

## A THEMATIC REVIEW ON ACCOUNTING CONSERVATISM AND CORPORATE TAX PLANNING

Noor Emilina Mohd Nasir<sup>1</sup>, Siti Nurhazwani Kamarudin<sup>2\*</sup>, Norfadzilah Rashid<sup>3</sup>, Najihah Marha Yaacob<sup>1</sup>

<sup>1</sup>Faculty of Accountancy, Universiti Teknologi MARA, Cawangan Terengganu, 23000 Dungun, Terengganu, Malaysia

<sup>2\*</sup>Faculty of Accountancy, Universiti Teknologi MARA, Cawangan Selangor, Kampus Puncak Alam, 42300 Puncak Alam, Selangor, Malaysia

<sup>3</sup>Faculty of Business and Management, Universiti Sultan Zainal Abidin, 21300 Kuala Nerus, Terengganu, Malaysia

\* Corresponding author's e-mail: [hazwanikamarudin@uitm.edu.my](mailto:hazwanikamarudin@uitm.edu.my)

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### ABSTRACT

*Corporate tax planning as a strategy for minimising tax liability by companies has been frequently discussed. Many discoveries have been established by previous academics regarding the determinants of corporate tax planning. However, accounting conservatism is infrequently discussed in the context of corporate tax planning. Accounting conservatism is the accounting principle that businesses employ when preparing financial statements. Since tax reporting is dependent on audited financial statements, the choice of accounting principle impacts tax strategy. Thus, the main purpose of this paper is to examine the accounting conservatism patterns discussed by previous researchers. Using ATLAS.ti 22, the results report a thematic review analysis of the literature on accounting conservatism and taxation from 2000 to 2022. Keyword searches yielded 123 and 124 articles, respectively, in the Web of Science and Scopus databases. Nonetheless, only 22 articles were included for the analysis after being filtered based on inclusion and exclusion criteria. The analysis revealed a few studies that analysed the connection between accounting conservatism and corporate tax preparation. This finding highlights the significance of further research into the impact of accounting conservatism on the implementation of tax planning strategies.*



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## INTRODUCTION

Taxes are vital to a country, as they play an important role in ensuring the government's revenue collection as well as contributing to the country's economic growth. In the corporate world, the main objective is to maximise shareholders wealth by generating income and maximising the firm's value. Tax is also a significant cost that businesses endure as a contribution to the society in which the tax revenue collection will be used to finance social needs. Due to the fact that taxation distributes the wealth of businesses to the government, the majority of businesses create and implement managerial strategies in order to minimise their tax obligations (Chyz *et al.*, 2019). Therefore, businesses will shape their tax planning strategies to ensure they are able to reduce their tax liabilities. In the same vein, Khimesari and Mirbargkar (2016) stated that tax avoidance activities are usually referred to as tax-saving measures, thereby increasing the firm's value. Nevertheless, the companies need to evaluate the costs and benefits of conducting tax planning strategies to avoid any uncertainties and risk.

The accounting data presented in the financial statements will be used to determine the companies' tax liabilities. Indeed, accounting income is always used as the basis for calculating taxable income (Koubaa & Jarboui, 2017) resulting in the connection of financial and tax reporting. As a result, management is frequently obliged to utilise discretion in the implementation of accounting principles, as this is a critical component in the preparation of financial statements. As opposed Mora & Walker (2015), the concept of conservatism will generally be incorporated into the conceptual framework of financial reporting. Therefore, it is the responsibility of managers to use their best judgement when selecting which accounting policies are appropriate for tax and financial reporting purposes.

Tax provides an additional motivation for companies to be conservative, if they are financially stable, with the objective of increasing deferred income to reduce the present value of tax (Ferramosca & Ghio, 2018). Thus, companies may strive to increase their expenses while they are

profitable in order to reduce their taxable revenue and consequently their tax liability. As a result, accounting conservatism will be viewed as one of the accounting strategies used to reduce tax liability, since companies will be compelled to report a higher accounting income but a lower taxable income. For the businesses to effectively implement tax planning strategies, it is critical that they apply accounting rules and tax regulations.

