The Effect of Corporate Social Responsibility on Tax Avoidance and Earnings Management: The Moderating Role of Political Connections

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ABSTRACT

This study aims to examine the effect of CSR towards tax avoidance and earnings management practices as well as the role of political connections as moderating variable. This study finds evidence that CSR has a positive effect toward tax avoidance, real earnings management, and aggregate earnings management. The results indicate that broader CSR disclosure is done to cover opportunistic behaviors and maintain the legitimacy and corporate image in the eyes of the stakeholders. However, for political connections, it is generally not proven to have a significant role in moderating the effect of CSR towards tax avoidance and earnings management practices. This research is expected to provide input to users of financial statements to be more careful in assessing company ethics. Besides, the government is also expected to make regulations to ensure that the content of disclosures made by the company is not just a green wash statement for stakeholders.

JEL Classifications: M14, M41, G32, H26

Keywords: CSR; earnings management; political connections; tax avoidance

I. INTRODUCTION

An ethical assessment of a company can be based on the implementation of corporate social responsibility (CSR) to its community where the company operates. On the one hand, the company fulfills the needs of the public by selling its products, but on the other hand, the operational activities often bring damage and negative impacts to various stakeholders such as the community and the nearby area (Fauzi, 2009). To minimize the negative impacts generated by the operational activities, the company must consider the interests of stakeholders, one of them through the implementation of CSR activities.

Another assessment of company ethics can also be seen from the indications of tax avoidance and earnings management practices. Tax avoidance is an act performed by a company to avoid and delay tax payments by exploiting the gap or gray area of the tax regulations (Pohan, 2013), while earnings management, according to Healy and Wahlen (1999), is an act of companies to manipulate financial statements to influce the outcomes or results prompted by accounting data or to mislead stakeholders about company performance because what is reported does not reflect the fact.

Based on ethics theory, CSR activities should encourage companies to minimize unethical behavior such as tax avoidance and earnings management. However, research results such as Prior et al. (2008) and Lanis and Richardson (2013) find empirical evidence that the purpose of firms performing CSR activities are to cover unethical actions to minimize the risks of the immoral action. This type of CSR is in line with what is mentioned by Smith (2003) and Stolz (2010). They say company’s motivation in performing CSR activities can be divided into two: normative and strategic. The normative motivation is to fulfill its obligations as part of the community group in accordance with prevailing norms and ethics. By doing the strategic motivation, the company wants to accomplish a certain purpose, including to cover the opportunistic actions so that the company's legitimacy and reputation is preserved.

Furthermore, this study will complement relevant researches on the role of political connections in moderating the influence of CSR on tax avoidance and earnings management practices. Previous research (Leuz and Oberholzer Gee, 2006; Francis et al., 2005; Christensen and Murphy, 2004) suggests that political connections are an important component to analyze corporate behavior. In Indonesia, Wulandari and Rahman (2005) finds that the performance of companies having no political connections is better than that of other companies that have. In addition, companies that have political connections tend not to consider the positive impacts of CSR activities on developing legitimacy and creating a positive image in the eyes of any stakeholders.

Kim and Zhang (2016) finds evidence that a company having political connections tends to do more tax avoidance practices for several reasons, namely to have a low probability to be detected, to have a better exposure on future regulatory changes, be free of transparency pressure, having lower political costs, and be a more risk taker compared to companies having no political connections. Other research results are also documented by Chaney et al. (2011) that says companies having political connections have a lower quality of financial statements than that of other companies that do not have. Therefore, political connections are believed to play a role in moderating the influence of CSR on tax avoidance and earnings management practices. Throughout the literature review, there is no research examining the role of political connections in controlling the influence of CSR on both practices.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

A. CSR and Tax Avoidance

Lanis and Richardson (2012), using a sample of 408 listed companies in Australia, conclude that the more corporate investments in social activities, the less likely it is to do tax avoidance. The results of this study are further strengthened by Hoi et al. (2013) concluding that socially irresponsible companies have a greater amount of book tax differences (BTD). Landolf (2006) mentioned that when companies evade the tax obligation, public attention would refer this as unethical actions. The unethical actions will damage the reputation and legitimacy of the company to the community. However, contradictory research results are obtained when Lanis and Richardson (2013) proves that to perform beneficial actions such as tax evations and to maintain their reputation and legitimacy, the company discloses more CSR so that such horrible actions can be covered and legitimacy and reputation of the company is preserved. Because the main theory used in this study is the theory of ethics, the hypothesis related to the influence of CSR on tax avoidance practices are as follows:

H1: CSR has a negative effect on tax avoidance.

B. CSR and Earnings Management

Related research on CSR and earnings management, Chih et al. (2008) summarize four different hypotheses: (1) myopia avoidance hypothesis, a CSR-oriented company is not only focusing on increasing the current period's earnings but it is also focusing on maintaining the quality of relationships with future stakeholders; (2) predictable earnings hypothesis, a CSR-oriented company is seeking to reduce the information asymmetry between internal and external investors; (3) multiple objective hypothesis, when carrying out CSR activities using internal resources for the benefit of stakeholders, management will be more inclined to do things that benefit its own interests; and (4) institutional hypothesis, there is no relationship between CSR and earnings management because lack of concern for CSR may be due to institutional factors not related to earnings management practices.

