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DECISION USEFULNESS APPROACH TO FINANCIAL REPORTING: A CASE FOR MALAYSIAN INLAND REVENUE BOARD

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ABSTRACT

This paper aims at determining whether or not financial reporting of companies in Malaysia provides useful information to Inland Revenue Board for income tax determination. The respondents in this study were staff of the Inland Revenue Board, Jalan Duta, Kuala Lumpur, and, for the purpose of the study, copies of questionnaire were distributed to them to illicit their responses. The data collected were analyzed, using SPSS. Most of the respondents are satisfied that companies' financial reporting follows the requirements of relevant laws in the country and that they comply with appropriate accounting standards. But the respondents query the decision usefulness level of the financial reporting of companies to the Inland Revenue Board's functions of tax assessment and income tax determination. It is for this reason that adjustment becomes necessary to the income measurement shown in the income statement of companies for proper income tax determination by the Malaysian Inland Revenue Board. It is, therefore, recommended that appropriate laws on companies financial reporting in Malaysia should include a clause that would require companies to prepare an adjusted income statement which would be decision useful to Inland Revenue Board as part of the items of financial statements to be reported by the companies.

Keywords: Financial reporting, Decision usefulness, Inland revenue board, Tax determination.

JEL Code: M41

INTRODUCTION

Decision usefulness approach to financial reporting is an approach to the preparation of financial accounting information that emphasis on the theory of investor decision making in order to infer the nature and types of information that investors need (Decision Usefulness Approach, 2009). It is an approach usually adopted to satisfy the information needs of the primary users of the financial reports of the reporting entities: investors and creditors. Other stakeholders to a firm's financial and non-financial activities are hardly considered in addressing their specific information needs through adjustment of general purpose financial reports.

According to Wild (2008) and Fellingham (2005), accounting is viewed as the measurement activity that provides financial reports in support of decision makers and their business decisions. Financial reporting is the communication of financial information useful for making investment, credit, and other business decisions (Chiappetta *et al.*, 2009). Such communications are carried in general purpose financial statements such as balance sheet, income statement, equity reports, cash flow statement, and notes to the financial statements. Financial reporting is governed by statutory and common law as well as institutional and ethical standards. Unfortunately, Financial reporting sometimes falls short of both legal and ethical standards, which makes the reports useful to some of the target users (like Inland Revenue Board) as they take informed decisions. Lamont (1992) states that of all the powers of government, other than its authority to declare war, none bears so incisively upon the welfare of citizens, both privately and in their economic enterprise, as does its power to tax.

The effect of taxation is that subjects are forced to give up hard earned earnings or possessions without receiving visible benefits in return (Coetzee, 1993). In every jurisdiction, Inland Revenue Board is empowered to collect tax from individuals and companies. Inland Revenue Board is an agent of government that provides services in assessing, administering, collecting and enforcing the payment of income tax and other taxes that are under its jurisdiction Malaysian (Inland Revenue Board, 2012). Adequate information is needed as the income tax payable is determined by the tax authorities for fairness to be shown, and that is where decision useful financial statement to the Inland Revenue Board becomes necessary. In the absence of useful guiding information on tax assessment and collection taxation, could be unnecessarily heavy or too low, which could lead to some uncertainty and crisis in the economic system of a country (Dickson and Nwaobia, 2012; Ngerebo, 2013).

Although there are a number of individuals and companies who have been voluntarily reporting their income and are paying their tax liabilities properly, there are a few individuals and companies who have not been doing so. Taxpayers, especially companies, need to submit their audited financial statements to Inland Revenue Board for the purpose of income tax determination.

The objective of this study is to determine whether or not financial reporting of companies in Malaysia provides useful information to Inland Revenue Board for income tax determination. To achieve this objective, the study makes effort to find answers to the following research questions:

1) Is companies' financial reporting in line with the disclosure requirements of Malaysian Inland Revenue Board?
2) Is the financial reporting of Malaysian companies useful to Inland Revenue Board for the purpose of income tax determination?

The outcome of this research allows room for a better understanding of the relevance of the financial statements provided by Malaysian companies to the decision taken by the Inland Revenue Board in determining the tax liabilities of reporting entities.

