

# The Effect of Audit Quality on Tax Avoidance

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**Abstract**— This research aims to examine the effects of audit quality on tax avoidance of manufacturing companies listed in Indonesia Stock Exchange (IDX) period 2012-2017. Audit quality is proxy by auditor size, audit fee, and audit tenure. Tax avoidance measured by Current ETR. This research uses secondary data with database collection technique. Total sample used in this research is 312. The analysis technique used is panel data regression analysis. The result of the research found that audit quality by audit size and audit fee has negative effect on Tax Avoidance, and audit tenure has positive effect on Tax Avoidance.

**Keywords**— *auditor size, audit fee, audit tenure, Tax Avoidance*

## I. INTRODUCTION

State revenue plays an important role for people's welfare. One of the country's most potential revenues is sourced from tax revenues. However, in the optimizing of government tax revenues, there is a barrier in the form of taxpayer disobedience. In the implementation, taxpayers and governments have different interests related to tax payments. The sustainability of the governance course requires funding mostly sourced from tax revenues. On the other hand, the company as taxpayers considers the tax as a burden that can reduce the profits of the company due to its nature.

The difference in interest between the government and taxpayer body triggers the non-compliance by the management of the company. Such disobedience is the company's effort to conduct tax avoidance that will impact the diminishing of state treasury receipts. Tax avoidance activity is a transaction made by the company to reduce the burden of taxation by utilizing gaps in the tax rules.

One indicator that causes tax avoidance is the audit quality factor. Audit quality is a performance auditor in the auditing process that is guided by the Professional Public Accountant Standard. The more qualified audit results carried out by auditors in providing services to the company, then the action of profit manipulation for tax interest tends not to be done by the company [1].

Some previous research on the influence of quality audits on tax avoidance has been conducted by several researchers. Aimed at testing the influence of family ownership on tax avoidance practices moderated by audit quality showed that there was a negative influence between family companies with quality audits as To moderate tax avoidance practices [2].

Which tested the influence of audit fee, audit tenure, and rotation of audit on the quality of audit in 2008-2012 with a sample of 230 public go companies on the Indonesia Stock

Exchange, the results showed that an influential audit fee Audit, tenure audits and audit rotation have significant effect on audit quality [3]. Previous study [4] and [5] showed mixed results. Using the audit quality variables measured using the auditor size proxy, audit fee, and the tenure audit of Current ETR demonstrate that the auditor size positively affects Current ETR, the audit fee negative and significant impact on Current ETR, and tenure audits have no effect on Current ETR [4]. The results of the found a positive influence between the audit quality on tax avoidance [5].

This research is a development of research [2] which examines the influence of family ownership on tax avoidance action by being moderated by audit quality variables in the period of 2008-2013 years. The study used the samples of the company listed on the Tunisian Stock Exchange with a sample number of 55 companies.

The difference in this research with the research of [2] was the first, researchers set the audit quality variables as independent variables in the [2] as moderation variables. Secondly, researchers added a measurement of audit quality variables in which [2] was measured only by the auditor size. In this research researchers added the audit fee and audit tenure as a measurement of audit quality that refers to the research of [3]. This research also uses the latest year that is 2012-2017 so it is expected to provide the latest information for users of financial statements and there is no thorough similarity between this research with previous research.

This research aims to analyses and obtain empirical evidence on the effect of quality audits on tax avoidance. The results of this research are expected to add literature related to the audit quality and tax avoidance in the company in Indonesia. This research is limited to audit quality variables measured by three proxies namely the auditor size, audit fee, and audit tenure. The measuring instrument for tax avoidance practices in this research is using Current Effective Tax Rate. The samples used in this study were manufacturing companies that published annual and financial reports on the Indonesia Stock Exchange in 2012-2017 (six years).

## II. THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

### A. Agency Theory, Signalling Theory, Tax Avoidance, Audit Quality

Agency theory is the basic thing used to understand the concept of corporate governance. Agency theory was first introduced by [6] involving the relationship between the

principal and the agent, the principal as the owner of the company entrusted the management of the company's operations to others in the company, namely the manager (agents) [6]. The relationship triggers a difference in interest that causes the inefficiencies of information obtained. Tax avoidance performed by the management of the company because there is a conflict of interests of the stakeholders who want to get a high profit so that management does the burden saving for stakeholders. The efforts of the manager to manipulate financial statements are very contrary to the principle of good corporate governance which emphasizes aspects of transparency and accountability of financial reporting.

