DOES INDEPENDENT COMMISSIONER CONTRIBUTE TO DECREASE EARNINGS MANAGEMENT AND TAX AVOIDANCE ACTIVITIES

Alfian Nur Zaman ¹, Arum Puspita Maharani ², Amrie Firmansyah ³*
¹ 4132220038_alfian@pknstan.ac.id, ² 4132220058@pknstan.ac.id,
³ amriefirmansyah@upnvj.ac.id
¹,² State Finance Polytechnic STAN, Jakarta, Indonesia
³ Universitas Pembangunan Nasional Veteran Jakarta, Indonesia
*corresponding author

Abstract

This research examines independent commissioners' role in moderating earnings management's influence on tax avoidance practices in the building construction subsector. This research uses data from building construction subsector companies listed on the Indonesia Stock Exchange during 2017-2020. Of the 15 companies observed, 42 samples were obtained using purposive sampling, which was used in the research. Data processing uses regression analysis for cross-sectional data. The research results show that earnings management positively affects tax avoidance. Meanwhile, the presence of independent commissioners does not strengthen the positive influence of earnings management on tax avoidance. This research contributes to providing financial accounting research results related to the role of independent commissioners in monitoring manager policies in building construction subsector companies in Indonesia.

Keywords: Corporate Governance, Earnings Quality, Tax Planning

Abstrak


Kata Kunci: Kualitas Laba, Perencanaan Pajak, Tata Kelola Perusahaan
INTRODUCTION

State revenues in the State Revenue and Expenditure Budget (APBN) consist of tax revenues, customs and excise revenues, non-tax state revenues, and grant receipts (Undang-Undang RI, 2004). In the 2020 APBN posture, state revenue is projected to be IDR 2,233.2 T, of which 83.5% or IDR 1,865.7 T is targeted to be obtained from tax revenues (Direktorat Jendral Anggaran, 2020). The taxation sector's revenue is the prime source of the state budget (Rusydi, 2013). The preparation of revenue targets in the APBN posture is prepared in year -1, namely in 2019 for the 2020 APBN (Direktorat Jendral Anggaran, 2020). Then, the preparations did not consider the impending Covid-19 pandemic destabilizing the world economy, including Indonesia. It underlies the state revenue target change through tax revenue to only IDR 1,198.82 T.

Following Figure 1, it can be seen that in the last five years (2016-2021), there has been a fluctuating trend regarding the growth of tax revenues. This fluctuating trend occurred between 2002 and 2012. This event can be used as learning material related to whether the steps taken by the Directorate General of Taxes have been appropriate in carrying out their duties so far. According to Putri, 2010 for most companies, taxes are considered a cost that will reduce company profits and net income. It creates a reluctance to pay, leading to activities that lead to tax avoidance. According to (Scott, 2015), one of the factors for tax avoidance carried out by companies is a negative attitude in responding to political costs. Companies naturally tend to plan to weaken their political costs, and paying taxes is one of those political costs (Scott, 2015).

Figure 1. Tax revenue in 2020

Source: Kemenyrian Keuangan RI (2020) and Undang-Undang RI (2020)

In the 2015-2019 RPJMN, it is stated that priority service sectors include (a) non-oil and gas export driving services, namely transportation services, tourism services, and construction services. From the 2020 tax revenue data taken from the DJPb revenue realization report, 52.41% was supported by taxes from the non-oil and gas sector and 3.1% from the oil and gas sector. It means that tax revenue from construction has a large share. From year to year, the demand for construction is increasing. Growth in the construction sector is considered higher than in other sectors. It is then believed that there is a strong relationship between economic growth and growth in the construction sector (Hendriko, 2010). Construction development in infrastructure development will continue as a priority by the
president-elect for 2019-2024. It is stated in mission number 3, which aims to realize an Advanced Indonesia that is sovereign, independent, and has a personality based on cooperation.

