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Earnings Management and Tax Aggressivity before and During the Covid-19 Pandemic (an Evidence from Indonesia)

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ABSTRACT: Companies facing financial crises tend to manipulate reported earnings in unfavorable markets. Earnings management is an effort to manage earnings by managers to meet the expected profit level to obtain personal gain. The Covid-19 pandemic has caused the government to issue various tax incentives that individuals and companies can utilize. Under these conditions, management as an internal party can manage earnings to meet its expectations. This study examines differences in earnings management before and during the Covid-19 pandemic and the effect of earnings management on tax aggressiveness. The data from this study are the financial statements of manufacturing companies listed on the Indonesia Stock Exchange. The sampling method is purposive sampling. The analytical method used is the comparative test and multiple regression analysis. The results of this study are the same in the level of tax avoidance, accrual earnings management, and actual management before and during the Covid-19 pandemic. This study also concludes that real earnings management negatively affects tax aggressiveness, while accrual earnings management does not. This research indicates that the government needs to increase supervision and control over the possible tax avoidance that companies can carry out. While accrual earnings management does not. This research indicates that the government needs to increase supervision and control over the possible tax avoidance that companies can carry out. While accrual earnings management does not. This research indicates that the government needs to increase supervision and control over the possible tax avoidance that companies can carry out.

Keywords: Earnings Management, Tax Aggressiveness, Pandemic, Covid-19

INTRODUCTION

Financial performance and market activity have been adversely affected by the Covid-19 pandemic (Estrada et al., 2020). Covid-19 has had significant adverse effects on several companies, resulting in financial losses and the closure of operations. Since the outbreak of Covid-19, the government

has instructed policies that limit community mobilization. People are advised to stay indoors to prevent the transmission of the Covid-19 virus. As a result, the company experienced a sharp decline in revenue because buying and selling activities were disrupted, which affected the company's profits.

Profit is an important item in financial statements and is believed to be a measure of the performance of an entity (Cohen, 2010; Haque, 2016). Profit is considered a benchmark for achieving performance for an entity. (Lev, 1989) states that an increase in an entity's profit is a good signal that the company's performance is increasing. Conversely, a decrease in profit indicates that the company's performance is declining. It causes management to be motivated to engage in deviant behavior. Managers carry out earnings management so that financial reports are good.

Companies facing financial crises tend to manipulate reported earnings in response to a negative market environment (Ait Novatiani et al., 2022; Choi et al., 2011). Earnings management attempts to manipulate profit managers to meet the expected profit level to obtain personal gain (Pipatnarapong et al., 2020; Schipper, 1989). Internal parties, such as managers, have more information than external parties. To take advantage of this information asymmetry, managers may resort to opportunistic behavior, such as taking personal advantage under the guise of compensation. Managers, acting in the capacity of agents assigned to oversee company operations, are frequently faced with conflicts of interest. According to Jensen and Meckling (Jensen & Meckling, 1976),

(Gunny, 2010) and (Kim et al., 2018) stated that earnings management is divided into accrual and real earnings management. The practice of accrual earnings management is legal because it is under the umbrella of Generally Accepted Accounting Principles (PABU). Accrual earnings management can be done by modifying the accumulation of income or expenses in financial accounts (Badertscher, 2011). Accrual earnings management arose because management could adopt an accounting system to help them achieve their financial goals. In contrast, actual earnings management is the practice of managing earnings badly. Managers generate actual profits in a variety of ways, including through unconventional methods such as the use of time and operating structures, investments,

On the other hand, the Covid-19 pandemic has prompted the government to carry out various initiatives to maintain economic stability, such as providing tax subsidies to taxpayers, especially business taxpayers, so that the economy does not fluctuate (Keuangan, 2020). Incentive package that includes reduced corporate tax rates and import taxes. Minister of Finance Regulation Number 23 of 2020, later replaced by PMK Number 110 of 2020, regulates the provision of tax incentives during a pandemic.

