



## Can Tax Avoidance Be a Moderator in the Relationship Between Earnings Management and Firm Value?

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### ABSTRACT

**Purpose :** The study examines the effect of earnings management on firm value and investigates whether tax avoidance moderates this relationship in the context of the Indonesian capital market. The research is motivated by concerns about financial transparency and corporate credibility in emerging markets, where weak enforcement and managerial discretion often influence investor confidence.

**Method :** The study uses panel data of 3,835 firm-year observations from non-financial companies listed on the Indonesia Stock Exchange during 2010–2022. Samples were selected through purposive sampling based on data completeness and reporting consistency. Multiple regression analysis is employed to test the proposed hypotheses.

**Findings :** The result reveals that earnings management significantly reduces firm value, confirming that discretionary financial reporting practices weaken market confidence. Meanwhile, tax avoidance does not strengthen this negative effect, indicating that investors view tax minimization independently from earnings management behavior.

**Novelty :** The study provides empirical evidence from an emerging market showing that tax avoidance does not amplify the adverse market perception of earnings management. The findings emphasize that investor responses in Indonesia are shaped more by earnings quality than tax strategies.

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### INTRODUCTION

Expanding Indonesia's capital market offers companies the prospect of enhancing their valuation among investors and presents significant challenges in how companies navigate market expectations. The value of a firm is typically regarded as a principal indicator that reflects market perceptions of a company's prospective and stable financial performance (Abbas & Ayub, 2019; Folajimi et al., 2023). This value has significant consequences as it informs investors' investment decisions and evaluates a company's growth potential. In an increasingly competitive capital market like that observed in Indonesia, where volatility and expectations constantly change, investors rely heavily on firm value indicators to inform their investment decisions (Yung & Root, 2019).

To understand the significance of this concept more deeply, firm value can be theoretically explained through several perspectives in financial literature. According to Intara et al. (2024), firm value represents the present value of all expected income or benefits generated throughout a company's operational life, reflecting the overall economic advantages produced during its existence. Similarly, Al-Shouha et al. (2024) emphasize that firm value is a fundamental indicator for investors when making investment decisions, as it serves as the basis for evaluating a company's performance and prospects in the market. In line with this view, Subanidja et al. (2016) state that the primary objective of a company is to maximize shareholders' wealth, with profit serving as an instrument to assess this value; therefore, firm value reflects the level of prosperity received by shareholders from corporate performance. Furthermore, Nebie & Cheng (2023) explain that in financial literature, firm value is often measured as the sum of the market value of equity and the market value of debt, representing the total wealth distributed between shareholders and creditors. Oktaviani et al. (2019) also highlight that firm value embodies public trust in a company after a series of operational and financial achievements. These perspectives suggest that firm value is a comprehensive

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measure of a company's ability to create and sustain economic benefits while signaling credibility and long-term sustainability to the market.

Many external and internal factors influence a firm's value in a dynamic capital market context. Internal factors are frequently subject to company management control through the implementation of strategic policies. Managerial policies of financial reporting and taxation strategies significantly influence investor perceptions (Khan & Shoaib, 2024; Subanidja et al., 2016). In the absence of rigorous management of managerial policies, the potential risks faced by the company are amplified. For instance, tax avoidance or aggressive earnings reporting decisions can raise investor concerns, as these policies are frequently associated with a dearth of transparency and corporate accountability (Allayannis & Simko, 2022; Leung, 2016).

Additionally, imprudent managerial practices, such as manipulating financial statements to present a more favorable performance than is the case, can result in distortions in the assessment of firm value (Yorke et al., 2016). Such manipulations create a false impression among investors and can precipitate uncertainty in the capital market. When firms engage in real earnings management to meet short-term performance targets, the reliability of financial information declines, reducing investor confidence and potentially discouraging further investment. Limiting such practices can therefore strengthen internal governance and support firm value creation (He et al., 2020). It can result in the misallocation of resources, whereby companies with weaker financial fundamentals may appear more attractive than those with stronger financial health (Folajimi et al., 2023).

This condition may ultimately lead to a disruption in the efficiency of the capital market. An inefficient market cannot ensure optimal capital allocation, affecting overall economic growth (Abbas & Ayub, 2019; Subanidja et al., 2016). Therefore, managerial policies must be transparent and accountable if a healthy and stable capital market is to be maintained. It emphasizes the importance of good management practices in maintaining the integrity of financial information presented to the public to create sustainable trust among investors and other stakeholders (Subanidja et al., 2016; Yung & Root, 2019).

