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The Influence of Tax Avoidance Modified by Corporate Governance on Earnings Management

(Empirical Study on Manufacturing Companies Listed on the Indonesia Stock Exchange in 2014-2017)

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Abstract
This study aims to empirically examine the effect of tax avoidance which is moderated by corporate governance on earnings management. The populations in this study were Manufacturing Companies Listed on the Indonesia Stock Exchange in 2014 to 2017. The samples in this study used purposive sampling method, so the samples amounted to 52 manufacturing companies. The type of data used is secondary data. Data collection techniques are documented from www.idx.co.id. The analytical method used is Moderated Regression Analysis. The results of this study indicate tax avoidance has a significant positive effect on earnings management and corporate governance weakens the influence of tax avoidance on earnings management.
Keywords: earnings management, tax avoidance, corporate governance

Introduction

According to Larastomo, et al (2016) earnings are an important indicator in assessing a company's financial performance. Profit information also helps owners or other parties in estimating the company's earning power in the future. The company strives to achieve high profits to meet investor expectations so that they are considered good, so that it will have an impact on the compensation that will be received. These conditions motivate managers to manage earnings in an opportunistic manner by manipulating them to achieve levels of profit that do not apply earnings management to achieve certain profit targets.

According to Scott (2015) earnings management is often carried out by utilizing gaps from accounting standards, so that information in financial statements is not in accordance with the actual conditions that can harm the parties concerned. Earnings management is intentionally carried out by management to trick stakeholders who want to know the company's performance and conditions. Earnings management can damage information produced by financial statements and become misleading information. Information generated from earnings management also results in biased financial reports and reduces the credibility of financial statements because the reported earnings figures do not reflect the actual conditions (Healy and Wahlen, 1999).

Rahman, et al (2013) stated that one of the motivations in the practice of labalamalah is the implementation, the company will try to minimize the taxes that will be paid. The company has the responsibility to pay taxes in accordance with the provisions of the law that applies to a country. Payment of taxes issued by companies is a burden. Therefore, companies tend to choose safe ways by avoiding tax legally by tax evasion. The company then makes every effort to reduce the burden on taxes paid.

Tax avoidance is an effort to avoid taxation that is carried out legally and safely for taxpayers, because it does not conflict with taxation provisions. Tax avoidance uses a number of methods and techniques that tend to utilize the gray area contained in the law and taxation regulations themselves to minimize the amount of tax owed (Pohan, 2016).

Prakosa (2014) explains that tax avoidance is an effort made legally without violating the applicable rules or standards, but tax avoidance can give a big loss to the state because it reduces the income of the State Budget (APBN). Tax avoidance can be done by managers to make earnings management. Tax avoidance on earnings management is carried out by company managers by using income and expense items to achieve the desired profit.

Managers can use existing loopholes to minimize profits so that payment of tax obligations becomes low as stated by Hoque et al. (2011). Managers have opportunistic nature, with the existence of these characteristics the manager will carry out tax avoidance methods and tactics for personal interests that are not aligned with the company's objectives, so this will cause agency problems. Tax avoidance and earnings management carried out by company managers which are acts of deviation can be prevented by monitoring and managing good companies or good corporate governance.

According to the Indonesian Institute for Corporate Governance (IICG, 2012) Corporate governance is a series of mechanisms that direct and control a company so that the company's operations run with the expectations of stakeholders. Naftalia (2013) states that with the presence of corporate governance, it is expected to function as a tool to give confidence to investors and creditors that they will receive a return on the funds they have invested in a company.

This corporate governance mechanism can be used to manage, monitor, control and reward. This corporate governance can also monitor principal and agent relations to reduce earnings management actions (Hart, 1999). The linkage of corporate governance to the relationship of tax avoidance and earnings management cannot be separated from the existence of agency problems. Agency conflicts caused by this information asymmetry can be controlled through corporate governance. This corporate governance is also expected to minimize agency conflicts that occur within a company. Companies that run good corporate governance can overcome and weaken tax avoidance and earnings management relationships.

