

THE EFFECT OF BOOK-TAX DIFFERENCES AND CORPORATE GOVERNANCE DISCLOSURE ON THE QUALITY OF EARNINGS USING ACCOUNTING CONSERVATISM AS MODERATING VARIABLES

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ABSTRACT

Good quality earnings will provide more information on the financial performance of companies that are relevant to the decision made by the decision makers (Dechow et al., 2010). The purpose of this study was to analyze (1) whether BTD has significant influence negatively the quality of earnings, (2) whether disclosure CG has a significant impact positively on the quality of earnings, and (3) whether the accounting conservatism weakened the effects of these two variables against earnings quality. The data used in this research obtained from publikasian financial statements published by the Indonesia Stock Exchange from 2012 to 2014, as well as corporate governance indices obtained from IICG (Indonesian Institute of Corporate Governance). Based on the results of regression testing suggests that the CG has a significant positive effect on earnings quality and accounting conservatism weaken the relationship, but BTD does not affect the quality of earnings.

Keywords: book tax differences; corporate governance disclosure; quality of earnings; accounting conservatism, moderating variables

Introduction

Good quality information is important in decision making. Lots of interested parties on good quality information, among which are the investors, government, auditors, creditors, and much more. For that profit, as a financial information that is widely used as a basis for decision-making, also need to have good quality.

Good quality earnings will provide more information on the financial performance of companies that are relevant to the decision made by the decision makers (Dechow et al, 2010). That definition is taken by SFAC no. 1 which states that financial reporting should provide information about the company during the accounting period runs.

There are many factors that can affect the quality of earnings. Some of them are book-tax differences / BTD (Chen et al, 2012; Huang and Wang, 2013), the disclosure of corporate governance / CG (Xu et al, 2015), and ownership structure (Al-Rassas et al, 2016). This study tried to see the influence of these three variables with the quality of earnings. In addition, this study will also try to use accounting conservatism as a moderating variable (Penman and Zhang, 2002).

The purpose of this study was to analyze (1) whether BTD has significant influence negatively the quality of earnings, (2) whether disclosure CG has a significant impact positively on the quality of earnings, and (3) whether the accounting conservatism weakened the effects of these two variables against earnings quality.

The significance of this study were (1) As far as I know, there are only a little studies that examine the impact of BTD and disclosure CG together, and (2) the use of variable accounting conservatism as moderating variables.

The contribution of this study is to provide insight to investors that the information provided by profit may be affected by financial statements numbers, and provide additional ideas and new research opportunities for academics and researchers in the field of accounting.

LITERATURE STUDY AND DEVELOPMENT HYPOTHESIS

The purpose of financial accounting is different from the purpose of tax regulations. Taxation is designed to achieve the policy objectives, namely to increase revenue and provide incentives or disincentives for taxpayers to engage in certain economic activities. In contrast, financial accounting is designed to provide information that is credible and relevant information about the performance of a company. Accordingly, the information required by the tax authority different from that required by the market participants. For example, financial accounting requires that future estimates of the potential losses and loan loss reserves, guarantees, elimination of assets and contingent liabilities to match costs with revenues. Tax rules do not allow the occurrence of the cuts until economic performance occurs or loss is realized. Because in the calculation of corporate income (book income) have more flexibility, the BTD will have more information on profits through the process of accrual accounting (Huang and Wang, 2013)

Joos et al. (2000) found that a large BTD will weaken the earnings-return relationship and concluded that the market recognizes the company with a large BTD has manipulated revenue and showed lower profits. Hanlon (2005) provide evidence that BTD is

a strong indicator of the persistence of earnings, accruals, income and cash flows for the year ahead. He also found that the BTD affect market expectations on future earnings persistence. The greater persistence of earnings, the lower the quality of earnings.