Salewski and Zulch (2012) investigate the effect of CSR activities on earnings management practices in ten developed countries and has evidence that companies in these countries report more CSR activities to cover up the observed actions such as earnings management. However, Scholtens and Kang (2013) prove that CSR-oriented companies have a positive influence on investor protection. It affects the creation of better financial statements that does not engage in accrual earnings management practices. In addition, based on ethical theory, companies focused on CSR activities are considered as ethical companies so that their actions do not only consider the economic aspects but also consider other aspects that are more comprehensive for the interests of stakeholders. One of them is by providing high quality and not misleading financial report. Therefore, the hypothesis related to the effect of CSR on accrual earnings management practices are as follows:

H2a: CSR has a negative effect on accrual earnings management.

Companies that are active in implementing and disclosing their CSR activities tend not to practice real earnings management because they have a high commitment to manage their companies as a steward of the shareholders (Chih et al., 2008). In addition, according to Bozzolan et al. (2015), although the CSR-oriented companies involved in earnings management practices, firms will choose the least profitable techniques. On the other hand, the real earnings management practices result in a singnificant risk of a declining long-term corporate performance as the practices directly affect the company's cash flow. Therefore, the hypothesis developed related to the influence of CSR on real earnings management practices are as follows:

H2b: CSR has a negative effect on real earnings management.

A more comprehensive study of the effects of CSR on the practice of earnings management both accrual and real (later referred to as aggregate earnings management) has been accomplished by Kim et al. (2012). The study shows empirical evidence that socially responsible companies have a tendency not to engage in aggregate earnings management practices. In line with ethical theory, ethical companies will not engage in practices that can weaken companies such as aggregate earnings management, because they higly commit to the responsibilities given by shareholders to manage their companies. As a result, the tendency to practice aggregate earnings management is reduced. Therefore, the hypothesis related to the influence of CSR on aggregate earnings management practices are as follows:

H2c: CSR negatively affects aggregate earnings management.

C. The Moderating Role of Political Connections on the Association between CSR and Tax Avoidance

Before discussing the role of political connections in moderating the effect of CSR on tax avoidance practices, Kim and Zhang (2016) document that politically active companies are more active in doing tax avoidance practices because of some characteristics: to have lower detectable risks, to have better information regarding future tax regulation changes, to have lower political costs, and to have closeness with policy makers. Therefore, the hypothesis related to the direct influence of political connections against tax avoidance practices are as follows:

H3a: Political connections have a positive effect on tax avoidance.

Lin et al. (2015) state that companies having political connections are suspected of making CSR a tool to seek sympathy for the government to take take advantage of the closeness. This makes the implementation of CSR motivation is no longer normative, but more to a strategic motivation. In addition, companies having political connections can utilize the power and political influence to build legitimacy with society. Therefore, companies having political connections are not estimated to consider CSR disclosure to build legitimacy and as a result have a higher potential for tax avoidance practices. Therefore, the hypothesis is as follows:

H3b: Political connections weaken the negative impact of CSR on tax avoidance.

D. The Moderating Role of Political Connections on the Association between CSR and Accrual Earnings Management

Another characteristic of companies with political connections is they are not subject to transparency pressure so that information asymmetry of companies with political ties becomes greater and triggers accrual earnings management practices (Chaney et al., 2011). In addition, another characteristic of firms having political connections is the low risk to be detected if they take such opportunistic actions (Kim and Zhang, 2016), to increase opportunities and incentives in implementing practice earnings management. From this, political connections are suspected to have a positive effect on the accrual earnings management practices. Therefore, the hypothesis related to the direct influence of political connections on the accrual earnings management practices is as follows:

H4a: Political connections have a positive effect on the accrual earnings management.

Despite the enthusiastic implementation of CSR, the companies' prospects for accrual earnings management are also greater for companies with political connections, so the negative impact of CSR on accrual earnings management practices is considered weaker for companies with political links. In addition, based on the theory of legitimacy, companies developing political connections do not consider the implementation of CSR activities to build and gain legitimacy from the community and the surrounding environment, because for such companies, legitimacy can be obtained with the power and political influence. Therefore, the hypothesis related to the role of political connections in moderating the negative effects of CSR on accrual earnings management is as follows:

H4b: Political connections weaken the negative impact of CSR on accrual earnings management.

E. The Moderating Role of Political Connections on the Association between CSR and Real Earnings management

The study by Braam et al. (2015) states that companies having political connections are interested in using real earnings management strategies because it is more difficult to detect and at the end it can disguise the political preferences of the company. Commitment and a sense of social responsibility to a company having a political connections are lower due to the existence of greater power so that the company does not pay so much attention to the negative impact of real earnings management practices on the performance. Therefore, the hypothesis in relation to the role of direct political connectionships to real earnings management practices is as follows:

H4c: Political connections have a positive effect on real earnings management.