Some previous studies that explain the relationship, corporate governance, tax avoidance, and earnings management. Anne's research, et al (2016) found a positive influence on tax avoidance with earnings management. Research conducted by Anne, et al. (2016) found that corporate governance indicated by company owners consisting of commissioners, independent commissioners and institutional ownership found that institutional ownership negatively moderates the relationship of tax avoidance and earnings management. Research conducted by Wang and Chen (2012) found a positive relationship between tax avoidance and earnings management. Putri (2017) and Wijaya and Christiawan (2014) also found that tax avoidance had a positive effect on earnings management.

Based on the description above, the hypothesis proposed in this study are:

H1: Tax avoidance has a positive effect on earnings management

H2: Corporate governance can weaken the relationship between tax avoidance and earnings management

Methods

The population in this study were all manufacturing companies listed on the Indonesia Stock Exchange (BEI) from 2014-2017 which totaled 155 companies. The sampling technique in this study used purposive sampling technique.The type of data used in this study is documentary data. Data sources in this study are secondary data sources. Data collection techniques in this study are documentation techniques by collecting and viewing the annual financial statements of the Manfaktur Company in 2014-2017 published through the IDX website www.idx.co.id.

The dependent variable in this study is earnings management. Earnings management is measured using aggregate use accrual-based model developed by Dechow et al (1995), the Modified Jones Model.

$$DAC_{it} = \frac{TAC_{it}}{A_{it-1}} - NDAC_{it}$$

TAC: Total Accruals
Ait : Total Assets
NDAC : Nondiscretionary Accruals
DAC : Discretionary accruals

The independent variable of this study is tax avoidance. Tax avoidance in this study uses three measurement proxies, namely as follows:

a. ETR

$$ETR = \frac{TaxExpense}{PretaxIncome}$$

b. Cash ETR

$$CETR = \frac{\Sigma_{T}^{N} = Cashpaidtax}{\Sigma_{\Gamma}^{N} = pretaxincome}$$

c. DTE

$$DTE \frac{DTE_{it}}{Avg.TA_{it}}$$

Tax Expenses	: tax expense
Pretax Income	: earning before tax
Cash Paid Tax	: cash tax payments
DTE	: deferred tax burden
Avg. TA	: average total assets

This study uses corporate governance as a moderator variable. Measurement of Corporate Governance through the company's internal control mechanism using a factor score consisting of four dimensions. This measurement refers to Wahidahwati's (2012) research in line with Syah (2009) and Kristanti and Priyandi (2016). Each dimension has the following indicators: 1) The Board of Commissioners (45%) consists of: (a) the size of the board of commissioners; (b) independent commissioner; (c) percentage of shareholder ownership of the board of commissioners; and (d) big four or non big four KAP information. 2) Audit Committee (20%), consisting of: (a) the size of the audit committee; (b) percentage of independent audit committees; and (c) audit committee expertise. 3) Management (20%), consisting of: (a) the size of the board of directors; (b) Managerial ownership; and (c) family relationships. 4) Investors (15%), measured through the percentage of institutional ownership. The measurement of all these indicators can be formulated as follows.

$$CG = \frac{JumlahSkoryangdiperoleh}{Jumlahskoryangdiharapkan} X\ 100\%$$

This study uses a control variable. The control variable used in this study is the size of the company. Company size is measured based on total assets to get better and valid results, so the transformation of raw data into data is the natural logarithm value of the data itself (Ln Total Assets).

Data analysis in this study uses Moderated Regression Analysis. Data is processed using eviews8 software. This study uses panel estimation Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). Next to determine the best estimation method between CEM and FEM using Chow Test or Likelyhood Test, while FEM and REM use the Hausman Test. The feasibility test of the model consists of the Determination Coefficient Test (R2), F Test, and t Test. The analysis used to test the equation is mathematically formulated as follows:

$$EM = \alpha + \beta_1 ETR_{it} + \beta_2 CG_{it} + \beta_3 ETR_{it} * CG_{it} + \beta_4 Size_{it} \varepsilon \textit{Model 1}$$

$$EM = \alpha + \beta_1 CETR_{it} + \beta_2 CG_{it} + \beta_3 CETR_{it} * CG_{it} + \beta_4 Size_{it} \varepsilon . \textit{Model 2}$$

$$EM = \alpha + \beta_1 DTE_{it} + \beta_2 CG_{it} + \beta_3 DTE_{it} * CG_{it} + \beta_4 Size_{it} \varepsilon . \textit{Model 3}$$

