

Motivation, Tax, and Firm's Condition Effect on Earnings Management

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ABSTRACT: This research purpose is to obtain empirical evidence on the effects of motivation bonus, motivation debt contracts, deferred tax assets, tax planning, firm's growth, firm's performance, firm's size, earnings power, and firm's sales growth on earnings management. This research's population comes from the non-financial companies listed in Indonesia Stock Exchange from 2015 to 2017. From the purposive sampling method, the samples obtained for the research were 114 non-financial listed companies with 342 data. This research used multiple linear regressions for the method of analyzing data. The results showed that motivation debt contracts, deferred tax assets, firm's growth, firm's size, and firm's sales growth have an influence on earnings management of the non-financial companies in Indonesia. Whereas, motivation bonus, tax planning, firm's performance, and earnings power did not affect earnings management of the non-financial companies in Indonesia.

Keywords: Motivation, tax, firm's condition, earning management.

1 INTRODUCTION

Information in the financial statements becomes a window that presents the company's condition. Information regarding profit is used by all parties, including creditors, investors, as well as the government, in order to make decisions. Due to the importance of how profit affects decision making, any particular actions intended to mislead the amount reported in the statements can affect the users in making decisions (Healy & Wahlem 1999).

Management controlling the firm's day-to-day activities will likely intend to manipulate their accounting for earnings. That is done so that earnings appear to be more positive, look good, and stable, which might not reflect the actual condition. Management conducts earnings management through various ways relating to the accounting methods because there are numerous ways to do so. The accounting policies require management to make judgments that favor them. Through tax planning, management can pay lower taxes than the actual amount and therefore resulting in higher profit statements, up to making use of the deferred tax asset to compensate for future periods. The desire for bonuses resulting from profits in the financial state-

ments, along with the management's need to comply with the credit terms in order to gain credit, becomes a likely possibility that management does not act with best intentions to focus on the owner's best interests, but instead their own interests (Gulzar & Wang 2011).

Agency theory emerges due to the non-synchronization between the agent and the principal's decisions or objectives (Ross 1973). The agents are including CEOs and management, whereas the shareholders act as principals. This separation of duties as well as their functions, and yet still connected, causes a conflict that is likely to happen due to differences in interests, which leads to influencing the quality of the earnings being reported. This theory becomes the base of managers seeking to manipulate or maximize earnings to maximize personal gains (Jensen & Meckling 1976). Stakeholders or investors motivate management to take care of the company, and thus they are paid according to results. This incentive makes managers keep their earnings result upwards and maximized (Mahjoub & Miloudi 2015). This theory becomes the root of this research regarding earnings management.

Another theory for earnings management is the signaling theory. Information is vital in determining

how the market and the users react and how they can make the necessary decision based on the information provided (Connelly et al. 2011). When it comes to providing information, the manager has the ability or power to share or 'signal' the type of information they want the users to undertake. In reality, information is imperfect between stakeholders and management. This is because management is the most informed element of the company's condition. (Mahjoub & Miloudi 2015).

According to Sun & Rath (2009), earnings management becomes as a signaling mechanism to portray the company's future prospects. By engaging in the act of earnings management, managers can create an increasing and stable earnings string, affecting how stakeholders, especially investors, perceive the company. Managers maximize share price for the sake of current shareholders when their shares are sold to future shareholders; thus, current shareholders provide incentives for managers to conduct earnings management (Nurdianah & Linda 2015).

According to Guna & Herawaty (2010), earnings management is defined as the activities intentionally done that can have an impact on the number of profits created by management to report in the financial statements. It is stated that when managers are given choices to apply a set of accounting policies, there is a natural tendency for managers to choose particular policies that would maximize their personal interest. In other words, managers have a higher chance to behave unethically to maximize their own interest rather than to satisfy the shareholders in a given opportunity. It seems that earnings management on its surface to be somewhat considered as appropriate and acceptable. According to Nahandi et al. (2012), earnings management is a legal activity and considered reasonable to be performed since there is a power lies in the hands of managers to make decisions in reporting financial statement to achieve stability in earnings. Although earnings management seems to have a negative image of perspective, yet it is legal to be performed.