Several major tax avoidance cases have been subject to action by the Directorate General of Taxes (DJP), including the cases of Asian Agri, Adaro, Bumi Resources, Indofood, Indosat, Kaltim Prima Coal (KPC) and PT Airfast Indonesia (a subsidiary of PT Freeport McMoran) (Rusydi, 2013). This data shows that large companies do a lot of tax avoidance. This fact also shows the aggressiveness of tax avoidance by company management. Tax for companies is calculated through the company’s net profit on the income statement in the company’s financial statements (Wardani et al., 2019). Profit has a close relationship with taxes because the amount of tax paid is determined by the amount of profit received by the company, so increased profits will result in the amount of tax paid (Yuliza et al., 2020). In essence, the practice of earnings management causes the reliability of reduced earnings because, in earnings management, there is a bias in measuring earnings, so the reporting of earnings is not as it should be reported (Arisandy, 2015).

Tax avoidance by managers by utilizing asymmetric information can be conducted in line with earnings management practices. Differences in interests between managers and shareholders result in managers acting according to certain motives (Scott, 2015). Tax avoidance measures aim to reduce tax expenses, increasing the amount of profit used to calculate bonuses given to managers (Bunaca & Nurdayadi, 2019). Shareholders need information that can be used to obtain dividends (Firmansyah et al., 2022). Earnings information can also be used in making shareholder decisions regarding their current and future investments (Roychowdhury et al., 2019). The existence of earnings management carried out by managers with the aim of tax avoidance can result in biased earnings information. Thus, testing the relationship between earnings management and tax avoidance needs further investigation.

Several studies that have tested earnings management on tax avoidance have had varying results. Falbo & Firmansyah (2021), Pajriansyah & Firmansyah (2017), Septiadi et al. (2017), and Wardani et al. (2019) suggested that earnings management is positively associated with tax avoidance. However, several studies found that earnings management is negatively associated with tax avoidance (Delgado et al., 2023; Octavia & Sari, 2022; Rifai & Atiningsih, 2019; Sánchez-Ballesta & Yagüe, 2020). Furthermore, Alfarizi et al. (2021), Ferdiawan & Firmansyah (2017), Henny (2019), Hutapea & Herawaty (2020), Manuel et al. (2022), and Rahmadani et al. (2020) concluded that earnings management is not associated with tax avoidance. The differences in previous test results encourage testing of earnings management on tax avoidance to need to be reconducted.

This research aims to examine earnings management on tax avoidance. This research places independent commissioners as a moderating variable in testing the relationship between earnings management and tax avoidance, which is rarely employed in previous research. An independent commissioner has no association with the company and has a spirit of leadership, professionalism and shareholder trust by acting as a supervisor and balancer of decisions without full decision-making (Amalia & Firmansyah, 2022). The existence of asymmetric information regarding the company's financial accounting information results in managers
having more perfect information than shareholders (Scott, 2015). To reduce losses due to these conditions, shareholders are willing to incur greater agency costs, including monitoring manager performance by independent commissioners (Amalia & Firmansyah, 2022). Independent commissioners can discipline managers' performance to align their interests with those of shareholders (Firmansyah et al., 2021).

Tax avoidance activities carried out with earnings management can harm the interests of shareholders. Independent commissioners are expected to reduce earnings management activities by utilizing discretion over certain accounting policies that align with reducing the company's tax expenses. Eksandy (2017) and Ningrum & Nurasik (2021) found that independent commissioner has a negative effect on tax avoidance. Other research suggested that independent commissioner can reduce earnings management activities (Abdillah et al., 2016; Asyati & Farida, 2020; Silmy et al., 2020). Furthermore, Putri et al. (2018) concluded that independent commissioners are negatively associated with earnings management and tax avoidance. Thus, it is expected that an independent commissioner can play a role in reducing tax avoidance carried out by earnings management.

