The Effect of Executive Narcissism and Characteristics of External Auditors on Foreign Ownership on Tax Avoidance as Moderating Variable (A Study on Energy Sector Companies of the Indonesian Stock Exchange)

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Abstract. The study aimed to examine the impact of executive narcissism and external auditor characteristics on foreign ownership of tax avoidance as moderating variables. This study used a quantitative method with IDX-listed energy sector companies for 2016-2020 as the research objects. The study revealed that executive narcissism affected tax avoidance, while external auditor characteristics with three different proxies presented no effect on tax avoidance. Besides, foreign ownership could not moderate the impact of executive narcissism and external characteristics on tax avoidance.
Keywords: Tax Avoidance, CEO Narcissism, Auditor Education, Auditor Gender, Auditor Tenure, Foreign Ownership.

1. Introduction

Tax revenue is the most significant state revenue in Indonesia. However, it still becomes a problem when the level of revenue is less maximum. In 2021, based on data from the Central Statistics Agency in Indonesia, the tax ratio was recorded at 9.11 percent of GDP (Gross Domestic Product). The energy sector is one of Indonesia's significant contributors to state tax revenues. It is due to the product's high economic value and taxes in almost all activities, both income tax and other central and regional taxes. Thus, companies try to avoid taxes engaged in this sector.

Tax avoidance is an action to reduce the amount of tax owed by taking advantage of loopholes in tax regulations so that it is legal to do so [1]. Tax avoidance differs from *tax evasion* in that *tax evasion* refers to efforts to reduce the tax payable by violating tax regulations [2].

The executive, as the tone at the top of the company, plays an essential role in the strategy and governance of the company they lead. Managers as agents can be involved in conflicts of interest with company owners [3]. Corporate executives' narcissistic nature can affect their performance and policies. Narcissistic individuals may make unethical and moral

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decisions and manipulate policies to achieve goals [4],[5],[6],[7], including tax avoidance policies. The author finds *a research gap* in the correlation between the effect of executive narcissism and external auditor characteristics. Meanwhile, there are limited empirical studies discussing CEO narcissism, and none of the studies on CEO narcissism and accounting. Around 2010, no published studies focused on the correlation between narcissism and accounting [8].

External auditors based on agency relations serve as agents who ensure that financial statements are prepared somewhat based on generally accepted standards. However, external auditors tend to be involved in corporate tax planning [9],[10]. In research on the size of KAP as a proxy for external auditors, a study by Li and Lin (2005) in Alves (2013) found that companies audited by Big 5 offices reported more earnings management. Anne et al. in Alves (2013) discovered that Big 6 office clients have higher abnormal accruals than clients from other KAPs [11]. Together with previous studies, a larger KAP can contribute to reducing or increasing earning management, which is associated with tax avoidance in the context of this research.

The ownership structure affects the fulfillment of the company's tax obligations ([12]. Besides, creating an efficient environment and sustainable company growth [12] and management affect the decisions, including tax avoidance actions [12]. In particular, foreign owners are more helpful in understanding corporate strategies, such as tax avoidance, procedures, and increasing shareholder wealth [13].

Therefore, the researchers are interested in analyzing the characteristics of external auditors and their effect on tax avoidance. This study aims to analyze the effect of executive narcissism and external auditor characteristics on tax avoidance and the moderating effect of foreign ownership on the effect of executive narcissism and external auditor characteristics on tax avoidance. The research method uses quantitative secondary data determined by the purposive sampling method.

2. Methods

This study was conducted using quantitative methods on a particular population or sample. The data were collected from secondary data from the Indonesia Stock Exchange website or the website of each sample company. The sample was determined by purposive sampling method by setting criteria, such as the sample was a company listed and included in the energy sector company on the Indonesia Stock Exchange, consistently displayed comprehensive annual reports along with financial statements that had been audited during the 2016-2020 period, and obtained a CETR value below 1. Based on these criteria, 85 observations were obtained. The data was then processed using *Eviews 10* software. In data processing, classical assumption, regression model selection, and hypothesis testing were carried out. The classical assumption test conducted a normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test. In the regression model selection test, the Chow and Hausman test was carried out to select the regression model. In the hypothesis test, an MRA (moderated regression) test was carried out to test the effect of the independent variable on the dependent variable and also tested the effect of the moderating variable on the effect of the independent variable on the dependent variable. The independent variables included in this study were executive narcissism (X1) and three variables that represented the characteristics of external auditors, namely auditor education level (X2), auditor gender (X3), and auditor tenure (X4). The dependent variable included in this study was tax avoidance (Y), measured by the Cash-Tax Effective Rate (CETR). Meanwhile, the moderating variable was foreign ownership (M), measured by comparing the number of foreign shareholdings to the total number of outstanding shares. The author also used some control variables to prevent bias calculations, including firm age (AGE), firm size (SIZE), political connections, leverage, capital expenditure, and asset return.