Results

1. Statistic Descriptive

The results of descriptive analysis using Eviews8 note that Earning Management (EM) has a mean of 0.059 with a standard deviation of 0.059. The maximum value of earnings management is 0.330 and the minimum value is 0,000. The maximum ETR value is 0.596 and the minimum value is 0.070. Cash ETR has a mean value of 0.301 with a standard deviation of 0.147. The maximum value of Cash ETR is 0.951 and the minimum value is 0.026. DTE with a mean value of 0,000 with a standard deviation of 0.005. The maximum value of DTE is 0.02 and the minimum value is -0.03. Corporate governance (CG) with a mean value (average) of 46.26 with a standard deviation of 6.08. The maximum and minimum corporate governance (CG) values are 64.17 and 34.03. company size (Size) which has a mean value of 28.62 with a standard deviation of 1.66. The maximum and minimum values of the company size are 33.20 and 25.62.

2. Panel Regression Estimates

The first test is Chow Test. This test is a test to determine the Common Effect Model or Fix Effect Model which is best used in estimating panel data. Based on the results of data processing, in model 1 the probability is 0.000 which is smaller than the critical value (0.05), model 2 has a probability value of 0.003 <0.05, and model 3 has a probability value of 0.006 <0.05 so it can be concluded that H0 for the model 1, 2 and 3 are rejected and Ha is accepted. So the estimation that is better used in these three models is Fixed Effect Model, for that it is necessary to proceed to the Hausman Test.

Hausman Test is a statistical test to choose whether the Fixed Effect Model or Random Effect Model is the most appropriate model for estimating panel data. Based on the processed data, the probability for model 1 is 0.446, which is greater than the critical value (0.05), model 2 is 0.808> 0.05, and for model 3 has a probability value of 0.818> 0.05. Then it can be concluded that H0 for this model is accepted and Ha is rejected, so that a good estimate is used in models 1, 2, and 3, this is the Random Effect Model.

3. Moderated Regression Analysis (MRA)

The results of the study that can be continued in this study are only model 1, because models 2 and 3 do not meet the model feasibility test which results in low adjusted R^2 and F test greater than 5%. Based on the processed data, the following equation can be obtained:

$$EM = -\,0.087 + 1{,}068TA - 0{,}026TA * CG - 0{,}004Size$$

4. Feasibility Test Mode

Adjusted R^2 value is 0.039. This shows that the contribution of the independent variable to the dependent variable is 3.9%. and 96.1% is determined by other variables not analyzed in the model in this study. The F test is proven by the results of calculations that show that the probability value (F-statistic) <0.05 = 0.017, so that it can be concluded that the independent variables in the equation model have a significant effect on the dependent variable. Based on the results of processed statistical data, it is known that the effect of the independent variables on the dependent variable is partially as follows:

a. 1) The regression coefficient of TA is positive for 1.068 and has a significance value smaller than α (sig <α), namely sig 0.022 <0.05, meaning that TA has a significant positive effect on EM. The conclusion is hypothesis 1 is accepted.

b. The regression coefficient of TA * CG has a negative value of -0.025 and has a significance value smaller than α (sig <α) which is sig 0.010 <0.05, meaning that CG can weaken the relationship of tax avoidance to earnings management. The conclusion is that hypothesis 2 is accepted.

The Effect of Tax Avoidance on Earnings Management

Based on the results of statistical analysis using the program Eviews 8 in this study, it was found that the first hypothesis was accepted. This statement is based on the TA coefficient value of 1.068 and the value of tax evasion probability (TA) of 0.022 is smaller than significance (α = 0.05) meaning that when viewed from the tax avoidance coefficient (TA) which indicates a positive direction, it can be concluded that tax avoidance positive and significant influence on earnings management.

