CHAPTER I

INTRODUCTION

1.1 Background of the Study

Every large company, as well as a small company, surely expects to generate maximum profit. Profit is an increase within the capital (net assets) from the side of transaction or transactions that rarely occur from a business entity, and from all the transactions or other case that owned by a business entity during a period, except those arising from the income or investment of the owners (Stela & Rhumah, 2017). Generally, profit is the difference from income over costs in a certain period. Profit is often used as a basis for taxation, dividend policy, investment guidelines, decision making and prediction elements. Income in a company will certainly be subject to corporate income tax that has been regulated in the *Undang-Undang No 16 Tahun 2009* regarding General provisions and Tax procedures (*Ketentuan Umum dan Tata Cara Perpajakan)*.

In maximizing the profit of a company, usually, there is a strategy or method that are used by a group of members in the company to carry out this process. The name of this process is Earnings Management *(Manajemen Laba)*. In business, earnings management has an understanding as a way for finance managers to determine whether the profits earned from running a business can really profitable to the company. This process is made in the financial statement, which will later be shown to the stakeholders or interested parties in the company or organization. Earnings management is a process that is carried out purposely, in accordance with accounting principles, to direct the level of reported earnings (Priharto, 2019). It could be also be said that this process is to manipulate profits on financial statements in order to get profits.

A financial statement is a process of recording a company's financial transaction activities at the end that describes the financial condition of the company in a bookkeeping period and is a common description of the company's performance (maxmanroe.com, n.d.). The company's financial statements are arranged for those who have an interest in the company's performance achieved during a certain period as a form of management's accountability. Financial statements are also used as a tool to understand the company's financial condition for financial decisions that used by internal and external parties. According to Financial Accounting Standards that applicable in Indonesia, the most frequently provided financial statement are the statement of financial statement position, the income statement or the statement of comprehensive income, the statement of cash flows, and the statement of change in equity (Pangestika, 2020). Financial statements that are often considered by the user of the report is the income statement. For management, financial statements are a tool to report to outside parties on their participation in investing in companies. So that the report can be used as a basis for evaluation for the next policy step. The income statement presents all elements of the company's revenue and expenses, which will produce the actual condition of the company's net profit or a net loss. Profit is an important part of the company, especially with the distribution of dividends to the owners of the company, so management trying to reach the profit targets to gain benefit for certain parties. Earnings management is suspected of having manipulated the company's financial statements. Earnings management is an effort to intervene or influence the information in financial statements carried out by company managers with the aim of tricking stakeholders who want to know the performance and condition of the company. The term intervention is usually used as a basis by some parties to assess earnings management as fraud (Utami, 2019). But there are some other parties who consider this managerial manipulation activity is not a fraud. The reason is that the company's managerial intervention is still using generally accepted accounting methods and procedures. Earnings management (*manajemen laba*) is the act of reducing or increasing earnings in a certain period by management without causing a decrease and increase in corporate economic profits for the long term. One of the reasons why managers do earnings management techniques are for increasing shareholder confidence in the company’s performance and also in improving the relations with creditors (Panjaitan & Muslih, 2019). Companies that are experiencing financial distress will be possible to do earnings management. Where the action is taken so that the stock price of the company does not go down and looks stable, in order to cover losses that may be experienced in a row by covering debt and presenting good financial statements. Managers try to take advantage of opportunities in some activities or events in companies that affect the earnings management. These factors are tax planning, deferred tax expense, deferred tax assets and company size.

Taxes are dues that must be paid by the people or taxpayers to the state for the government's benefit and for the general public prosperity. In a fairly competitive market, managers usually look for a legal loophole (*celah*) to reduce their tax burden. Thus, companies, especially multinational companies, will try to minimize tax payments because the benefits received from the government are the same, no matter if they pay taxes in large or small amounts. But of course, this argument is not accepted by the tax authorities, although in general, taxation does not have a big role in earnings management decisions as long as the method used does not violate applicable regulations. The conclusion is that managers are motivated by earnings management to reduce profits in order to reduce the payment of tax burden.

Tax Planning (*Perencanaan Pajak*) is the method that can be done or planned by the Taxpayer to minimize tax burden without violating applicable taxation regulations or can also be referred to as a way to avoid taxes without breaking applicable taxation regulations (Subekti, 2020b). Taxpayers try to pay tax as little as possible. Otherwise, the government needs taxes as funds for expenditures in the context of national development. Therefore, taxpayers are expected to reduce their tax burden legally. Higher the profits, the company's tax burden is also high. Both tax planning and earnings management aim to achieve profit by manipulating earnings figures in the financial statement. Therefore they both are related to one another. Therefore, the company's management will use several earnings management techniques to reach the target.

Another factor that affect the earnings management is deferred tax expense. The tax expense that can be impact by increase or decrease the tax burden that must be paid in the future are called deferred tax expense (Rafinska, 2019). Deferred tax expense also can be interpreted as expenses that appear from the difference between profit in the financial statements (accounting profit) and profits used as the basis for calculating taxes. Tax savings or tax delays (*deferred tax*) through the tendency of companies to reduce reported profits associated with positive accounting theory that is "Political cost hypothesis" so that the deferred tax expense can affect earnings management as a motivation for tax savings (Achyani & Lestari, 2019).