Company managers can use tax avoidance techniques to respond to tax incentives during a pandemic. (Kovermann & Velte, 2021; Shackelford & Shevlin, 2001) state that managers are faced with a trade-off when determining the amount of profit in financial statements with tax reporting. Managers who want to reduce corporate taxes will issue or delay revenue recognition and speed up expense recognition to lower profits and taxes. (Abdelfattaha & Aboud, 2020; Kovermann & Velte, 2021; Pipatnarapong et al., 2020; Ravenda et al., 2020) stated that increasing tax rates could reduce company profits. Taxes payable include items that maximize business value as long as the

benefits outweigh the costs. (Desai & Dharmapala, 2009; Suk et al., 2021). Shareholders will also encourage management to manage the tax burden to be competitive (H. Chen et al., 2021).

In addition, managers can use tax incentives to carry out tax avoidance operations. (Frank et al., 2009) define tax aggressiveness as an act of reducing the tax burden legally or illegally by a company. Companies can exploit tax laws to their advantage because there are usually loopholes or loopholes that can be exploited. Tax aggressiveness is part of aggressive tax avoidance(Rusli, 2021) states that tax evasion is more common during a pandemic. The work-from-home policy implemented during the pandemic can also decrease control over tax service activities. During the pandemic, (Rusli, 2021) also stated that the government provided many incentives to implement incentives at a fast pace.

Accrual-based earnings management has increased while actual-based earnings management has experienced a significant decline in companies infected with Covid-19, according to research conducted by (Xiao & Xi, 2021) with a company background from China. Aspects of corporate governance and Corporate Social Responsibility (CSR) are also studied as moderating variables in the study of (Xiao & Xi, 2021). In the era of Covid-19, (H. Chen et al., 2021; S. Chen et al., 2010) stated that opportunistic management behavior increased after the Covid-19 crisis because managers were more willing to take advantage of the situation to maximize their profits. The opposite result, (Azizah, 2021) found that earnings management in Indonesia was different between the first quarter of 2019 (before the pandemic) and the first quarter of 2020 (during the pandemic). During a pandemic, earnings management practices have decreased because managers are more careful in managing their earnings. (Firmansyah, 2020) came to a different conclusion stating that there is no difference between accrual and actual earnings management in the pandemic era.

Then a study on tax aggressiveness during the Covid-19 pandemic was conducted by (Rusli, 2021), who compared Indonesia and Malaysia using financial performance as a moderating variable. According to the conclusions of this study, capital intensity, inventory intensity, and sales growth in Indonesia and Malaysia all contribute to tax aggressiveness. According to (Firmansyah, 2020), the level of tax evasion before and after the pandemic was similar. (Simamora & Rahayu, 2020) shows that actual earnings management does not affect tax evasion. In comparison, (Machdar, 2019) found that both types of earnings management, accrual and actual, affect tax evasion.

There needs to be more consistency in the results of previous studies. This study tries to reduce the gap in research results and uses earnings management and tax aggressiveness variables before and during the pandemic. This study relies on the Indonesian stock market for its data, namely the Indonesia Stock Exchange (IDX). Covid-19 has had the most significant impact on the manufacturing industry, so we chose this sector. Manufacturing companies consist of different types of industries, namely consumer goods, basic and chemical industries, and other industrial sectors. (Nurhaliza, 2021) stated that manufacturing companies experienced a decline in revenue of around 90% due to Covid-19. Previous studies in Indonesia only used companies in the consumer goods industry sector. This study tries to expand the research object, namely the manufacturing sector.

METHOD

This study used a purposive sampling method in sampling. The criteria set are manufacturing companies with complete data listed on the IDX in 2019 and 2020.

This study has two main variables to calculate tax aggressiveness: earnings management and tax aggressiveness. Earnings management is divided into two, namely accrual earnings management and actual earnings management (Gunny, 2010). (Gunny, 2010) explains that accrual earnings management is a legal earnings management practice because this practice is still within the scope of generally accepted accounting principles. Unlike the case with actual earnings management, which includes illegal practices, managers carry it out to achieve the desired profit level through deviant actions.

Tax aggressiveness is reducing taxable income designed through tax planning, whether using methods classified as legal (tax avoidance) or: tax evasion). There are two proxies: the effective tax rate and the cash effective tax rate.

