THE EFFECT OF ACCOUNTING COSERVATISM AND CORPORATE GOVERNANCE MECHANISM ON TAX AVOIDANCE

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ABSTRACT

In Indonesia, tax represents expenditure that reduces revenues for companies while for government, tax is a source of income. The companies adjusts income statements to minimize tax expense, thus affects net income reported. The purpose of this study is to explain the influence of accounting conservatism and corporate governance mechanism against tax avoidance. This study sampled 123 companies listed in Indonesia Stock Exchange (IDX) in 2014 until 2016. The sampling technique uses the following criteria: (1) companies listed in IDX particularly manufacturing sector; (2) having audited financial statements over the period of 2014-2016; (3) having data on managerial ownership, institutional ownership, audit quality; (4) generate consecutive earnings over the period of 2014-2016. Meanwhile, hypothesis testing used multiple regression analysis. The results of this study indicate that conservatism has no effect on tax avoidance, managerial ownership has a negative effect on tax avoidance, institutional ownership has no effect on tax avoidance and audit quality has no effect on tax avoidance.

Keywords: Conservatism, Managerial ownership, Institutional ownership, Audit Quality, Tax avoidance.

INTRODUCTION

Some giant companies stumble on tax avoidance problems in 2016 until 2017. They were, among others, Amazon and Google, and now is IKEA, a household appliance company. IKEA is accused to regulate earnings from subsidiaries with high tax rates to subsidiaries with low tax rates. IKEA management has promised to pay their tax in full and in accordance with tax regulations. Unlike IKEA, Google is doing tax avoidance strategy by establishing a marketing division in Indonesia that is not in the form of a Permanent Business Entity (BUT). Google transactions are conducted online, between customers with Google office based in Singapore. This makes it difficult for the Tax Office in Indonesia to collect tax, because there is no physical form of Google's BUT.

In Indonesia, tax represents expense that reduces revenue for the companies; while for the government, tax is a source of income. The companies adjust their income statements to minimize the tax expense, thus affects net income reported. Reduction of the tax can be done by tax avoidance. This mechanism is justified by law by utilizing the loopholes contained in tax regulations to avoid paying tax. Effective Tax Rate (ETR) is an ideal tax rate calculated in a company and is able to explain cumulative effects of various tax incentives and changes in corporate tax rates. The effectiveness of companies in managing tax is measured by comparison between the real tax paid by the companies and the net income before tax (Earning Before Tax) (Liansheng et al., 2007).

In addition, Pohan (2013) states that tax avoidance is an effort by a company using accounting methods legally in accordance with tax provision by utilizing gray area in tax law so that tax payable becomes smaller. Although tax avoidance is legal, the government still does not want it. Tax avoidance phenomena in Indonesia can be seen from its tax ratio

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(Darmawan and Sukartha, 2014). Preparation of good financial statements cannot be separated from the companies' internal control. The control within the companies can be done through Corporate Governance mechanism. Implementation of Corporate Governance mechanism is able to improve professionalism, transparency and efficiency as well as optimizing the functions of GMS, board of directors and board of commissioners (Irawan and Aria, 2012). Corporate Governance has priority on accountability and accountability of reports as well as on decision of selecting accounting methods that may influence the decision to avoid tax in the companies.

Agency theory explained that the problem of tax depend on the corporate governance. Institute owner has positive relationship with corporate tax avoidance rate (Minnick and Noga, 2010). Desai and Dharmapala (2009) stated that the tax avoidance causes the increase of agency fee. Therefore, corporate governance is necessary because arrange the corporate tax report is not easy. The effective tax fee depends on the implementation method in the use of resource. Company with high fees indicates that the management is fail in business activity which has purposes to tax avoidance (Kiesewetter and Manthey, 2018).

Accounting conservatism is used in companies because economic activities have a high level of uncertainty. Companies in Indonesia choose conservative accounting although in reality conservatism is a controversial concept because it is more likely to recognize a loss than a profit that is not yet obtained for certain. Conservatism leads to biased financial statements because it lacks of relevance and decreases quality of profits gained, so it can not be used to evaluate corporate risks. Management commitment to inform transparent, relevant and reliable financial statements is the factor determining the level of accounting conservatism in corporate financial reportings (Baharudin and Wijayanti, 2011). This causes the principle of conservatism applied by the companies will affect the financial statements that serve as the basis economic decision makings. Economic decisions taken by the company management related to tax avoidance are not done unintentionally (Budiman and Setyono, 2012). Thus, the companies that apply accounting conservatism will obtain low level of tax aggressiveness.