In terms of tax computation, companies must adhere to the tax regulations, where numerous incentives will be offered to them as a way of reducing their tax liability. The company will pay the tax based on the statutory tax rates enacted by the tax authorities. However, by having the tax incentives, companies are able to lessen their taxes by applying the tax that is favourable to them. The companies are under pressure to reduce their tax payments by shifting income between periods (Lara *et al.*, 2009). Examining the factors that influence the level of tax planning among corporations is crucial to ensuring that companies do not engage in aggressive tax planning, which will lead to tax evasion that is illegal by law.

Determining the factors that influence tax aggressiveness has been a focal point of accounting research since 2000 ((Halioui *et al.*, 2016). Additionally, accounting conservatism has dominated accounting theory arguments for many years, as it is considered a fundamental aspect of reporting quality (Ferramosca & Ghio, 2018). Yet, research on accounting conservatism and tax planning is scarce, which raises the question of whether accounting conservatism influences the extent of corporate tax planning. Thus, this review was motivated by the notion that accounting conservatism is one of the tax planning strategies utilised by businesses to decrease their tax burden. The discrepancy between financial and tax reporting enables managers to engage in aggressive tax planning, which negatively impacts the government's revenues. Such loopholes necessitate thorough research on the relationship between accounting conservatism and corporate tax planning, which contributes to the significance of the research. Therefore, this paper uses thematic analysis to discover the patterns discussed in the relevant literature.

## METHODOLOGY

This study employed both quantitative and qualitative analysis in identifying the patterns of themes in previous research conducted on accounting conservatism and corporate tax planning. Specifically, the study used thematic analysis technique, which was developed by the study of Zairul (2020) using ATLAS.ti version 22 as a tool to assist in the process of reviewing the existing literature. As defined by Braun & Clarke (2012), thematic analysis is ‘a method for systematically identifying, organising, and offering insight into patterns of meaning (themes) across a data set’. This technique facilitates a deeper understanding of the meanings and experiences that are common to the researchers. There are few stages conducted in this study, as illustrated in Figure 1.

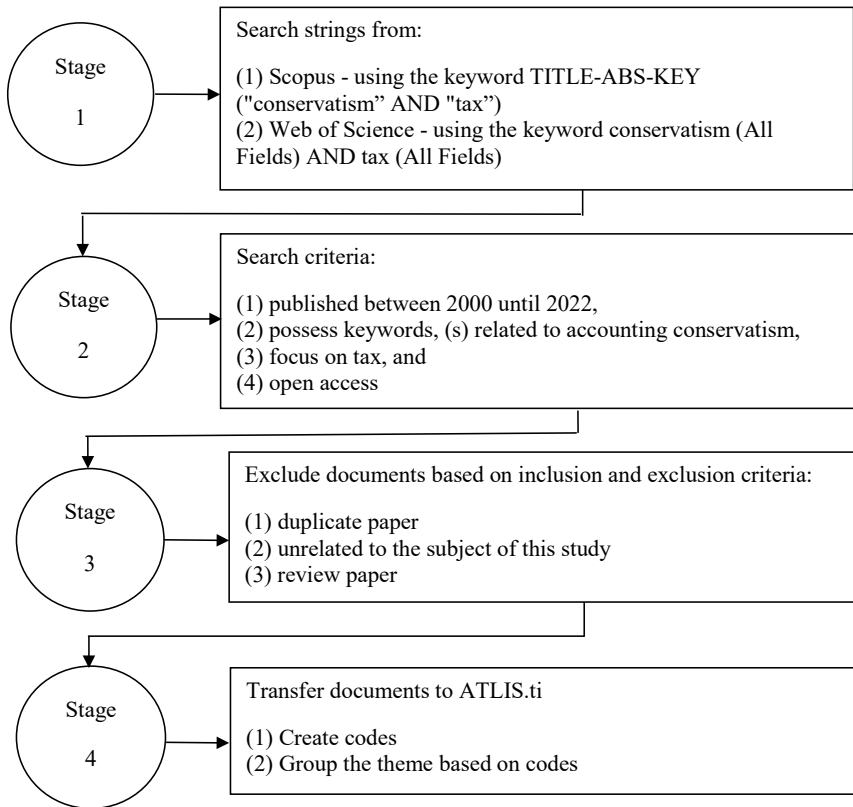


Figure 1: Stages in Conducting Thematic Analysis

The first step entailed a database search for the journal article. SCOPUS and Web of Science, the most comprehensive abstract and citation databases of peer-reviewed literature, were searched for the primary data sources. Using the search keywords ‘conservatism’ and ‘tax’ yielded 123 documents from the Scopus database and 124 from the Web of Science database. Table 1 displays the search string for the literature retrieved from the Scopus and Web of Science databases. Based on the search, the documents were reduced to 23 and 28, respectively.