The signal theory was first introduced by [7]. Signaling theory suggests how a company should give signals to users of financial statements. The signal is what information has been done by management to realize the wishes of shareholders. One of the types of information issued by companies that can be signals for parties outside of the company, especially for investors is the annual report. The information in the annual report is about financial statements and non-accounting information, i.e. information unrelated to financial statements. The disclosure of financial statements by the company can provide a positive signal for shareholders to be able to know the state of the company during this period and can be used as a decision making material in the future [7].

Tax Avoidance is an effort that affects the tax obligations by utilizing weaknesses in tax laws and regulations to minimize the amount of tax owed. Broadly the definition of the tax avoidance is an effort in reducing the explicit tax and inaugurated all transactions that can affect the explicit tax debt of the company [8]. The action of this tax avoidance can give an indication of the benefits for the company does not pay the tax burden so that the profit generated will increase. This is influenced by the manager's encouragement and desire to achieve higher profit figures in order to prosper shareholders.

The definition of audit quality referring to De Angelo's quality Theory of Audits ([9] is all possible (probability) that can occur when an auditor audits the client's financial statements and finds violations or errors that occur and Report in the audited financial statements [9]. The probability of an auditor in reporting violations/fraud depends on the independence of the auditor to the client. Therefore, many research then uses the capacity and independence of auditors as a measure of the quality of audits reflected in the size and reputation of the auditor size (Big4/NonBig4). The most important thing in implementing auditing is the transparency which is one of the principles of corporate governance. Good quality of audit is assessed by the ability of auditors in conducting audits in accordance with the Professional Standard of Public Accountant. The objective of the quality of the audit is to improve the performance results of the client's financial reporting audit that can be used by the financial report user with an independent attitude of an auditor and is transparent in its reporting.

#### *B. The Effect of Audit Quality by Auditor Size on Tax Avoidance*

A company wants high-quality audits to detect any disserving in the financial reporting presented. Auditors are required to bridge the conflicts of interest between agents and principals. According to [9] auditor size which included the Big Four class was able to provide better audit quality results than the Non Big Four. The principal is more trusting of the audit conducted by the auditor size Big Four as it has more qualified skills and expertise than the audit conducted by the auditor size Non Big Four. Auditor Size Big Four gained good reputation by the public that financial reports were reported with high credibility.

Previous research to test the influence of audit quality that is profiled by the auditor size of against the tax avoidance by [10] shows the quality of audit based on the auditor size negatively affects the tax avoidance measured use the Current ETR [10]. It is supported by the research of [11] which finds the result that the auditor size negatively affects the tax avoidance measured through the Current ETR [11]. Based on these results, researchers argue that companies using the Big Four in auditing will lower tax avoidance practices, so the first hypothesis that researchers ask is as follows:

*H1: Auditor Size has a negative effect on Tax Avoidance*

#### *C. The Effect of Audit Quality by Audit Fee on Tax Avoidance*

Audit fee is the amount of reward gained by the auditor on the professional services in the audit process of the company. An auditor must maintain its independence when giving opinions, should not be influenced by how much reward the company (client) provides. The determination of the audit fee is determined by the auditor and the client based on the contract, according to the time spent on the audit process, the services required for the audit process. The results of several previous studies of [4], showed that the audit fee was negatively and significantly impacted by tax aggressiveness through tax avoidance activities. Based on these results, researchers argue that auditors with high and independent competence will produce better quality audits so as to set a higher fee for client companies. This indicates that the quality of good audits will make it difficult for the company to conduct tax avoidance, so that the second hypothesis that researchers ask as follows:

*H2: Audit Fee has a negative effect on Tax Avoidance*

#### *D. The Effect of Audit Quality by Audit Tenure on Tax Avoidance*

Audit tenure is the term of employment contract between the auditor and the company. The duration of cooperation will create proximity with management that can cause auditors tend to pay attention to the importance of management than the public interest, so as to decrease the independent attitude of auditors [12]. The independence attitude of auditors that can be reduced due to the length of cooperation done with the company likely affects the quality and competence of work in auditing and disclosing the errors contained in the company's financial statements. The

results of some previous research that was Shiba (2015) at the company in Tehran showed that the audit tenure positively influence the tax avoidance. It was supported research [12] in Indonesia stating that increasing the period of cooperation has made auditors have the knowledge and experience to design effective audit procedures Including in terms of assisting the company in conducting tax avoidance practices due to the special relationship between auditors and Client companies. Based on the results, researchers argue that the length of cooperation between auditors and companies will improve tax avoidance practices so the third hypothesis that researchers ask as follows:

*H3: Audit Tenure has a positive effect on Tax Avoidance*

**III. RESEARCH METHODS**

This research uses secondary data by collecting and analyzing the company's financial and annual report data listed on the Indonesia Stock Exchange in the period 2012-2017. The dependent variables in this study were the practice of tax avoidance which was proscribed with Current ETR. Its independent variable is the quality of auditing This research uses four control variables are profitability, leverage, company size, and Pre Book Tax income (PBTI).

The tax avoidance practice in this study is measured through an Effective Tax Rate (ETR) value. The low ETR value illustrates the increasing tax avoidance practices and vice versa. The measurement of tax avoidance practice in this research refers to the research of [8]. The Current ETR measurement aims to view the amount of tax charges currently charged or within the period of the current year that can be seen in the company's income statement. The formula to determine the Current ETR value is Current Income Tax Expense divided by Pre-Tax Income.

The independent variable in this study is the quality of audits measured using three proxies are the auditor size, audit fee, and audit tenure. The first proxy is auditor size, which is defined as the small of the public accountant firm which belongs to the public accountant Big Four and in addition to the public accountant firm Big Four, which categorizes the size of the researcher using dummy variables. That is if the company is audited by public accountant firm in the Big Four is given a value of 1 and instead was given a value of 0 if the company is audited by public accountant firm other than those belonging to the public accountant firm Big Four.

The second proxy is an audit fee which is interpreted as a reward received by the public accountant firm after conducting audit services [13]. The measurement of audit fee in this study refers to the research conducted by [3]. Data on the audit fee is profiled by the professional fees account contained in the financial statements and measured using the natural logarithm of the data on the professional fees account. In the financial statements, the magnitude of the professional fees consist of various payments made by the company to the services of experts or professionals. For example, public accountant services, lawyers, notary, and various other professional services. So it can be said the payment of audit services conducted by public accountants is one aspect that is included in the account professional fees.

The third proxy is the tenure audit, which is interpreted as the length of a public accountant firm auditing a company consecutively. Measurement of tenure audit on this research refers to the research conducted by [3] which measured using the size of the year that is the number of years a public accountant firm. This information is seen in the independent auditor's report in annual report. In this research there were 4 types of control variables used to control the influence of variables independent of dependent variables. The first variable is profitability measured through a return on asset ratio. The formula of Return on Asset is Net Profit for the year divided by Total Asset. The second variable is leverage measured through debt to asset ratio. Here is the formula of Debt to Asset Ratio is Total Liability divided by Total Asset. The third and fourth variables are firms size and Pre Book Tax Income (PBTI). Measurement of firms size is measured natural logarithm total assets.

The population of this research is all companies listed on the Indonesia Stock Exchange (IDX), while its samples are manufacturing companies with sampling techniques that are purposive sampling with the following criteria are Manufacturing companies registered in IDX period 2012-2017, do not delisting and do not conduct IPO in research, The company has an annual financial report that expires on December 31, using rupiah currency, The company does not suffer any losses or Pre Tax Income (negative or zero) during the research period, and The company has complete variable data during the research period.

**IV. RESULTS AND DISCUSSION**

The population data used in this research is the go public company listed on the Indonesia Stock Exchange (IDX) during 2012-2017 with a total of 566 companies. The total samples that meet the criteria set by 52 companies per year, so that the overall observation amount during the 2012-2017 period is 312 companies (52 × 6 years) which can be seen in Table I.

TABLE I. SAMPLE CHARACTERISTICS

Description	Total of Companies
Number of companies recorded in the research period (2012-2017)	566
Number of companies other than those included in the manufacturing company (2012-2017)	(406)
Company conducting IPO (2012-2017)	(24)
Delisting companies (2012-2017)	(9)
Companies moving sectors to non manufacturing	(2)
Companies that use currencies other than rupiah	(28)
Companies that have a negative Pre Tax Income	(40)
Variable data that is not fully available as needed	(5)
Companies selected to be samples per year	52
Total Sample Period 2012-2017	312

Based on the results of the descriptive statistical test in table II, it is known that the amount of data used in this study is 312 sample data. This research tests the dependent variables of tax avoidance as measured by Current ETR. Of these tax avoidance proxies mean the average value of Current ETR 0.28. So overall the average company does not do tax avoidance because the average value is above 25% (0.25). The independent variables in this study consist of two

variables are audit quality and corporate governance. The audit quality variable consists of three proxies are auditor size, audit fee, and audit tenure.

