

Audit committees, political connections, and audit quality on tax avoidance

Nurlita Sukma Alfandia¹, Pebrika Ayunda Putri²

^{1,2}Taxation, Department of Bussiness Administration, Brawijaya University, Indonesia

ARTICLE INFO**Article history:**

Received Mar 24, 2023

Revised Mar 28, 2023

Accepted Apr 15, 2023

Keywords:

Audit Committee;
Audit Quality;
Political Connection;
Tax Avoidance.

ABSTRACT

Differences in the results of previous studies regarding the relationship between audit committees, political connections, and audit quality on tax avoidance make this research necessary. This study aims to thoroughly review and identify empirical evidence about the impact of audit committees, political ties, and audit quality on tax avoidance. Tax avoidance is a dependent variable. Audit quality, audit committees, and political connections are independent variables. Political connections were calculated using the number of Board of Commissioners with the formula of calculating the number of Commissioners: The Board of Commissioners was politically connected. The audit committee was calculated using the number of members of the company's audit committee. The audit quality measurement in this study is dummy variables. This study is explanatory research and uses a quantitative methodology. The 36 samples included in this study are mining firms listed between 2017 and 2019 on the Indonesia Stock Exchange. Purposive sampling was used to collect samples, while multiple linear regression was the technical data analysis method used in this study. When selecting how to disclose financial information, the corporation considers the audit committee. Political connections negatively affect tax avoidance. It reveals how political ties to the board of commissioners also affect tax evasion. Audit quality has a detrimental effect on tax evasion as well. The Big Four Public Accounting Firm's (KAP) audit standard ensures accurate financial data.

This is an open access article under the [CC BY-NC](#) license.

**Corresponding Author:**

Nurlita Sukma Alfandia,
Taxation, Department of Bussiness Administration,
Brawijaya University,
Jl. Veteran, Ketawanggede, Kec. Lowokwaru, Kota Malang, Jawa Timur 65145,
Email: nurlita.sukma@ub.ac.id

1. Introduction

Tax revenue is the main budget source for Indonesia, so it must be supported by good infrastructure, such as tax collection governance that is free from corruption, collusion, and nepotism. One of the parties that contribute taxes to the state is a company. If the company earns large profits in its operational activities, the income tax payments to the state are also large. The company considers paying taxes as one of the expenses because it can reduce the amount of net profit. Companies consider taxes a burden, so there is a desire to reduce the tax burden. One of the company's efforts to reduce the tax burden is through tax avoidance practices.

Tax avoidance is an tax aggressiveness strategy carried out by companies in order to minimize the tax burden, so that this activity creates risks for companies including fines and bad company reputation in the public eye. It can include tax savings/ tax sheltering, so tax aggressiveness and sheltering can be equated to or referred to as tax avoidance measure (Kovermann & Velte, 2019). This tax avoidance does not conflict with tax laws and regulations because it takes advantage of loopholes in tax laws that will affect state revenues in the tax sector.

The issue of tax avoidance is complex and unique. On the one hand, it is permissible, but on the other hand, tax avoidance is undesirable. From a traditional perspective, tax avoidance mechanisms must

increase shareholder value, and from an agency perspective say that tax avoidance provides different predictions (Desai & Dharmapala, 2006). Several cases have given the impression that tax evasion is common in today's business world. The phenomenon of tax evasion was also exposed in 2016 with the Panama Papers investigative document. Tax avoidance can occur through a transfer pricing mechanism with other countries. Indonesia also participates in automatic information exchange cooperation agreed upon by more than 100 countries to reduce cross-border tax avoidance by companies (Firmansyah et al., 2022).