LITERATURE REVIEW

Theoretical Underpinning

When conditions are not ideal, there is no such thing as 'perfect' or 'true and fair' financial statements. Instead, accountants try to prepare statements that are useful to users. To do this, the accountant must identify who are the users and understand their decision problems and information need. Examples of users are investors, government, creditors and others. Investors need the information to decide whether they should invest in a company or not, while government interested in the allocation of resources and, therefore, the activities of entities. It also needs the companies accounting information in the estimation of national income. Creditors are interested in companies' information to enable them determine whether or not amounts owing to them will be paid when due. Single-person decision theory, which is based on the viewpoint of an individual who must make a decision under conditions of uncertainty, is the underpinning theory to this study. The theory sets out a procedure for allowing additional information to be obtained from reporting entities to revise a decision-maker's subjective assessment of the probabilities of what might have happened after a decision is made. The theory is promoted by scholars like Raiffa (1968), Demski (1972), Sterling(1979), Ijiri (1983), Solomons (1989), Laffond (1989), Staubus (1999), Cartney(2004), Henderson (2005), Godfrey *et al.*(2006) and Scott (2009).

Single-person decision usefulness theory takes the view that "if we can't prepare theoretically correct financial statements, at least we can try to make financial statements more useful". The usefulness of financial statements should not be restricted to investors and creditors. Other stakeholders to the affairs of reporting entities, like Inland Revenue Board, should also obtain accounting information that is useful to their decision needs from the reporting entities. Financial statements adopt a reasonable trade-off between relevance and reliability. Relevance and reliability are both critical for the quality of the financial information, but both are related such that an emphasis on one will hurt the other and vice versa. Hence, preparers of financial statements have to trade-off between them to make sure that they are both reflected without having any of the two exercising dominant influence on the direction of the financial statements. Accounting information is relevant when it is provided in time, but at early stages of an entity's operations information is uncertain and hence less reliable no matter how timely it is.

Conceptual Framework

Financial reporting is orientated to one of two ways: towards decision makers (the users who require the information contained in financial statements for particular decisions) or towards the decision models being used to make those decisions, for which that information constitutes the input (Sterling, 1970). Users of financial reports might be able to make direct use of the information contained therein to take various informed decision or they might have to employ the services of some experts to guide them in appreciate the message contained therein and how to utilize it in taking informed decisions. In any case, the beauty of financial report is its decision usefulness and, so, it is ethical for a reporting entity to try and make it very useful to identified users, even where some adjustments to the theoretical financial statements becomes necessary.

The purpose of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions. In their capacity as capital providers, decision usefulness requires relevance and reliability of information (Barth *et al.*, 2001). Seen from the accounting regulators' perspective, relevance is concerned with the economic phenomena of the capital providers' decisions and it is the application of the qualitative characteristics of relevance that will identify the economic phenomena to be depicted in the financial reports. Reliability too is defined in terms of other characteristics although of course it is also dependent on the decision being taken. What might be reliable information for one purpose may be insufficiently reliable for another (Solomons, 1986). This makes it important or necessary for reporting entities to ensure that appropriate adjustments are made to general purpose financial statements with a view to making financial statements more useful to every target user.

Williams (2009) states that accounting research for the past four decades has focused heavily on the concept of decision-usefulness, which then also became the agreed-upon guide for judging the effectiveness of accounting and financial reporting. This connection between i) the users of financial statements, ii) the objective of decision-usefulness and iii) accounting standard setting was forged fairly recently and was initially quite controversial (Young, 2006). The Malaysian Inland Revenue Board is empowered to require a company or any person involved with that company to produce the company's books of accounts and any other documentation for inspection, tax assessment and income tax collection (Taxes Management Act, 1970). The Board deserves useful information for accurate decision on the tax liability to be settled by the taxpayers (the reporting entities).

