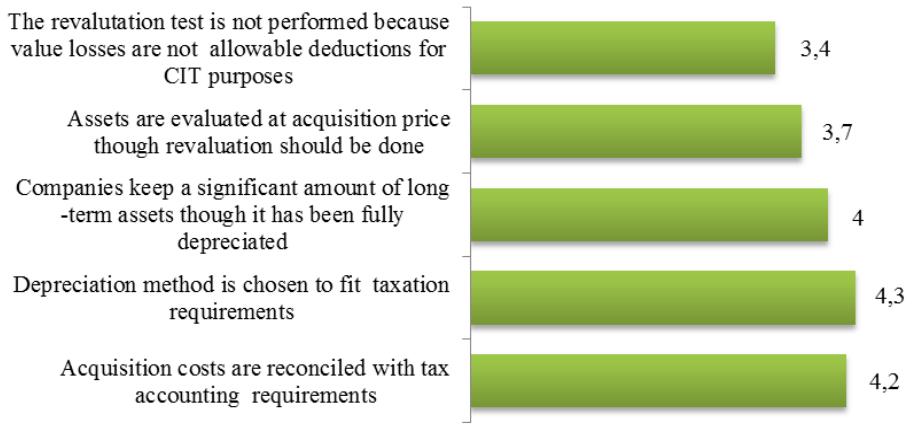

Figure no. 2 – Treatment of long-term tangible assets in financial statements

The next question deals with financial assets. As shown in Figure no. 3, 45% of experts agree and 18% of experts strongly agree that a revaluation test is not performed. This means that financial assets such as shares, bonds or other securities in company's possession are recorded in the accounts at acquisition cost. In the event such assets lose value, a majority of the companies do not perform revaluation test and do not record reduction in investments' value in financial statements. As a result, the balance sheet of the company records the overstated value of investments. At the same time the loss incurred during the reporting period goes unrecorded. Therefore, the balance sheet reflects a better financial situation than warranted by true evaluation and the Income and Loss Statement shows misleading business results. All this would not happen if companies kept to business accounting standards.

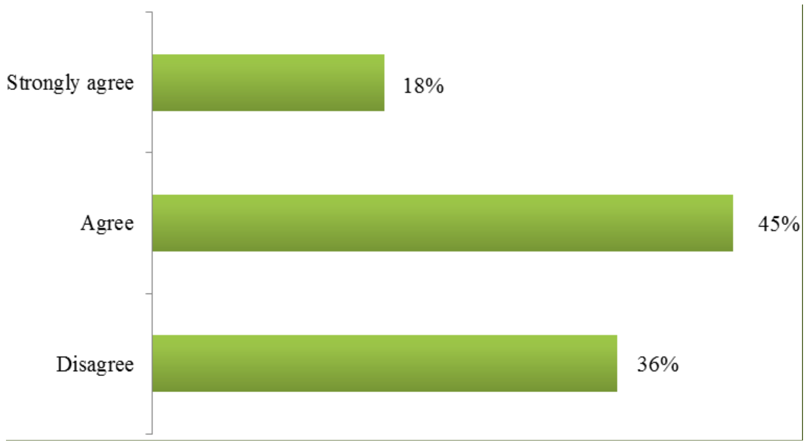

Figure no. 3 – Revaluation test of financial assets is not performed because value losses are not allowable deductions for CIT purposes

The next three questions were devoted to the treatment of inventory in financial statements. Experts were given several statements about the treatments of inventory and were asked to assign values from 1 meaning "strongly disagree" to 5 "strongly agree".

55% of experts agree and 9% strongly agree that inventory prices and losses in inventory value are recorded with the corporate income tax in mind (see Figure no. 4). 45% of experts agree and 9% of experts strongly agree that depreciated inventory is often sold below acquisition costs because such loses are recognized in financial accounting as well as for tax purposes. This means that the requirement of business accounting standards to recognize loss in inventory value during the same reporting period if net realizable value of inventory falls below acquisition costs is ignored. The practice of writing inventories down to net realizable value is consistent with the view that the carrying amount of assets should not be carried in excess of amounts expected to be realized from their sale or use during the operating cycle (Authority of Audit and Accounting, 2004b).