This research contributes to the financial accounting research literature related to the role of independent commissioners in reducing tax avoidance practices carried out by earnings management, which currently occur, especially in companies in Indonesia. Apart from that, it is also expected that the capital market supervisory authority can use this research to monitor earnings management activities by listed companies and improve policies regarding the requirements for more competent independent commissioners to protect investors in the Indonesian capital market.

LITERATURE REVIEW

Agency theory states that there are differences in the interests of managers and shareholders, resulting in managers having more perfect information than managers (Jensen & Meckling, 1976). A company’s management is closely related to agency problem where there is a contractual relationship between the owner as a stakeholder and management as an agent who is given the authority to make decisions to maximize the owner’s profits, assigned to manage the top company to maximize owner value (Jensen & Meckling, 1976). In business practice, in the company's perception, paying taxes is considered taxes that reduce earnings, so managers attempt to take advantage of the flexibility in accounting standards for efficiency (Payne & Raiborn, 2018).

Romain (2015) concluded that between external and internal parties as users of financial statements within a company, sometimes various interests can cause conflicts that can harm parties with mutual interests. The manager is generally better informed about the company’s financial and operating positions than the owner (Scott, 2015). Therefore, management will be more flexible in carrying out earnings management, which also results in the consequences of tax avoidance without the approval or permission of the owner. This information asymmetry also increases the potential for a conflict of interest due to the dissimilarity of goals, where management does not always act following the
interests of the company owner.

One motive to obtain a bigger bonus result in managers carrying out certain policies to increase profits (Bunaca & Nurdayadi, 2019). Tax avoidance is an example of a manager's policy through tax planning to minimize tax expenses (Pajriansyah & Firmansyah, 2017). A low tax expense impacts the potential for greater profits to be earned so that the objectives of the manager's motives can be achieved (Bunaca & Nurdayadi, 2019). Tax avoidance is expected to be conducted in line with earnings management.

Fundamentally, earnings management is a method chosen to publish revenue information that benefits the company by adjusting it to management's interests (Scott, 2015). The adjustment can be made by increasing or decreasing the company's earnings (Scott, 2015). However, although earnings management aims to generate accounting profits, there are other consequences, such as an increase in tax expenses due to the increase in accounting profits (Pajriansyah & Firmansyah, 2017). Falbo & Firmansyah (2021), Pajriansyah & Firmansyah (2017), Septiadi et al. (2017), and Wardani et al. (2019) found that tax avoidance is carried out by earnings management. Using loopholes in tax rules used by managers is in line with earnings management activities that do not violate financial accounting standards. Managers carry out these actions by utilizing information that is perfect compared to shareholders. Thus, certain motives of managers can be achieved by carrying out these two activities.

**H1: Earnings management is positively associated with tax avoidance**

Agency problems can result in losses for shareholders (Jensen & Meckling, 1976). Shareholders only obtain information the company presents through financial statements and annual reports. Companies are encouraged to implement good governance authority to increase the transparency of financial information (Amalia & Firmansyah, 2022). One action to implement this is to place an independent commissioner whose task is to monitor the performance of managers' authority (Amalia & Firmansyah, 2022). An independent commissioner has no link with the corporation and acts as a supervisor and balancer of choices without complete decision-making authority (Amalia & Firmansyah, 2022).

The existence of Independent Commissioners is intended to encourage and create a more independent and objective climate for public companies (Silitonga & Simanjuntak, 2019). The existence of an independent commissioner supports the creation of one of the good corporate governance principles, namely fairness, by providing fair treatment to all controlling and minority shareholders (Nugraheni et al., 2022). Eksandy (2017) and Ningrum & Nurasik (2021) concluded that independent commissioners can decrease tax avoidance. Also, Abdillah et al. (2016), Asyati & Farida (2020) and Silmy et al. (2020) found that independent commissioner is negatively associated with earnings management activities. Putri et al. (2018) found that independent commissioners can decrease earnings management and tax avoidance. Thus, the independent commissioner is expected to be able to monitor financial reporting, especially earnings management activities, for tax avoidance purposes.

