Determinant of Earning Management

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Abstract. Earnings management is an activity that manages profits according to management requirements. Several factors influence earnings management, such as earning power, tax planning, and deferred tax assets. This research aims to reexamine the influence of these three variables on earnings management. This research uses all manufacturing companies listed as population. The secondary data is obtained from the annual report and analyzed using multiple linear regression analysis. The research results show that earning power and tax planning positively affect earnings management, while deferred tax assets do not.

Keywords: Deferred tax assets, Earning power, Tax planning.

1 Introduction

Taxes are the primary source of state income, especially in Indonesia. The government sets various tax regulations to maximize state income. Nevertheless, company management wants the tax costs to be as low as possible. The tax a company pays is determined by the profit the company earns in one period. Companies will use loopholes in tax regulations to minimize the tax burden. If the taxes to be paid are burdensome, the manager will try to overcome them by doing earnings management [1].

Earnings management is an activity that manages profits according to specific goals and objectives [2]. In general, earnings management changes the numbers on financial reports or manipulates the company's accounting process [3] [4]. Tax planning and deferred tax assets influence earnings management [5]. Variables that affect earnings management are deferred tax expenses, tax planning, and deferred tax assets [2]. Earnings power and company size affect earnings management [6]. This study uses three factors influencing earnings management: earning power, tax planning, and deferred tax assets.

Earning power is the capacity to assess a company's efficiency by looking at the size of its profit generation [7]. Potential investors often use earnings power to control the efficiency in generating the size of profits. It motivates management to conduct earnings management practices that provide personal benefits and the company's market value [6]. Previous research stated that earnings power has a significant effect on earnings management [6] [7]. Meanwhile, other research confirm that earnings power fails to affect earnings management [8].

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Tax planning is a step to manage business taxpayers or a series of taxpayers so that tax debts, such as income tax and other tax costs, are minimal. Tax planning generally refers to corporate taxpayer transactions with low tax debt but still within the relevant tax law [4]. Tax planning has a positive earnings management [4], [9], [10]. Andrayani et al. (2018) research states that tax planning does not affect earnings management [11].

Deferred tax assets are income tax that is recovered in future periods. This regulation is regulated in the Statement of Financial Accounting Standards No. 46 [12]. The previous findings reveal that deferred tax assets positively affect earnings management [2], [11], [13].

The study was conducted because there were inconsistencies in previous empirical studies. Therefore, the study analyzes earning power, tax planning, and deferred tax assets' role in earnings management. The study is expected to provide theoretical benefits, namely providing a clear description and understanding of the taxation factors that influence earnings management practices. The results are expected to contribute ideas to minimize earnings management practices in attracting investors to invest in their companies.

2 Literature Review

2.1 Agency Theory

Agency theory is one of the fundamental theories used in the business world to explain the agency relationship between the principal as the owner of the company and the agent as the company's manager. Managers were signaling to maximize earnings management. The signal is given from accounting information disclosure.

2.2 Earning Power and Earning Management

Earnings power determines a company's efficiency by looking at its size in generating profits. Potential investors often use earnings power to control efficiency in generating the size of profits. This fact motivates management to conduct earnings management practices that provide personal benefits and the company's market value [6]. The high earnings power assurance a return on investment. Companies must have good performance to maximize earnings power. Earnings power positively affects earnings management, meaning that the higher the earnings power level, the more vigorous earnings management activity [6] [7]. The first hypothesis is:

H_1: Earning power has a positive effect on earnings management.

2.3 Tax Planning and Profit Management

Tax planning is the first process in implementing tax management. Tax planning as a step in managing business taxpayers or a series of taxpayers so that tax debts, such as income tax and other tax costs, are minimal [4]. Tax planning is carried out in various ways so that tax payments can be kept to a minimum and company profits can increase. The method taken by managers to minimize tax payments is an action of earnings management. Tax planning positively affects earnings management [4], [9], [10]. This result means that the better the corporate tax planning, the better the earnings management. One of the motivations for earning management is tax

motivation. Management will carry out tax planning to achieve low taxes, and it is in carrying out tax planning that profit management practices will occur. The second hypothesis is:

H_2: Tax planning has a positive effect on earnings management.

2.4 Deferred Tax Assets and Earning Management

Deferred tax assets due to future income tax effects [2]. Deferred tax assets are the income tax that is recovered in future periods. These provisions are regulated in the tax regulations in the Statement of Financial Accounting Standards No. 46 established by the Association of Indonesian Accountants [12]. Deferred tax assets positively affect earnings management [2], [11], [13]. This is because deferred tax assets whose amounts are increased by management are motivated to minimize tax payments so as not to harm the company. The third hypothesis is:

H_3: Deferred tax assets have a positive effect on earnings management.