Referring to the theory of legitimacy that has been discussed earlier, companies having political connections gain legitimacy from the influence of political connections inherent in the company. Therefore, companies having political connections are not using CSR as a tool to build legitimacy, and have greater incentives to practice real earnings management, so that the hypothesis is developed on the direct influence and role of political connections in the moderation of CSR influence to real earnings management practices are as follows:

H4d: Political connections weaken the negative impact of CSR on real earnings management.

F. The Moderating Role of Political Connections on the Association between CSR and Aggregate Earnings management

Similar to the two previously hypotheses, companies with political links have lower detectable risks, tend to be risk takers, and are less pressured to implement transparency so that opportunities and incentives to practice earnings management, both accrual and real, are larger than companies with no political connections (Chaney et al., 2011). Therefore, the hypothesis concerning the direct influence of political connections on the practice of aggregate earnings management is as follows:

H4e: Political connections have a positive effect on aggregate earnings management practices.

In addition, the legitimacy required by the company to operate can be obtained through the company's political connections. As a result, incentives for CSR activities are smaller, and incentives to practice earnings management, both accrual and real, are larger than those for firms having no political connections. Therefore, political connections weaken the negative impact of CSR on the practice of earnings management, both accrual and real. Thus, the next hypothesis is as follows:

H4f: Political connections weaken the negative impact of CSR on aggregate earnings management.

III. RESEARCH METHOD

A. Sample Selection

The population used in this study is all companies listed on the Indonesia Stock Exchange (BEI) in 2014-2016. The selection of the study period is based on the selection of political officials in the 2014 elections and to minimize the influence of different government regimes (Fisman, 2001; Mietzner, 2006). Data sources used in this research are: Indonesian Capital Market Electronic Library (ICAMEL), datasream, annual reports of the companies (used for content analysis to compute CSR disclosure based on GRI G4 framework, and data related to political connections based on the content analysis of the board of commissioners and the board of directors background), and a list of state/regional officials, legislative members, and party officials (to identify political connections). The sample selection using purposive sampling technique as summarized in Table 1.

Table 1
Sample selection

Selection Criteria	Tax Avoidance Model	Earnings Management Model
Population	1,582 companies-year	
Companies that belong to the Financial Industry	265 companies-year	
Companies with negative earnings and/or equity	56 companies-year	
Companies whose financial reporting period are not one full year and do not end on December 31	85 companies-year	
Companies whose data is not complete	217 companies-year	240 companies-year
Companies that have ETRs outside 0-1 range	108 companies-year	N/A
Number of Research Sample	851 companies-year	936 companies-year
Selected Sample Percentage	53,79%	59,17%

B. Research Variables and The Operationalization

Book Tax Difference (BTD), the difference in pre-tax profit under accounting and taxes divided by total assets, is used as tax avoidance proxy because it is considered able to explain tax avoidance practices performed by management (Hanlon and Heintzman, 2010). For sensitivity tests, it generally uses the proxy of effective tax rate (ETR), the ratio of current tax expense to the profit before tax according to the books, as it not only can measure the company's efforts to minimize the tax paid, but can also masure the company's effort to delay the tax payment (Amidu et al., 2016). For earnings management, it is divided into three types: earnings management accrual uses model of Kothari et al. (2005) as it is considered capable of describing opportunistic actions compared to other accrual earnings management models (Amidu et al., 2016) and it already considers the effect of Return on Asset (ROA), and real earnings management uses model of Roychowdurry (2006) and Cohen et al. (2008); and aggregate earnings management refers to the research of Bozzolan et al. (2015) which adds the decile of residual absolute accrual earnings management and absolute real earnings management values. Because this study is focused to see the amount of earnings management, the residual value is the absolute number (Ding et al., 2018).

As a dependent variable, CSR is measured using proxy of CSR disclosure level based on the GRI G4 framework, since there is a positive relationship between CSR activity and its disclosure level (Nazari et al., 2017). Assessment of CSR disclosure content was performed by content analysis method with 149 valuation aspects. As a result, CSR value is obtained from percentage of disclosure according to GRI G4 divided by 149. GRI is considered as the most relevant framework and is often used as a global CSR disclosure standard (Verbeeten et al., 2016).

Political connections are measured by a variable of board connections based on board of commissioners and directors' bios in annual reports after matching them with political position data. As stated by researches of Faccio (2006), Fan et al. (2007), and Habib et al. (2017), a company is categorized as having political connections if members of the board of commissioners and directors have been or are currently serving as head of the central or regional government, legislative members, ministers or ranks of cabinet, political party officials, or other political positions such as members of the military, Ambassador, and so forth as mentioned in annual reports. If previous research (Habib et al., 2017) measures the proxy of political connections with dummy, to be more accurate this study will use the percentage of composition of board of commissioners and directors who have political connections divided by total board of commissioners and directors.