Tax avoidance itself occurs because many factors influence it. One of them is when a company has political connections that are owned by the board of commissioners. The board of commissioners of a company has the experience that encourages them to have political connections. Of course, this political connection can be used by several parties to achieve goals, one of which is tax avoidance. The impact of political connections has high jurisdiction in countries with high levels of corruption (C. J. Chen et al., 2010). Differences in the characteristics of companies with political connections and those that do not have political connections in less developed countries and with high levels of corruption (Faccio, 2006). Political connections can be hometown, workplace, and education ties (Y. Chen et al., 2019). Companies that are in a competitive industrial environment tend to incur higher costs as a strategy to ease their tax burden. Companies need to build political connections so that they have a competitive advantage (Tang, 2023).

The political connection can be seen whether the independent board of commissioners has concurrent positions as a politician affiliated with a political party, the independent committee of commissioners has multiple positions as government officials, or the independent board of commissioners has concurrent positions as a military official, former government officials, or former military officers does not affect the level of tax aggressiveness carried out by a company. Because politically connected companies tend to pay lower taxes and even lower tax audits than politically unconnected companies during the observation period (Ardillah & Vanesa, 2022).

One reflection of good corporate governance is the existence of an audit in a company. Therefore, a company needs to have an audit committee as the party authorized to oversee the financial reporting process within the company so that the existence of an audit committee within the company will minimize the possibility of earnings management. Nonetheless, audit committees that have an accounting or financial background in a company influence tax avoidance practices. It is because a company's audit committee members need to carry out their functions properly to increase the integrity and credibility of the company's financial reporting (Sari & Somprawiro, 2020). An audit committee was formed to supervise preparing its financial statements to avoid management fraud and do more tax aggressiveness in the company. The credibility of financial reporting will be worked properly if there is support from all elements of the corporate governance, including the audit committee, to control economic and tax policy (Ardillah & Vanesa, 2022).

The audit quality is one of the main factors that can be considered in this regard. The better the audit's quality, the better the auditor can carry out his duties professionally based on professional ethics, competence, and independence. Audit quality is the possibility that the auditor will find material misstatements in the financial statements. As one of the *prima donna* sources of state revenue, mining companies also play a role in economic growth. The coal company PT Adaro Energy Tbk is a large coal mining company in Indonesia that has received the title of the golden taxpayer from the Director General of Taxes. Adaro takes advantage of the transfer pricing scheme through its subsidiary in Singapore to avoid taxes in Indonesia.

2. Research Method

The research method used is quantitative with explanatory research. Data collection was carried out by accessing the pages www.idx.co.id and www.idnfinancials.com. The research variables used in the research are divided into independent and dependent variables. Independent variables, namely audit committee, political connections, and audit quality. The dependent variable is tax avoidance.

The audit committee is defined as having an important role as a part of the company that must exist in implementing good corporate governance (Sunarto et al., 2021). The audit committee is measured using the total committee number of personnel serving as audit committees. Political connections are defined by the board of commissioners of companies that have connections with the government using the board of commissioners (Gray & Debreceny, 2014). Such connections may stem from previous experience in government or be aligned with political structures. The number of politically connected commissioners is the indicator used to measure this variable. The variable operational definition of *audit quality* is the main indicator in selecting an auditor. Public Accounting Firms affiliated with the Big Four are considered to be of higher quality than non-Big Four KAPs because they are considered more experienced in conducting audit

assignments. The audit quality indicator is a dummy variable, namely 1 if the company uses the Big Four KAP and 0 otherwise. The dependent variable in this study, namely tax avoidance, is measured using the Cash ETR formula: cash tax paid divided by pre-tax income.

The population in this study were all 49 mining companies listed on the Indonesia Stock Exchange with a research period of 2017 – 2019. Sampling was carried out using a purposive sampling technique. The criteria used include mining companies that have issued financial reports, have been audited for the 2017 – 2019 period, and have data related to research variables. Based on these criteria, a sample of 36 companies was obtained. The number of samples in the research period 2017 – 2019 (three years) is 108 samples.

3. Results And Discussions

Each variable has passed the classical assumption test. The results of testing the hypothesis using multiple linear regression analysis are as follows.