One of the primary concerns for investors is the prevalence of earnings management practices among company managers. Earnings management refers to the actions of managers who manipulate the company's financial statements, either through managing accruals or real activities, intending to achieve specific financial targets. The considerable pressure exerted by investors and shareholders on managers to meet earnings expectations is frequently identified as the primary motivating factor for implementing such (Abbas & Ayub, 2019; Khan & Shoaib, 2024). Earnings management can provide short-term benefits, such as maintaining stock price stability and attracting new investors (Chen, 2016). However, this practice carries significant long-term risk, creating a misleading perception of the company's financial condition.

Investors lacking access to accurate information may assign an erroneous valuation to a company based on manipulated financial data, leading to an inaccurate assessment of the company's prospects (Subanidja et al., 2016). This practice erodes the integrity of the capital market, disrupts the optimal allocation of resources, and diminishes investor confidence in the company (Yung & Root, 2019). Therefore, it is imperative to comprehend how earnings management practices influence firm value to ensure the stability of the capital market and investor confidence. This is especially crucial in emerging markets, such as Indonesia, where financial transparency and accountability remain challenging (He et al., 2020).

The primary issue addressed in this study is how earnings management, as an opportunistic managerial practice, affects firm value in Indonesia. In the context of agency theory, which underscores the inherent conflict of interest between agents (managers) and principals (shareholders), earnings management is frequently regarded as a form of opportunistic behavior on the part of managers, whereby they seek to maximize their benefits at the expense of shareholders' interests (Jensen & Meckling, 1976). Given their superior knowledge of the company's circumstances, managers are motivated to manipulate financial statements to present a more favorable image of the company's profitability than is warranted (Khan & Shoaib, 2024). This practice can lead to suboptimal decision-making by investors, which may ultimately harm the company's long-term well-being (He et al., 2020).

Further research on earnings management in Indonesia is warranted, given that emerging markets often have less robust oversight mechanisms than developed countries (Abbas & Ayub, 2019; Subanidja et al., 2016). In Indonesia, the nascent role of regulation and supervision creates a greater opportunity for managers to exploit flexibility in financial reporting standards (Subanidja et al., 2016). Consequently, further research is required to elucidate the impact of earnings management practices on firm value in an emerging market context.

Prior research has yielded inconclusive results regarding the impact of earnings management on firm value, both in developed and developing countries. Yorke et al. (2016) discovered that while tax avoidance may enhance firm value in Ghana, the conjunction of tax avoidance and earnings management has a detrimental impact on firm value. This indicates that although tax avoidance may be perceived as a strategy to reduce the fiscal burden, when coupled with aggressive earnings management practices, investor confidence in the company may diminish, ultimately leading to a decline in firm value. This finding is particularly pertinent in an emerging market context such as Indonesia, where regulatory oversight and transparency still require strengthening (Yorke et al., 2016).

In Indonesia, research by Subanidja et al. (2016) demonstrated that earnings management substantially impacts firm value, particularly within the manufacturing sector. Managers frequently undertake this practice in response to pressure to meet market expectations and maintain stock price stability. In a study conducted in Pakistan,

Abbas & Ayub (2019) found that earnings management is an effective strategy for companies that are not facing financial difficulties. However, when a company is experiencing financial challenges, this strategy can become opportunistic and destructive. This finding suggests that the effectiveness of earnings management is contingent upon the firm's specific context, including its financial condition. Additionally, it indicates that in emerging markets, such as Indonesia, the impact of earnings management on firm value can be highly variable (Abbas & Ayub, 2019; Subanidja et al., 2016).

This study aims to conduct a more comprehensive examination of the influence of earnings management on firm value in Indonesia, with a particular focus on the role of tax avoidance as a moderating variable. Earnings management was selected as the independent variable because it is a prevalent practice among managers seeking to influence market perceptions of company performance. Ibrani et al. (2019) have previously highlighted that managers frequently employ earnings management to adjust their financial reporting to meet profit targets, particularly when under pressure from investors. This practice can be opportunistic and tends to occur more frequently in developing countries with accounting regulations that are still in the developmental stage, such as Indonesia (Ibrani et al., 2019). Subanidja et al. (2016) also observed that the market conditions are still developing in Indonesia, allow managers more space to engage in earnings management than in developed countries, making this research particularly relevant.