The hypothesis formulas for the explanation of the theory are:

H1: Accounting conservatism negatively affects tax avoidance.

H2: Managerial ownership negatively affects tax avoidance.

H3: Institutional ownership negatively affects tax avoidance.

H4: Audit quality negatively affects tax avoidance.

LITERATURE REVIEW

Conservatism

Conservatism is one of the principles used in accounting. Conservative accounting is a policy taken by companies in the face of two or more alternatives in the preparation of financial statements. If more than one alternative is available, his conservative attitude tends to choose an alternative that will not make assets and income too large. In principle, the company will recognize a loss first and suspend revenue that is not yet gained at that time. Accounting Conservatism is the practice of lowering profits and net assets in response to bad news, but not raising profits and net assets in response to good news. If associated with tax avoidance, the internal commitment of the company and management to inform transparent, accurate and non-misleading financial statements is the factor determining the level of accounting conservatism in corporate financial reporting (Baharudin and Wijayanti, 2011). However, according to Tresno et al. (2012), with the existence of government regulation, the company's tendency to avoid tax will be decreasing even though the company chooses conservative

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accounting methods. Thus, it suggests that companies applying accounting conservatism will have a low level of tax aggressiveness. Bornemann (2018) analyze the positive relationship between the decrease in corporate tax rates and the company's accounting conservatism. Conservatism that conducted by company recognizing the burden than recognizing the profit that have not been obtained yet with real so that the profit which reported is understatement.

Corporate Governance Mechanism

Corporate governance mechanism is a monitoring mechanism that aims to harmonize various interests of management and shareholders so it can minimize the management's behavior that comes from conflict of interests (Ujiyantho and Pramuka, 2007). The results of Pramudito and Sari (2015) study showed that managerial ownership negatively affected tax avoidance: the higher the managerial ownership in a company, the lower the tendency of the company to avoid tax; on the contrary, the lower the managerial ownership, the higher the tendency of the company to avoid tax. The application of Corporate Governance Mechanism used to control the agency conflict. Concentration of institutional ownership is company stocks owned by institutions (insurance companies, banks, investment companies and other institutional ownerships). The reality is that it does not show the truth for those outside the United States. Sugeng (2009) states that companies outside the United States are generally controlled by large shareholders. Institutional ownership shows a comparative ownership. The more investment given to an organization, it will surely make the monitoring system within the organization higher. In practice, institutional ownership certainly has a more effective monitoring function than the managerial ownership structure. Meanwhile, the traditional view of corporate tax avoidance show that shareholder value should increase with activity of tax avoidance. Corporate Governance mechanism becomes the benchmark in the assessment of corporate tax savings. The effect from tax avoidance is the increasing of corporate assessment. Corporate with bad governance should increase the corporate value to be better from the other corporate (Desai and Dharmapala, 2009). Quality audits on previous studies are often associated with KAP (public accounting firm) size, where a KAP that belongs to the Big Four has better audit quality compared to the Non-Big Four. This is based on the idea that the Big Four KAPs have a higher partner ratio than the Non-Big Four as well as the number of audit specializations are varied and the audit quality is more stringent than the Non-Big Four. It is hoped that good corporate governance encourages several things, one of which is to improve professionalism, transparency and efficiency as well as to optimize the functions of GMS, board of directors and board of commissioners (Irawan and Aria, 2012). Issues of accountability and responsibility are the main focus of corporate governance. This also includes decisions on the selection of accounting methods in the field of taxation that may affect the decision to avoid tax in a company. Given this good corporate governance, it suggests that tendency of company to avoid tax will be lower.

