

**TAX MISREPORTING  
AND AUDIT ADJUSTMENT**

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**Universiti Utara Malaysia**

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KOLEJ PERNIAGAAN  
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# **TAX MISREPORTING AND AUDIT ADJUSTMENT**

A thesis submitted to College of Business in partial fulfilment of the requirements

for the degree of Master of Business Administration (Accounting)

Universiti Utara Malaysia

By

Md Fahmi bin Md Said

May, 2010

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## ABSTRACT

*The purpose of this study is to examine the extent of tax misreporting committed by firms in Malaysia. Tax misreporting is measured by independent variables namely firm size, types of tax agent, types of ownership and types of business sectors. The study takes the approach of using actual data sample from 555 corporate tax audit cases that has been audited and finalised in the year of 2009 by the Inland Revenue Board of Malaysia (IRBM). The level of tax misreporting is primarily measured by the IRBM's audit adjustments. Using t-test and ANOVA, the study indicates size of firms, types of tax agents, form of ownerships and types of business sectors have significant difference to audit adjustments. The study recommends that the IRBM could utilize firm's characteristics in selecting tax audit cases in future; change and revamp tax audit approach because tax evasion possibly could be hardly detected by tax authority in future. The study provides useful feedback to the government as a policymaker to revamp and improve current approach on tax audit; reinforce and design effective tax administration systems in order to curb tax evasion which results an increase in government's revenue and any loopholes to the tax administration can be improvised as tax evasion cannot be compromised in Malaysia.*

## ABSTRAK

*Tujuan utama kajian ini dijalankan adalah untuk mengenalpasti tahap kesalahan pelaporan cukai yang dikemukakan oleh syarikat-syarikat di Malaysia. Kesalahan pelaporan cukai ini diukur berdasarkan ciri-ciri syarikat yang mengemukakan pelaporan cukai kepada agensi percukaian kerajaan Malaysia, Lembaga Hasil Dalam Negeri (LHDNM). Antara ciri-ciri yang dijangka mempunyai perbezaan dan mempengaruhi tahap kesalahan pelaporan cukai adalah saiz sesebuah syarikat, jenis agen cukai yang digunakan, jenis pemilikan syarikat dan jenis industri perniagaan yang diceburi. Kajian ini mengambil pendekatan menggunakan sampel data asal iaitu 555 kes audit luar syarikat di seluruh Malaysia yang diselesaikan dalam tahun 2009 oleh LHDNM. Tahap kesalahan pelaporan cukai ini diukur melalui pelarasan audit oleh pegawai audit luar LHDNM. Melalui analisis “T-test” dan “ANOVA”, hasil kajian ini mendapati saiz sesebuah syarikat, jenis agen cukai, jenis pemilikan syarikat dan jenis industri perniagaan mempunyai perbezaan signifikan dan mempengaruhi tahap kesalahan pelaporan cukai oleh syarikat-syarikat di Malaysia. Kajian ini mengemukakan cadangan supaya LHDNM boleh menggunakan ciri-ciri syarikat ini sebagai kriteria pemilihan kes; mengubah cara dan memperkuatkannya pendekatan audit percukaian kerana pengesanan pelarian cukai mungkin akan menjadi lebih sukar di masa hadapan; membuat dasar seperti kerajaan khususnya boleh mengemaskini dan memperkuatkan sistem pentadbiran percukaian agar dapat mengawal dan mengurangkan pelarian cukai dan meningkatkan pungutan cukai khususnya di kalangan syarikat di masa hadapan.*

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## **ABBREVIATIONS**

AGRI	= Agriculture
COMM	= Commercial
CONST	= Construction
CONTR. CO.	= Controlled Company
CPA	= Certified Public Accountant
GAO	= U.S. Government Accountability Office
IRBM	= Inland Revenue Board of Malaysia
IRS	= Internal Revenue Service
MANUF.	= Manufacturing
NON-CONTR. CO.	= Non-controlled Company
NON-CPA	= Non-Certified Public Accountant
RE	= Real Estate
SAS	= Self Assessment System
SERV	= Service
SIG.	= Significance
SMEs	= Small Medium Enterprises
SPSS	= Statistical Package for Social Science
STD. DEV.	= Standard Deviation

# **CHAPTER ONE**

## **BACKGROUND OF THE STUDY**

### **1.0 Introduction**

This study examines the extent of tax misreporting in Malaysian corporate tax audit that have been carried out by Malaysian tax authority. The study used actual data obtained from the Inland Revenue Board of Malaysia (IRBM) field audit cases which has been finalised in 2009. The firm's characteristics such as size of a firm, types of tax agent/preparer, form of ownerships and types of business sectors are the selected determinants to measure the relationship between firm characteristics and tax misreporting in Malaysia. In this study, the extent of tax misreporting is primarily measured by the level of total audit adjustments that are upheld after taxpayers appeal.

Tax misreporting is a form of non-compliance act because it could possibly lead to tax evasion. Tax misreporting occurs when taxpayer's intentionally or unintentionally minimizes or lowers their tax liability which is against the provisions of tax laws; however tax avoidance involves reduction of tax liability which is legal or within the provisions of existing tax laws (Klassen et al, 1993). In lowering or minimizing tax liability, financial reporting fraud possibly becomes common within firms. The role of top management, auditor and tax preparer who prepares financial statement and tax submission are questionable. Big firms such as Enron and WorldCom have crumpled because of fraud committed within auditors and its top

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