**Table 1: Search Strings from Scopus and Web of Science**

Database	Search strings	Results
Scopus	TITLE-ABS-KEY (“conservatism” AND “tax”) AND (LIMIT-TO (PUBYEAR, 2022) OR LIMIT-TO (PUBYEAR, 2021) OR LIMIT-TO (PUBYEAR, 2020) OR LIMIT-TO (PUBYEAR, 2019 ) OR LIMIT-TO (PUBYEAR, 2018) OR LIMIT-TO (PUBYEAR, 2017) OR LIMIT-TO (PUBYEAR, 2016) OR LIMIT-TO (PUBYEAR, 2015) OR LIMIT-TO (PUBYEAR, 2014) OR LIMIT-TO (PUBYEAR, 2013) OR LIMIT-TO (PUBYEAR, 2012) OR LIMIT-TO (PUBYEAR, 2011) OR LIMIT-TO (PUBYEAR, 2010) OR LIMIT-TO (PUBYEAR, 2009) OR LIMIT-TO (PUBYEAR, 2008) OR LIMIT-TO (PUBYEAR, 2007) OR LIMIT-TO (PUBYEAR, 2006) OR LIMIT-TO (PUBYEAR, 2005) OR LIMIT-TO (PUBYEAR, 2004) OR LIMIT-TO (PUBYEAR, 2003) OR LIMIT-TO (PUBYEAR, 2002) OR LIMIT-TO (PUBYEAR, 2001) OR LIMIT-TO (PUBYEAR, 2000))	<ul style="list-style-type: none"> <li>• 123 documents (all fields)</li> <li>• 23 documents (limit to open access and year)</li> </ul>
Web of Science	Results for conservatism (All Fields) AND tax (All Fields) and 2022 or 2021 or 2020 or 2019 or 2018 or 2017 or 2016 or 2015 or 2014 or 2013 or 2012 or 2011 or 2010 or 2009 or 2008 or 2007 or 2006 or 2005 or 2004 or 2003 or 2002 or 2001 or 2000	<ul style="list-style-type: none"> <li>• 124 results (all fields)</li> <li>• 28 results (limit to open access and year)</li> </ul>

For the second step, articles were chosen based on the following criteria: (1) publication between 2000 and 2022, (2) inclusion of accounting conservatism-related terms, (3) focus on tax, and (4) open access. Then, the documents were examined according to inclusion and exclusion criteria adopted from Zairul's study (2020). Due to their incompatibility with the scope of this review, review articles were excluded. In addition, this process involves eliminating identical articles, revising author names, and assuring the accuracy of metadata. The list of documents yielded several bibliometric data, including the article's title, author, year, author's region, keyword used, periodical, and subject area. The phrase "bibliometric data" refers to the statistical analysis of the articles performed to track the output and author information obtained from ATLAS.ti. In this study, no additional software, such as vosviewer or publish or perish, was utilised to analyse the bibliometric data. In conclusion, 22 papers were selected for thematic analysis. The documents were uploaded to ATLAS.ti 22 and turned into primary documents, concluding the fourth step indicated in Figure 1. In addition, as depicted in Figure 2, a word cloud was generated based on the frequency of occurrence in 22 documents.

The screenshot displays the ATLAS.ti software interface. The top navigation bar includes 'File', 'Home', 'Search & Code', 'Analyze', 'Import & Export', 'Tools', 'Help', 'Documents', 'Tools', and 'View'. The main workspace is divided into several sections:

- Left Panel (Explore):** Shows a search bar and a list of document groups:
  - Accounting conservatism (26)
  - Documents (9)
  - Memos (0)
  - Networks (0)
  - Document Groups (140)
  - Code Groups (1)
  - Memo Groups (0)
  - Network Groups (0)
  - Multimedia Transcripts (0)
- Top Panel (Search & Filter):** Includes options for 'Show in Network', 'Word Cloud', 'Word List', 'Word Concepts', 'Report', 'Excel', and 'Export'. It also has 'Search & Filter' and 'Tools' buttons.
- Right Panel (Document Manager):** Lists document groups with search bars and icons for 'Rename Document', 'Delete', 'Focus Group', and 'Coding'. Below this is a 'Code Distribution across Documents' bar chart.
- Bottom Panel (Comment):** A text area with the placeholder 'Nothing to display.'