A majority of the experts agree that this loss is not entered into the accounts because this loss in value is not recognized as allowable deduction for taxation purposes in in that reporting period.Companies may resort to this practice because during the next reporting period if inventory is sold at a less than acquisition cost the losses can be deducted from taxable income . Therefore a significicant number of accountants tend to postpone the recognision of losses attributable to the reduced value of inventory to later periods when such inventory is sold and losses can be „realized“.

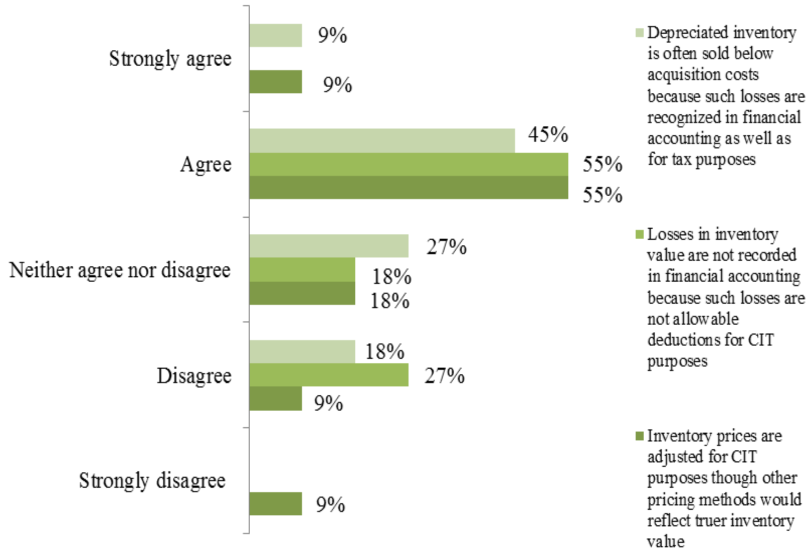

Figure no. 4 – Treatment of inventory in financial statements

When calculating the cost of inventories used in production or the cost of sold inventories, an entity may apply FIFO (assuming that the items of inventories that were purchased or produced first are used first), LIFO (assuming that the items of inventories that were purchased or produced last are used first), weighted average cost, specific identification of cost or other appraisal methods, depending on the movement of inventories in the entity and other conditions (Authority of Audit and Accounting, 2004a) .

However, some experts note (55% of experts agree and 9% of experts strongly agree) that companies tend to apply appraisal methods, usually FIFO, to record the cost of sold inventories even in those cases when other appraisal methods would show a more accurate value of inventory in the balance sheet. If FIFO method is applied and the value of inventory is rising, the value of inventory recorded in the ballance sheet is somewhat lower than the current market price. At the same time, the Income and Loss Statement understates the business results of the company.

As shown in Figure no. 5, 82% of the experts agree and 9% strongly agree that companies keep a special account “Unallowable deductions” for CIT purposes. This means that diverse expenses that should be attributable to specific causes and recorded in specific accounts are all recorded under a single heading. Presentation of information in such a form may mislead certain external users of the information. Such presentation makes it unclear what kind of expenses and in what amounts the company sustained during the reporting period. The expert’s opinion confirms that this problem is widespread among Lithuanian companies.

