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Factors Influencing Earnings Management: Deferred Tax Liability, Tax Planning, and Company Size

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ABSTRACT

This study examines the factors influencing earnings management, with a focus on deferred tax liability, tax planning, and company size. In a competitive business environment, companies strive to achieve optimal financial performance while minimizing tax liabilities, which often leads to *earnings management* practices. The research addresses three primary questions: the impact of deferred tax liability, tax planning, and company size on *earnings management*. Utilizing a qualitative approach and comprehensive literature review, this study analyzes relevant theories and empirical findings from various sources, including *Mendeley* and *Google Scholar*. The results suggest that deferred tax liability and tax planning significantly affect *earnings management*. Larger companies are more likely to engage in such practices due to greater resources and heightened investor expectations. Nonetheless, some studies present contradictory evidence, underscoring the complexity of these relationships. This research contributes to the tax accounting literature by synthesizing existing knowledge and proposing hypotheses for future studies. It also identifies additional determinants of *earnings management*, such as managerial ownership, audit quality, and corporate governance. The findings hold implications for policymakers, regulators, and corporate managers, emphasizing the importance of transparency and ethical conduct in financial reporting. Further research is recommended to investigate other influencing variables and contextual differences across industries.

Keywords: *Profit management, deferred tax burden, tax planning and company size*

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INTRODUCTION

In recent years, the business world has witnessed intense competition, compelling companies not only to strive for greater market share with attractive products and offers but also to present robust financial performance across all business activities. This dual objective requires policies that support the company's business continuity. Companies generally have two main targets: first, to achieve good financial performance, characterized by the highest possible profits reported through accountability reports to stakeholders (Wulansari, 2019); and second, to compile taxable income as efficiently as possible so that the resulting tax burden is minimized (Yunila & Aryati, 2018). To achieve these targets, management undertakes activities in preparing financial statements addressed to external parties and stakeholders. The business practices carried out by management in this context are referred to as *earnings management* (Midiastuty et al., 2016).

A prominent case illustrating the risks of *earnings management* is the investigation reported by CNBC in 2019, based on findings from PT Ernst & Young Indonesia for AISA's new management. The report revealed suspicions of inflated funds in AISA's receivables, inventories, and fixed assets, with the previous management allegedly inflating assets by IDR 4 trillion. Furthermore, EBITDA was reportedly overstated by IDR 662 billion, and other assets

by IDR 329 billion, particularly in the food industry unit. This was linked to allegations of collecting farmers' rice from government subsidies to process and repackage it as premium rice. As a result, the rice business, which had contributed 50% of TPS Food's revenue, ceased operations, causing the company to lose potential revenue of IDR 2 trillion per year.

Based on this case, it is evident that management may engage in profit management to avoid reporting losses. One approach in *earnings management* involves manipulating deferred tax expenses, as seen in the fluctuations of tax burden values over different periods. Managers analyze and determine various steps to manage profits based on the amount of deferred tax expense, aiming for greater efficiency and to avoid the negative impact of losses on financial reporting downgrades. According to Baraja et al. (2019), deferred tax expense is a cost arising from temporary differences between accounting profit and fiscal profit. The assumption is that higher profits lead to higher tax burdens, which can reduce the company's net profit. To minimize the tax burden in financial statements, managers engage in *tax planning*. The ultimate goal of tax planning is to manage reported profits by determining and analyzing the amount of profit to be reported, which is an indication of *earnings management* practices (Midiastuty et al., 2016).

Empirically, many students and authors face challenges in finding supporting articles for their scientific work, whether as previous or relevant research. Such articles are essential to strengthen theoretical foundations, analyze relationships or influences between variables, and build hypotheses. This article discusses the influence of deferred tax burden, tax planning, and company size on *earnings management*, presented as a literature review in the field of tax accounting.

In recent years, the business world has experienced heightened competition, prompting companies to pursue both market dominance and strong financial performance. This dual pursuit often leads to *earnings management* practices, where companies manipulate financial statements to meet stakeholder expectations or minimize tax liabilities. Previous research has investigated various factors influencing *earnings management*, such as deferred tax liability, tax planning, and company size. For example, Baraja et al. (2019) found that deferred tax liability positively affects *earnings management*, while Lubis and Suryani (2018) reported contrary findings. Similarly, *tax planning* has been identified as a tool for profit manipulation, though its effectiveness is debated, as seen in the contrasting results of Rusdyanawati et al. (2021) and Clara Jesika (2022). These inconsistencies highlight the complexity of the relationship between tax-related variables and *earnings management*.

Despite extensive studies, gaps remain in understanding the interplay between deferred tax liability, tax planning, and company size. Much of the existing literature examines these variables in isolation, overlooking their combined effects. Additionally, while some studies focus on large corporations, fewer examine small and medium-sized enterprises, creating a knowledge gap regarding how company size moderates *earnings management* practices. Furthermore, the role of contextual factors, such as industry-specific regulations or economic conditions, is often underexplored. These gaps limit the generalizability of findings and call for a more integrated approach to studying the determinants of *earnings management*.

