

## The Mediating Role of Financial and Non-Financial Reporting Quality in the Relationship between Labor Costs and Tax Avoidance<sup>1</sup>

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### INTRODUCTION

This study aimed to fill a research gap by examining whether the cost of labor, which is paid in the form of wages and salaries, can increase the quality of financial and non-financial reporting and thereby reduce tax avoidance. Based on strong theoretical foundations, it was assumed that the payment factor, according to the motivation and human resource theories, leads to the improvement of work quality and increases organizational and social accountability. It also increases employees' motivation to provide accurate work, creates a form of monitoring behavior in the context of corporate governance, and enhances the quality and effectiveness of internal controls, participation in organizational goals, and ultimately the provision of high-quality raw and primary financial and non-financial information to the financial department of the company. In other words, the result of this increase in financial quality and non-financial reporting quality is the reduction of errors, frauds, the presentation of transparent and high-quality reports, and the

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lack of re-presentation, so that based on the theory of stakeholders and legitimacy, the quality of reporting decreases. Representation issues and reduction of tax avoidance.

## **MATERIALS AND METHODS**

In this study, the desired variables, including tax avoidance through the effective tax rate, were first obtained. Additionally, the cost of employee wages and salaries was calculated through the natural logarithm of disclosed wages and salaries in the board of directors analytical report, following Xiang et al., (2023), and the quality of financial and non-financial reporting was measured through the quality of commitment items, following Andrew et al., (2017) and Darabi & Sajjadi-nejad (1401), as well as the natural logarithm of the total words of corporate social responsibility reports, following Nazari et al., (2017). The collected data were then analyzed using appropriate statistical methods. The sample of this study included 105 companies listed on the Tehran Stock Exchange from 1391 to 1400, and multiple regression models with a combination of data patterns were used to test the research hypotheses with fixed and random effects. It is important to note that to examine the effect of independent variables on tax avoidance, a pause was used for explanatory and control variables. Furthermore, multiple control variables were used to control for the potential endogeneity problem .

## **RESULTS AND DISCUSSION**

The research results demonstrate that labor costs (with t-statistics of 1.10 and with a probability of 0.271) do not have a significant impact on tax avoidance. This finding contradicts the theoretical foundations of the present study. Among the limited relevant studies, the research by Xiang et al., (2023) and Li et al., (2019), show positive and significant effects between minimum wages and salaries and tax avoidance and planning, respectively. It should be noted that corporate tax policies are influenced by various factors, including business factors, corporate governance factors, auditor-related factors, financial reporting factors, industry factors, general characteristics, capital market factors, social factors, etc. (Dastgir et al., 2019). Given this, and the emphasis

on the results of the mediating hypotheses that have demonstrated the significant impact of labor costs on tax avoidance by entering them into statistical models, rejecting the first hypothesis of the study is justifiable.

The results further show that the cost of employee wages and salaries has a positive and significant effect on the quality of financial (with t-statistics of 3.34 and a probability of 0.001) and non-financial reporting (with t-statistics of 2.79 and a probability of 0.005), indicating that companies that pay their employees higher wages and salaries also achieve better financial and non-financial reporting. Therefore, contrary to previous studies that considered the board of directors, auditors, and financial employees as influential factors in the quality of financial reporting, this study shows that the total workforce of the company can be considered an effective factor in improving the quality of financial and non-financial reporting. In other words, the entire workforce is effective in the financial reporting process. The result is consistent with motivation and human resource theories, which suggest that the pay factor for employees affects their quality and quantity and makes them responsible to the organization and society, creating motivation to achieve high-quality financial and non-financial reporting. Hassan-gholizadeh et al., (1398) and Rezaei Pitenoi et al., (1398) have also somewhat obtained results consistent with the present hypothesis.

The evidence shows that the mediating hypothesis regarding the effect of financial reporting quality as a mediating variable in the relationship between labor cost and tax avoidance, there is no reason to reject this mediating effect at a high level of confidence of 95%. The introduction of this variable in this relationship has significantly reduced tax avoidance created through an increase in labor costs. Additionally, the mediating effect of non-financial reporting quality is significant at a high level of confidence of 95%. The reducing mediating effect of these variables is in line with legitimacy and stakeholder theories, which result in increased attention of companies to their employees as a part of stakeholder groups in the organization and society, better financial reporting quality, and consequently the legitimacy and protection of stakeholder interests.

## CONCLUSION

The results of this study demonstrate that labor costs, such as wages and salaries, are a significant factor in improving the quality of financial and non-financial reporting in companies. Therefore, in addition to filling the research gap in the field of the study's subject matter, this study highlights the importance of paying attention to labor costs and the benefits of high-quality financial and non-financial reporting.

**Keywords:** Tax avoidance, Financial and Non-financial Reporting Quality, Labor Costs.

**JEL Classification:** M41, H26, J30.

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