Proxy quality audits based on auditor size are measured with dummy variables with a maximum value of 1 representing a company audited by the Big Four public accountant firm and a minimum value of 0 representing a company audited by public accountant firm other than Big Four. Can be seen from the table 3 Average company using the service of Big Four of 48% which is 152 companies from 312 companies and the remainder of 52% i.e. as many as 160 companies from 312 companies using other than Big Four. The proxy audit fee has an average value (mean) of 22.17 or 22% which means that the average company pays a high audit fee to the auditor for the services provided. The tenure audit proxy has an average value (mean) of 2.97 which means that the average public accountant firm that is in cooperation with the company for 3 consecutive years.

TABLE II. DESCRIPTIVE STATISTICS

Variabel	Mean	Max	Min	Std. Dev
CETR	0.27	0.36	0.05	0.13
AF	22.17	28.65	17.23	2.21
AT	2.97	6.00	1.00	1.70
ROA	0.10	0.40	0.03	0.09
DAR	0.41	0.88	0.11	0.17
SIZE	28.47	33.32	25.27	1.71
PBTI	26.03	31.01	20.17	2.29
Sampel	312			

Source: EVIEWS 9 (2019)

The research also uses four control variables are profitability, leverage, company size, and profit before tax. The first control variable are profitability is measured by using a return on asset (ROA) ratio which has an average value of 0.10. It can be interpreted that the average company can generate a net profit of 10% of the total assets owned. The second control variable of leverage is measured using Debt to Asset Ratio (DAR) which has an average value of 0.41. It can be interpreted that 41% of the company's total assets can still cover debts with assets owned. The third control variable is the size of the company measured through the natural logarithm of the company's total assets. Has an average value of 28.47 and the fourth control variable of profit before tax has an average value of 26.04.

Table III presents a summary of the results of hypothesis testing between the dependent variable, the independent variable and the control variable in this study.

*A. The Effect of Audit Quality by Auditor Size on Tax Avoidance (H1)*

Hypothesis 1 states that the quality of audits by auditor size negatively affects tax avoidance practices measured using Current ETR. The R- Squared value in the above table indicates that the tax avoidance variable by the Current ETR is influenced by independent variables the Audit Fee of 61.35% (0.6135) and the remaining 38.65% explained by other causes outside the model. Based on the results of the hypothesis testing showed that the auditor size negatively affects the tax avoidance practices measured

through Current ETR. This is evidenced by the significance value indicating the value of 0.0296 at a significance level of 5%. It can therefore be concluded that the hypothesis 1 was supported. The results of this research are in accordance with the research conducted by [11] stating that there is a negative influence on the auditor size on tax avoidance but not in line with the research results [5] showing the auditor size positively affects the tax avoidance.

TABLE III. TEST RESULTS OF HYPOTHESIS

Variable	Coefficient	Prob	VIF
C	0.4556	0.0152**	
AS (H1)	-0.0512	0.0296**	1.687
AF (H2)	-0.0314	0.0031***	1.681
AT (H3)	0.0134	0.0115**	1.037
ROA	0.3840	0.0757*	1.222
DAR	0.0003	0.4989	1.093
SIZE	0.0429	0.1066*	1.116
PBTI	0.0945	0.0000***	1.623
R-Squared		0.6135	
Adjusted R-Squared		0.5286	
F-Statistic		0.0000	
Test Results		FixedEffect	
Sig	*** 1%, ** 5%, * 10%		
N	312		

Note: This table presents the result of testing hypothesis 1,2, and 3. The dependent variable uses tax avoidance through Current ETR, and the independent variable is Auditor Size (AS), Audit Fee (AF), Audit Tenure (AT)

Source : EVIEWS 9, 2019

This result has been tested with classic assumptions. Table III presents the results of multicollinearity test with SPSS 17. VIF values for the variable auditor size, audit fee, audit tenure, profitability, leverage, company size, and pre book tax income are smaller than 10.0, so it is concluded that this variable is not affected by multicollinearity problems. Heteroscedasticity test with EVIEWS 9 shows that the probability value is 0.9786, this value is greater than 0.05, it can be concluded that the data in this study were not affected by heteroscedasticity.