Tax avoidance is used as a moderating variable in this study because this practice often runs together with earnings management in manipulating the company's financial performance. As explained by Hasan et al. (2021), tax avoidance is a common strategy companies use to legally reduce the tax burden, which can increase net income. Tax avoidance allows companies to retain more funds that can be allocated for investment, dividend payments, or maintaining profits, all of which impact market perception and firm value. However, when tax avoidance is carried out in conjunction with earnings management practices, investors and other stakeholders can question the integrity of the company's financial reporting (Hasan et al., 2021).

Tax avoidance practices combined with earnings management often provide negative signals to the market about the transparency and honesty of the company. Tree & Wang (2024) show that companies that engage in tax avoidance and earnings management tend to be seen as less reliable, as both practices potentially reflect greater manipulation in the management of corporate finances. Markets may perceive firms that use tax avoidance and earnings management simultaneously as entities that pursue short-term gains at the expense of long-term trust and stability (Tree & Wang, 2024).

The interaction between tax avoidance and earnings management also creates potential risks for companies, especially their image, in the eyes of investors. Investors aware of these practices may be more cautious in assessing a company's long-term prospects, which may lead to a decline in share prices and an increase in the cost of capital. As a result, the combination of tax avoidance and earnings management is often regarded as a poor indicator of weak corporate governance, which can lower the company's overall value (Subanidja et al., 2016). However, empirical evidence on the moderating role of tax avoidance in the relationship between earnings management and firm value in Indonesia remains limited and inconclusive. Previous studies have primarily examined the direct effect of earnings management or tax avoidance on firm value. However, few have explored how these practices influence market perception and firm valuation in emerging market settings.

The principal distinction between this study and those that precede it is the methodology, which integrates earnings management and tax avoidance as intervening variables in determining firm value. Most previous studies have focused on the direct effect of earnings management on firm value without considering the potential moderating influence of tax avoidance. For example, research by Subanidja et al. (2016) indicated that earnings management directly impacts firm value within the manufacturing sector in Indonesia. However, the study did not assess the potential interaction between earnings management and tax avoidance. Additionally, research by He et al. (2022) addressed earnings management but did not examine the interaction between this practice and tax avoidance in influencing firm value.

Conversely, studies that examine tax avoidance often differentiate this variable from earnings management. For instance, Abbas & Ayub (2019) highlight the impact of tax avoidance on firm value, but do not investigate the interaction with earnings management. Consequently, this study addresses the gap by examining the interaction between these two practices within the context of the emerging Indonesian market, thereby offering a novel perspective to the existing literature (Abbas & Ayub, 2019; He et al., 2020; Subanidja et al., 2016).

The utilization of Indonesian company data in this study is also noteworthy due to the distinctive attributes of the country's capital market and business environment. Indonesia is home to one of the largest capital markets in Southeast Asia and boasts a distinctive corporate ownership structure that differs from that observed in developed countries. Many companies in Indonesia are under the control of families or government entities, which frequently exert considerable influence over managerial policies and strategic decisions (Abigail & Dharmastuti, 2022). This centralized ownership structure gives rise to distinct dynamics compared to companies in developed countries, where ownership is more dispersed.

Furthermore, Indonesia's regulatory and supervisory framework governing taxation and financial reporting is evolving. Notwithstanding advancements in implementing international accounting standards, the supervision of earnings management and tax avoidance in Indonesia remains less rigorous than in developed (Subanidja et al.,



2016). This renders the Indonesian context especially intriguing for study, as it permits further investigation of how managers exploit regulatory loopholes to maximize firm value through earnings management and tax avoidance. Consequently, this study is of significant interest to academic and policy audiences. It offers valuable insights for policymakers in Indonesia on enhancing the supervision of managerial practices, thereby maintaining the integrity of the capital market (Abigail & Dharmastuti, 2022; Subanidja et al., 2016).