BTD itself consists of two components, namely the permanent differences and temporary differences. Jackson (2015) mentions that the temporary differences arises when the financial accounting and tax accounting record economic events in different time periods, which are recorded as deferred tax expense. Temporary differences alter the balance between current and deferred tax expense, but does not alter the tax burden of a company. Permanent differences are recognized transactions for one purpose, namely financial or tax purposes. The permanent differences affecting the impact of the overall tax burden recorded in the financial statements. Researchers typically measure permanent differences by removing temporary differences of BTD total. This means an empirical measure for permanent differences usually also will include tax credits and tax accruals. The second major category BTD (temporary differences and permanent differences) have different implications for the changes in the components of future earnings (both profit before taxes and the tax burden).

H1: BTD has a positive significant effect on the quality of earnings.

Research on the relationship CG quality earnings reporting, Beasley (1996) examined the monitoring role of outside directors on the usefulness of financial reporting. Beasley found that the possibility of fraudulent financial statements is inversely proportional to the number of outside directors. Dechow et al. (1996) show that companies that earnings manipulation is possible if the company has a board of directors who are less independent or with the chief executive officer (CEO) and chairman of the board who has another position. Klein (2002) found a negative relationship between the independence of the audit committee and board of directors with abnormal accruals. This finding confirms that the information tends to be more informative financial statements for companies that have more outside directors to oversee the actions of the manager.

H2: Disclosures CG has a positive significant effect on the quality of earnings.

Penman and Zhang (2002) found that the measurement of investment and joint effect of accounting conservatism indicates that investors do not appreciate the combination of changes in invetasi and conservatism, so they question the quality of the profit shown.

H3: Accounting Conservatism weakened the influence of BTD and disclosure of CG on the quality of earnings.

RESEARCH METHODS

This study examined the influence between variables so using multiple regression test. The unit of analysis used in this study is organizational, because the life of the data collected from the companies listed on the Indonesia Stock Exchange. The time periods used are from the years 2012-2014 to get the latest data. The data used in this research is secondary data. Secondary data obtained from publikasian financial statements published by the Indonesia Stock Exchange from 2012 to 2014, as well as corporate governance indices obtained from IICG (Indonesian Institute of Corporate Governance).

The sample selection was based on purposive sampling, with criteria, first, during the observation, the company never delisting from the Indonesia stock exchange. Second, the financial statements are reported in the rupiah currency. Third, the company is registered and followed the judgment of corporate governance organized by IICG during the period of observation. Finally, the company has complete data as required in the variable investigators.

Based on these criteria, this study uses 10 company that has complete data as many as 30 firm-years. According to Dechow et. al. (2010), earnings quality can be measured using earnings persistence, abnormal accruals, earnings smoothness, loss recognition, and beating the target. In this study, the quality of earnings will be measured using earnings persistence (Dechow and Schrand, 2004) with the formula:

$$X_{t+1} = \alpha_t + \beta X_t + \epsilon_t$$

Book-Tax Differences (BTD) is divided into two, namely the temporary differences and permanent differences.

Temporary differences are measured by using the formula (Jackson, 2015):

$$\frac{\text{Deffered tax expense}}{t} \times \frac{(1-t)}{\text{average asset}}$$

Permanent difference measured by subtracting the BTD of temporary differences:

$$\text{PERM} = \text{BTD} - \text{TEMP}$$

While BTD measured using formula:

$$\text{BTD} = \frac{(\text{net income} - \text{taxable income})}{\text{average asset}}$$

where:

$$\text{Taxable income} = \frac{\text{beban pajak berjalan}}{t} \times (1-t)$$

Disclosure of Corporate Governance (CG) was measured using the Data CGPI (Corporate Governance Performance Index) of IICG (The Indonesian Institute of Corporate Governance)

Givoly and Hayn (2000) concluded that in the long term, the accumulated amount of the net profit will be turned into operating cash flow. Because accrual is the difference between net profit and cash flow, the accumulated accrual may be used as a measure

of accounting conservatism. Indicates negative accrual accounting conservatism, and an increase in negative accrual would indicate an increase in the level of accounting conservatism.