Table 1. Regression Analysis

Model	Unstandartized Coefficients		Standardized Coefficients	t	Sig
	B	Std. Error	Beta		
1 (Constant)	-67.434	36.418			
X1	34.560	11.223	.276	3.079	.003
X2	-28.629	13.536	-.191	-2.115	.037
X3	-21.808	10.269	-.191	-2.124	.036

Multiple linier regression model : $Y = -67.434 + 34.560X1 - 28.629X2 - 21.808X3 + 0.05$

Information can be derived in the following formats from the regression equation: (a) The constant value displaying the number -67,434 indicates that tax avoidance will decline by -67,434 if the audit committee, political ties, and audit quality are all zero. (b) Tax avoidance will increase by 34,560 units yearly X1 (audit committee). If all other variables remain constant, an increase of 1 audit committee will result in a 34,560 unit rise in tax avoidance. (c) Tax evasion will decline by -28.629 units yearly X2 (political connection). Tax Avoidance will decrease by -28.629 units if the number of commissioners reflecting a company's political connections grows by one unit, providing all other factors remain unchanged, (d) Tax evasion will decline by -21.808 units yearly X3 (audit quality). If all other factors remain constant, a 1-unit increase in the audit quality rating will result in a -21.808 unit drop in Tax Avoidance.

Based on table 1, the sig. audit committee is 0.003 less than the sig. α of 0.05. Thus the first hypothesis is accepted, that there is an influence of the audit committee on tax avoidance. sig. value political connection is 0.037 less than the value of sig. α of 0.05. Thus, political connections affect tax avoidance. Likewise, for the sig value. audit quality, namely 0.036 less than the sig value. α of 0.05.

The test results show that the audit committee affects the tax avoidance of mining companies. Audit committees influence tax avoidance. Many or at least the number of audit committees affects tax avoidance (Anita Wijayanti, Endang Masitoh, 2018). Some companies prefer to have a minimum number of audit committees in order to produce effective results. The essential role of the audit committee is to ensure the independence and objectivity of the external auditor, in addition to monitoring company management. However, these results are different from previous research. The audit committee has a negative effect on tax avoidance because the audit committee can oversee all company activities so that tax avoidance can be minimized (Fauzan et al., 2019). In banking companies, the tendency of companies to do tax avoidance aggressively is not seen from the number of audit committees but seen from the quality and independence of the audit committee itself to analyze whether the company is doing tax evasion (Mita Dewi, 2019).

According to a number of studies based on the agency theory, corporate governance and tax avoidance are related because managers are always motivated to reduce tax liabilities and boost the worth of their companies (Dang & Nguyen, 2022). The audit committee has an important role as one of the company organs in implementing good corporate governance (Tai et al., 2020). According to the Indonesian Audit Committee Association (IAI), the audit committee works professionally and independently, assisted by the board of commissioners. Thus its task is to assist and strengthen the function of the board of commissioners or supervisory board in carrying out the oversight function of the process of financial reporting, risk management, auditing, and implementation of corporate governance.

According to BAPEPAM Number: KEP-29/PM/2004, the number of audit committees is at least three people in a company because it can minimize tax avoidance practices by companies. The audit committee is flexible in monitoring the mechanism for improving the quality of information for company owners and management. Audit committees with fewer members tend to act more efficiently, but they also

have weaknesses, namely the lack of experience of members. It shows that the company pays attention to the audit committee's financial report decisions. The linkage of mining companies, one of which is PT. Bayan Resources Tbk having four audit committees is one of the reference factors for conducting an internal audit of the company. The size of the audit committee has been found to be negatively correlated with tax avoidance activities. The reason for this connection is that many directors on the Audit Committee could profit from a range of shared expertise and experiences, preferring the stringent oversight roles on management decisions and limiting aggressive tax avoidance tactics (García-Meca et al., 2021).