The urgency of this research is underscored by the increasing scrutiny of corporate financial practices by regulators, investors, and the public. High-profile cases, such as the PT Ernst & Young Indonesia investigation in 2019, reveal the severe consequences of unethical

earnings management, including reputational damage and financial losses. Understanding the drivers behind such practices is critical for developing policies that promote transparency and accountability. Moreover, as tax laws and accounting standards evolve, companies must adapt their strategies, making it essential to identify how these changes influence *earnings management*. This research addresses these pressing issues by providing empirical insights into the factors shaping financial reporting behaviors.

This study introduces novelty by synthesizing fragmented literature into a cohesive framework that simultaneously examines deferred tax liability, tax planning, and company size. Unlike previous studies that often focus on one or two variables, this research adopts a holistic approach to uncover their collective impact on *earnings management*. It also incorporates recent empirical evidence, such as the work of Setiowati et al. (2023), to reflect contemporary trends in financial reporting. By bridging theoretical and practical perspectives, the study offers a nuanced understanding of how tax and size-related factors interact to shape *earnings management* strategies.

The primary objective of this research is to analyze the influence of deferred tax liability, tax planning, and company size on *earnings management*. Specifically, it seeks to determine whether these variables act as enablers or deterrents of profit manipulation. The study also aims to reconcile conflicting findings from prior research by contextualizing them within a broader framework, thereby providing clarity on the conditions under which *earnings management* is most likely to occur. Additionally, the research explores secondary factors, such as managerial ownership and audit quality, to identify their potential moderating effects.

The benefits of this research extend to multiple stakeholders. For policymakers, the findings can inform the design of regulations that curb unethical financial practices while accommodating legitimate *tax planning*. Corporate managers can use the insights to align their reporting strategies with ethical standards and regulatory requirements, thereby enhancing stakeholder trust. Investors and analysts may leverage the results to detect red flags in financial statements, improving decision-making. Academics will benefit from the integrated theoretical framework, which can serve as a foundation for future studies on *earnings management* and related topics.

By addressing gaps in the literature and offering practical implications, this research contributes to the ongoing discourse on corporate financial integrity. It underscores the need for a balanced approach that considers both the strategic and ethical dimensions of *earnings management*. The study's findings are particularly relevant in today's dynamic business environment, where transparency and accountability are paramount. Ultimately, the research aims to foster a culture of responsible financial reporting that benefits companies, investors, and society at large.

METHOD

The method used in writing this scientific article was a qualitative approach combined with library research. This method was employed to analyze and examine theories, as well as the relationships or influences between variables, using books and journals sourced online from *Mendeley*, *Google Scholar*, and other online media. The literature utilized in this research consisted of findings from national and international scientific studies relevant to *earnings management*.

This article discussed the influence of deferred tax burdens, tax planning, and tax measures on *earnings management*. In qualitative research, the literature review had to be applied consistently with methodological assumptions. This meant it needed to be used inductively so as not to predetermine the questions posed by the researcher. One of the main reasons for conducting qualitative research was that the research was exploratory in nature (Ali & Limakrisna, 2013).

RESULTS AND DISCUSSION

Based on relevant theoretical studies and previous research, the discussion of this literature review article in the concentration of Tax Accounting is:

The effect of deferred tax burden on profit management

Based on the results of research conducted by (Baraja et al., 2019) there are results that show a figure of 0.027. However, the test of the article written by Baraja, L. M., et al (2019) used the two-tails method while the study used one tail, the result was 0.0135. These results show that the deferred tax burden has a positive effect on profit management. These results are supported by research from (Bunaca & Nurdayadi, 2019) which states that the burden of deferred tax has a significant effect on profit management.

Deferred tax expenses will arise due to differences between fiscal and commercial financial statements which cause temporary differences. Thus, the negative correction formed will have an impact on commercial profits that are greater than commercial profits. So as to increase the burden and reduce the company's profit (Halimah & Wahyuningsih, 2023). The profits presented are not only aimed at stakeholders but also to shareholders. So that profits that show great results will attract stock investors and can increase the company's shares. On the other hand, the amount of profit is also presented to the tax authorities. A larger reported profit will be good news for management, but it means the taxes charged will also be higher. So here, management has their opportunity to manage profits in such a way that they can minimize the value of taxes imposed.

Therefore, the greater the value of the deferred tax burden, the higher the likelihood of the company reengineering to manage the company's profits. The results of this study contradict the research from (Lubis & Suryani, 2018) which states that the burden of deferred taxes has no effect on profit management. Likewise, research from (Kanji, 2019) states the same thing, namely supporting the result that the deferred tax burden does not have a significant effect on profit management.

The influence of tax planning on profit management

According to (Ricy et al., 2020), it is stated that the initial stage in performing profit management is tax planning as a suggestion where to deal with taxation correctly but reduce the taxes paid to a minimum. Therefore, it can be said that tax planning is the amount of profit in the report that is prepared in such a way, management will regulate profits in practice regulating profits if the profits generated by the company are high so that the tax burden paid is lower (Pebriyani & Lahaya, 2023). This can happen because all companies want the tax paid to be at the minimum nominal amount possible (Rusdyanawati et al., 2021). With the goal of a company that wants to make a profit, when the profit achieved is high, it will motivate the management to be able to manage profits. This is because the greater the profit obtained, the greater the tax imposed. Therefore, the company strives to regulate profits so that the taxes

imposed are more efficient and effective. This is also supported by the large profit level that can be used as a rejection of management performance. So the possibility of companies to do tax planning in the context of company management is getting bigger.