Review of Empirical Studies

According to Wild (2008) and Fellingham (2005), accounting is considered as the measurement activity that presents financial reports in support of decision makers and their business decisions. The usefulness of accounting information is made up of many factors which, according to Ijiri and Jaedicke (1966), Buys (2008) and Dzinkowski (2010), include the timeliness, reliability, relevancy and materiality of the presented accounting data. Financial statements are to provide information for decision making purposes and to show the results of stewardship of the management. Both objectives cannot be achieved by using the same set of accounting standards (Gjesdal, 1981). Generally Accepted accounting principles (GAAP) are the accounting rules used to prepare and standardize the reporting of financial statements items, such as balance sheets, income statements and cash flow statements, for publicly traded companies and many private companies (Paul, 2008). Reporting entities have to comply with the provisions of appropriate laws and accounting standards in preparing financial statements. At the same time they would want to ensure the usefulness of the statements for facilitating effective decision making by all users of the information contained therein.

The relationship between the powers and practices of the Inland Revenue Board in tax assessment and collection in the context of the usefulness of the reporting entities' financial statements for that purpose is largely ignored. Accounting has restricted itself to the technical computation and recording of tax liabilities or to the technicalities of tax investigations (Helsby, 1986). The study of the relationship between Malaysian Inland Revenue Board and accounting practice has become more relevant since the Board's modification of its investigation techniques in 1976 (Coetzee, 1993). These investigation techniques include an in-depth examination of the 'companies' accounts' and an inquiry into the records and underlying information from which they are constructed. The Board has therefore "moved away from being a technically oriented body to primarily an investigative agency", resulting in an increasingly adversarial world of tax investigations (Helsby, 1986).

STATEMENT OF METHODOLOGY

This section describes and explains the population and sampling frame as well as the instrument used to obtain data. The data are used to answer research questions as outlined in section one of the paper. Staff in the Inland Revenue Board, Jalan Duta, Kuala Lumpur, Malaysia are used as respondents in this study. According to Sekaran and Bougie (2010), population refers to the entire group of people, events or things of interest that the researcher wishes to investigate. It is the group of people, events, or things of interest on which the researcher wants to make inference (based on sample statistics). The population of this study consists of 30 staffs who are involved in the tax assessment and collection work of the Inland Revenue Board, Jalan Duta, Kuala Lumpur. For the purpose of the study, the researchers distributed copies of the questionnaire to all the 30 staffs, thereby resorting to 100% sampling of the population.

The questionnaire was delivered with the cover letter to each of the target respondents at Inland Revenue Board, Jalan Duta, Kuala Lumpur. Table 3.1 shows the process of data collection for this study. Data were analyzed using descriptive statistics that include mean, standard deviation, frequency, and percentage, with the use of SPSS. For section A, the researchers used frequency and percentage method while for sections B and C; the data were analyzed using mean and standard deviation.

RESULTS AND DISCUSSION

This section of the paper explains the findings of this research. All findings were based on questionnaire that was administered on the respondents. The data were analyzed using the SPSS (version 19.0). This section begins with the data collected through Section A of the questionnaire, which exhibits the demographic information of the respondents in the Inland Revenue Board, Jalan Duta, Kuala Lumpur. These include gender, age and race, length of service and education level. Copies of the questionnaire were distributed to thirty employees of Inland Revenue Board, who are involved in assessment and collection of companies' income tax. Respondents were given a week to complete the questionnaire, so they had enough time to answer the questions. After one week, 20 completed copies of the questionnaire were collected.

Demographic Analysis

Table 4.1 shows the distribution of the respondents' gender. As shown in table 4.1, ten respondents (50%) are male and another 10 (50%) are female. This shows that the respondents' gender is balanced; suggesting that gender biasness could not influence the outcome of the study.

Table 4.2 shows the respondents' age. From the table, it is clear that ten respondents (50%) are in the age bracket of 21 to 30 years old; 9 of respondents (45%) are in the age bracket of 31 years old and above and only one respondent (5%) belongs to the age bracket of less than 21 years old. This implies that majority of the respondents are in the age bracket of 21-30 years, suggesting that most of the income tax assessors and collectors in the Malaysian Inland Revenue Board are youth who need a lot of on-the-job and off-the-job training and re-training for them to be effective and efficient as tax administrators.