The formula for calculating the Effective Tax Rate used in (Hidayati & Fidiana, 2017) is as follows.

$$ETR = \frac{Beban\ Pajak\ Penghasilan}{Laba\ sebelum\ pajak}$$

Meanwhile, the second proxy for tax aggressiveness is the cash effective tax rate (Cash ETR), which describes the ratio of taxes paid by companies per rupiah of income received (Cheng et al., 2012). Low Cash ETR values can indicate tax evasion practices.

$$Cash\ ETR = \frac{Pajak\ Penghasilan\ Yang\ Dibayar}{Laba\ sebelum\ pajak}$$

Then, accrual earnings management in this study uses discretionary accruals using the model in Kothari et all (2005) or performance-matched discretionary accruals. This proxy is also used by (Firmansyah, 2020). The equation used to calculate the value of discretionary accruals is as follows.

$$\frac{Accruals}{TA\ t-1} = \beta 0 \left(\frac{1}{TA\ t-1}\right) + \beta 1 \left(\frac{\Delta REV - \Delta REC}{TA\ t-1}\right) + \beta 2 \left(\frac{\text{PPE}}{TA\ t-1}\right) + \beta 3\ ROA + \varepsilon$$

Information

accruals : *income after tax- cash from operations*

TA t-1 : total assets of the company in the previous year

ΔREV : change in income from the previous period

ΔREC : change in accounts receivable from the previous period

PPE *: plant, property,* and equipment

ROA : return on assets is obtained from net income divided by total assets

Meanwhile, actual earnings management in this study follows Zang (2011) by adding up abnormal overproduction and discretionary expenses. This study uses estimates for normal production costs according to research by Roychuwdury (2016). The formula used to obtain the abnormal overproduction value is as follows.

$$\frac{Prod}{At-1} = \alpha 0 + \left(\frac{1}{At-1}\right) + \beta 1\left(\frac{St}{At-1}\right) + \beta 2\left(\frac{\Delta St}{At-1}\right) + \beta 2\left(\frac{\Delta St-1}{At-1}\right) + \varepsilon$$

Information:

Prod/At-1 : production costs in year t scaled by total assets in year t-1 where PRODt = COGSt+ΔINVt

1/At-1 : intercept that is scaled by total assets in year t-1 with the aim that operating cash flows do not have a value of 0 when sales and running lag are 0

St/At-1 : sales in year t scaled by total assets in year t-1

ΔSt/At-1 : sales in year t minus sales in year t-1 scaled by total assets in year t-1

ΔSt-1/At-1 : change in sales in year t-1 scaled by total assets in year t-1

$\alpha 0$: Constant

ε : error in year t

If the residual result is positive, the company takes real earnings management actions by manipulating production costs. Based on Roychuwdury (2006), earnings manipulation by reducing discretionary expenses is calculated using the following formula.

$$\frac{DISEXPi}{At-1} = \alpha 0 + \alpha 1\left(\frac{1}{At-1}\right) + \beta\left(\frac{St}{At-1}\right)i + \varepsilon$$

Information:

DISEXP/ At-1: discretionary expenses are defined as the sum of advertising expenses, research and development expenses, selling expenses, and administrative and general expenses t scaled by total assets in year t-1

1/At-1: intercept scaled with total assets in year t-1 with the aim that operating cash flow does not have a value of 0 when sales and sales lag are 0

St/At-1: sales in year t scaled by total assets in year t-1

$\alpha 0$: Constant

ε : residual in year t

If the residual value is negative, it indicates that the company is taking real earnings management actions through discretionary expense manipulation, then the value is multiplied by -1.

This study uses control variables: profitability, firm size, and leverage. Profitability is measured using Return On Equity (ROE), which compares profit after tax with the company's total equity.

$$ROE = \frac{Laba\ Bersih}{Ekuitas}$$

While the company's size uses the natural asset logarithm, the third control variable is leverage, measured by the debt-to-equity ratio (DER) with the following formula.

$$DER = \frac{Total\ Liabilitas}{Ekuitas}$$

The statistical analysis method used in this study consists of classic assumption tests and hypothesis testing. Hypothesis testing on hypotheses 1, 2, and 3 in this study was made using a different test. Meanwhile, testing for hypotheses 4 and 5 was carried out using multiple linear analyses. The research model is as follows.