The 'Code Distribution across Documents' bar chart shows the following data:

Code	Count
4)Objective	2
5)Methodology	1
6)Findings	1
8)Conservatism	1

The 'Document Manager' section lists the following documents:

Name	Count
Robin (2015) - Do industry-specialist auditors influence stock price crash risk?	(1)
Khimesari (2016) - Investigating the relationship between corporate ownership an	(1)
Koubaa (2017) - Normal, abnormal book-tax differences and accounting conserv	(0)
Rao (2020) - Tax system changes in the budget: Confusing signals	(0)
Kabir (2014) - The behaviour of earnings, accruals and impairment losses of failed	(1)
Afrizal (2020) - The effect of accounting conservatism, CSR disclosure and tax avo	(1)
Jiménez-Angueira (2021) - The effect of conservative financial reporting and tax a	(1)
Le (2022) - The effects of state ownership and tax rate cuts on accounting conserv	(1)
Arachi (2019) - The Role of Taxes in Earnings Management: Evidence from Writed	(1)
Wong (2015) - Managing discretionary accruals and book-tax differences in antici	(1)
Benkraiem (2022) - How do International Financial Reporting Standards affect inf	(0)
Rigueun Koubaa (2017) - Direct and mediated associations among earnings quality	(0)
Lara (2009) - The economic determinants of conditional conservatism (Los determ	(1)
Badenhorst (2013) - The relationship between conservatism in financial reporting	(0)
Liu (2019) - The impact of ownership structure on conditional and unconditional	(0)

Figure 2: Metadata Generated and Coded in ATLAS.ti 22

## **DISCUSSION ON RESULTS AND FINDINGS**

### **Quantitative Results**

This section provides related literature on the subject of study. These 22 articles have been reviewed accordingly from various journals across different countries and years. These research strings discovered 22 articles in a variety of journals, as depicted in Table 2. As compared to other journals, two articles were published in the *European Accounting Review*, *Journal of Accounting, Auditing, and Finance*, and *Journal of International Accounting, Auditing, and Taxation*, respectively. Table 2 also shows the trend of publishing from year to year from 2000 until 2022. Based on the findings, the year 2017 had the highest number of publications, with four articles on the topics of accounting conservatism and corporate tax. Nevertheless, the other years only recorded between one and two publications per year, which recommends that research on this topic is scarce and hence more studies should be conducted.



Table 2: Review Articles Based on Journals

Country	2000	2005	2007	2009	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total
Journal of Accounting	1														1
European Accounting Review		1								1					2
Accounting Review			1												1
Journal of Accounting, Auditing and Finance				1	1										2
Journal of Business, Finance and Accounting				1											1
South African Journal of Accounting Research					1										1
Australian Accounting Review						1									1
Auditing: Journal of Practice and Theory							1								1
Journal of International Financial Management and Accounting							1								1
Review of Accounting and Finance								1							1
Journal of Financial Reporting and Accounting									1						1
Asian Academy of Management Journal of Accounting and Finance									1						1
IIOAB Journal									1						1
Review of Business Management										1					1
Public Finance Analysis											1				1
Journal of International Accounting, Auditing and Taxation												1		1	2
International Journal of Advanced Science and Technology															1
Asian Review of Accounting													1		1
Pacific Accounting Review														1	1

Table 3 shows the 17 countries that contributed to the publications on accounting conservatism and corporate tax. China and the United States marked the highest numbers of publications among other countries. The findings also reveal that the research themes are popular in Southeast Asian countries like Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

Table 3: The Dispersal of Publications According on Country

Country	2000	2005	2007	2009	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total
Indonesia	1														2
Malaysia	1														1
Korea	1														1
Philippines	1														1
Taiwan	1														1
Thailand	1														1
Czech Republic		1													1
China			1				1			1	1				4
United States				1			2						1		4
South Africa															1
New Zealand						1									1
Tehran								1							1
Tunisia								1							2
Brasil									1						1
Italy											1				1
Vietnam														1	1
French														1	1

\*few articles study more than 1 country

Furthermore, to achieve uniformity in the sub-categories, the 22 research publications were evaluated iteratively for similarities and differences. A word cloud based on the frequency of occurrences in 22 documents was generated as illustrated in Figure 3. The size of the word cloud is used to determine which articles have the most discussion on a particular topic. The main theme with the phrase ‘tax’, ‘accounting’ and conservatism’ have the most often discussed topics.