Furthermore, in order to avoid the influence of other variables on dependent variables independent to the context of this study, this research incorporates several control variables. For tax avoidance, there are SIZE, LEV, CAPINT and MBV. However, for the earnings management control, there are SIZE, LEV, AUDITOR, GROWTH and MBV. For real earnings management, ROA is added because in the related model, the ROA variable has not been considered. However, ROA is considered to be able to reflect the expectations of corporate profits that become one of the incentives to do earnings management.

IV. RESULT AND DISCUSSION

A. Descriptive Statistics

Statistics descriptive of variables in our tax avoidance model is presented in Table 2. The average difference between tax per accounting principles and tax per fiscal law (BTD) is 0.39% with standard deviation of 7.35%. Although the average amount is small, the BTD has a positive sign indicating that the earnings before taxes according to accounting of the sample companies is greater than the tax return reported by the company. Hence, it could indicate tax avoidance practices. The average effective tax rate (ETR) rate is 15.93% that is less than the prevailing corporate tax rate in Indonesia (25%). Thus, it can be an indication that there is tax avoidance. The lower the effective tax rate, the higher the indication of tax avoidance. In addition, the standard deviation of ETR is also quite high, more than its average of 17.80%.

For the accrual discretionary value, the maximum value for accrual earnings management is 33.36%, which is the result of winsorizing. However, if we view the initial data, the maximum value for the variable of earnings management of this accrual is equal to 149.8%. For real earnings management variable, descriptive statistic result indicates that the mean is equal to 34.46%. For descriptive statistics on aggregate earnings management, the value ranges from 0-2 and the average is approaching 1 because aggregate earnings management value is obtained from the sum of decile accrual earnings management and decile real earnings management, which values are respectively between 0-1.

Table 2
Descriptive statistics for the tax avoidance model

Variable	N	Mean	Std. Dev.	Min.	Max.
BTD	851	0.0039	0.0735	-0.7772	0.5778
ETR	851	0.1593	0.1780	0	0.9727
CSR	851	0.3087	0.1227	0.0940	0.9396
CPC	851	0.0333	0.0540	0	0.4337
SIZE	851	9,419.26	21,950.48	39,84	261,855.00
LEV	851	0.2529	0.1730	0.0002	0.8105
CAPINT	851	0.3809	0.2493	0.00005	0.9446
MBV	851	2.1985	2.4185	0.0921	11.5690

Description: BTD = the difference betweeen pre-tax profit per accounting and per fiscal divided by total assets ETR = ratio of current tax expense to profit before tax per bookkeeping; **CSR** = CSR disclosure level based on GRI G4 framework; **CPC** = percentage of commissioners and directors who have political connections; **SIZE** = company size measured by total assets (in millions of rupiah); **LEV** = ratio of debt to total assets of the company; **CAPINT** = ratio of fixed assets to total assets of the company; **MBV** = the ratio of market value to the book value of the company's equity.

Table 3
Descriptive statistics for the earnings management model

Variable	N	Mean	Std. Dev.	Min.	Max.
ABSAEM	936	0.0632	0.0630	0.00007	0.3336
ABSREM	936	0.3446	0.3417	0.00003	1.6564
EM_ALL	936	0.9999	0.4396	0.0449	1.9850
CSR	936	0.3122	0.1229	0.0940	0.9396
CPC	936	0.0993	0.1325	0	0.7143
SIZE	936	9,849.63	21,511.18	28.065	261,855
LEV	936	0.2691	0.1788	0.0002	0.8105
MBV	936	2.2238	2.5911	0.0039	12.0334
AUDITOR	936	0.3985	0.4899	0	1
GROWTH	936	0.0606	0.2900	-0.9593	1.5384
ROA	936	0.0309	0.0840	-0.4330	0.5930

Description: ABSAEM = absolute accrual earnings management; **ABSREM** = value of residual earnings management that is made an absolute number; **EM_ALL** = sum of reverse AEM and REM deciles; **CSR** = CSR disclosure level based on GRI G4 framework; **CPC** = percentage of commissioners and directors who have political connections; **SIZE** = company size assessed by total assets (in millions of rupiah); **LEV** = ratio of debt to total assets of the company; **MBV** = ratio of market value to book value of equity of the company; **AUDITOR** = auditor quality: 1 if affiliated with Big 4, 0 if otherwise; **GROWTH** = growth rate assessed by percentage change in sales; **ROA** = the rate of return on assets: the ratio of net income to the total assets of the company.

The average CSR item disclosure is still low (at 31%). This does not agree with PwC survey results (2016) showing more than half of companies use GRI references. The trade, services and investment industries have the highest rate of disclosure according to GRI G4 framework of 39.75%, while other industries has the lowest disclosure rate of 19.28%. For political connections, the average of political connections is quite small, only about 3.33% (tax avoidance model) and 9.93% (earnings management model). For comparison of political connections between state-owned enterprises (SOEs) and non-SOEs, the SOEs are still far beyond non-SOEs of 14.52% versus 2.84% for tax avoidance model and 32.48% versus 8.8% for earnings management model. In addition, about 25% of the political positions in this study come from the military.