Model 1

$$\text{ETRit} = \beta 0 + \beta 1 AEMit + \beta 2 REMit + \beta 3 ROEit + \beta 4 DERit + \beta 5 SIZEit$$

Model 2

$$\text{Cash ETRit} = \beta 0 + \beta 1 AEMit + \beta 2 REMit + \beta 3 ROEit + \beta 4 DERit + \beta 5 SIZEit$$

Information:

ETR : tax avoidance using *effective tax rate* company i in year t

Cash ETR : tax avoidance using *cash effective tax rate* company i in year t

AEM : company i accrual earnings management in year t

AEM : actual earnings management of company i in year t

ROE : profitability of company i in year t

DER : leverage of company i in year t

SIZE : the size of the company i in year t

RESULT AND DISCUSSION

Table 1 shows descriptive statistics for each variable in the pre-pandemic period.

Table 1. Variable Descriptive Statistics Before the Pandemic

	N Valid	Means	Median	Mode	Std. Deviation	Minimum	Maximum
ETR 2019	200	,2565330	,0200800	,00000a	,71950793	-3.37055	6.93455
CTR 2019	200	,1817500	,1994550	,00000	1.06269304	-5.52588	7.62781
AEM 2019	200	,0000003	-,0005900	,02962a	,11006349	-,47995	,65368
REM 2019	200	,0000009	,0680200	-,00353	,28558980	-1.38484	,66504
PRODS 2019	200	,0000003	,1412500	,00240a	,60268114	-3.10594	1.05823
DISEXP 2019	200	-,0000001	-,0261650	,00946a	,21742316	-,52730	1.33310
ROE 2019	200	,0484097	,0643150	,09864a	,38122668	-2.89562	2.02779
DER 2019	200	1.1129604	,8787800	,08117a	1.18027923	-2.54227	8.23216
2019 sizes	200	28.1345614	28,1949250	26.50683a	2.21565671	16.06332	32.40329

Source: processed data

Table 2 shows descriptive statistics for each variable in the period during the pandemic

Table 2. Descriptive Statistics During the Pandemic

	N Valid	Means	Median	Mode	Std. Deviation	Minimum	Maximum
ETR 2020	200	,2229400	-,0307600	-,15451a	1.23040438	-9.68534	8.03168
CETR 2020	200	,2322691	.0541850	,00000	1.56154568	-9.61590	8.44500
AEM 2020	200	,0000002	1.1247200	-70.32097a	10.04207386	-70.32097	32.80996
REM 2020	200	,0000007	1.4656050	-87,67827a	21.99990091	-87.67827	166.87846
PRODS 2020	200	-,0000002	2.4466400	-130.3542a	44.58513750	-130.3542	330,65192
DISEXP 2020	200	,0000002	-,3531650	-21.30531a	8.55472511	-21.30531	52.02845
2020 ROEs	200	-,0966620	.0326750	-,14445a	1.05765451	-9.22724	2.03554
DER 2020	200	1.2176699	,8514900	,08978a	1.88620117	-6.30052	10.41667
2020 SIZES	200	28,1108370	28.1442750	26.54570a	2.29091571	16.09223	32.72561

Source: processed data

Table 3 shows descriptive statistics before and during the pandemic

Table 3. Descriptive Statistics Before and During the Pandemic

	N Valid	Means	Median	Mode	std. Deviation	Minimum	Maximum
ETR	400	,1394140	-,0010500	,00000	1.00667024	-9.68534	8.03168
CETR	400	,2070095	,1292400	,00000	1.33418120	-9.61590	8.44500
AEM	400	,0000003	.0662750	,02962a	7.09234063	-70.32097	32.80996
BRAKE	400	,0000008	,1387100	-,00353	15.53808186	-87.67827	166.87846
PROD	400	,0000000	,2201650	,00240a	31.48979802	-130.3542	330,65192
DISEXP	400	,0000000	-,0573350	,00946a	6.04347000	-21.30531	52.02845
ROE	400	-,0241262	.0475050	-,14445a	,79729175	-9.22724	2.03554
DER	400	1.1653151	,8662250	,08117a	1.57224388	-6.30052	10.41667
SIZE	400	28.1226992	28,1730400	26.50683a	2.25080590	16.06332	32.72561