Tax Avoidance

In general, compliance to meet tax obligation is usually measured and compared to the amount of tax saving, tax avoidance and tax evasion, all of which are aimed at minimizing tax liability. This is done through several means: from tax exemptions, tax deductions, tax incentives, non-taxable income, tax suspensions, state-borne tax to co-operation with tax authorities, bribery and counterfeiting. The reduction of tax fares not identical with tax avoidance activities because there are still other factors that influence it. The presentation of excessive financial report indicates the existence of profit management practices. The profit management is possible occur through accounting methods in the process of preparing financial report. Pohan (2013) states that tax avoidance is an effort to avoid tax that is legally done and safely for taxpayers because it does not conflict with taxation provisions where the

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methods and techniques used tend to take advantage of gray areas in laws and tax regulations themselves to minimize the amount of tax payable. Tax avoidance is one of the efforts to minimize the tax liability that is often done by the company, because it is still within the frame of prevailing tax regulations. Although tax avoidance is legal, the government still does not want it. Tax avoidance phenomenon in Indonesia can be seen from its tax ratio. The tax ratio shows the government's ability to collect tax revenues or re-absorb GDP from the public; the higher tax ratio of a country, the better state tax collection performance (Darmawan and Sukartha, 2014).

RESEARCH METHOD

Population and Sampling Procedure

The population used in this study is manufacturing sector listed in the Indonesia Stock Exchange. The sample selected in this study have these criteria: (1) companies listed in IDX particularly manufacturing sector; (2) having audited financial statements over the period of 2014-2016; (3) having data on managerial ownership, institutional ownership, audit quality; (4) generate consecutive earnings over the period of 2014-2016.

Table 1. Sample selected in this study

Remarks	Amount
Total manufacturing companies	148
Companies that do not meet one of the criteria of corporate governance mechanisms	(84)
	<u>(23)</u>
Companies that suffer losses	41
Number of samples	

Type and Source of Data

In this study, the data used are secondary data in the form of annual financial statements that have been audited in the period of 2014 – 2016.

Operational Definition

Accounting Conservatism

Conservatism can be measured on the basis of the Givoly and Hayn model (2000) in order to get more accurate results. It explains that if accruals are negative, earnings are classified as conservative because profit is lower than cash flow earned by company in a certain period.

$$\text{KNSV} = \frac{\text{Net Profit} - \text{Operation Cash Flow} - \text{Depreciation}}{\text{Total Asset}} \text{ X - 1}$$

i. *Managerial Ownership is the percentage of shares owned by company management in t period.*
ii. *Institutional Ownership is percentage of shares owned by an institutional party in t period.*
iii. *Audit Quality*

Audit quality is proxied with auditor reputation indicating that the higher the audit quality, the better the reputation. To measure the audit quality, the size of Public Accounting Firm (KAP) is used. In this study, the KAP that is used as a measure is the Big Four KAPs because they have good reputation in Indonesia. Audit quality is measured by dummy variable with value 1 if it is audited by the Big Four KAPs and 0 if otherwise.

iv. *Tax Avoidance*

Tax avoidance is measured by Cash Effective Tax Rate (CETR) method. CETR is a division between tax liabilities paid with net income before tax (Swenson, 2007).

$$CETR = \frac{\text{Cash Tax Paid}}{\text{Pre-Tax Income}}$$

Cash Tax Paid = Tax liability paid in t period
Pre-Tax Income = Income before tax in t period

Data Analysis Technique

Descriptive statistical analysis is a technique that provides information about data collected and does not mean to test hypothesis. Descriptive statistics provide an illustration or a description of data (Ghozali, 2006). In addition, classical assumption test (normality, multicollinearity, autocorrelation and heteroscedasticity) are also performed. In testing the hypothesis (H1, H2, H3 and H4), this study uses multiple linear regression analysis with its equation as follows:

$$PP = \alpha + ß1KNSV + ß2MAN + ß3INST + ß4KOMIT + ß5KA + e$$

RESULTS AND DISCUSSION

Descriptive Statistics

Based on the results of descriptive statistics in Table 1.2, it can be obtained a description of each variable studied as follows: Conservatism has an average value of 0.063979 which indicates that the companies used as research sample are still less conservative in applying accounting principles in preparation of financial statements. Managerial ownership has an average value of 0.032 which means that only 3% of management owns shares of the companies. Institutional ownership has an average value of 0.424494 which means that 40% of the companies' shares are owned by institutions. Quality audit has an average value of 0.598361 which means that nearly 60% of companies used as research sample using external audit services included in the Big Four. Tax avoidance has an average value of 0.82925 which means that the companies do tax avoidance in accordance with the tax law.