Figure 3: A Word Cloud Based on the Frequency of Words Generated by ATLAS.ti 22

### Qualitative Results

The study employed the network tool in ATLAS.ti 22 to generate the network view based on the thematic review as presented in Figure 4. A more in-depth discussion of the network view is presented in the following section.

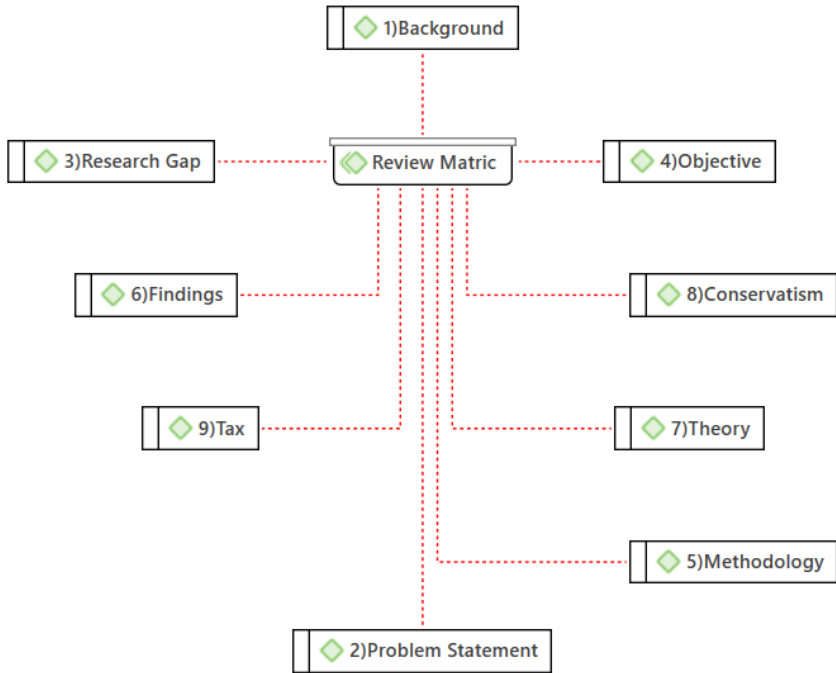


Figure 4: A Network View Generated by ATLIS.ti 22

## Definition

There are few definitions of accounting conservatism, as discussed by previous researchers. In accordance with Statement of Financial Accounting Concepts (SFAC) Number 2, conservatism is defined as ‘prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered’ (FASB, 1980). Based on this definition, the dynamic nature of the corporate environment, which is subject to ups and downs, is exposed to challenge and unforeseen risk, requiring them to react in the safest manner possible. Whereas a recent study by Le & Moore (2022) defined conservatism as ‘an asymmetric recognition of gains and losses’.

On the other hand, Badiei *et al.* (2014) are of the opinion that conservatism can be viewed as a technique for controlling managers’ motives to disclose information that they choose to report and limiting

the opportunistic and optimistic behaviours of the managers. As a result, accounting conservatism denotes a possible monitoring tool for lowering the agency cost between the managers, who act as agents on behalf of shareholders as the principal. Thus, it can be seen that accounting conservatism can mitigate the opportunistic behaviour of the managers and will align the interests between the managers and shareholders with the main objective of increasing the firm's value. Furthermore, as cited by Kronbauer *et al.* (2017), Hendriksen (1982) discussed three perspectives of conservatism, which include the elements of pessimism: the avoidance of overstating profit, and the information asymmetry between management and stakeholders. Hence, these components determine the different levels of conservatism exercised by the companies.

In his initial work, Basu (1997) demonstrated how accountants' risk-averse attitudes contribute to the reasons for accounting conservatism. Similarly, accountants must record assets and income at their lowest possible values, while liabilities and expenses must be recorded at their highest possible values (Kronbauer *et al.*, 2017). Before recognising the revenues, accountants typically analyse the costs incurred and forecast the losses. This is reinforced by Afrizal *et al.* (2020), who state that earnings should be documented as soon as they are realised, whereas losses should be recorded as soon as feasible. Hence, one might state that losses are recorded before income. Additionally, accounting earnings influence public information by either accelerating or decelerating news reporting, depending on the sort of news (Ferramosca & Ghio, 2018). It can be concluded that managers use accounting conservatism when providing financial information based on their discretion or judgement.