Nurdiniah & Herlina (2015) stated that sometimes, management would be given bonuses or compensation for the achievements that the management has gained in specific amounts desired by the board or the shareholder. With that said, the bigger the bonus, the higher the motivation will be. A higher ratio means that the company is more effective in utilizing the assets to produce a net profit after tax. Nevertheless, this can also trigger earnings being managed for the management's self-interest. Guna & Herawaty (2010) and Aygun et al. (2014) found a positive influence on earnings management from motivation bonus contracts, with an understanding

that firms with higher profitability would show higher earnings manipulation. Based on the explanation above, the hypothesis is Ha1 Motivation bonus has an influence on earnings management.

Motivation debt contracts, also known as leverage, are the ratio between the total company's liabilities and total company's asset. This ratio shows the number of assets owned by the company that was funded by liabilities. The greater the leverage ratio, the higher the firm value of debt, which also signifies a greater risk of the firm being unable to fulfill its debt contracts. Through still the hypothesis, aggressive earnings management will be done by the company in order to comply with the debt contracts (Watts & Zimmerman 1986). The amount of debt will then motivate management to do earnings management. Bassiouny et al. (2016) and Arifin & Desriana (2016) found that leverage has a positive influence on earnings management. The greater the level of debt, the company encourages companies to do earnings management because higher company risk will increase the uncertainty of earnings in the future. Based on the explanation above, the hypothesis built is: Ha2 Motivation debt contracts have an influence on earnings management.

Waluyo (2014) stated that deferred tax asset means the income tax recoverable amount or the amount that can be recovered in periods after or in the future. This results from differences in deductibles temporary differences, and we can compensate for the losses in the future. This type of asset is related to taxation and can be advantaged by the managers when, in critical times, they have to carry a burden of tax expenses in certain years. When the company achieves a profit less than what is required in the taxation method, the company gains deferred tax assets. Thus, managers at some point try to increase the numbers in this account for that reason, as well as to minimize future years of paying taxes when they have deferred tax assets to reduce the payments. Handoko (2016) and Warsono (2017) mentioned that deferred tax asset does increase the probability of earnings being managed by management. Based on the explanation above, the hypothesis built is: Ha3 Deferred tax asset has an influence on earnings management.

Tax planning is considered one of the management functions to save tax legally, although sometimes it may be considered as tax avoidance or even worse, evasion. Suandy (2011) stated that tax planning is a systematic analysis of various types of tax plans selected that have an aim or focus or a single goal, which is to minimize the current tax liabilities for the current as well as future periods whenever possible. This can be done through the minimizing

or controlling of the cash outflows in order to get more accurate budgeting for tax. If the company wants to signal the need to gain more investors and increasing share price, management has the ability to bloat the amount of revenue even though that also means higher taxes to be paid. Sumomba & Hutomo (2012) agreed that tax planning does influence the act of earnings management by the management. Managers are inclined to decrease the tax payment whenever possible by having a professional judgment that sometimes can be inclining to a certain party rather than to others, which in this case is the government by reducing tax payments. Based on the explanation above, the hypothesis built is: Ha4 Tax planning has an influence on earnings management.

The firm's growth in this research shows the definition of the growth of assets in total, including current assets, non-current assets, as well as other assets when compared between the year and the previous year examined (Sun & Rath 2009). The growth of a firm reflected from the asset may have been the result of earnings management created by the managers, either in legal or somewhat illegal matters in order for the financial statements to look good and appealing for the shareholders, but recent and prospective ones. Debnath (2017) and Sun & Rath (2009) concluded that the firm's growth opportunity is positively associated. Companies with high growth rates have pressure to continue to grow, which ultimately drives earnings management. Based on the explanation above, the hypothesis built is: Ha5 Firm's growth has an influence on earnings management.

Moradi et al. (2012) defined the firm's performance as a return on net worth. The performance of a firm is found out through the performance coefficient on the gross income when compared to the equity of the shareholders. Manipulation of earnings is done to maintain the firm's performance as to how the proportion of shares that have been withheld by the investors can result in better economic conditions of the company, seen from the net income it can gain (Pratiwi & Budi 2009). Because of that, net income is managed to please the investors and to keep the company's performance to be sought as in good condition. Marian & Hussain (2014) also stated that there is a positive influence between the performance coefficient and the earnings management coefficient. Based on the explanation above, the hypothesis built is: Ha6 Firm's performance has an influence on earnings management.