Audited financial statements by Public Accountant Firm Big 4 according to some trusted references are more qualified so that have a lower level of fraud than the Public Accountant Firm Non Big 4. The relationship between the auditor size and the negative tax Avoidance caused by auditors including Big 4 is more competent and professional, thus having more knowledge on how to detect tax avoidance measures. This indicates that the company that is audited by the Public Accountant Firm Big 4 will increasingly difficult to do tax avoidance its high Current ETR value indicating the current tax expense is greater than the income before tax.

*B. The Effect of Audit Quality by Audit Fees on Tax Avoidance (H2)*

Hypothesis 2 states that the quality of audits based on audit fee negatively affects tax avoidance practices measured using Current ETR. Based on the results of the hypothesis testing indicates that the audit fee negatively affects tax avoidance practices measured through Current ETR. This is

evidenced by the significance value indicating the value of 0.0031 at a significance level of 1% and 0.0686 at a significance level of 10%. It can therefore be concluded that the hypotheses 2 was supported.

This research is in line with the research results of [4], but not with the research results Maharani [5] which indicates the audit fee positively affect on tax avoidance. The audit fee can improve the audit quality, making it difficult for the company to conduct tax avoidance practices. The results of this research show that the greater the audit fee established by the auditor will result in better quality of audit that will lower tax avoidance practices.

### *C. The Effect of Audit Quality by Audit Tenure on Tax Avoidance (H3)*

Hypothesis 3 states that the quality of audits based on audit tenure positively affects the tax avoidance practices measured using Current ETR. Based on the results of the hypothesis testing showed that the audit tenure positively impacted the tax avoidance practices measured through the Current ETR. This is evidenced by the significance value indicating the value of 0.0115 at a significance level of 5%. It can therefore be concluded that the hypothesis 3a was supported. The research was in line with the research results of [14], [15]. The longer the company is audited by the auditor size, the more tax avoidance is increased, the value of Current ETR is getting smaller. Long-time relationships between auditors and companies will create proximity so that they can cause auditors to pay attention to management interests and to influence the quality of the resulting audits. It is indicated that the same or successive Public Accountant Firm in auditing the company will reduce the independence properties that must exist in an auditor. The independence principle due to these intertwining can affect the quality of the resulting audits, so that in this hypothesis it shows that the longer the bond between the same auditor in a few years to audit a company will produce a poor quality of audits that will improve tax avoidance practices.

## V. CONCLUSIONS AND SUGGESTIONS

This research aims to provide empirical evidence and know the overview of tax avoidance practices in manufacturing companies listed on the Indonesia Stock Exchange (IDX) by testing the influence of audit quality of the practice Tax Avoidance. A few conclusions that can be taken from the test results in this research is the quality of audit based on the auditor size negatively affects the tax avoidance practice when measured through Current ETR, meaning that the Public Accountant Firm Big Four can lower tax avoidance practice because of its expertise and competence, the quality of audit based on audit fee negatively affects the Tax Avoidance practice when measured by Current ETR. This means that the greater the audit fee set by the auditor will produce good audit quality, so that tax avoidance practice decreases, and audit quality based on audit tenure influential to tax avoidance practices when measured through Current ETR. The length of Public Accountant Firm a company in a row is indicated

that the Public Accountant Firm overrides its independence, thereby increasing the Tax Avoidance effort.

This research has some limitations that can affect the results of the research, among others: first, this research is limited to companies in the manufacturing sector listed on IDX so as not to represent the entire company listed on IDX. Secondly, the study period was done only in 2012-2017 so that it could not be generalized for previous years. Thirdly, this study only uses independent variables of audit quality. Fourth tax avoidance measurement using Current ETR.

Based on the limitations outlined, there are some suggestions for further research on expanding samples, not only the manufacturing sector, but adding samples to the entire enterprise sector in IDX. Add a longer span of time to describe the direct effect of the company's tax avoidance. Adding proxies are used in corporate governance variables such as the Independence of audit committees and adding independent variables that are suspected to affect tax avoidance practices such as profit management and financial distress conditions.

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