3. Results and Discussion

3.1 Descriptive Statistical Analysis

Based on the data processing results, the average executive narcissism and the level of auditor education represented by auditor education level, auditor gender, and auditor tenure were 2.80, 0.05, 0.07, and 1.58, respectively. The average tax avoidance was 0.32, and the average foreign ownership as a moderating variable was 0.20.

3.2 Normality test

Based on the results, the probability value of the Jarque-Bera test showed a probability result above 0.05, so it can be drawn that the data from this study were normally distributed. The following presents the results of the normality test:

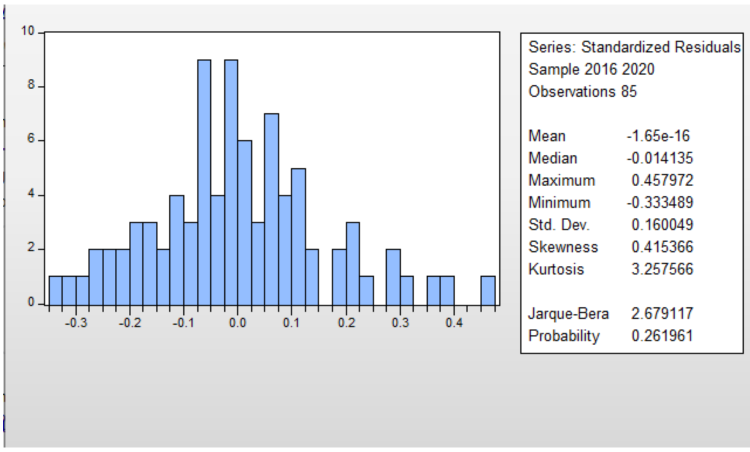

Figure 1. Normality Test

3.3 Multicollinearity Test

Based on the test, there were no symptoms of multicollinearity because the value of the Variance Inflation Factors (VIF) was less than 10. The following are the results of the multicollinearity test:

Table 1. Multicollinearity Test

Variance Inflation Factors

Samples: 1 85

Included observations: 85

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.476441	1068,737	NA
CEOPHOTO	0.001364	25.20434	1.209808
AUD_EDU	0.013262	1.399982	1.334101
AUD_GENDER	0.008205	1.299122	1.207419
AUD_TENURE	0.001088	7.119958	1.055159
AGE	4.92E-06	10.32502	1.381322
CAPEX	0.011215	6.566287	1.616698
LEV	0.031200	2.720872	1.346250
POLCON	0.002189	2.022136	1.189492
ROA	0.106170	3.023052	1.313036
SIZE	0.000509	994.9797	1.418177
FOREIGN	0.012153	2.891468	1.803671

3.4 Heteroscedasticity Test

In the heteroscedasticity test, there were no symptoms of heteroscedasticity. It was concluded that based on the results of the Glejser Test, the probability value was more significant than 5% for all variables included in this study. The following are the results of the heteroscedasticity test:

Table 2. Heteroscedasticity Test

Dependent Variable: ABSRES

Method: Least Squares Panel

Samples: 2016, 2020

Periods included: 5

Cross-sections included: 17

Total panel (unbalanced) observations: 83

Variable	Coefficient	Std. Error	t-Statistic	Prob.

X1	0.028897	0.033771	0.855672	0.3962
X2	0.040736	0.097721	0.416866	0.6785
X3	0.058827	0.071294	0.825137	0.4131
X4	0.033865	0.024948	1.357450	0.1806
XC_AGE	0.007458	0.013902	0.536450	0.5940
XC_CAPX	0.290568	0.289597	1.003352	0.3204
XC_LEV	0.034420	0.183288	0.187794	0.8518
XC_POLCON	0.018921	0.075048	0.252115	0.8020
LOG_XC_ROA	-0.038103	0.025383	-1.501101	0.1395
XC_SIZE	0.012992	0.082913	0.156692	0.8761
XM	0.239869	0.390266	0.614630	0.5415
XI_X1	-0.064145	0.119580	-0.536416	0.5940
XI_X2	-75.14018	430.0500	-0.174724	0.8620
XI_X3	-0.127742	0.466987	-0.273545	0.7855
XI_X4	0.044540	0.073688	0.604444	0.5482
C	-0.871886	2.272534	-0.383662	0.7028

3.5 Model Test of Panel Data Regression

The Chow test resulted in a decision to use the common effects model or the fixed effects model used in hypothesis testing using panel data. The results obtained from the Chow test for using the fixed effects model and the regression model test were followed by the Hausman test. The Hausman test was carried out to decide whether to use the random or fixed effects model. Based on the results of the Hausman test, the decision was obtained to use the fixed effects model and not continue with the Lagrange multiplier test because the Hausman test had obtained a regression model decision.