To determine whether the total negative accruals due to accounting conservatism, Givoly and Hayn distinguish between accrual operating and non-operating accrual. To measure accounting conservatism, which is used is a non-operating accrual. Non-operating accrual obtained from the reduction of the total accrual operating accruals. Accrual operation itself consists of changes in accounts receivable, inventory changes, changes in prepaid expenses, accounts payable changes, and changes in tax debts. Thus, measurements using accrual accounting conservatism by Givoly and Hayn (2000) are:

$$\begin{aligned} \text{ACC}_{it} &= \text{NI}_{it} + \text{DEP}_{it} - \text{CFO}_{it} \\ \text{OpACC}_{it} &= \Delta\text{AR}_{it} + \Delta\text{I}_{it} + \Delta\text{PE}_{it} - \Delta\text{AP}_{it} - \Delta\text{TP}_{it} \\ \text{NonOpAcc}_{it} &= \text{ACC}_{it} - \text{OpACC}_{it} \end{aligned}$$

Where:

ACC _{it}	=	Total Accrual
NI _{it}	=	Net income on year t
DEP _{it}	=	Depreciation on year t
CFO _{it}	=	Operating Cash Flow on year t
OpACC _{it}	=	Operating accrual on year t
ΔAR _{it}	=	Changes on Account Receivables
ΔI _{it}	=	Changes on Inventories
ΔPE _{it}	=	Changes on prepaid expenses
ΔAP _{it}	=	Changes on Account Payables
ΔTP _{it}	=	Changes on Tax Payables
NonOpAcc _{it}	=	Non-operating accrual on year t

The control variabel in this research are first, company size which measured by using the logarithm of total assets (Alves, 2014), second company growth prospects measured using sales growth. Third, Leverage is measured by using Alves (2014) formula

$$LEV = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

And final, Operating Cash Flow measured by using Alves (2014) formula:

$$OCF = \frac{\text{Operating Cash Flow}}{\text{Total assets}}$$

In this study, the data analysis technique used is multiple regression analysis. The research model is as follows:

$$\begin{aligned} \text{QUAL}_{it} &= \alpha + \beta_1\text{BTD}_{it} + \beta_2\text{CG}_{it} + \beta_3\text{SIZE}_{it} + \beta_4\text{GROWTH}_{it} + \beta_5\text{LEV}_{it} + \beta_6\text{OCF}_{it} + \varepsilon_{it} \\ \text{QUAL}_{it} &= \alpha + \beta_1\text{BTD}_{it} + \beta_2\text{CG}_{it} + \beta_3(\text{CONS} * \text{BTD}) + \beta_4(\text{CONS} * \text{CG}) + \beta_5\text{SIZE}_{it} + \beta_6\text{GROWTH}_{it} + \beta_7\text{LEV}_{it} + \beta_8\text{OCF}_{it} \\ &+ \varepsilon_{it} \end{aligned}$$

where:

QUAL	=	Earning Quality, measured by earnings persistence
BTD	=	Book-Tax Differences
CG	=	Corporate Governance, measured using Corporate Governance Perception Index from Indonesia Institute of Corporate Governance
CONS	=	Accounting Conservatism, measured using non-operating accrual
SIZE	=	Size, measured by total assets
GROWTH	=	company growth, measured using asset growth
LEV	=	Leverage, measured by dividing total liabilities with total assets
OCF	=	Operating Cash Flow, measured using cash flow available for operating activities.

RESEARCH RESULT

H1 sought to test whether the Book-Tax Differences have an influence on the quality of earnings. From table 1, we can see that the sig. 0.013 indicates that the model suitable for use in regression testing.