## **Types and Factors of Accounting Conservatism**

Beaver and Ryan (2005) have pointed out in the accounting literature that there are two varieties of conservatism: unconditional, also known as news-independent conservatism, and conditional or news-dependent conservatism. Managers use both unconditional and conditional conservatism to minimise the present value of taxes and thereby increase the company's worth (Lara *et al.*, 2009). In contrast, Badenhurst (2013) employed two types of accounting conservatism referred to as discretionary and non-discretionary in a previous study. According to the study,

discretionary conservatism refers to the degree of conservatism utilised by organisations when applying relevant financial reporting standards, whereas non-discretionary base is derived from the inherent conservatism of accounting rules.

In addition, based on the thematic analysis, previous researchers (such as Koubaa & Jarboui, 2017; Lara *et al.*, 2009) indicated that accounting conservatism can be influenced by four distinct elements, including contracting, litigation, taxation, and regulation, as described by Watts (2003). In addition, existing literature asserts that contracts and litigation are governed by conditional conservatism, but taxation and regulation are governed by unconditional conservatism (Lara *et al.*, 2009; Qiang, 2007). In terms of contracting and litigation, companies are obligated to serve the equity holder and the debit holder’s best interests, hence generating conditional conservatism. Despite the fact that taxation and regulation encourage businesses to participate in activities that result in the smoothing of their earnings, they yet promote unconditional conservatism.

### Measurement Model of Accounting Conservatism

Prior studies on accounting research have developed various models to measure accounting conservatism. Based on the thematic analysis, the most common measurement models used by the researchers are listed in Table 4.

**Table 4: Measurement model of accounting conservatism**

Approach	Measurement model	Author(s)
Stock returns	$Earnings_i = \beta_1 + \beta_2 DummyReturn_i + \beta_3 Return_i + \beta_4 DummyReturn_i \times Return_i + \epsilon$	Basu (1997)
Accrual	$\frac{(Income\ before\ tax\ and\ ordinary\ items + Depreciation - Operating\ Cash\ flow)}{Total\ Asset}$	Givoly & Hayn (2000)
Market to book ratio	$= \alpha_t + \alpha_1 + \sum_{j=0}^6 \beta_j Return_{t-j,t} + \epsilon_{t,i}$	Beaver & Ryan (2000)
C-Score	$C\_Score = \beta_1 + \beta_2 Size + \beta_3 MTB + \beta_4 Leverage$	Khan & Watt (2009)

The first model to measure accounting conservatism was developed by Basu (1997). Using Basu's model, it is hypothesised that earnings are more responsive to bad news than good news under accounting conservatism (Chen *et al.*, 2018). This model measures stock returns based on earnings per share and has been the most widely used method for determining accounting conservatism among researchers for decades. Notably, the most significant flaw of this model is identified through accounting conservatism, which is calculated at the industry level rather than at the firm level (Ferramosca & Ghio, 2018). Thus, it is more suitable for the pooled data, which consists of different industries across the years. Khan & Watts (2009) then modify Basu's model to be a linear function of market-to-book ratio, size, and leverage by using the C-score. This improves the earliest model, where it is able to measure the firm's value by including the other variables that may have a different effect on the level of accounting conservatism due to different characteristics of the firm.

Apart from that, accruals can also be used in measuring conservatism. The model developed by Givoly & Hayn (2000) discusses conservatism as a downward tendency in cumulative earnings with cumulative operating cash flows (Qiang, 2007). The researchers opposed the idea that the higher the negative accruals, the more conservative the accounting. Next, conservatism can also be measured using the market to book value of equity by Beaver and Ryan (2000). According to Lara *et al.* (2009), the researchers employ the market value of equity as a proxy for conservatism, which is referred to as a sustained downward tendency in the book value of equity. Thus, this model quantifies the accounting conservatism by computing how the book value of equity changes over time. Beaver and Ryan (2000) concluded that the high conservatism of the companies represented by their low book-to-market ratio explains this. The summary of accounting conservatism based on thematic analysis is shown in Figure 5.



