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

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Abstract

This study looks at how independent commissioners can moderate the impact of earnings management on tax avoidance in the building construction subsector. This study analyzes data from building construction subsector businesses listed on the Indonesia Stock Exchange between 2017 and 2020. Of the 15 firms evaluated, 41 samples were gathered using purposive sampling, which was employed in the study. Cross-sectional data are processed using multiple linear regression. The study's finding indicates that earnings management has a favorable impact on tax avoidance. Meanwhile, the presence of independent commissioners does not increase earnings management's favorable impact on tax avoidance. This study contributes to the provision of financial accounting research findings about the role of independent commissioners in reviewing management policies in Indonesian building construction subsector enterprises.

Keywords: Corporate Governance, Earnings Quality, Tax Planning

Abstrak

Penelitian ini mencoba menguji bagaimana komisaris independen dapat memoderasi dampak manajemen laba terhadap penghindaran pajak pada subsektor konstruksi bangunan. Penelitian ini menganalisis data pada perusahaan subsektor konstruksi bangunan yang terdaftar di Bursa Efek Indonesia pada tahun 2017 hingga 2020. Dari 15 perusahaan yang dievaluasi, diperoleh 41 sampel dengan menggunakan purposive sampling yang digunakan dalam penelitian ini. Data cross-sectional diolah dengan menggunakan analisis regresi linear berganda. Temuan penelitian menunjukkan bahwa manajemen laba mempunyai dampak positif terhadap penghindaran pajak. Sementara itu, kehadiran komisaris independen tidak meningkatkan dampak positif manajemen laba terhadap penghindaran pajak. Penelitian ini memberikan kontribusi terhadap pemberian temuan penelitian akuntansi keuangan tentang peran komisaris independen dalam menelaah kebijakan manajemen pada perusahaan subsektor konstruksi bangunan di Indonesia.

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

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INTRODUCTION

The State Revenue and Expenditure Budget (APBN) includes state revenues such as taxes, customs and excise, non-tax state income, 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 Jenderal 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 Jenderal 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 profits to minimize their political costs, and paying taxes is one of those political costs (Scott, 2015).

Figure 1. Tax revenue in 2020

Source: Kementrian 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). The president-elect will continue to prioritize infrastructure development from 2019 until 2024. Mission 3 states that the goal is to create an Advanced Indonesia that is sovereign, autonomous, and has a cooperative personality.

The Directorate General of Taxes (DJP) has taken action in many large tax avoidance cases, including those 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 revelation also demonstrates the company's management's active tax-dodging tactics. Companies pay taxes based on their net profit on the income statement in their financial accounts. (Wardani et al., 2019). Profit is closely linked to taxes since the amount of tax paid is decided by the amount of profit obtained by the firm. Therefore, increasing earnings will result in more taxes 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. Managers operate according to particular reasons when their interests differ from those of shareholders (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). Earnings management by managers for tax avoidance might result in skewed earnings information. Thus, examining the association between earnings management and tax avoidance requires more inquiry.

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 strongly correlated with tax avoidance. However, multiple research indicated that earnings management is negatively related to 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 study aims to investigate the effect of earnings management on tax avoidance. This research uses independent commissioners as a moderating variable to evaluate the association between earnings management and tax avoidance, which has seldom been used in prior studies. 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 have a negative correlation with earnings management and tax avoidance. Thus, it is believed that an independent commissioner can decrease tax avoidance through earnings management.

This study adds to the financial accounting research literature on the function of independent commissioners in minimizing tax avoidance tactics carried out by earnings management, which are currently prevalent, particularly in Indonesian firms. Aside from that, the capital market supervisory authority is expected to 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

According to agency theory, managers have more perfect information than managers since their interests differ from those of their shareholders (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 results in managers implementing 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 related to 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 presence of an independent commissioner is meant to encourage and establish a more impartial and objective environment for public corporations (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. As a result, the independent commissioner is intended to be able to examine financial reporting, particularly earnings management operations, for tax avoidance purposes.

H2: Independent commissioner reduces the favorable relationship between earnings management and tax avoidance.