The board of commissioners can be assisted by the presence of an audit committee within the organization in monitoring management as it prepares the company's financial statements, and it can also have an impact on the practice of tax evasion by the organization. The audit group also exerts control over managers to boost business profits, as opposed to how managers typically lower tax liabilities. It is what motivates management to engage in tax evasion. Based on this, the audit committee has the power to stop any improper behavior or activities pertaining to the company's financial statements. Therefore, the more audit committees a business has, the more tax avoidance there will be (Ekonomi et al., 2020).

Political connections affect mining companies' tax avoidance. The size of the value of political connections influences companies to carry out tax avoidance (Dinda Nurrahmi & Rahayu, 2020). Companies that have political connections result in these companies obtaining various privileges such as ease of obtaining loans, low risk of tax audits, and others which result in companies tending to do tax evasion. A company is said to have political connections if at least one major shareholder (a person who has at least 10 percent of the voting rights based on the number of shares owned) or one of the leaders (CEO, president director, vice president director, section head or secretary) is a member of parliament, minister, or has a close relationship with a political figure or party (Faccio, 2006).

Companies with political connections can use these connections to carry out tax avoidance activities (Putra & Suhardianto, 2020). Companies with political connections are always looking for loopholes to avoid taxes through these connections in order to maintain good relations with consumers, investors, and the public to continue running their businesses. If the board of commissioners from outside has a political and legal background, it will play an important role in dealing with political issues. Political connections can provide benefits to the company through many connections (Chaney et al., 2011; Faccio, 2006; Gray & Debreceeny, 2014; Handoko et al., 2022). Politically skilled boards of directors and commissioners can assist in taking action to influence the government using their expertise. This expertise is divided into two ways, namely 1) experience from previous participation in government and knowledge of procedures owned, such as friendship with decision-makers, and 2) experience conducting transactions with the government as a competitor in legal or administrative legal actions.

The political connection between the board of directors and the board of commissioners negatively affects tax aggressiveness (Putra & Suhardianto, 2020). It indicates that state-owned enterprises tend to avert tax aggressiveness. The state-owned enterprises with political connections are inclined toward compliance with the prevailing taxation regulation to enhance their image as obedient taxpayers. Although a political connection is established between the government and parliament, the board of directors and the board of commissioners do not take into their advantage of taxation. That indicates how state-owned enterprises tend to uphold the government's work plan concerning tax revenue (Iswari et al., 2019).

Audit quality has a negative effect on the tax avoidance of mining companies. Audit quality affects tax avoidance (Anita Wijayanti, Endang Masitoh, 2018). The auditor must express an opinion on the financial statements. In addition, the auditor must report to management on any risks identified, both internal and external, and provide advice for managing these risks. Audit quality is important in implementing good corporate governance in a company. The Big Four public accounting firms (KAP) have the ability and high quality of work to ensure the quality of financial information reported to investors. Transparency of financial reports has a close relationship with audits. Good audit quality will produce financial reports that are more useful for interested parties.

Audit quality is related to auditor selection, companies choose their audit quality through their choice of auditors. An audit is conducted to assess whether the financial statements have been made following applicable regulatory standards and the company's actual conditions. Several kinds of literature have proven that high tax rates will be followed by increased tax evasion and evasion. Based on the Public Accountant Profession Standard (SPAP), an audit carried out by the auditor can be of high quality if it meets the provisions or auditing standards. Auditing standards cover the professional qualities of independent auditors and considerations used in conducting audits and preparing auditor reports. Besides that, educational factors, audit structure, supervisory abilities, professionalism, and workload support quality audits.

4. Conclusion

The tests and analyses that have been carried out show that the audit committee has a positive effect on tax avoidance. The company pays attention to the audit committee in making financial report decisions. The political connection has a negative effect on tax avoidance. It shows that political connections through the board of commissioners also affect tax evasion. Audit quality also has a negative effect on tax avoidance. The audit quality of the Big Four Public Accounting Firm (KAP) guarantees reliable financial information. Audit committees, political ties, and audit quality, all having to be zero, will reduce tax evasion. An increase in audit committee members will result in more tax evasion, assuming all other factors remain constant. Under the assumption that all other variables remain constant, Tax Avoidance will decrease if the number of commissioners who reflect the company's political connections grows by one unit. A higher audit quality rating will result in less tax avoidance, assuming all other variables remain constant.