Firm size displays the complex scope of extension of a certain enterprise (Subramanyam 2010). The size of the firm can be measured by the company's total assets, total sales, and market capitaliza-

tion (Guna & Herawaty 2010). Ali et al. (2015) said that despite having a strong internal control system, large-size firms are having more chances of doing earnings management due to the proficiency to negotiate with auditors in a mean that auditors ignore the practice of earnings management done by the management due to negotiation power. Ajit et al. (2013) found that there is a positive significance between firm size and earnings management. It shows that the bigger the size of the company, the more the earnings management practices conducted in order to fulfill the certain obligation and pressure being weighted on. Based on the explanation above, the hypothesis built is: Ha7 Firm's size has an influence on earnings management.

Subramanyam (2010) stated that earnings power is related to the level of how the company will expect the company's income or profit in the future. Earnings are also used to estimate in how it can contribute to future earnings. For managers to sustain this desired condition, managers can manage how this earnings power should be, by increasing the total sales when necessary to keep the earnings power stable and show the manager is doing its job on keeping the operational condition in the original state. Earnings power and its influence toward earnings management is that the higher the amount of net income that is obtained by the company, the higher the chance for the managers of the company to decrease its amount of profit with a purpose as to avoid the commandment to obtain a higher profit than past performance in future periods. Pratiwi & Purnomo (2009) achieved a similar conclusion that earnings power does have a positive influence on earnings management. Based on the explanation above, the hypothesis built is: Ha8 Earnings power has an influence on earnings management.

Llukani (2013) stated that the firm's sales growth is the growth of a firm in terms of sales. As firms, from time to time, produce financial reports, the one that generates income positively comes from the sales revenues. The growth of sales is considered as to how the firm is doing in terms of succeeding in the business world. For the firm's sales growth, it is considering the growth from one period to another. The company wants to keep its condition stable. Rather than having fluctuations that can result in uncertainty and loss of trust, managers incline to sustain sales growth. This is done to the extent that the growth, although not significant, but seen as a more positive signal than a high increase followed by a low decrease in sales growth. Llukani (2013) and Abbadi et al. (2016) believed that the firm's sales growth affects the action of doing earnings management. Based on the explanation above, the hy-

pothesis built is: Ha9 Firm's sales growth has an influence on earnings management.

2 RESEARCH METHODS

This study population was the non-financial companies listed in Indonesian Stock Exchange from 2015 to 2017. The sample was 114 listed non-financial companies through a selection of purposive sampling, with a total of 342 data. The criteria used are companies that reported financial statements in rupiah currency ended on December 31, consistently earned a positive profit, consistently reported deferred tax assets and current tax expense. The data analysis used for this research was the multiple linear regressions model.

Earnings Management is the dependent variable for this research that is derived from previous researches of Aygun et al. (2014). Earnings management was measured from discretionary accruals. Modified-Jones model was used for calculating earnings management in this research.

Motivation Bonus or return on asset (ROA) measures the overall effectiveness of management in generating profits with its available assets. The higher the firm's return on total assets, the better the effectiveness of management in generating profits with its available assets (Aygun et al. 2014). This variable can be measured by dividing the net income of firm *i* for year *t* with the book value of total assets of firm *i* for year *t*. For motivation debt contracts, leverage was used as the variable measurement, depicting the ratio between the total of the company's liabilities towards the total company's asset. This variable can be measured by total liabilities divided by the total assets (Abed et al. 2012).

Waluyo (2014) stated that deferred tax asset means the income tax recoverable amount or the amount that can be recovered in periods after or in the future. This results from differences in deductibles temporary differences, and through that, we can compensate for the losses in the future. Deferred tax asset is measured as deferred tax assets at the end of period *t* to *t-1* divided by the value deferred tax assets at the end of period *t*. Tax planning is a systematic analysis of various types of tax plans selected, that has an objective or focus to minimize the current tax liabilities for the recent as well as the future period whenever possible. The tax planning measurement used previous research by Tiearya and Yuyetta (2004), with the applicable tax rate applicable from Income Tax Law Article 17 verse 2a (*UU PPh Pasal 17 Ayat 2*).

The firm's growth in this research shows the definition of the growth of assets in total, including current assets, non-current assets, as well as other assets when compared between the year and the previous year examined (Debnath 2009). The firm's performance is defined as the return on net worth (Sun & Rath 2009). The firm's performance was measured through a proportion of the net of income towards the total of the shareholders' equity.