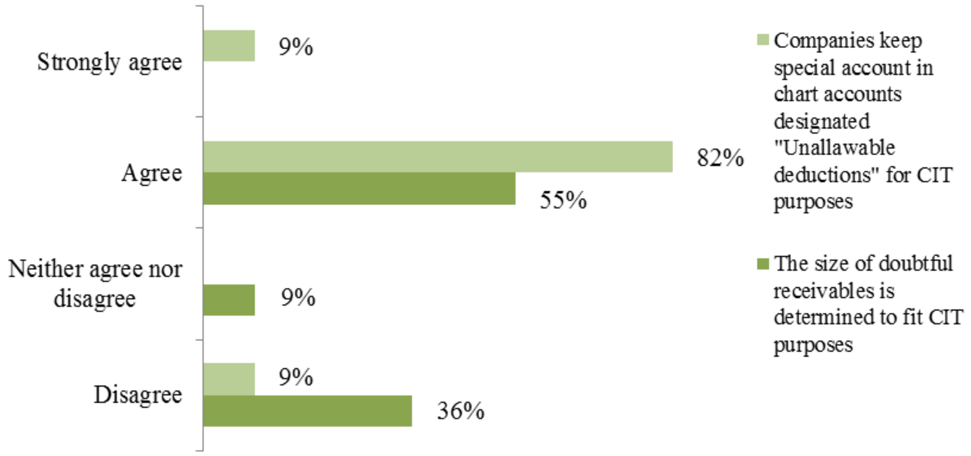

Figure no. 5 – Treatment of receivables and special accounts

Also 55% of the experts agree that the size of doubtful receivables is determined with CIT in mind. Provisions of the tax law impose stricter requirements for doubtful receivables to be recognized as allowable deductions when calculating the tax payable. Therefore a smaller amount of doubtful receivables is being recorded than it would be if the company would follow general accounting principles. As a result companies show larger accounts receivable and smaller doubtful receivables on their balance sheets.

However, 36% of the experts disagree with such a statement which shows a division of opinion among experts on this issue. This result could be explained by the fact that, despite the requirements of the tax law, a significant number of companies have introduced and use such methods to determine doubtful receivables that allow determining accurately amounts the company does not expect to receive in the future. This also provides evidence that, in keeping with the provisions of CIT law, these companies will convert doubtful amounts into bad debts when computing the tax payable. In this case the balance sheet information of such companies about amounts receivable and possible losses due to bad debts will be accurate. The companies that choose to use such methods will also be in compliance with taxation rules.

5. CONCLUSIONS

The previous research emphasized tax planning, the minimization of tax liabilities using deferred taxes (Taylor and Richardson, 2012; Laux, 2013), and the impact of such deferment on companies' stock prices (Chaney and Jeter, 1994; Wong *et al.*, 2011). This research contributes to the previous research by exploring to what extent and for what reasons companies avoid full recording of deferred taxes. It also attempts to shed some light on how such practices influence the quality of information presented in financial statements and what areas of accounting information are more likely to be distorted.

The results indicate that companies when confronted with the choice whether to use financial accounting standards (BAS) or follow taxation rules often give precedence to the latter. Results also provide evidence that the most significant distortions of information presented in financial statements are related to tangible assets, specifically application of faster depreciations methods and failure to revalue assets so that they reflect true asset value. As a result, the value of long-term assets recorded in the balance sheet is understated, thus making company's financial situation look worse than it is in reality.

Most experts agree that the treatment of financial assets may lead to misleading information about the company. Shares, bonds, or other securities in the company's possession are often recorded in the accounts at the acquisition cost. In the event such assets lose value, a majority of the companies do not perform a revaluation test and do not record reduction in investments' value in financial statements. As a result, the balance sheet of the company overstates the value of investments.

Experts also agree that the size of doubtful receivables is determined and inventory prices and losses in inventory value are recorded with CIT in mind. Most companies tend to apply inventory appraisal methods , usually FIFO, to record the cost of sold inventories. In such a case, if value of inventory is rising, the value of inventory recorded in the ballance sheet is somewhat lower than the current market price. The results of the company in the Income and Loss Statement are understated. The loss of writing inventories down to net realizable value often is not entered into the accounts because this loss in value is not recognized as an allowable deduction for taxation purposes in in that reporting period. This means that the requirement to recognize loss in inventory value is ignored. Such practices lead to inaccurate and often misleading information in companies' financial statements.