B. CSR, Tax Avoidance, and Political Connections

Based on the results of hypothesis testing 1a (H1a) as shown in Table 4, CSR affects tax avoidance practices, but the effect of CSR on the practice of tax avoidance is positive so that **H1a is not accepted**. This result is inconsistent with ethical questions suggesting that CSR-focused firms will minimize opportunistic measures such as tax avoidance because they are inconsistent to ethics and norms prevailing in society. The use of the CSR disclosure proxy level further demonstrates the company's efforts to preserve its legitimacy from the risks arising from tax avoidance practices, indicating that the motivation for CSR disclosure is a strategic motivation, to cover unethical acts such as tax avoidance.

Table 4

Regression results on the effect of CSR on tax avoidance and the moderating role of political connections

Variable	Prediction	TAXAVOID (BTD)	
		Regression 1a	Regression 1b
Intercept		-0.1746***	-0.1758***
CSR	-(H1a)	0.0464*	0.0453*
CPC	+(H3a)	-0.0859	-0.0996
CSR*CPC	-(H3b)		0.0824
SIZE	+	0.0061***	0.0062***
LEV	+	-0.0599***	-0.0603***
CAPINT	+	0.0075	0.0076
MBV	-	0.0009	0.0009
N		851	
Prob. F-Statistics		0.0032***	0.0062***

Description: BTD = the difference between accounting profit and taxable income divided by total assets; **CSR** = CSR disclosure level based on GRI G4 framework; **CPC** = percentage of members of the board of commissioners and directors who have political connections; **SIZE** = firm size measured by total assets; **LEV** = ratio of debt to total assets of the company; **CAPINT** = ratio of fixed assets to total assets of the company; **MBV** = the ratio of market value to the book value of the company's equity. Significance Level: *p<0.10; **p<0.05; ***p<0.01

The results of hypothesis testing 3a (H3a) and 3b (H3b) can be seen in the Table 4, regression columns 1a and 1b, consistently showing that the political connections has no effect on the practice of tax avoidance either directly or as moderation in weakening the negative impact of CSR on tax avoidance practices. Therefore, **H3a and H3b are also not supported**. Unsuccessful H3a and H3b is probably due to the measurement of political connections coming from the board connections. However, it may be the influence of political connections derived from other parties such as owners of company shares, other key management, through proximity to political officials, and the existence of corporate cooperation with the party politics in campaign or other funding, but this is difficult to measure because of the lack of related data disclosure in Indonesia.

For control variables, only SIZE or LEV respectively has a positive and negative effect on tax avoidance practices. The bigger the size of the company, the greater the incentive to do tax avoidance because big companies have greater economic political power (Siegfried, 1972). In addition, large companies have big tax burdens, so increasing management incentives for tax avoidance practices. For the LEV variable, it is in line with Richardson and Lanis (2007). With the selection of financing method through debt, the gap and the company's effort to avoid tax becomes smaller because the interest expense on the company's debt can reduce taxable income.

For other control variables, namely CAPINT and MBV, they are not proven to affect CSR corporate disclosure. The probable cause of CAPINT variable ineffectiveness of tax avoidance practice is the average fixed asset ownership ratio of the total company, only about 38.09%. Thus, the company has a limit to reduce or to postpone the tax payment through the depreciation expense of fixed asset owned company. However, the MBV variable indicates that the growing company is not too focused to reduce or to delay the payment of taxes (Lanis and Richardson, 2012).

C. CSR, Accrual Earnings Management, and Political Connections

The testing result of CSR influence to accrual earnings management can be seen in Table 5, regression column 2a, proving that CSR proxied with level of CSR disclosure does not influence the accrual earnings management practice. Therefore, **H2a is not supported**. The results of this study are in line with the institutional hypothesis that the lack of concern for CSR is more likely caused by institutional factors such as corporate culture, which are not related to factors that encourage accrual earnings management practices. In addition, the unavoidable effect of CSR on accrual earnings management practices is caused by the weakness of the accrual earnings management model that may not accurately separate the discretionary and non-discretionary accruals (Sebayang and Siregar, 2014).

Furthermore, the results of hypothesis testing 4a (H4a) and 4b (H4b) can be seen in Table 5, regression columns 2a and 2b, that are consistent with H3a and H3b test results. This shows that political connections has no significant effect on accrual earnings management practices and does not play a role in moderating the influence of CSR to accrual earnings management practices. Therefore, **H4a and H4b are also not supported**. The reason of this is the weakness of measuring political connections that only consider the connection of the board (board connections). The influence of political connections may also come from company shareholders or other key management members, the closeness of somebody who are not among the key management people of the company to political bureaucrats, and the cooperation of companies with political parties through campaign funding or the like that are difficult to measure because there are no open data on this matter.