This research still has limitations, so future research is still needed. Future research is expected to be able to add other variables beyond those that have been studied because, based on statistical test results, 84% of tax avoidance is explained or influenced by other variables that still need to be in this study. Future research is expected to be able to use other indicators in measuring political connection variables because this study only measures from the side of the board of commissioners.

References

- Anita Wijayanti, Endang Masitoh, S. M. (2018). PENGARUH CORPORATE GOVERNANCE TERHADAP TAX AVOIDANCE (Perusahaan Pertambangan yang terdaftar di BEL). *Jurnal Riset Akuntansi Dan Bisnis Airlangga*, 3(1), 322–340. <https://doi.org/10.31093/jraba.v3i1.91>
- Ardillah, K., & Vanesa, Y. (2022). Corporate Governance Structure, Political Connections, and Transfer Pricing on Tax Aggressiveness. *Sriwijaya International Journal of Dynamic Economics and Business*, 6(1), 51. <https://doi.org/10.29259/sijdeb.v6i1.51-72>
- Chaney, P. K., Faccio, M., & Parsley, D. (2011). The quality of accounting information in politically connected firms. *Journal of Accounting and Economics*, 51(1–2), 58–76. <https://doi.org/10.1016/j.jacceco.2010.07.003>
- Chen, C. J., Ding, Y., & Kim, C. (2010). High-level politically connected firms, corruption, and analyst forecast accuracy around the world. *Journal of International Business Studies*, 41(9), 1505–1524. <https://doi.org/10.1057/jibs.2010.27>
- Chen, Y., Huang, J., Liu, H., & Wang, W. (2019). Regional favoritism and tax avoidance: evidence from China. *Accounting and Finance*, 58(5), 1413–1443. <https://doi.org/10.1111/acfi.12447>
- Dang, V. C., & Nguyen, Q. K. (2022). Audit committee characteristics and tax avoidance: Evidence from an emerging economy. *Cogent Economics and Finance*, 10(1). <https://doi.org/10.1080/23322039.2021.2023263>
- Desai, M. A., & Dharmapala, D. (2006). Corporate tax avoidance and high-powered incentives. *Journal of Financial Economics*, 79(1), 145–179. <https://doi.org/10.1016/j.jfineco.2005.02.002>
- Dinda Nurrahmi, A., & Rahayu, S. S. E. . M. A. . A. . C. (2020). Pengaruh Strategi Bisnis, Transfer Pricing, dan Koneksi Politik Terhadap Tax Avoidance (Studi Pada Perusahaan di Sektor Pertambangan Yang Terdaftar Di Bursa Efek Indonesia). *Jurnal Akuntansi & Ekonomi FE. UN PGRI Kediri*, 5(2), 48–57.
- Ekonomi, J., Ridhawati, R., & Mulyani, S. (2020). THE EFFECT OF MANAGERIAL OWNERSHIP , INSTITUTIONAL OWNERSHIP AND AUDIT COMMITTEE ON TAX AVOIDANCE IN MINING COMPANIES LISTED ON THE IDX IN 2017-2020. 148–160.
- Faccio, M. (2006). American Economic Association Politically Connected Firms. *Source: The American Economic Review*, 96(1), 369–386.
- Fauzan, F., Ayu, D. A., & Nurharjanti, N. N. (2019). The Effect of Audit Committee, Leverage, Return on Assets, Company Size, and Sales Growth on Tax Avoidance. *Riset Akuntansi Dan Keuangan Indonesia*, 4(3), 171–185. <https://doi.org/10.23917/reaksi.v4i3.9338>
- Firmansyah, A., Arham, A., Qadri, R. A., Wibowo, P., Irawan, F., Kustiani, N. A., Wijaya, S., Andriani, A. F., Arfiansyah, Z., Kurniawati, L., Mabur, A., Dinarjito, A., Kusumawati, R., & Mahrus, M. L. (2022). Political connections, investment opportunity sets, tax avoidance: does corporate social responsibility disclosure in Indonesia have a role? *Heliyon*, 8(8). <https://doi.org/10.1016/j.heliyon.2022.e10155>
- García-Meca, E., Ramón-Llorens, M. C., & Martínez-Ferrero, J. (2021). Are narcissistic CEOs more tax aggressive? The moderating role of internal audit committees. *Journal of Business Research*, 129(July 2020), 223–235. <https://doi.org/10.1016/j.jbusres.2021.02.043>
- Gray, G. L., & Debreceeny, R. S. (2014). A taxonomy to guide research on the application of data mining to fraud detection in financial statement audits. *International Journal of Accounting Information Systems*, 15(4), 357–380.