Companies also fail to record deferred taxes when they should. There are enough guidelines and rules to guide accountants to record deferred taxes in the financial statements. In the experts' opinion, the laws on accounting and taxes are not too complicated. Therefore, the failure to compile financial statements accurately can be ascribed either to the low competency of accountants working on this task or to the deliberate decision of accountants to follow tax accounting rules rather than financial accounting rules. Such practices lead to financial statements that fail to provide a true and fair view of companies' financial condition to potential lenders and investors.

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ANNEEX 1
Questionairre

Dear Expert,

We (names omitted) professors at Mykolas Romeris University are conducting research on optimizing the corporate income tax in Lithuania in search of the best ways to reconcile diverging requirements of accounting principles and tax laws. The objective of this research is to find out if and how Lithuanian companies reconcile rules prescribed in Business Accounting Standards (BAS) with rules for computing corporate income tax.

The experts‘ evaluations are anonymous therefore responses to the questions will be analyzed only in generalized manner. We appreciate your honest responses to the questions below.

Your participation will contribute to the thoroughness of the research on the application of accounting standards in Lithuanian companies.

1. For what reasons deferred taxes are not shown in the accounts (financial statements) though it should be done? (evaluate from 1 to 5; 1 meaning "the most important reason", 5 meaning "the least important reason")

	1	2	3	4	5
Financial accounting is reconciled with tax accounting	☑	☐	☐	☐	☐
Low competency of accountants/bookkeepers	☐	☑	☐	☐	☐
Lack of guidance on methods and shortage of accounting standards	☐	☐	☐	☑	☐
Laws on accounting and taxes are too complicated	☐	☐	☑	☐	☐
The amount of deferred taxes is negligent	☐	☐	☐	☐	☑

SPECIALIZED PART OF THE QUESTIONNAIRE
(Evaluate from 1 to 5: „1“ meaning „strongly disagree“, „5“ meaning „strongly agree“)

Tangible long-term assets

1. Acquisition costs are used to meet tax accounting requirements	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5
2. Depreciation method is chosen to fit taxation requirements	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5
3. Companies keep a significant amount of long - term assets though it has been fully depreciated	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5

4. Assets are evaluated at acquisition price though revaluation should be done	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5
5. The revalutation test is not performed because value losses are not allowable deductions for CIT purposes	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5

Financial assets

6. The revaluation test of financial assets is not performed because the value losses are not allowable deductions for CIT purposes	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5

Inventory

7. Inventory prices are adjusted for CIT purposes though other pricing methods would reflect truer inventory value.	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5
8. Losses in inventory value are not recorded in financial accounting because such losses are not allowable deductions for CIT purposes	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5
9. Depreciated inventory is often sold below acquisition costs because such losses are recognized in financial accounting as well as for tax purposes.	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5

Receivables

10. The size of doubtful receivables is determined to fit CIT purposes	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5

Expenses

11 Companies keep special account in chart accounts designated "Unallawable deductions" for CIT purposes	Strongly disagree	1
	Disagree	2
	Neither agree, nor disagree	3
	Agree	4
	Strongly agree	5

INFORMATION ABOUT THE EXPERT

12. What is your educational achievement?
    - ☐ College (B.A)
    - ☐ Master‘s degree
    - ☐ Ph.D.
13. What is your profession/position?

14. What is your job experience in this profession?
    - ☐ from 5 to 10 years
    - ☐ from 10 to 15 years
    - ☐ from 15to 20 years
    - ☐ more than 20 years

INFORMACION ABOUT AUDITED COMPANIES

15. The number audits performed in last three years		
16. The number of audited companies whose balance value is	≤ 1 mln. EUR	
	1-5 mln. EUR	
	5-10 mln. EUR	
	10-20. mln. EUR	
	> 20 mln. EUR	
17. What is industiral/service field of the company‘s business?	Number of companies	Field

Thank you very much for your co-operation.