Table 5
Regression results on the effect of CSR on accrual earnings management practices and the moderating role of political connections

Variable	Prediction	ABSAEM	
		Regression 2a	Regression 2b
Intercept		0.1487^{***}	0.1483^{***}
CSR	-(H2a)	-0.0143	-0.0157
CPC	+(H4a)	0.0176	0.0147
CSR*CPC	+(H4b)		0.0782
SIZE	+	-0.0033^{**}	-0.0033^{**}
LEV	+	0.0364^{***}	0.0358^{***}
MBV	+	0.0011	0.0011
AUDITOR	-	0.0014	0.0014
GROWTH	+	0.0118^{**}	0.0119^{**}
N		936	
Prob. F-Statistics		0.0429^{**}	0.0628^{*}

Description: ABSAEM = absolute accrual earnings management; **CSR** = CSR disclosure level based on GRI G4 framework; **CPC** = percentage of commissioners and directors who have political connections; **SIZE** = company size measured by total assets (in millions of rupiah); **LEV** = ratio of debt to total assets of the company; **MBV** = ratio of market value to book value of equity of the company; **AUDITOR** = auditor quality: 1 if affiliated with Big 4, 0 if otherwise; **GROWTH** = growth rate measured by the percentage change in sales. Significance level: $^{*}p<0.10$; $^{**}p<0.05$; $^{***}p<0.01$

As control variables and the proxy for information asymmetry, the MBV is not proven to have an effect on the accrual earnings management practices. This may be caused by a weakness in the measurement of accrual earnings management that is not certainly able to properly separate discretionary and non-discretionary accruals. AUDITOR is also not proven to have an effect on accrual earnings management practice. It strengthens the result of Nindita and Siregar (2012) study saying that audit quality measured by Big4 and non Big 4 Big KAP proxy does not differ significantly.

As control variables that proved significant, the first SIZE variable had a negative effect on the accrual earnings management practices. This is consistent with the results of the research of Zhao et al. (2012) providing empirical evidence that company size negatively affects the practice of accrual earnings management due to stricter supervision of investors and creditors. As a result, profit manipulation through discretionary accruals becomes limited. Furthermore, the result of testing on the effect of LEV on accrual earnings management practices is positive that is the higher the debt level of the company, the higher the incentive to perform the accrual earnings management practice. Consistent with Brammer and Millington (2005), one of the company's incentives in conducting management practices the accrual of profit is to keep the value of profit and the management does not violate the debt contract to the creditors. Finally, the control variable that proved to have a significant positive effect was GROWTH, which is the proxy for corporate growth. Consistent with Skinner and Sloan (2002), the growing company has an incentive to perform accrual earnings management because price changes as a form of positive or negative earnings announcement reactions are smaller than those of firms with low growth rates.

D. CSR, Real Earnings Management, and Political Connections

From Table 6, the level of CSR disclosure has a significant positive effect on the practice of real earnings management meaning that **hypothesis 2b (H2b) is not supported**. The results of this study are in line with the theory of legitimacy explaining that in order to maintain the risk of legitimacy and reputation caused by opportunistic actions (such as real earnings management), the company will make a wider disclosure of CSR to disguise its opportunistic actions. Therefore, consistent with the results of CSR research on tax avoidance, the results of this study further reinforce the indication that CSR conducted by companies in Indonesia is driven more by strategic motivation, rather than normative. CSR becomes a risk management tool to shield the opportunistic actions undertaken to maintain the legitimacy and the company's reputation.

Table 6
Regression results on the effect of CSR on real earnings management as and the moderating role of political connections

Variables	Prediction	ABSREM	
		Regression 3a	Regression 3b
Intercept		1.3302^{***}	1.3378^{***}
CSR	-(H2b)	0.2811^{**}	0.3169^{**}
CPC	+(H4c)	-0.0334	-0.0077
CSR*CPC	+(H4d)		-0.8454^{*}
SIZE	+	-0.0381^{***}	-0.0388^{***}
LEV	+	-0.0669	-0.0580
MBV	+	0.0084^{**}	0.0080^{**}
AUDITOR	-	0.0445	0.0447
GROWTH	+	-0.0178	-0.0181
ROA	+	0.2822^{**}	0.2893^{**}
N		936	
Prob. F-Statistics		0.0005^{***}	0.0005^{***}

Description: ABSREM = absolute earnings management; **CSR** = CSR disclosure level based on GRI G4 framework; **CPC** = percentage of commissioners and directors who have political connections; **SIZE** = total assets (in millions of rupiah); **LEV** = ratio of debt to total assets of the company; **MBV** = ratio of market value to book value of equity of the company; **AUDITOR** = auditor quality: 1 if affiliated with Big 4, or 0 if otherwise; **GROWTH** = the percentage change in sales; **ROA** = the ratio of net income to the total assets of the company. Significance level: $^{*}p<0.10$; $^{**}p<0.05$; $^{***}p<0.01$

Furthermore, the test results of the influence of political connections on real earnings management practices can be seen in the Table 6, columns of regressions 3a and 3b, consistently showing that political connections have no significant effect on real earnings management practices. Therefore, **H4c is not supported**. This result may be due to institutional factors that make political connections and earnings management unconnected. Another possibility is that the influence of political connections may not only arise from board connections, but also start from shareholders, other key management, and proximity to political officials or corporate support to a particular political party, and the majority of political connections derived from the military which has no real power since the end of President Soeharto's term (Meitzner, 2006).