Table 1. ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.896	6	.483	4.447	.013 ^b
	Residual	1.302	12	.109		
	Total	4.198	18			

a. Dependent Variable: LOG_KUAL

b. Predictors: (Constant), OCF, LOG_BTD, CG, GROWTH, LOG_SIZE, LOG_LEV

Table 2. Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.120	3.653		1.128	.281
LOG_BT D	-.520	.295	-.899	-1.760	.104
CG	-.606	.198	-.622	-3.056	.010
LOG_SIZE	-.560	.408	-.952	-1.372	.195
GROWTH	.118	.495	.044	.239	.815
LOG_LEV	-.738	2.243	-.294	-.329	.748
OCF	1.614	1.678	.309	.962	.355

a. Dependent Variable: LOG_KUAL

Table 3. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.831 ^a	.690	.535	.32945

a. Predictors: (Constant), OCF, LOG_BT D, CG, GROWTH, LOG_SIZE, LOG_LEV

Tables 2 and 3 show that BT D and control variables have no effect on the quality of earnings with the adjusted R2 of 0.535. Only CG variables that affect the quality of earnings. Therefore the first hypothesis is rejected.

H2 trying to see the effect of the application of corporate governance on the quality of earnings. Application of corporate governance own views on corporate governance perception index issued by the Indonesian Institute of Corporate Governance.

Table 2 also shows that corporate governance is a positive and significant effect on the quality of earnings with sig. 0.01 Thus, consistent with Beasley (1996) and Klein (2002) which states that corporate governance affects the quality of earnings, H2 is accepted.

H3 aims to test whether the accounting conservatism weaken the relationship between BT D and CG on the quality of earnings. Table 4 again shows that the feasible research model used for testing.

Table 4. ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.073	8	.384	3.415	.037 ^b
	Residual	1.125	10	.113		
	Total	4.198	18			

a. Dependent Variable: LOG_KUAL

b. Predictors: (Constant), KONS_CG, KONS_BT D, OCF, GROWTH, LOG_SIZE, CG, LOG_BT D, LOG_LEV

In Table 5 and 6, it appears that both the moderating variable (KONS * BT D and KONS * CG) had no effect on the quality of earnings. In this case, the variable accounting conservatism weakened the relationship between BT D and CG with earnings quality significantly (adjusted R2 of 0.518), which means the H3 also accepted.

Table 5. Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.069	3.720		1.094	.300
LOG_BT D	-.981	.533	-1.697	-1.842	.095
CG	-.210	.440	-.215	-.477	.644
LOG_SIZE	-.706	.435	-1.199	-1.623	.136
GROWTH	.382	.556	.144	.687	.508
LOG_LEV	-1.452	2.354	-.580	-.617	.551
OCF	.444	1.950	.085	.228	.825
KONS_BT D	.412	.397	.541	1.039	.323
KONS_CG	-.158	.175	-.409	-.905	.387

a. Dependent Variable: LOG_KUAL

Table 6. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.856 ^a	.732	.518	.33542

a. Predictors: (Constant), KONS_CG, KONS_BTD, OCF, GROWTH, LOG_SIZE, CG, LOG_BTD, LOG_LEV

CONCLUSION

This study aimed to test whether BTD and CG have an influence on the quality of earnings, using accounting conservatism as moderating variables. Based on the results of regression testing, 2 and 3 accepted hypothesis, which suggests that the CG has a significant positive effect on earnings quality and accounting conservatism weaken the relationship. While the first hypothesis can't be accepted, which means BTD does not affect the quality of earnings.

The control variables used is 4, which is a measure of the company, the company's growth, leverage, and operating cash flow. From the test results indicate that the influence of the control variables of the earnings quality varies greatly.

The companies with large positive (negative) book tax difference have lower earnings persistence compared to company with small book difference with significant negative influence negative influence shows that the greater the difference between accounting profit and the fiscal profit represented by the tax account deferred will decrease profit persistence

Limitations of this study were (1) the data are limited, because the companies participating in the CGPI is still very little; (2) industrial use is still very limited, and most were banking. For further research can be done using different proxies, and the expected number of companies sampled and the data will be more.

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