The next factor that affects earnings management is deferred tax assets. Deferred tax assets is the amount of income tax recovered within the future or coming periods as a result of temporary deductible differences and remaining losses that have not been compensated (Subekti, 2020). Deferred tax assets differ from deferred tax expenses because they have different points of view. The number of deferred tax assets that are enlarged by management is motivated by the provision of political burdens on the company's size in carrying out earnings management and bonuses, so that motivates the company in managing profit so that if the amount of deferred tax assets gets bigger then the higher the management does earnings management (Citra Fitriany, 2019).

The last factor that plays an important role in earnings management is company size. In classifies the size of a company, the scale will be determined by various ways, such as expressed in total assets, total sales, and market value of shares (Riadi, 2020a). In terms of the ability to gain funds, large companies have great access to sources of funds both to the capital market and banks to fund their investments in order to increase their profits. Small companies tend to show good company's performance and conditions to attract investors to invest their capital in the company, while large companies are more careful in doing financial reports because large companies paid more attention to the public or the government. Small companies are considered to do more earnings management practices than large companies. So the factor shows that the larger the company size, the earnings management act decrease.

Table 1.1 Tax Planning, Deferred Tax Expense, Deferred Tax Assets and Company Size on Earnings Management in Year 2015 – 2019

Company Name	Year	Tax Planning	Deferred Tax Expense	Deferred Tax Assets	Company Size	Earnings Management
PT Wilmar Cahaya Indonesia, Tbk	2015	0.748	0.024	0.405	28.02699	0.01966
	2016	0.873	0.025	0.845	27.98587	0.00667
	2017	0.750	0.025	0.030	27.96222	0.00247
	2018	0.750	0.026	0.227	27.78713	0.05126
	2019	0.755	0.050	0.131	27.96254	0.02755
PT Indofood CBP Sukses Makmur, Tbk	2015	0.729	0.040	0.057	30.91045	0.00826
	2016	0.727	0.046	0.081	30.99493	0.00932
	2017	0.680	0.052	0.085	31.08480	0.00376
	2018	0.722	0.052	0.079	31.16812	0.00214
	2019	0.720	0.053	0.112	31.28710	0.00189
PT Indofood Sukses Makmur, Tbk	2015	0.747	0.018	0.163	32.15098	0.00411
	2016	0.713	0.030	0.019	32.04624	0.00045
	2017	0.671	0.028	0.035	32.11290	0.00930
	2018	0.666	0.025	0.142	32.20096	0.00148
	2019	0.674	0.029	0.117	32.19744	0.00294

Source: Prepared by the Researcher (2021)

Out of several Food and Beverage sub-sector Companies listed in Indonesia Stock Exchange, the writer chose PT Wilmar Cahaya Indonesia Tbk, PT Indofood CBP Sukses Makmur Tbk, and PT Indofood Sukses Makmur Tbk.

Based on the background information, noted that there are several factors that impact the earnings management, such as tax planning, deferred tax expense, deferred tax assets, and company size. In this research, the researcher is interested in researching the Food and Beverage sub-sector companies that listed on Indonesia Stock Exchange for the 2015-2019 period.

1.2 Problem Limitation

There are several main issues to be discussed in this research and the need for limitations so that the discussion focuses on a reference and does not deviate. This research focuses on tax planning, deferred tax expense, deferred tax assets and company size that affect earnings management in Food and Beverage sub-sector companies listed on Indonesia Stock Exchange.

1.3 Problem Formulation

Based on the background that has been explained, there are problems that arise in this research:

1. Does tax planning affect the earnings management for Food and Beverages sub-sector companies listed on Indonesia Stock Exchange?
2. Does deferred tax expense affect the earnings management for Food and Beverages sub-sector companies listed on Indonesia Stock Exchange?
3. Does deferred tax assets affect the earnings management for Food and Beverages sub-sector companies listed on Indonesia Stock Exchange?

4. Does company size affect the earnings management for Food and Beverages sub-sector companies listed on Indonesia Stock Exchange?
5. Does tax planning, deferred tax expense, deferred tax assets, and company size affect the earnings management for Food and Beverages sub-sector companies listed on Indonesia Stock Exchange?

1.4 Objective of the Research

Based on the background and the problem formulation, the objective of this research are:

1. To analyze the effect of tax planning on earnings management for Food and Beverages sub-sector companies listed in the Indonesia Stock Exchange.
2. To analyze the effect of deferred tax expense on earnings management for Food and Beverages sub-sector companies listed in the Indonesia Stock Exchange.
3. To analyze the effect of deferred tax assets on earnings management for Food and Beverages sub-sector companies listed in the Indonesia Stock Exchange.
4. To analyze the effect of company size on earnings management for Food and Beverages sub-sector companies listed in the Indonesia Stock Exchange.

5. To analyse the effect of tax planning, deferred tax expense, deferred tax assets, and company size on earnings management for Food and Beverages sub-sector companies listed in the Indonesia Stock Exchange.

1.5 Benefit of the Research

1.5.1 Theoretical Benefit

Theoretically, the expected benefits from this research are to be able to provide additional knowledge and understanding about tax, especially regarding the effect of tax planning, deferred tax expense, deferred tax assets, and company size on earnings management.

1.5.2 Practical Benefit

Practically, this research is expected for some benefits as follows:

1. For companies

   This research is expected to provide input to companies in making decisions and examine financial statements relating to factors that can affect earnings management.

2. For researcher

   This research is expected to be very useful for researchers in adding more knowledge and can contribute in the development of taxation especially related to the effect of tax planning, deferred tax expense, deferred tax assets, and company size on earnings management.