In addition to the main variables, this study includes firm size and leverage as control variables to account for differences in company scale and financial structure that may influence firm value. Larger firms generally demonstrate greater transparency, operational stability, and investor confidence due to economies of scale, reputational strength, and more effective governance mechanisms. Empirical findings consistently show that firm size has a positive and significant effect on firm value, as large firms tend to have better access to capital markets, stronger disclosure quality, and enhanced market credibility. Khan & Shoaib (2024) found that firm size increases firm value because it signals efficiency and stability in emerging markets, while Abigail & Dharmastuti (2022) confirmed that large firms in Indonesia exhibit higher firm value through improved performance and reputation. Li et al. (2024), and Tulcanaza-Prieto & Lee (2022) further demonstrated that firm size positively affects firm value by reflecting managerial competence and corporate sustainability. In contrast, leverage shows a negative association with firm value, as excessive debt raises concerns about financial distress and agency conflicts between managers and shareholders. Lee (2019), and Tulcanaza-Prieto & Lee (2022) documented that high leverage reduces firm value due to increased risk exposure and limited flexibility in financial policy, a result consistent with agency theory (Jensen & Meckling, 1976), which posits that higher debt levels elevate monitoring costs and reduce managerial efficiency. Meanwhile, according to signaling theory (Spence, 1973), firm size serves as a credible signal of corporate strength and reliability, reinforcing investor trust. Thus, controlling for firm size and leverage allows this study to better isolate the true effect of earnings management and tax avoidance on firm value, ensuring that variations in firm valuation reflect managerial behavior rather than differences in company scale or financial leverage.

Theoretically, this study has the potential to contribute to the existing literature on the impact of earnings management on firm value, particularly within the context of emerging markets such as Indonesia. In the existing literature, many studies have concentrated on the direct impact of earnings management or tax avoidance on firm value. However, a paucity of research has examined the interaction between these two factors. This study introduces tax avoidance as a moderating variable, offering a novel perspective on the influence of these two practices on one another and firm value. The interaction between earnings management and tax avoidance will provide new insights into how these practices can manipulate investors' perceptions of firm performance (Khan & Shoaib, 2024).

Moreover, this research will constitute a notable addition to the financial management literature on emerging markets. The capital market dynamics of emerging countries often diverge from those of developed countries, where regulatory, supervisory, and corporate governance frameworks are still evolving. Consequently, investigating managerial conduct in developing countries, particularly in tax avoidance and earnings management, will yield invaluable insights that can inform further academic research (Hasan et al., 2021). This study can serve as a crucial reference for scholars examining the dynamics of governance and managerial behavior in emerging capital markets, where transparency and accountability are frequently pivotal challenges. Therefore, this study contributes to the literature by testing the moderating role of tax avoidance in the earnings management–firm value nexus, which has not been explored in prior Indonesian studies.

The findings of this study have significant practical implications for capital market regulators and tax authorities in Indonesia. The results of this study can inform the formulation of stronger capital market regulations and more effective supervisory mechanisms to mitigate managerial manipulation practices, such as earnings management and tax avoidance. Regulators can leverage these findings to reinforce policies for the disclosure of financial information and enhance corporate transparency in financial reporting. This approach would safeguard investors' interests and promote the capital market's stability. Conversely, the findings of this study are also pertinent for company managers. The practical implications of this study suggest that managers should exercise greater caution when implementing earnings management and tax avoidance strategies. While these two strategies may offer short-term benefits, the findings indicate that in the long run, they may send negative signals to investors, particularly if excessive. Therefore, managers should consider the long-term impact of these decisions on firm value and investor confidence.

Earnings management is a practice whereby a company's financial statements are manipulated to meet specific targets. These may include, for example, maintaining stock price stability or meeting profit expectations set by shareholders (Abbas & Ayub, 2019; Hasan et al., 2021). This practice can be conducted through two principal methods: accrual management and real activity management (Chen, 2016; Yorke et al., 2016). From the agency theory perspective, earnings management reflects a significant conflict of interest between the principals (shareholders) and the agents (managers). Managers often exploit their access to information to manipulate financial figures to advance their interests, such as bonuses or position stability (Jensen & Meckling, 1976; Khan & Shoaib, 2024).

Earnings management is frequently precipitated by external pressures, such as market expectations, which compel managers to maintain the company's financial performance to present a more stable image to investors (Subanidja et al., 2016). In developing countries such as Pakistan, Abbas & Ayub (2019) posit that earnings management may be an efficacious strategy for companies not under severe financial pressure. However, this practice can

become opportunistic when companies experience more significant financial pressures. In Indonesia, Subanidja et al. (2016) found that earnings management practices are standard in the manufacturing sector and significantly affect firm value. This suggests that earnings management has a significant impact on firm value in both developing and developed countries.