3 Methodology

The population is manufacturing companies. Based on purposive sampling, the sample used in this research was 99 observation data based on predetermined criteria. Earnings management as a dependent variable. One method for determining earnings management is identifying earnings thresholds [2].

The independent variables include earning power, tax planning, and deferred tax assets. Earnings power determines a company's efficiency by looking at its size in generating profits. Earning power is measured using net profit and total assets [8]. Tax planning is an action that aims to minimize tax obligations by manipulating financial reports so that they can be reduced as low as possible. Tax planning measures the effectiveness of tax management in the current year's financial statements [2]. Deferred tax assets are the effects of income tax in the future. Deferred tax assets are the difference between deferred taxes in the current period and previous periods. Tax assets proxied the value of deferred tax assets at period t with t-1 divided by the value of deferred tax assets period t-1 [2]. The analysis method uses multiple linear regression. Before carrying out the multiple linear regression test, this study carried out classical assumption testing to know, test, and ensure the feasibility of the regression model.

4 Result and Discussion

Descriptive statistics are presented in Table 1.

Table 1. Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Dev
Earning Power	99	0.010	0.092	0.011	0.012
Tax Planning	99	0.017	0.018	0.073	0.017
Deferred tax assets	99	-0.062	0.092	0.038	0.013
Earning Management	99	-0.070	0.021	0.028	0.047

Source: processed data.

The earning power variable has an average value of 0.011, which indicates a relatively low number, while tax planning has a mean value of 0.073. The deferred tax assets variable has a mean value of 0.038, also the mean value for earnings management is 0.028. The result of regression analysis is shown in Table 2.

Table 2. Multiple Linear Regression Test Results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-3.097	1.956		-1.584	0.117
	Earning Power	0.146	0.036	0.375	4.098	0.000
	Tax Planning	0.060	0.026	0.215	2.340	0.021
	Deferred tax assets	-0.003	0.003	-0.085	-0.931	0.354
	Adjusted R-Square	0.455				
	F-test	8.279				
	Sig.	0.000				
a. Dependent Variable: ML						

The result of the coefficient of Adjusted R Square value is 0.455. This figure means the variables explain 45.5% of the earnings management (ML) variable.

4.1 Discussion of Research Results

The first hypothesis shows that the earning power variable has a positive regression. Based on these results, the earning power variable positively affects earnings management, or in other words, H1 is accepted. Potential investors often use earnings power to control efficiency. This motivates management to conduct earnings management practices that provide personal benefits and the company's market value [6]. The company generates good profits every year as a way to attract investors. Measuring profit capability by comparing a company's net profit with its income is effective and can illustrate the ability of management's income to generate company profits [7]. The results support the previous finding states earning power positively affects earnings management [6] [7].

The second result has a positive coefficient, which means the tax planning variable positively affects earnings management, or in other words, H2 is accepted. Tax planning is the process of implementing tax management. Tax planning is a step in managing business taxpayers or a series of taxpayers so that tax debts, such as income tax and other tax costs, are minimal. Tax planning generally refers to corporate taxpayer transactions with low tax debt but still within relevant tax laws [4].

The third results show that the deferred tax assets variable has a negative regression coefficient. Based on these results, it can be concluded that the deferred tax asset variable does not affect earnings management; in other words, H3 is rejected. Suppose later differences arise, which result in income tax obligations decreasing or after an audit in a more minor tax assessment. It will not be a problem, but if the opposite is true, it could hang around for years. New deferred

tax assets are recognized in the following years, so there will be more accumulation. Thus, financial reports become doubtful and not credible, which will attract the attention of interested users, such as creditors or shareholders, thereby reducing the level of trust of creditors or shareholders in the financial reports presented [14].

5. Conclusion

The study determine the role of earning power, tax planning, and deferred tax assets on earnings management. The results show that earning power and tax planning positively affect earnings management meanwhile not deferred tax assets. Limitations and suggestions in the research namely, first, manufacturing companies publish incomplete financial reports so that all the information needed by users of financial reports is limited, and this means that many companies cannot be sample companies because of these limitations. Further researchers are advised to look for other sources to complete the data. It was second, based on the R Square value of 45.5%, which means that other independent variables outside the research explain the rest. It is hoped that future studies add other independent variables, such as managerial ownership, company size, independent commissioners, board of directors, audit committee, tax incentives, and non-incentives.

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