The role of moderation of political connections in weakening the negative influence of CSR on real earnings management practice can be seen in Table 6, regression column 3b. The result of hypothesis 4d (H4d) test shows that political connections have a role in moderating the influence of CSR on real earnings management. This is weakening the positive influence of CSR on real earnings management practices so that **H4d is also not supported**. The results of this study are in line with study of Harymawan and Nowland (2016) saying that the influence of political connections in Indonesia has been changing as changes and improvements in government systems become more effective which makes firms with more political connections become more professional. As a result, corporate incentives to make CSR disclosure as a means to mask opportunistic acts decreases.

For control variables, SIZE variables have confirmed to negatively affect real earnings management, possibly due to greater oversight from stakeholders making the opportunity to practice real earnings management to be limited. While the positive effect of MBV on real earnings management is in line with Richardson (2000) stating that the higher the information asymmetry, the higher the management opportunities to practice real earnings management. For ROA, the higher the number, the higher the expectations to the company. As a result of this, the incentive to perform real earnings management is increasing (Dechow et al., 1995).

Other control variables such as LEV, AUDITOR, and GROWTH are not proven to have significant effect on real earnings management practices. For LEV and AUDITOR variables, it may be due to the nature of real earnings management that is difficult to detect so that there is no prove that they have a significant effect. For GROWTH variable, it is likely due to the small reactions of earnings announcement for the developing company so it is not necessary to do real earnings management to obtain certain profit.

E. CSR, Aggregate Earnings management, and Political Connections

The hypothesis 2c (H2c) is the test of CSR influence to aggregate earnings management. The result is consistent with the result of H2b test that CSR have positive effect to aggregate earnings management practice so that **H2c is also not supported**. These results further confirm that the motivation of sample companies in doing CSR disclosure in accordance with GRI G4 shows more to strategic motivation to cover the opportunistic actions. As a result, the level of CSR disclosure has a significant positive effect on tax avoidance practices or real and aggregate earnings management. In addition, the results of this study confirmes that the ethics of the company can not only be assessed from the level of CSR disclosure, but further assessment related to the indication of unethical practices such as tax avoidance and earnings management is needed. In addition, the high importance of legitimacy triggers the company to cover opportunistic actions by making disclosure of wider CSR.

Furthermore, the results of hypothesis 4e (H4e) and 4f (H4f) testing as seen in Table 7, regression columns 4a and 4b, consistently indicate that political connections have no significant effect on aggregate earnings management practices or moderate the effect of CSR on aggregate earnings management practices. Therefore, **H4e and H4f are not supported**. The independence of this political connections is caused not only by the measurement of political connections, but also by the measurement of aggregate earnings management through using the decile of the residual value of accrual earnings management and the real earnings management (absolute number). This biases the determination of aggregate earnings management. For example, on the one hand the value of residual accrual earnings management are positive, but on the other hand the value of residual real earnings management is negative. Therefore, if combined, the aggregate earnings management of this company is small because the direction is conflicting. However, because this study does not see the direction of earnings management from the beginning, this phenomenon cannot be captured by the aggregate earnings management measurement method.

Table 7
Regression result on the effect of CSR on aggregate earnings management and the moderating role of political connections

Variable	Prediction	EMALL	
		Regression 4a	Regression 4b
Intercept		1.9735***	1.9766***
CSR	-(H2c)	0.2859**	0.3020**
CPC	+(H4e)	0.0532	0.0782
CSR*CPC	+(H4f)		-0.7009
SIZE	+	-0.0392***	-0.0395***
LEV	+	0.0428	0.0490
MBV	+	0.0148**	0.0144**
AUDITOR	-	0.0268	0.0270
GROWTH	+	0.0834**	0.0834**
N		936	
Prob. F- Statistics		0.0054***	0.0080***

Description: EM_ALL = sum of AEM and REM deciles; **CSR** = CSR disclosure level based on GRI G4 framework; **CPC** = percentage of commissioners and directors who have political connections; **SIZE** = total assets (in millions of rupiah); **LEV** = ratio of debt to total assets of the company; **MBV** = ratio of market value to book value of equity of the company; **AUDITOR** = auditor quality: 1 if affiliated with Big 4, or 0 if otherwise; **GROWTH** = the percentage change in sales. Significance level: *p<0.10; **p<0.05; ***p<0.01

For SIZE variables, the test results prove that firm size negatively affects aggregate earnings management practices. This is consistent with the results of Zhou and Elder (2002) saying that a stricter supervision of investors and financial analysts creates the detected risk becomes so high that companies are reluctant to engage in earnings management practices. The positive influence of the MBV variable indicates the higher the information asymmetry, the higher the management opportunity to perform earnings management practices (Richardson, 2000). The positive effect of GROWTH on aggregate earnings management practices shows that the emerging companies are in the spotlight of many parties that generates pressures to perform earnings management.