**H2: Independent commissioner weakens the positive association between**
earnings management and tax avoidance

RESEARCH METHODOLOGY

The method used to prepare this research is a quantitative descriptive research method. The research object used comes from secondary data. In this study, the population used was building construction companies listed on the IDX in the 2017-2020 period. The research data is in the form of the company’s annual financial reports obtained from the websites www.idnfinancials.com and www.idx.co.id, as well as other relevant sources. Sampling was conducted by purposive sampling, eliminating companies conducting IPO after January 1, 2017, and companies that experienced losses in 2017-2020. The total number of samples employed in this study is 41 observations.

This study uses the dependent variable, namely, tax avoidance. The independent variable, namely earnings management. The moderating variable is the independent commissioner, and the control variables are leverage, profitability, and company size. The effective tax rate (ETR) proxies the value of tax avoidance. The ETR will reflect the actual tax rate paid by the company. With this measure, if a company has an effective tax rate lower than the statutory tax rate, it means that the company is using an intervention tool that reduces the company's payable income tax. In other words, the company is involved in tax avoidance activities. Thus, the ETR value is then multiplied by minus 1 (-1) to indicate the level of corporate tax avoidance, where a number close to zero (0) indicates a higher level of tax avoidance, as used by Manuel et al. (2022).

\[ \text{ETR} = \frac{\text{Tax Expense}}{\text{Earning Before Income Tax}} \]

Furthermore, earnings management actions use the discretionary accruals proxy, with discretionary accruals calculated by Kothari et al. (2005), following Pajriensyah & Firmansyah (2017) using the following formula:

\[ \text{TAt} = \text{Nli} - \text{CFOi} \]

Where: TAt is the Total accruals of the company i in year t, Nli = net profit of company i in year t, and CFOi = Cash from the company i operations in year t. Then, the total value of accruals is estimated using the multiple linear regression equation based on Ordinary Least Square (OLS) as follows:

\[ \frac{TACC_{it}}{TA_{it-1}} = \beta_1 \frac{1}{TA_{it-1}} + \beta_2 \frac{(\Delta \text{REV} - \Delta \text{REC})_{it}}{TA_{it-1}} + \beta_3 \frac{\text{PPE}_{it}}{TA_{it}} + \beta_4 \text{ROA}_{it} + \varepsilon_{it} \]

Where: TAccit is total accruals in company year t, TAit-1 is total assets in company i year t-1, ΔREVit is revenue at the company i in year t minus revenue in year t-1, ΔRECit is receivable at the company i in year t minus receivables in year t-1, PPEit is fixed assets in company i in year t, ROAit is return on assets in company i in year t, \( \varepsilon \) is error term or residual of the equation. Discretionary accruals are
obtained based on the residuals in the above equation. Furthermore, to minimize the bias of earnings management carried out with decreasing income, the value of discretionary accruals is absolute in this research.

The proxy of the independent commissioner follows Asyati & Farida (2020), Eksandy (2017), and Putri et al. (2018).

\[
\text{COMIND} = \frac{\text{number of independent commissioners}}{\text{total number of board of commissioners}}
\]

This study measures company leverage using the debt to total equity ratio as Brigham & Houston (2019) and Praptama et al. (2022) as follows:

\[
\text{DER} = \frac{\text{total debt}}{\text{total equity}}
\]

The profitability proxy is calculated through return on assets (ROA) as Bhimantara & Dinarjito (2021) and Praptama et al. (2022).

\[
\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}}
\]

Furthermore, the firm size proxy employs a natural logarithm of total assets, as Praptama et al. (2022).

\[
\text{SIZE} = \text{Natural Logarithm of Total Assets}
\]

This study uses multiple linear regression analysis techniques for cross-section data to test the hypothesis. This study below model to test hypotheses 1 and 2.

\[
\text{TAXAVOID}_i = \beta_0 + \beta_1\text{DA}_i + \beta_2\text{COMIND}_i + \beta_3\text{DA}_i*\text{COMIND}_i + \beta_4\text{DER}_i + \beta_5\text{ROA}_i + \beta_6\text{SIZE}_i + \varepsilon_i
\]