Firm size describes how big the firm is and can be measured by the natural logarithm of total assets. The scale of this variable is the ratio scale. This model is adapted from Ali et al. (2015). Earnings Power is the capability of a firm to obtain income or profit from the number of sales it has made. Earnings Power is received through the calculation of net income divided by total sales. Deriving the measurement from previous research by Rice (2016). For the firm's sales growth, according to Llukani (2013), the authors find the numbers in the ratio scale, and it is the comparison of growth of sales in firm *i* in the current year to the previous year and compare it with the sales of the period in the current year.

3 RESULTS AND DISCUSSIONS

The results of the t-test for the hypotheses test are summarized below:

Table 1. Hypotheses Test Results

Variable	Coeff.	Sig.
Motivation bonus	0.209	0.137
Motivation debt contracts	0.005	0.032
Deffered tax asset	0.001	0.003
Tax planning	0.698	0.278
Firm's growth	0.213	0.036
Firm's performance	-0.161	0.059
Firm's size	-0.004	0.003
Earnings power	0.030	0.051
Firm's sales growth	0.001	0.015

Motivation bonus significant value is 0.137, meaning that Ha1 is rejected and there is no influence of motivation bonus on earnings management. This is based on the notion that the bonus does not reflect on the variable definition of return on assets but rather on the bonus target amounts initially set by the company.

Motivation debt contracts showed a significant value of 0.032. Ha2, therefore, is accepted and motivation debt contracts influence earnings management. The positive coefficient shows that when the motivation of debt contracts is higher, so is the earnings management. This is from an understanding

that management conducts earnings management to deflect debt covenants.

Deferred Tax Asset has a significant value of 0.003. This means that Ha3 is accepted, deferred tax asset affects earnings management of companies. With the positive coefficient, the higher deferred tax asset, the higher earnings management will be. This is based on the understanding that when there is an increase in deferred tax assets that means the temporary time difference allows positive correction that affects the tax expenses commercially to be lower compared to the ones made by taxation laws.

Tax planning significant value is 0.278, meaning that Ha4 is rejected and that tax planning has no influence on earnings management. This is based on the understanding that companies do tax planning not to minimize tax costs or increase earnings, but follow tax regulations so as not to receive penalties or sanctions.

The firm's growth hypotheses test result shows a value of 0.036, meaning that Ha5 is accepted. The firm's growth has an influence on earnings management. If the firm's growth is high, earnings management will also be high. This is based on the notion that large growing firms are under pressure to keep growing and meet investors' demands and therefore create higher incentives to manage the earnings.

The firm's performance significant value is 0.059, meaning Ha6 is rejected. There is no influence on a firm's performance on the company's earnings management. This is based on the understanding that companies do not necessarily have to engage in the acts of managing their earnings due to their excellent performance.

The firm's size significant value is 0.003, which means Ha7 is accepted, and thus the firm's size influences earnings management. The negative coefficient shows that if the size increases, earnings management will decrease. This is based on the understanding that when the size of the company is big, it engages less in earnings management.

Earnings power has a significant value of 0.051, meaning that Ha8 is rejected; therefore, earnings power does not influence earnings management. This is based on the understanding that the company's ability to stably gain profits in future years lessens the management's need to conduct earnings management. Another reason is that management sees not only profit but also the company's goals in the future.

The firm's sales growth is 0.015; therefore, Ha9 is accepted, and the firm's sales growth has an impact on earnings management. The positive coefficient means that when the sales growth is high, so

does the earnings management. This is because companies that have high growth rates mean that there is a high margin to profit and, therefore, a higher possibility of earnings management.

4 CONCLUSION

The research has the purpose of finding empirical evidence of how deferred tax asset, tax planning, firm's growth, firm's performance, firm's size, motivation bonus, motivation debt contracts, earnings power, and firm's sales growth affect earnings management for the non-financial companies listed on the Indonesia Stock Exchange. From the hypotheses testing, it can be seen that deferred tax assets, firm's growth, firm's size, motivation debt contracts, and firm's sales growth influenced earnings management. Whereas tax planning, firm's performance, motivation bonus, and earnings power did not influence earnings management.

Limitations from this research are limited research periods of only three years, and only five variables were used. Hence a few recommendations could be implemented for future researches, such as the expansion of the research period and additions of variables that might influence earnings management. Further research also can compare the conditions between the region and country.

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