Table 2. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
KNSV	122	-0,165	0,968	0,063979	0,19408
MAN	122	0	0,0672	0,032243	0,30273
INST	122	0,0003	0,9522	0,424494	0,278
KA	122	0	1	0,598361	0,49225
PP	122	0,0003	1,6582	0,82925	0,25865

Classical Assumption

Normality Test

Asymp. sig value normality test in Table 3 shows 0.707 which means that the data have been normally distributed as indicated by the asymp. sig value is above 0.05.

Table 3. Normality Test

		Unstandardized Residual
N		123
Normal Parameters(a,b)	Mean	0,0000000
	Std. Deviation	0,15228933
Most Extreme Differences	Absolute	0,158
	Positive	0,158
	Negative	-0,090
Kolmogorov-Smirnov Z		2,353
Asymp. Sig. (2-tailed)		0,709

a. Test distribution is Normal.

b. Calculated from data.

Autocorrelation

Table 5 shows DW value of 2.063. Based on Table 1.4, there is no positive or negative autocorrelation, then du < d < 4-du. du value of 1.799 is obtained from the Durbin-Watson table with a significance of 5%, resulting in 1.799<2.075 <2.201. From these results, it can be concluded that the regression model is free from autocorrelation.

Tabel 4. Durbin-Watson test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0,4953	0,24265	0,21672	1,39217	2,075

a. Predictors: (Constant), KNSV, MAN, INST, KA
b. Dependent Variable: PP

a. Heteroscedasticity

To test whether or not heterocedasticity exists, Glejser test was performed. The Glejser test proposes to regress residual absolute value of independent variable (Ghozali, 2006: 108). It can be seen from Table 1.5 that the significance value of KNSV, MAN, INST, KA > level of trust (α) is 5%. Therefore, it can be concluded that the regression model does not contain heterocedasticity.

Tabel 5. Heterokedastisitas test

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	0,136	0,046		2,931	0,00406
	KNSV	0,064	0,058	0,096	1,111	0,268
	MAN	0,025	0,060	0,060	0,431	0,666
	INST	0,073	0,066	0,370	2,598	0,470
	KA	0,066	0,023	0,251	-2,818	0,385

a. Dependent Variable: RES2

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b. Multicollinearity

Table 1.6 shows tolerance value for KNVS, MAN, INST, KA variables of 0.810, 0.511, 0.756 and 0.891. The result shows that there is no independent variable that has tolerance value < 0,1. The table also presents VIF values for KNVS, MAN, INST, KA variables at 1.223, 1.841, 1.185, 1.162. VIF calculation result also shows the same thing that there is no single independent variable that has VIF > 10. Thus, it can be concluded that there is no multicollinearity among independent variables in the regression model.

Tabel 6. Multicollinearity test

Model		Unstandardized Coefficients		Standardized Coefficients	Collinearity Statistics	
		B	Std. Error	Beta	Tolerance	VIF
1	(Constant)	0,260	0,087			
	KNSV	0,032	0,109	0,024	0,810	1,223
	MAN	0,521	0,112	0,610	0,511	1,841
	INST	0,140	0,124	0,150	0,756	1,185
	KA	0,036	0,044	0,069	0,891	1,162

a. Dependent Variable: PP

Tabel 7. Hypothesis result

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0,4953	0,24265	0,21672	1,39217

Table 8. ANOVAb

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1,964	4	0,491	9,371	0.015
	Residual	6,130	117	0,052		
	Total	8,094	121			

a. Predictors: (Constant), KNSV, MAN, INST, KA
b. Dependent Variable: PP

Table 9. Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0,260	0,087		2,997	0,003
	KNSV	0,032	0,109	0,024	0,292	0,771
	MAN	0,521	0,112	0,610	4,639	0,000
	INST	0,140	0,124	0,150	1,124	0,043
	KA	0,036	0,044	0,069	0,826	0,410

