



# Earnings Management: New Evidence Based on Deferred Tax Expense

John Phillips, Morton Pincus and Sonja Olhoft Rego

University of Connecticut.

The University of Iowa.

**Abstract:**

We assess the usefulness of deferred tax expense in detecting earnings management. Assuming greater discretion under GAAP than under tax rules, and assuming managers exploit such discretion to manage income upward primarily in ways that do not affect current taxable income, then such earnings management will generate book-tax differences that increase deferred tax expense.

Our results provide evidence consistent with deferred tax expense generally being incrementally useful beyond total accruals and abnormal accruals derived from two Jones-type models in detecting earnings management to avoid an earnings decline and to avoid a loss. Only total accruals is incrementally useful in detecting earnings management to meet analysts' earnings forecasts. Deferred tax expense is more accurate than the accrual measures in classifying firm-years as successfully avoiding a loss, whereas no one measure is more accurate in classifying firm-years as avoiding an earnings decline or meeting analysts' forecasts.