For other variables, LEV and AUDITOR do not have significant effect on aggregate earnings management practices. For LEV variables, this variable has a significant effect on the accrual earnings management but does not affect real earnings management. Therefore, there is a possibility of LEV only affects earnings management practices that is potential to be noticeable. The controlling role of the creditor can be more effective on accrual earnings management practices compared to real earnings management or aggregate earnings management. The AUDITOR variable has no effect on all earnings management models and it is in line with previous research such as Nindita and Siregar (2012) saying that the quality of Big 4 and Non Big 4 auditors do not differ significantly.

F. Sensitivity Test

The results of the first sensitivity test using ETR as a tax avoidance proxy indicate that CSR has a significant positive effect on tax avoidance practices. This is consistent with tests conducted using BTD proxies, further indicating that the broader method of CSR disclosure is used as a means to disguise opportunistic measures such as tax avoidance. As a result, the legitimacy and reputation of the company can still be maintained. For political relation variables, the results are also consistent with the test using the BTD proxy, which confirm that political connections do not affect tax avoidance practices. The results of this study are in line with Francis et al. (2016) who find evidence that the political preferences of the board of commissioners and directors do not affect the effective tax rate because the ETR is more focused to certain tax management that does not involve the members of the board of commissioners and directors of the company. As a result, political connections have no effect on tax avoidance practices using ETR as a proxy.

The next sensitivity test is replacing the percentage of political connections with dummy as per the research of Faccio (2006) and Habib et al. (2017). Companies that have political connections rated 1 and rated 0 if they do not have relationships. Based on this sensitivity test, political connections are consistently not proven to moderate the negative influence of CSR on tax avoidance practices and earnings management. However, if political variables are seen as independent variables, political connections have a negative effect on tax avoidance practices, using both BTD and ETR as proxies. This result is consistent with the findings of Harymawan and Nowland (2016) and Mietzner (2006) arguing that the influence of political connections in Indonesia is following the change of governmental system and political conditions in Indonesia. As a result, firms with more political connections are more transparent and professional and the urge to act deceitfully diminishes.

For sensitivity test of earnings management model, political connections only acts as an independent variable that positively affects aggregate earnings management. However, for accrual earnings management and real earnings management, there is no prove that political connections is one of influencers either as an independent variable or as a moderating variable. The lack of consistency in the test results of the influence of political connections may be due to the weakness of measuring political connections merely based on board connections.

V. CONCLUSION

CSR is proved to have a significant positive effect on tax avoidance, real earnings management, and aggregate earnings management practices. This indicates that the level of CSR disclosure made by public companies in Indonesia is more strategic to shield deceiving actions so that the reputation and legitimacy of the company is maintained. In addition, the reasons for sample companies cannot be socially responsible because there are many trade offs in implementing CSR, specifically funds spent on CSR will reduce funds for meeting the needs of other stakeholders.

The role of political connections in moderating the influence of CSR on tax avoidance practices and earnings management is not proven. This result may be due to several things, such as the undetected political connections due to lack of transparency regarding the history or position of members of the board of commissioners and directors, more complex political connections, the relation is not only linked through board connections, and political connections are dominated by the military.

This study is expected to provide input to management. This means that efforts to mask opportunistic actions through extensive CSR disclosure can not last long because continuous scheming actions will be eventually exposed. In addition, this study would provide input to users of financial statements, especially investors that they do not to take for granted in assessing corporate ethics because high CSR disclosure is not necessarily free from tricky actions such as tax avoidance and earnings management. Finally, policy makers are expected to make rules that ensure that the disclosures' content made by the company is in line with the real world, not just a green wash statement for stakeholders.

This study is not subject several limitations. First, the use of CSR disclosure proxies is considered to be subjective and potentially does not reflect actual CSR performance. Therefore, further research should be using more objective proxies such as CSR performance data from independent appraisers or looking at company achievements in CSR. Second, the political connections in this study are limited to board connections only. The influence of political connections could come from shareholders, other key management, and closeness to political officials, or the cooperation between companies and certain political parties. Therefore, for further research, it is expected to conduct a more detailed analysis process to assess the political connections of the company. Third, the accrual earnings management measurement model used is not automatically able to separate the discretionary and non-discretionary accruals appropriately so that other types and other accrual earnings management measurements should be examined. Fourth, related to aggregate earnings management measurement, the related tool does not include the direction of earnings management so that the magnitude of aggregate earnings management is biased. Future research is expected to overcome the weaknesses of this aggregate earnings management.

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