RESEARCH METHODOLOGY

This research was prepared using a quantitative descriptive research approach. The research object is derived from secondary data. The population studied in this study consisted of building construction enterprises registered on the IDX between 2017 and 2020. The study material is in the form of the company's yearly financial reports, gathered from the websites www.idnfinancials.com and www.idx.co.id, among other sources. Purposive sampling was used to eliminate firms that became public after January 1, 2017, and those that lost money between 2017 and 2020. The total number of samples used in this investigation is 41.

This study employs the dependent variable, tax avoidance. The independent variable is earnings management. The independent commissioner is a moderator, while leverage, profitability, and firm size are control variables. The effective tax rate (ETR) approximates the value of tax avoidance. The ETR suggests the actual tax rate paid by the corporation. According to this metric, if a company's effective tax rate is lower than its statutory tax rate, it utilizes an intervention tool to decrease its taxable revenue. In other words, the corporation engages in tax avoidance. 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).

$$\mathrm{ETR} = \frac{\text{Tax Expense}}{\text{Earning Before Income Tax}}$$

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

$$TAit = NIit - CFOit$$

Where: Tait is the Total accruals of the company i in year t, NIit = net profit of company i in year t, and CFOit = 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:

$$\frac{\mathrm{TACC_{it}}}{\mathrm{TA_{it-1}}} = \beta_1 \frac{1}{\mathrm{TA_{it-1}}} + \beta_2 \frac{(\Delta\mathrm{REV} - \Delta\mathrm{REC})_{\mathrm{it}}}{\mathrm{TA_{it-1}}} + \beta_3 \frac{\mathrm{PPE_{it}}}{\mathrm{TA_{it}}} + \beta_4 \mathrm{ROA_{it}} + \varepsilon_{\mathrm{it}}$$

In this equation, TAccit represents total accruals in company year t, TAit-1 represents total assets in company i year t-1, ΔREVit represents revenue at the company i in year t minus revenue in year t-1, ΔRECit represents receivables at the company i in year t minus receivables in year t-1, PPEit represents fixed assets in company i in year t, ROAit represents return on assets in company i in year t, and ε represents the equation's error term or residual. The above equation's residuals are used to calculate discretionary accruals. Furthermore, to eliminate the bias of earnings management conducted with declining income, the value of discretionary accruals is absolute in this study.

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).

SIZE = Natural Logarithm of Total Assets

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

$TAXAVOID_i = \beta0 + \beta1DAi + \beta2COMIND_i + \beta3DA_i{*}COMIND_i + \beta4DER_i + \beta5ROA^i + \beta6SIZE_i + \varepsilon_i$

RESULT AND DISCUSSIONS

The results of descriptive statistical tests are shown in the table below:

Table 1 Descriptive Statistics

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

Source: processed data

According to the table above, firms in the building construction subsector engage in significant tax avoidance. This demonstrates that the maximum tax avoidance value is close to zero, at -0.0069, with average and median values of -0.1750 and -0.1210, respectively. Meanwhile, the value of discretionary accruals fluctuates, with a maximum of 0.4043, far from zero. Meanwhile, the mean value is 0.1002, and the median value is 0.0715, which is relatively low because it is near zero. Furthermore, some firms have no independent commissioner value, and others have more independent commissioners than the whole 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

Variable	Coeff.	t-Stat.	Prob.	
C	-0.8529	-3.2848	0.0022	***
DA	-0.2065	-0.7787	0.2234	
KOMIND	0.0315	0.1441	0.4436	
DA*KOMIND	1.9252	2.5192	0.0111	**
LEV	-0.1007	-0.8216	0.2114	
ROA	1.9527	3.1243	0.0031	***
SIZE	0.0290	2.7463	0.0069	***
R^2	0.9136			
Adj. R^2	0.8831			
F-stat.	29.9541			
Prob(F-stat.)	0.0000			

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

The Impact of Earnings Management on Tax Avoidance

This study finds that earnings management is unrelated to 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 (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 Function of the Independent Commissioners in the Relationship Between Earnings Management and Tax Avoidance

This study found that independent commissioner strengthens the positive association between earnings management and tax avoidance, so the H2 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 do 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

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 earnings management and tax avoidance.

This research had constraints relating to the sampling criteria, which reduced the number of samples utilized. 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.

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