a. Dependent Variable: PP

Hypothesis 1

Accounting conservatism does not affect tax avoidance as its significant value is 0.771 > 0.05. The results of this study also support the results of research conducted by Jaya and Kartika (2013). These results suggest that the conservatism principle is not a factor that encourages companies (taxpayers) to do tax avoidance. This principle is used for governments to maximize tax revenues and to narrow the space for corporations (taxpayers) to avoid even infringe tax. This shows that the use of conservative accounting method will not increase the tendency of companies to avoid tax, because with the existence of Government Regulation, the tendency to do tax avoidance will be lower. The results of this study are also consistent with Pramudito & Sari research (2015) which found that accounting conservatism has no effect on tax avoidance. Accounting conservatism is not the cause variable that affects the companies to avoid tax. The use of the principle of accounting conservatism used by the government in terms of taxation is evident from their policies such as forming reserves of doubtful accounts except for banks and leases with option rights, mining companies with their reclamation costs and not allowing the use of LIFO method to assess inventory and use of inventory to calculate principal price, pursuant to Article 9 paragraph (1) letter c and Article 10 paragraph (6) of Law Number 7 Year 1983 regarding Income Tax which has been amended several times until the last amendment. Under the law, conservatism is not a reason for tax avoidance because accounting conservatism is used by the government to maximize tax revenues.

Hypothesis 2

Managerial ownership has an effect on tax avoidance as its significance value is 0.000 < 0.05. This result indicates that managerial ownership negatively affects tax avoidance. It also reinforces the results of research conducted by Meilinda and Cahyonowati (2013) also Sari and Martani (2010). The results of these studies indicate that the higher managerial ownership, the lower tendency of companies to avoid tax; on the contrary, the lower managerial ownership, the higher tendency of companies to avoid tax.

Hypothesis 3

Institutional ownership has no effect on tax avoidance as its significance value is 0.263 > 0.05. From t test result, t value of institutional ownership is equal to -1.659817 with significance level of 0.0987 which is smaller than alpha 0.10. Thus it means that institutional ownership has a negative effect on tax avoidance. The results of this study support the results of research conducted by Khurana and Moser (2009) in Annisa and Kurniasih (2012) stating that the amount of institutional ownership will affect the policies undertaken by companies. The existence of institutional ownership indicates institutional pressure to the management of companies to engage in aggressive tax policies to maximize profits for institutional investors. The institutional owners play an important role in monitoring, disciplining and influencing managers. This should force the management to avoid selfish behavior, but the institutional owners also have an incentive to ensure that the management makes decisions that maximize institutional shareholders' welfare, because the ownership structure has not been able to control well the management actions of its opportunistic attitude in managing profit.

Hypothesis 4

Audit quality has no effect on tax avoidance because its significance value is 0,410 > 0,05. The quality of external auditors has no significant effect on tax avoidance with opposite movement direction. This is not in line with Anisa and Kurniasih (2011) in their research which concludes that quality of external auditors has significant influence on tax avoidance. Chai and Liu (2010) in Anisa and Kurniasih (2011) state that the more qualified external auditors of a company, they tend not to manipulate corporate profits, especially for tax purposes. However, this is not yet acceptable. KAPs must also maintain credibility for their track record and continuity of service provisions. The results of this study are in line with Jaya, Arafat, and Kartika (2013) study which states that there is no significant effect on the quality of external auditors on tax avoidance. The results of this study also support Rahmi Fadilah (2014) research which shows audit quality has no significant effect on tax avoidance. The reason why the quality of audit does not affect tax avoidance is companies which are

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audited by The Big Four KAPs tend to be trusted more by tax authorities as those KAPs have high work integrity and quality by always applying prevailing rules. However, companies can provide many and better benefits to reputable KAPs for committing fraud to maximize their welfare.

CONCLUSION

Based on the above discussion, it can be concluded that conservatism has no effect on tax avoidance, managerial ownership has a negative effect on tax avoidance, institutional ownership has no effect on tax avoidance and audit quality has no effect on tax avoidance. Suggestions that can be given are to use other variables that are suspected to affect tax avoidance such as taxation and loan regulations to interested parties. It is also necessary to observe that tax avoidance activities are allowed as long as these efforts are conducted not solely to avoid tax and still within the limits of good business customs.

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