Report on Bachelor / Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University

Student:	Matěj Mišoň
Advisor:	Jiří Novák M.Sc., Ph.D.
Title of the thesis:	Deferred tax as an indicator of earnings management

OVERALL ASSESSMENT *(provided in English, Czech, or Slovak):*

Short summary

The goal of the thesis is to study the relationship between the deferred tax items and earnings management. Earnings management is in the thesis identified in a firm when it reports a small profit related to the total assets, which I find problematic. To estimate this relationship the author uses 1373 firm-year observations from FTSE 350 index over the 2016 - 2019 period.

I find the scope and the contribution of the thesis very limited as if I was reading a draft instead of the finished thesis.

Contribution

There is no data-summarizing table in the text, e.g. empirical distribution of the variables used in the regression setting or their sample correlations. There are only 3 tables with the empirical results which are further without captions. These 3 tables report estimated regression coefficients for 3 models which are very similar. All 3 models use dependent variables (DAC, ΔCFO, NS), model 1 further uses variable ΔNDTL, model 2 does not use ΔNDTL, instead uses DTE, while model 3 uses both DTE and ΔNDTL[1].
Interpretations of these 3 tables are problematic with statements such as "Other variables are also insignificant, but they are only control variables which have no importance to the overall research." or "Also, to have significant result for Accruals is not the main hypothesis of this study, so it is not necessarily needed".

Thesis also contains contradicting statements, e.g. claiming that the accruals are estimated using the Jones model (p.16) but in the methodology section claiming the DeAngelo model is used instead (p.25).

Methods

Author uses a simple probit model but does not discuss or check any of the model assumptions. There are no diagnostics plot or discussion of validity of the estimation procedure.

Dependent variable ("earnings management") definition as net income normalized by total equity is more than questionable[2]. Reasoning behind selecting FTSE 350 firms ("FTSE 350 firms are considered, as they are big enough to try to sway investors to a certain path by possible earnings management.") seems invalid to me as there is motivation to manage earnings for smaller companies as well.
It is also not clear why the model is set up in the way it is.

Literature

Literature review is written in a very disconnected way which makes it hard to read and understand. For example, the main model is introduced in the following fashion without being mentioned previously

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[1] DAC - discretionary accruals scaled by total assets , ΔCFO - cash flow from operations change from previous year, scaled by total assets, NS - net sales, ΔNDTL - change of net deferred tax liability from previous year scaled by total assets, DTE - deferred tax expense scaled by total assets
[2] Author admits this himself in the thesis.

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at all: "The main accruals model used in this analysis is the Jones model with another regression how to describe discretionary (here called abnormal) accruals."

Author mentions the extensive number of papers from the research domain[3], however they are just listed with short descriptions without linking them to a coherent description of the research domain.

Manuscript form

Manuscript contains many sentences which clearly don't belong to academic text, e.g. "However, this model is very weirdly set up and weakly explained."

Thesis written in a mix of tenses, often referring to later parts of the thesis as if the author would only be doing it in the future and previous parts of the thesis were already done. As an example, introduction is written in a future tense (e.g. "This study will mainly focus on …", "I will also try …", etc.).

It is also organized in an illogical way, e.g. why are hypotheses introduced in the methodology section after description of different methods of accruals estimation? Detailed independent variables definitions should be moved to the appendix.

There is a number of unclear sentences not adding value to the text, e.g. ". The reasoning and further explanation is described elsewhere in this thesis."). When referring to other parts of the text, it should be clear where the reader can find it.

There is also badly rendered text in the thesis, e.g. in Section 3.2 - Hypothesis, there are asterisks around what appears to be a subtitle.

Further, there are multiple grammatical and syntactic results scattered around the thesis.

Overall evaluation and suggested questions for the discussion during the defense

Questions:

- Explain clearly how net income normalized by total equity represents "earnings management" and is used by you as the dependent variable. Clarify your reasoning for using actually convicted companies in the study.
- What is your motivation for estimating models 1 and 2 when they contain the same independent variables as model 3 and the only difference is excluding the variable DTE in model 1 and ΔNDTL in model 2?
- Why do you consider variables which are insignificant to be the most important ones?
- Why did you choose only 4 years of data for the analysis and FTSE 350 firms only?

*In my view, the thesis **does not** fulfill the requirements for a bachelor thesis at IES, Faculty of Social Sciences, Charles University, I **do not** recommend it for the defense and suggest a grade **F**.*

*The results of the Urkund/Turnitin analysis **do** indicate significant text similarity with other source, however this source is previously undefended version of this thesis.*

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[3] I am not familiar with this area of the research, therefore my report is based only on the literature I've done myself.

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SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY	POINTS
Contribution (max. 30 points)	7
Methods (max. 30 points)	8
Literature (max. 20 points)	13
Manuscript Form (max. 20 points)	10
TOTAL POINTS (max. 100 points)	38
GRADE (A – B – C – D – E – F)	F

NAME OF THE REFEREE: Martin Hronec

DATE OF EVALUATION:

8.1.2023, Martin Hronec
(Digitally signed)

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Referee Signature

EXPLANATION OF CATEGORIES AND SCALE:

CONTRIBUTION: The author presents original ideas on the topic demonstrating critical thinking and ability to draw conclusions based on the knowledge of relevant theory and empirics. There is a distinct value added of the thesis.

METHODS: The tools used are relevant to the research question being investigated, and adequate to the author's level of studies. The thesis topic is comprehensively analyzed.

LITERATURE REVIEW: The thesis demonstrates author's full understanding and command of recent literature. The author quotes relevant literature in a proper way.

MANUSCRIPT FORM: The thesis is well structured. The student uses appropriate language and style, including academic format for graphs and tables. The text effectively refers to graphs and tables and disposes with a complete bibliography.

Overall grading:

TOTAL	GRADE
91 – 100	A
81 - 90	B
71 - 80	C
61 – 70	D
51 – 60	E
0 – 50	F