- <https://doi.org/10.1016/j.accinf.2014.05.006>
- Handoko, L. Y., Sari, M. M. R., Suaryana, I. G. N. A., & Putri, I. G. M. A. D. (2022). Political Connections, Blockholder Ownership, and Tax Avoidance: Evidence from Indonesia. *Budapest International Research and Critics Institute (BIRCI-Journal)*, 10824–10836. <https://doi.org/10.33258/birci.v5i2.4897>
- Iswari, P., Sudaryono, E. A., & Widarjo, W. (2019). Political connection and tax aggressiveness: A study on the state-owned enterprises registered in Indonesia stock exchange. *Journal of International Studies*, 12(1), 79–92. <https://doi.org/10.14254/2071-8330.2019/12-1/5>
- Kovermann, J., & Velte, P. (2019). The impact of corporate governance on corporate tax avoidance—A literature review. *Journal of International Accounting, Auditing and Taxation*, 36, 100270. <https://doi.org/10.1016/j.intaccudtax.2019.100270>
- Mita Dewi, N. (2019). Pengaruh Kepemilikan Institusional, Dewan Komisaris Independen dan Komite Audit Terhadap Penghindaran Pajak (Tax Avoidance) pada Perusahaan Perbankan yang Terdaftar di Bursa Efek Indonesia Periode 2012-2016. *Maksimum*, 9(1), 40. <https://doi.org/10.26714/mki.9.1.2019.40-51>
- Putra, Z. K. P., & Suhardianto, N. (2020). The Influence of Political Connection on Tax Avoidance. *Jurnal Akuntansi Dan Keuangan*, 22(2), 82–90. <https://doi.org/10.9744/jak.22.2.82-90>
- Sari, K., & Somprawiro, R. M. (2020). Pengaruh Corporate Governance, Koneksi Politik dan Profitabilitas Terhadap Potensi Tax Avoidance. *Jurnal Akuntansi*, 9(1), 90–103. <https://doi.org/10.37932/ja.v9i1.78>
- Sunarto, S., Widjaja, B., & Oktaviani, R. M. (2021). The Effect of Corporate Governance on Tax Avoidance: The Role of Profitability as a Mediating Variable. *Journal of Asian Finance, Economics and Business*, 8(3), 217–227. <https://doi.org/10.13106/jafeb.2021.vol8.no3.0217>
- Tai, V. W., Lai, Y. H., & Yang, T. H. (2020). The role of the board and the audit committee in corporate risk management. *North American Journal of Economics and Finance*, 54. <https://doi.org/10.1016/j.najef.2018.11.008>
- Tang, T. Y. H. (2023). An Investigation of Tax-Related Corporate Political Activity in China: Evidence From Consumption Bribery. *Journal of Accounting, Auditing and Finance*, 38(1), 77–103. <https://doi.org/10.1177/0148558X20965698>