Hypothesis testing

Test R^2

Based on the results of the R^2 test, the R^2 coefficient value was 0.805. This result proved that the independent variable's ability to explain the dependent variable was 80.5%, and other unstudied variables explained the remaining 19.5%.

F test

Here are the results of the F test:

Table 3. F. test

Dependent Variable: LOG_Y

Method: Least Squares Panel

Samples: 2016, 2020

Periods included: 5

Cross-sections included: 17

Total panel (balanced) observations: 85

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG_X1	-2.866024	0.904290	-3.169362	0.0025
X2	-0.259301	0.877511	-0.295496	0.7688
X3	-1.243648	0.637782	-1.949959	0.0565
X4	-0.260613	0.222890	-1.169246	0.2475
XC_AGE	0.334402	0.118614	2.819258	0.0068
XC_CAPX	0.299229	2.489283	0.120207	0.9048
XC_LEV	-0.795084	1.559417	-0.509860	0.6123
XC_POLCON	-0.044691	0.663367	-0.067370	0.9465
XC_ROA	0.735297	2.215763	0.331848	0.7413
XC_SIZE	-1.324248	0.694073	-1.907936	0.0618
XM	-3.279031	3.410786	-0.961371	0.3407
XI_X1	1.035825	1.090731	0.949662	0.3466
XI_X2	-489.7617	3843,804	-0.127416	0.8991
XI_X3	7.997854	4.195869	1.906126	0.0621
XI_X4	0.028415	0.644838	0.044066	0.9650
C	31.27827	18.70130	1.672519	0.1003

Based on the F test result, the F's probability value on the executive narcissism variable was 0.0025 or smaller than 0.05. Therefore, it was obtained that executive narcissism significantly affected tax avoidance. Meanwhile, on other variables, there was no effect on tax avoidance, including three variables that represented the characteristics of external auditors.

4. Discussion

Based on the results of hypothesis testing, it was discovered that executive narcissism affected tax avoidance and was negatively related to tax avoidance. The more narcissistic the company's executives were, the more companies tended to do tax avoidance. It could also be drawn that executive narcissism was a determining factor in tax avoidance practices by companies. Since tax avoidance is a legal practice [14],[15],[16],[17], tax avoidance is an achievement for executives who successfully implement and successfully reduce their tax payable, which is also consistent with the assumption that narcissistic executives need recognition [18]. However, the authors did not find the effect of external auditor characteristics on the three variables of tax avoidance. Thus, the characteristics of external auditors were not a determining factor for corporate tax avoidance practices. The author also revealed that foreign ownership did not moderate the effect of executive narcissism, auditor education level, and auditor tenure on tax avoidance. However, the authors found a moderating effect of foreign ownership on the effect of auditor gender on tax avoidance.

5. Conclusions and Suggestions

The study discovers the effect of executive narcissism on tax avoidance, meaning that executive narcissism is not a determining factor of tax avoidance. Meanwhile, the characteristics of external auditors do not determine the practice of tax avoidance. Foreign ownership cannot moderate the effect of most independent variables on tax avoidance. Thus, the authors suggest that several parties, including companies, provide space for the widest possible expression and for executives to show in the public sphere to improve their self-image, which impacts their performance. Public accounting firms are expected to provide equal career opportunities for both men and women, according to their educational backgrounds. For the government, it is expected to design a policy that narrows the gaps for companies to avoid tax by studying the characteristics of the agents involved in operating the company so that state losses due to tax avoidance activities can be minimized. Finally, future researchers must explore other calculations in measuring tax avoidance and other variables. Future researchers can also add variables that are more commonly discovered in society, such as tax compliance or tax collection and auditing practices. Future researchers can also use different sectors and years of observation to increase the uniqueness of the research results. Finally, further researchers can also use different software to get different results to enrich the literature on the topic of tax avoidance.

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