Table 4.3 indicates that all the 20 respondents who returned the completed questionnaire are Malays. This suggests that in the income tax assessment and collection unit/department of the Malaysian Inland Revenue Board a great majority, if not all, of the staff a Malay.

Table 4.4 exhibits the study's finding about the length of service of respondents. It shows that 90 percent of the respondents have been working in the Inland Revenue Board for less than 4 years and only 10 percent of them have been working in the Inland Revenue Board for between 4 to 6 years. This implies that most of the respondents are inexperienced in income tax assessment and collection, which further justifies the need for training and, of course, effective supervision and mentoring.

Table 4.5 reports the highest academic qualification of the respondents. The table shows that majority of the respondents possess bachelor's degree and above with 85 percent response rate and only 15 percent of the respondents are Diploma holders. This implies that the Board's recruitment requirement emphasizes greatly on possession of a university degree. However, it is not confirmed if the Bachelor degrees or above must be in the areas of Taxation, Accounting, Finance, Economics and other relevant areas.

Test of Research Questions

Research Question 1

Is companies' financial reporting in line with the disclosure requirements of Malaysian Inland Revenue Board?

In order to test this research question, seven questions were asked. A five point Likert scale was used to elicit responses. These include: 1= strongly disagree, 2= disagree, 3= uncertain,4= agree, and 5= strongly agree. Table 4.6 indicates results obtained using the descriptive statistics of mean and standard deviation.

Findings show that the overall mean for this result is a mean score of 3.77 (SD=.097) as shown in table 4.6. The high mean score of 3.77 indicates that most of the respondents agreed and are satisfied that Malaysian companies' financial reporting follows the disclosure requirements of relevant laws and relevant accounting standards. The Board, however, has to adjust the companies' profit for tax purpose in line with the provisions of the country's income tax law. The Board rejects financial reports that are not in strict compliance with the provision of appropriate Malaysian laws and appropriate accounting standards in use in the country.

Where the financial statements of reporting entities are not in compliance with the disclosure requirements of relevant laws and accounting standards in Malaysia, the Inland Revenue Board reject the financial statements (especially the income statement) and assess the reporting entities income for tax purpose using Best of Judgment Assessment (BOJA). This is bound to result to higher tax liability than the liability that could be arrived at using the audited income statement as a basis of the tax assessment. This shows that financial statements (especially income statement) must be tailored to be decision useful to the tax authority.

Research question 2
Is the financial reporting of Malaysian companies useful to Inland Revenue Board for the purpose of income tax determination?

Research question two focuses on whether or not financial statements provided by Malaysian companies are useful to Inland Revenue Board for tax liability determination. Three questions were asked with five point Likert scale used to elicit responses. These include: 1= strongly disagree, 2= disagree, 3= uncertain, 4= agree, and 5= strongly agree. Table 4.7 indicates results obtained using the descriptive statistics of mean and standard deviation. Finding: Based on the results in table 4.7, it can be concluded that majority of the respondents felt uncertain at mean score of 3.28 (SD=.248) as to whether or not financial statements of Malaysian companies are really useful to Inland Revenue Board for determining the income tax liabilities of the reporting entities. But where the statements are acceptable to the tax authority, the statements would be useful since they serve as basis of tax liability computation, after adjusting the income for tax purpose. It is for this reason that the Board must have to critically adjust profit as per the income statement provided for the purpose of arriving at chargeable profit on which tax rate is applied to determine the tax liability. The adjustment is to be made as per the provisions of income tax law.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

Based on the review of related literature, results obtained and discussions thereon, the following are the major conclusions of the study:

1. Decision usefulness approach to financial reporting practices of companies is normally skewed towards serving the interest of investors (existing and prospective) and, to some extent, creditors. No specific approach to financial reporting is found, from the literature, to be in practice for the provision of decision useful information to other stakeholders, like the Inland Revenue Board, apart from the general purpose financial report.
2. The age bracket, length of working experience, and educational qualifications of the participants in this study suggest that the Malaysian Inland Revenue Board is 'youth dominant'. This suggests that reasonable investment is required for on-the-job and off-the-job training and retraining of the Inland Revenue staff, for career development, efficiency and effectiveness in tax administration to be assured.
3. Even though the Board has to adjust profit as per the income statement of the reporting entities for tax purpose, the Malaysian Board of Inland Revenue is satisfied that the audited financial statements accompanying tax returns of companies are prepared in compliance with the provisions of appropriate laws and relevant accounting standards. But the income statement, in particular, must be tailored to be decision useful to the tax authority before income tax liability is determined.