Ownership in public companies can provide opportunities for management companies to make choices for accounting methods or policies for personal use. Researchers prove that the various methods used by companies to carry out tax evasion have the main goal of earnings management. Tax avoidance is part of tax planning carried out with the aim of minimizing tax payments. The higher tax evasion carried out by the company means that the higher earnings management is carried out by the company, whereas the lower the tax avoidance means the lower earnings management. Therefore, tax avoidance has a positive effect on earnings management.

In the context of the company, tax evasion is intentionally carried out by the company in order to minimize the amount of tax payment that must be done and simultaneously increase the company's cash flow. Tax avoidance on earnings management is carried out by companies using income and expense items to achieve the desired profit. Management can use existing accounting loopholes to minimize profits so that payment of tax obligations becomes low. Tax avoidance has made the country lose tax revenue potential which should be used to reduce the state budget burden (Budiman and Setiyono, 2012).

Tax payments that are increasing or decreasing will affect the net income that will be generated. If income before tax is constant, the greater the tax burden paid, the smaller the net income generated, and vice versa. Researchers prove that the various methods used by companies to avoid taxation by minimizing the tax burden paid have the main objective to make earnings management. This result is in line with the research of Putri (2017), Anne, et al (2016) and Larastomo, et al (2016), and Wang and Chen (2012) who found that tax avoidance had a positive effect on earnings management. The effect of tax avoidance on earnings management is due to differences between tax regulations and accounting regulations in terms of recognition and income that can be utilized by management to make profit engineering (Wardana, 2014).

The Influence of Corporate Governance in Moderating Tax Avoidance and Earning Management

Based on the results of statistical analysis using the program Eviews 8, it was found that the interaction between ETR * CGEM has a coefficient of -0.025 and a probability of 0.010 is smaller than significance ($\alpha = 0.05$). This shows that tax avoidance that negatively moderates (weakens) or explains corporate governance can weaken the relationship of tax avoidance to earnings management. So the hypothesis that has been formulated in H2 cannot be rejected or in other words H2 is accepted.

Tax avoidance and earnings management in a company can be minimized through a good corporate governance mechanism so that it can harmonize the interests of various parties, corporate governance is an effort made by all parties with an interest in the company to run the company properly in accordance with the rights and their respective obligations (Arifin, 2005). Therefore, the existence of corporate governance practices within the company will limit management's actions to tax evasion which can motivate the emergence of earnings management.

The implementation of good corporate governance principles can contribute to improving company performance. The better corporate governance in this company can reduce the occurrence of tax avoidance that can lead to earnings management, and vice versa, corporate governance that is not good in a weak sense can indicate high tax avoidance so that it will improve earnings management in the company. Measurement of corporate governance variables in research uses a score of quality measurement of corporate governance itself so that it can show that all indicators that exist in corporate governance do not only focus on one of the indicators of corporate governance.

Conclusion

Based on the data analysis, this research found that tax avoidance has a significant positive effect on earnings management and corporate governance can weaken the influence of tax avoidance on earnings management. The results of this study can be expected, so that the company provides information presented in financial statements that describe the actual conditions so that the information can be useful for stakeholders in making decisions. Companies need to improve corporate corporate governance so that they can reduce agency conflicts. Policy implications, one of which is that the board of financial accounting standards must enforce regulations that can minimize tax avoidance and earnings management. This regulation is needed to increase the responsibility of management and accountants in the credibility of financial statements.

This study has limitations in the low value of adjusted R^2, which is only 3.9%, indicating that many other variables have a large contribution in influencing earnings management. The time span of observation used in this sampling is from 2014-2017, so the research data cannot represent the entire data that is on the IDX. This study uses samples from manufacturing companies, so that the results of the study cannot be generalized to other company sectors. This research does not distinguish between the current tax burden and deferred tax burden in measuring tax avoidance, especially in the ETR proxy.

The next researcher, should conduct research for more than 5 years so that the results obtained are better quality, adding to the category of companies that will be used as research samples, for example all companies listed on the Indonesia Stock Exchange (IDX) so that the results of the research can be generalized. For further researchers to use other measuring instruments in measuring earnings management, tax avoidance, and corporate governance, and adding other variables identified can affect earnings management because of the low adjusted R^2 value generated in this study. Other variables, such as: CEO turnover, executive compensation, information asymmetry, financial distress and other variables.

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