


Do Managers Use the Valuation Allowance Account to Manage Earnings around Certain Earnings Targets?

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This paper provides additional evidence on earnings management via the deferred tax asset valuation allowance account (VAA). Earlier publications that do not find evidence of earnings management via the VAA examine contractual incentives using broad samples. A more recent publication finds evidence consistent with earnings management via the VAA but examines capital-market-based incentives using a homogeneous sample. To bridge the gap between these studies, we exploit a heterogeneous sample over an extended time period but examine capital-market-based incentives to manage earnings. The results provide substantial evidence that firms use the VAA to smooth earnings toward the mean analyst forecast. However, the results do not provide evidence that firms use the VAA to smooth earnings toward positive or prior year’s reported earnings targets or engage in “big bath” behavior for any of the earnings targets.

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