Recommendations

Based on the conclusions of the study, the following recommendations are hereby made:

(i) Appropriate laws in Malaysia (like BAFIA), which made some provisions for corporate financial reporting, should carry a clause that would require reporting entities to prepare an adjusted income statement which would be decision useful to Inland Revenue Board as part of the items of financial statements to be reported by the taxpaying companies.

(ii) While investment in training, mentoring and supervision is good for career development of staff of the Board, it is important to ensure that staffs to be recruited to the tax assessment and collection unit/department have strong background in taxation or accounting, especially good knowledge of financial statements preparation, interpretation and adjustment for taxation and other purposes.

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APPENDICES

Table-3.1. Data collection procedures

Duration	Activities
Week 1	➢ Researchers distributed thirty copies of the questionnaire together with the cover letter. ➢ Respondents were given one week to complete the questionnaire. ➢ Only 40 percent of return rate was expected.
Week 2	➢ Followed up through telephone calls due to time constraint. ➢ Achieved more than the targeted response as 20 respondents returned completed copies of the questionnaire.

Source: Researchers' Design, 2012

The questionnaire used has been designed with the three sections as shown in table 3.2 below:

Table-3.2. Survey instrumentalization

Section A: Demography	➢ The questionnaire asked for information related to the participants': (a) Gender; (b) Age; (c) Race; (d) Length of Service; and (e) Education level.
Section B : Financial Statements	➢ The questionnaire asked for data related to financial reporting provided by companies to the Inland Revenue Board.
Section C : Decision Usefulness	➢ The questionnaire asked for information related to the decision usefulness approach of financial reporting to Inland Revenue Board. ➢ For section B and C, the questionnaire utilizes a Likert-type scale with 5 response alternatives : 'Strongly disagree'(weighted 1), 'Disagree' (weighted 2), 'Uncertain' (weighted 3), 'Agree' (weighted 4), and 'Strongly Agree'(weighted 5)

Source: Researchers' Design, 2012.

Table-4.1. Gender of respondents (n=20)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	male	10	50.0	50.0	50.0
	female	10	50.0	50.0	100.0
	Total	20	100.0	100.0	

Source : Field Survey, 2012

Table-4.2. Age of respondents (n=20)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	less than 21 years	1	5.0	5.0	5.0
	21-30 years	10	50.0	50.0	55.0

	31 and above	9	45.0	45.0	100.0
	Total	20	100.0	100.0	

Source : Field Survey, 2012

Table-4.3. Race of respondents (n=20)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	malay	20	100.0	100.0	100.0

Source : Field Survey, 2012

Table-4.4. Length of services of respondents (n=20)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	4-6 years	2	10.0	10.0	10.0
	less than 4 years	18	90.0	90.0	100.0
	Total	20	100.0	100.0	

Source : Field Survey, 2012

Table-4.5. Educational level of respondents (n=20)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Diploma	3	15.0	15.0	15.0
	Bachelors Degree and above	17	85.0	85.0	100.0
	Total	20	100.0	100.0	

Source : Field Survey, 2012

Table-4.6. Descriptive statistics of overall Financial reporting in line with the disclosure requirements of Malaysian Inland Revenue Board

	N	Mean	Std. Deviation
MEANFINANCIAL	20	3.7714	.09722
Valid N (listwise)	20		

Source : Researchers' Design, 2012

Table-4.7. Usefulness of *Financial reporting of Malaysian Companies to Inland Revenue Board for Income Tax Determination.(n=20)*

Descriptive Statistics

	N	Mean	Std. Deviation
MEANRB	20	3.2833	.24839
Valid N (listwise)	20		

Source : Researchers' Design, 2012

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