RESULT AND DISCUSSIONS

The following are the results of descriptive statistical tests presented in the table:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Median</th>
<th>Max.</th>
<th>Min.</th>
<th>Std. Dev.</th>
<th>Obs</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXAVOID</td>
<td>-0.1750</td>
<td>-0.1210</td>
<td>-0.0069</td>
<td>-0.7294</td>
<td>0.1764</td>
<td>41</td>
</tr>
<tr>
<td>DA</td>
<td>0.1002</td>
<td>0.0715</td>
<td>0.4043</td>
<td>0.0024</td>
<td>0.1038</td>
<td>41</td>
</tr>
<tr>
<td>COMIND</td>
<td>0.3598</td>
<td>0.3333</td>
<td>0.6667</td>
<td>0.0000</td>
<td>0.1465</td>
<td>41</td>
</tr>
<tr>
<td>LEV</td>
<td>0.5770</td>
<td>0.6057</td>
<td>0.8537</td>
<td>0.1827</td>
<td>0.1798</td>
<td>41</td>
</tr>
<tr>
<td>ROA</td>
<td>0.0380</td>
<td>0.0350</td>
<td>0.1402</td>
<td>0.0006</td>
<td>0.0308</td>
<td>41</td>
</tr>
<tr>
<td>SIZE</td>
<td>22.6952</td>
<td>22.2928</td>
<td>25.5467</td>
<td>20.1039</td>
<td>1.6424</td>
<td>41</td>
</tr>
</tbody>
</table>

Source: processed data

Based on the table above, companies in the building construction sub-sector
carry out high tax avoidance levels. This shows that the highest tax avoidance value is close to 0, namely -0.0069, and the average and median values are -0.1750 and -0.1210, respectively. Meanwhile, the value of discretionary accruals varies, with a maximum value of 0.4043, which is quite far from 0. Meanwhile, the mean value is 0.1002, and the median value is 0.0715, which is quite low because it is close to 0. Furthermore, some companies do not have an independent commissioner value, but some do have more independent commissioners than the entire board of commissioners. The next step is to perform a normality test and a heteroscedasticity test on the model to ensure that the model obtained is the best model to test the hypothesis. From the hypothesis testing that has been conducted, a summary of the hypothesis testing is obtained as follows:

Table 2 The Summary of Hypothesis Testing

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coeff.</th>
<th>t-Stat.</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>-0.8529</td>
<td>-3.2848</td>
<td>0.0022***</td>
</tr>
<tr>
<td>DA</td>
<td>-0.2065</td>
<td>-0.7787</td>
<td>0.2234</td>
</tr>
<tr>
<td>KOMIND</td>
<td>0.0315</td>
<td>0.1441</td>
<td>0.4436</td>
</tr>
<tr>
<td>DA*KOMIND</td>
<td>1.9252</td>
<td>2.5192</td>
<td>0.0111**</td>
</tr>
<tr>
<td>LEV</td>
<td>-0.1007</td>
<td>-0.8216</td>
<td>0.2114</td>
</tr>
<tr>
<td>ROA</td>
<td>1.9527</td>
<td>3.1243</td>
<td>0.0031***</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.0290</td>
<td>2.7463</td>
<td>0.0069***</td>
</tr>
<tr>
<td>R²</td>
<td>0.9136</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adj. R²</td>
<td>0.8831</td>
<td></td>
<td></td>
</tr>
<tr>
<td>F-stat.</td>
<td>29.9541</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prob(F-stat.)</td>
<td>0.0000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: *** the significant level in 1%, ** the significant level in 5%, * the significant level in 10%

The Effect of Earnings Management on Tax Avoidance

This study concludes that earnings management is not associated with tax avoidance, so H₁ is rejected. The test result is in line with Alfarizi et al. (2021), Ferdiawan & Firmansyah (2017), Henny (2019), Hutapea & Herawaty (2020), Manuel et al. (2022), and Rahmadani et al. (2020). The existence of agency problems that cause asymmetry of information obtained by shareholders can encourage managers to have motives different from those of shareholders, such as earnings management activities and tax avoidance. However, neither was carried out in the same context in this research.