Based on the results of research conducted by (Saputra & Kuntadi, n.d.) it is stated that tax planning has an effect on tax management. The results of the study showed a Tax Retention Rate (TRR) figure with a tcal value of 2.451 and a ttable of 1.68488 which means a tcal > ttable. While the significance probability value is 0.019, 0.05. It shows that it has a significant effect on profit management.

These results are supported by research (Rusdyanawati et al., 2021) and (Baraja et al., 2019) stating the same results. However, it is contrary to research (Clara Jesika, 2022) and (Prihatiningsih, 2019). This can happen because of the desire and target of each management to achieve good division performance in order to get bonuses or rewards. So profit management arises due to self-interest, not tax planning.

The effect of company size on profit management

Based on research, according to Setiowati et al., (2023) it is stated that company size has a positive effect on profit management. According to Setiowati et al., (2023) large companies have a great drive to do profit management. This can happen because of several things that encourage management to manage profits.

Company size is an assessment of the size or size of the company. In general, the size or size of a company is quite important for investors because it affects the investment they will invest in the company. This investment illustrates that the bigger the company, the more funding sources the company has. The many possible sources of funding will encourage management to do profit management. Large companies are considered more thorough and critical so that they are able to manage these profits (Setiowati et al., 2023a). In addition, the purpose of profit management in large companies is related to the presentation of financial statements where management wants the presentation of the best company performance to be presented in the financial statements (Nathaly & Yuniarwati, n.d.).

On the other hand, there is research that shows that the size of the company has a negative effect on the company. This is because the management wants to remain cautious and maintain the good image of the company. Profit management is considered to be able to hurt the positive image of the company. Because there is strict supervision by external parties (Purnama, 2017). Thus, managers tend to avoid this practice. Meanwhile, small companies tend to practice profit management because of the need for funding that encourages managers to do profit management. Companies compete to present financial statements that reflect the best performance results to attract investors. So that small companies tend to manage profits (Meilani & Widyastuti, 2022).

This research is in line with research (Joe & Ginting, 2022) and (Adyastuti & Khafid, 2022) which states that company size has a significant positive effect on profit management. This research contradicts (Kristiana & Rita, 2021).

Conceptual Framework

Based on the formulation of the problem, theoretical studies, relevant previous research and discussion of the influence between variables, the thinking framework of this article is as follows.

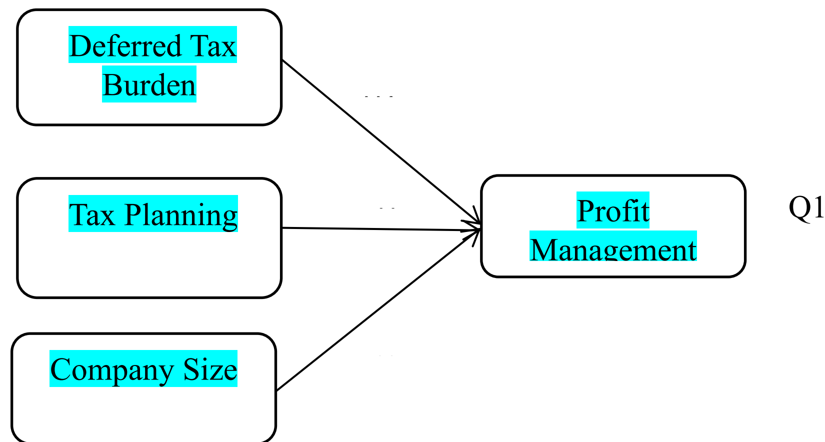

Figure 1. Conceptual Framework

Based on the conceptual framework image above, deferred tax expenses, tax planning, and company size affect profit management. Apart from these three exogenous variables that affect profit management, there are many other variables that affect it, including:

a) Managerial Ownership: (Komang Januartana Putra et al., 2023).
b) Audit Quality: (Alexander, 2021)
c) Good Corporate Governance: (Ambarwati et al., 2024).
d) Dividend Policy: (Ayu et al., 2012).
e) Leverage: (Meilani & Widyastuti, 2022)
f) Profitability: (Purnama, 2017).

CONCLUSION

Based on the theoretical framework, relevant literature, and discussions, this study formulated hypotheses that deferred tax burden, tax planning, and company size each affect *earnings management*. However, it is important to note that many other factors—such as managerial ownership, audit quality, good corporate governance, dividend policy, leverage, and profitability—may also influence *earnings management* across different types and levels of organizations. Therefore, further research is needed to identify additional determinants beyond those examined in this article. Future studies are encouraged to explore industry-specific dynamics or conduct cross-country comparisons to assess the universality of these findings, as well as to undertake longitudinal research to observe how changes in tax policies or economic conditions impact *earnings management* trends over time. Such research would deepen the understanding of this complex phenomenon and its implications for global financial markets.

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