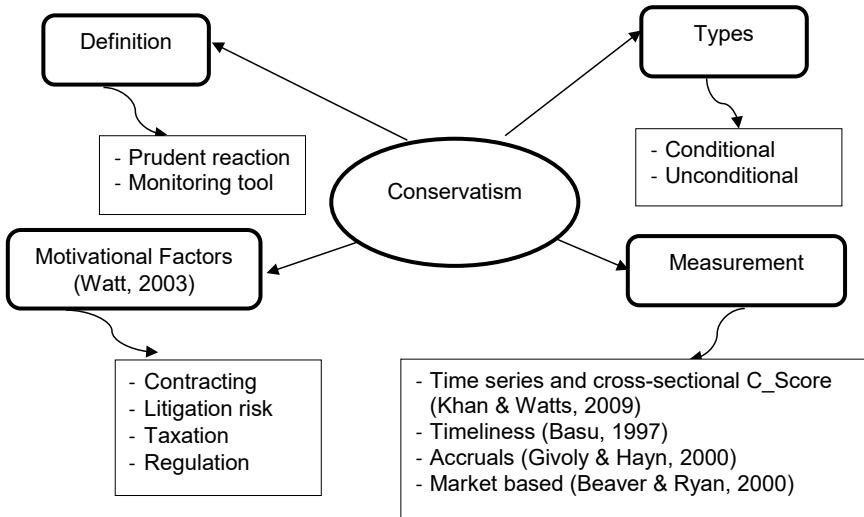


Figure 5: A Summary of Review Paper

## Relationship Between Accounting Conservatism and Tax

The empirical evidence indicates that businesses have a financial incentive to minimise their tax liability, which they accomplish through conservative accounting practises (Khimesari & Mirbargkar, 2016). Arachi & Bucci (2019) are of the opinion that tax reporting driven by the opportunistic behaviour of the manager aims to reduce the quality of financial reporting on the firm’s performance for the external stakeholders. Managers frequently take advantage of this discretionary authority to manage accounting income in an upward direction, resulting in huge book tax differences and, as a result, increased deferred tax liabilities (Koubaa & Jarboui, 2017). Therefore, the management’s decision in reporting the financial information might also influence the tax reporting.

Tax policy and accounting conservatism are two techniques firms might employ to receive tax incentives (Mehrani & Seyyedi, 2014). Similarly, Arachi & Bucci (2019) supported the notion that management may employ discretionary conservatism to reduce net income in order to minimise the tax to which it is subject under the applicable tax law. As a result, businesses may exploit the loopholes between these two policies to decrease their tax liability. Lara *et al.* (2009) concluded in a previous

study that unconditional conservatism helps managers reduce their tax liability when they opt to shift income across periods. Hence, accounting conservatism may lead to a reduction in current income and an increase in conditional conservatism.

## **CONCLUSION**

This review paper investigates the existence of elements of accounting conservatism in preparing the financial statements. In particular, it provides new empirical evidence on the role of accounting conservatism in discretionary accounting choices and its effects on tax planning. Based on the 22 articles reviewed, it is evident that there are limited studies on the influence of accounting conservatism on corporate tax planning. Also, only one of them covered Malaysian companies. Therefore, this paper contributes to the gap for future research. As the Malaysian economy provides a special setting for the study of conservatism in accounting, more studies can be undertaken in this area. Finally, to better understand the peculiarities of the Malaysian institutional environment in terms of the quality of financial and tax reporting, it is essential to examine the issue of accounting conservatism in Malaysia.

## **LIMITATIONS OF STUDY AND FUTURE RESEARCH**

The approach of thematic review analysis that was used for this study has some limitations that are related to the constraints of this study. Despite the fact that this methodology is ideal for compiling the existing literature on any field of research, it does have a few drawbacks that just cannot be avoided. As the approach of this study begins with the selection of keywords, failure to include relevant keywords in the review can result in the omission of content that is pertinent to the methodology.

Future studies should explore whether accounting conservatism has an impact on corporate tax planning among listed companies in Malaysia due to the different regulatory landscape in the financial and tax reporting landscape. Thus, the different regulatory system in Malaysia may offer an interesting dimension since the managerial judgement on the recognition

of gains and losses over income and expenses may affect the level of accounting conservatism.

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