a. Multiple modes exist. The smallest value is shown

Table 4 Summary of "Ranks" Comparative Test

Var	Negative Ranks			Positive Rating			ties
	Q	Means	sum	Q	Means	sum	Q
ETR	106	103,39	10959	92	95.02	8742	2
CETR	109	95.63	10424	87	102.09	8882	4
AEM	37	108.97	4032	163	98.58	4032	0
BRAKE	64	124.95	7997	136	88.99	12103	0
PROD	73	124.66	9100	127	88.61	11000	0
DISEXP	132	112.81	14891	68	76,6	5209	0

Table 5 Comparative Test Summary

Variable	Wilcoxon Asymp.Sig. (2-tailed)
ETR	0.170
CETR	0.332
AEM	0.000
BRAKE	0.012
PROD	0.246

DISEXP	0.000

Source: Processed data

Table 6 shows no difference in tax aggressiveness before and during the pandemic using the Effective Tax Rate (ETR) and the Cash Effective Tax Rate (CETR) because both values were above the significance value of 0.05. Meanwhile, in terms of earnings management, both accrual earnings management (AEM) and actual earnings management (REM), there are differences between the period before and during the Covid-19 pandemic. There was no difference in actual profit management proxied by production expenses before and during the pandemic. In contrast, actual profit management proxied by discretionary expenses showed a level of difference between before and during the pandemic.

Table 6 Summary of Hypothesis Testing 4 and 5

Var	Model 1 (ETR)				Model 2 (CETR)			
	Coeff	t-stat	Prob		Coeff.	t-stat	Prob	
C	1.575	2,509	0.012		0.446	0.551	0.582	
AEM	0.001	0.184	0.427		0.024	2,644	0.005	**
BRAKE	-0.001	-0.269	0.394		0.010	2,435	0.008	**
ROE	0.157	2,437	0.008	**	0.119	1,436	0.078	*
DER	0.044	1.316	0.095	*	0.147	3,411	0.001	**
SIZE	-0.057	-2,565	0.006	**	-0.014	-0.504	0.307	
R2		0.141				0.243		
Adj. R2		0.132				0.227		
F-Stat		2,514				7,378		
Probs (F-Stats)		0.029				0.000		

Source: Processed data

Based on table 6, both models show a prob F stat value of less than 0.005, meaning both models are feasible to use. Model 1 shows the significant value of AEM and REM above the significance value of 0.05, which indicates that earnings management cannot increase tax aggressiveness (ETR). In model 2, the significance value of AEM and REM is less than 0.05, indicating that earnings management can increase tax aggressiveness (CETR).

Differences in accrual earnings management (AEM) levels before and during the pandemic

The results of hypothesis testing show differences in the accrual earnings management (AEM) level before and during the pandemic. These results differ from the research by Firmansyah and Ardiansyah (2020), which tested 37 companies in the consumer goods sector, while in this study, 200 companies were used in the manufacturing sector. The results of this study support Azizah's research (2021) which shows differences in the level of accrual earnings management before and during the pandemic, although in Azizah's study, the periods used were different, namely Q1 2019 and Q2 2020.

Descriptive statistical results show differences in the accrual management level before and during the pandemic. The average before and during the pandemic is above 0, meaning that the company is still managing earnings, so its performance is still considered good even though it is a pandemic. However, on average, it shows a downward trend between the period before and during the pandemic. There are several reasons for the decline in earnings management during a pandemic. Namely, management is more focused on business continuity than earnings management. Management is still considering the level of earnings management appropriate to pandemic conditions so that it is not too conspicuous.

Differences in real earnings management (REM) levels before and during the pandemic

The results of hypothesis testing show differences in the accrual earnings management (AEM) level before and during the pandemic. The level of accrual earnings management has decreased. It can be because almost all companies have experienced a decline in profits. If a company does too much earnings management, the company may even look strange and can be suspected of manipulating profits during a pandemic. In this study, the REM value is the sum of overproduction and manipulated discretionary expenses. Companies can carry out overproduction activities to reduce the cost of production so that company profits can increase.