This research indicates that managers in building construction subsector companies do not use earnings management to avoid taxes. Even though managers have discretion in choosing certain accounting policies, these efforts are not made to minimize the company’s tax expenses. Tax avoidance is a form of tax planning to save tax expenses (Duhoon & Singh, 2023). There are differences between several regulations regarding financial accounting standards and tax regulations in Indonesia, resulting in tax avoidance actions not being carried out through earnings management. Tax avoidance is carried out by exploiting loopholes in tax regulations in Indonesia (Manuel et al., 2022). Thus, tax avoidance and earnings management activities have different patterns, so earnings management actions are carried out
for purposes besides tax avoidance.

The Moderating Role of The Independent Commissioners on The Association Between Earnings Management and Tax Avoidance

This study found that independent commissioner strengthens the positive association between earnings management and tax avoidance, so the H$_2$ is rejected. The result of this finding is thought to be because independent commissioners rarely attend meetings and gatherings at the company, which causes the supervisory function provided by independent parties to be diluted and increases managers' opportunities to avoid taxes by earnings management. These findings also suggest that the supervisory function of the independent board of commissioner members is lacking in building construction subsector companies. The placement can also cause this lack of supervisory function or the addition of independent board members or commissioners to fulfill formal requirements (Nugroho & Firmansyah, 2017). It could also be caused by the selection or assignment of commissioner positions to building construction subsector companies that do not consider commissioners' competence and integrity but tend to be a matter of honor or appreciation only.

Another allegation is that the independent board of commissioners’ insight or knowledge regarding the company's core business is also very lacking, and this causes supervision carried out over the company’s activities to be less than optimal. Independent commissioner does not focus on earnings management actions with the aim of tax avoidance, considering that independent commissioners consider that accounting standard reporting and tax reporting are different. Another presumption is that independent commissioners are required to contribute to maximizing shareholder wealth. Tax avoidance actions are considered to increase firm value (Irawan & Turwanto, 2020; Widodo & Firmansyah, 2021). On the other hand, independent commissioners are obligated to monitor manager performance to align shareholder interests (Mahrani & Soewarno, 2018). However, independent commissioners encourage managers to avoid tax by performing earnings management actions.

CONCLUSION

The results of the study lead us to conclude that liquidity ratio as measured by This research finds that earnings management has a positive effect on tax avoidance. Managers in building construction subsector companies take advantage of tax loopholes by aligning their discretion in choosing accounting policies that can reduce the company's tax burden. Apart from that, this research also found that independent commissioner increases the positive influence of earnings management on tax avoidance. There are allegations of a lack of supervision by independent commissioners regarding manager performance and formalities in placing independent commissioners, resulting in increased profit management and tax avoidance.

This research has limitations related to the sampling criteria, reducing the number of samples used. Future research can use infrastructure sector company
data to produce more comprehensive research. Earnings management in this research uses discretionary accruals, both income decreasing and income increasing, so the goals of earnings management between the two may have different motives. Future research can use earnings management with the sole aim of decreasing income to test tax avoidance. This research suggests that the Tax Authority in Indonesia coordinates with the Capital Market Authority in monitoring earnings management actions, which impact increasing tax avoidance. The capital market authority also needs to monitor the selection of independent commissioners for listed companies.

REFERENCES


Zaman, Maharani & Firmansyah, Does Independent Commissioner...


Rahmadani, R., Muda, I., & Abubakar, E. (2020). Pengaruh ukuran perusahaan, profitabilitas, leverage, dan manajemen laba terhadap penghindaran pajak
Zaman, Maharani & Firmansyah, Does Independent Commissioner...