Furthermore, in terms of the manipulation of discretionary expenses, the results of statistical tests show that discretionary expenses have increased, which indicates that the level of manipulation of discretionary expenses has also increased. The reason is that amidst the uncertain conditions of a pandemic, companies are also pressing discretionary expenses, for example, by suppressing or postponing employee training, official travel, and transportation expenses. These costs can be reduced because of instructions from the government regarding restrictions on mobilizing community activities or what is called Large-Scale Social Restrictions (PSBB).

The uncertain pandemic conditions have led to uncertain economic conditions, so high profits are considered strange and suspicious. Thus, aggressive earnings management can threaten the management's position (Azizah, 2021).

Differences in the Level of Tax Aggressiveness Before and After the Pandemic

The results of the hypothesis test showed that there was no level of tax evasion before and during the pandemic. Even though there were opportunities for managers to take advantage of tax avoidance more aggressively during a pandemic, such as tax incentives, this condition did not result in managers being more aggressive in tax evasion. The results of this test are following Firmansyah and Ardiyansah (2020). Even during work-from-home for tax officials, the level of control and supervision of the provision of tax incentives still needs to be improved. In addition, during a pandemic, tax incentives in the form of reducing PPh rates can make management focus on goals other than tax avoidance.

The results of the descriptive analysis show that before the pandemic period, the average tax burden ratio was25.65% then decreased to 22.29% during the pandemic even though the government has provided tax incentives and reduced tariff adjustments for go-public companies that meet the requirements of Perppu No. 1 of 2020 article 5 paragraph 3.

Effect of Accrual Profit Management (AEM) on Tax Aggressiveness

The statistical test results show that accrual earnings management does not affect tax aggressiveness (ETR) during the pandemic. This result is different from the research of Pajriansyah and Firmansyah (2017) and Suyanto and Supramono (2012). In the pandemic era, profit management is no longer the goal of aggressively avoiding taxes (tax aggressiveness) because, in the pandemic era, there are tax incentives and reduced rates provided by the government to taxpayers. Thus, managers usually carry out earnings management to pursue incentives in the form of bonuses. However, earnings management is carried out at a reasonable stage to not arouse suspicion from the auditor or shareholders (Azizah, 2021).

Effect of Real Earnings Management (REM) on Tax Aggressiveness

Statistical test results show that during the pandemic period, actual earnings management positively affects tax aggressiveness (CETR). These results show that tax aggressiveness decreased when managers in companies used profit manipulation through real activities—the pandemic period resulted in high uncertainty about economic conditions resulting in the management of real earnings by managers allegedly not intended for tax avoidance activities. Managers carry out real earnings management to increase company profits in order to achieve predetermined profit targets. Even though the pandemic tends not to disrupt companies in the consumer goods industry sector as much as companies in other sectors, companies need to increase profits to convince company owners about the company's sustainability in the future. Managers' efforts to achieve this targeted profit can be based on gaining shareholder trust in the hope that they will still be allowed to occupy the current position. Therefore, managers make all efforts to meet the targeted profits, one of which is practicing real earnings management. However, incentives from the government in the form of reduced tax rates make the relative cost of using real earnings management practices lower so that managers are more flexible in practicing real earnings management. On the other hand, the advantages of real earnings management in the form of being more difficult to detect by Tax Authority employees make companies refrain from using their discretion in carrying out earnings management for tax avoidance motives vulnerable to future tax audits and risk-endangering their position.

CONCLUSION

The conclusion is that there were differences in the level of earnings management before and during the pandemic. However, it was found that there was no difference in tax aggressiveness before and during the pandemic. Then accrual and actual earnings management partially have a positive effect on tax aggressiveness proxied by the effective cash rate, but when proxied by ETR, it has no effect.

This research is expected to provide both theoretical and practical contributions. Theoretically, this research will add references related to earnings management and tax aggressiveness. Whereas practically, it can add input to the Government, especially the Directorate General of Taxes, so that tax aggressiveness by companies can be minimized.

The limitation of this study is that it only used one period before and one period during the pandemic. Future research can use a longer period to make the effects more visible. Future research can also add other variables that have a greater influence on tax aggressiveness, not only earnings management.

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