One of the primary reasons earnings management has a detrimental impact on firm value is that this practice reduces the quality of information available to investors and other stakeholders (Hasan et al., 2021). A reduction in the quality of available information results in distortions in investment decision-making processes, leading to an inaccurate perception of the company's financial condition (Yorke et al., 2016). When investors ascertain that financial reports have been manipulated, their trust in the company is significantly eroded, which frequently precipitates a decline in stock prices and elevated market volatility (Tree & Wang, 2024).

Prior research indicates that the adverse consequences of earnings management are more pronounced when such practices are sustained over an extended period. Leung (2016) posits that while earnings management may offer short-term benefits such as stock price stability, it ultimately erodes the company's reputation among investors. Furthermore, Chen (2016) discovered that the revelation of earnings management tends to reduce investor trust in managers and the company, prompting a shift in investments towards more transparent entities. Consequently, the aggregate effect of this trust decline results in a firm value reduction (Chen, 2016).

Furthermore, agency theory posits that earnings management is frequently an indicator of inadequate corporate governance, where controls and supervision are insufficient (Jensen & Meckling, 1976). When internal oversight mechanisms, such as audit committees and boards of directors, are not functioning effectively, managers have greater freedom to engage in opportunistic earnings management practices (Yorke et al., 2016). Hasan et al. (2021) argue that managers are more incentivized to manipulate financial statements due to lower detection risk in a weak governance environment. It can result in harmful behavior, which ultimately has a negative impact on firm value.

In the context of emerging markets, such as Indonesia, the effect of earnings management on firm value merits further investigation, particularly given the ownership structure, which is often concentrated in families or government entities (Abigail & Dharmastuti, 2022). In these markets, external oversight mechanisms such as audits are often less stringent, thereby facilitating managers' exploitation of regulatory and oversight deficiencies (Subanidja et al., 2016). Abbas & Ayub (2019) highlight that earnings management risk is elevated in countries with emerging market regulation due to the absence of rigorous supervision from market authorities and investors. Considering these findings, it can be concluded that earnings management practices have the potential to inflict significant damage to firm value. This may occur through reduced investor confidence, increased stock price volatility, and disruption of capital market integrity.

#### **H<sub>1</sub>: Earnings management has a negative effect on firm value**

Tax avoidance is an effort companies make to reduce their tax liabilities by utilizing loopholes or imperfections in tax regulations (Hasan et al., 2021). This practice is frequently regarded as a legitimate strategy to enhance the company's financial efficiency, thereby increasing net income and consequently strengthening the company's financial position (Tree & Wang, 2024). With a reduced tax burden, companies can increase net income, which can then be utilized to enhance cash flow or reinvest in business development (Qu et al., 2020).

However, from the agency theory perspective, tax avoidance can give rise to uncertainty and potential conflicts of interest between management (agents) and shareholders (principals). Agency theory posits that managers, as agents, possess a more comprehensive understanding of the company's operations and strategies than shareholders. This enables managers to make decisions that may be personally beneficial, such as through earnings management (Jensen & Meckling, 1976; Khan & Shoaib, 2024). When managers exploit legal loopholes to engage in tax avoidance, this action can be viewed as a strategy that may increase net income in the short term. However, if not managed properly, it can also increase the risk for the company (Abbas & Ayub, 2019; Subanidja et al., 2016).

Prior research indicates that earnings management frequently precedes tax avoidance practices (Hasan et al., 2021). In this context, management can utilize tax avoidance to increase company profitability without directly manipulating financial statements. By reducing the tax burden, the company's net profit is enhanced, which can help offset the negative impact of earnings management on firm value (Tree & Wang, 2024). Additionally, Chen (2016) discovered that legitimate tax avoidance can enhance investors' positive perception of management efficiency despite the continued prevalence of earnings management practices.

It is, however, important to understand that tax avoidance also entails certain risks. In the context of agency theory, the market's perception of managerial actions is of paramount importance. If the market deems tax avoidance aggressive or more than legal limits, it may result in prospective legal challenges and heighten investor uncertainty (Qu et al., 2020; Yorke et al., 2016). For instance, Tree & Wang (2024) illustrate that excessive tax avoidance can prompt investors to question the integrity of management, which can subsequently diminish confidence in the company's financial statements and reduce the firm's value.

From the perspective of signaling theory (Spence, 1973), managerial decisions such as tax avoidance and earnings management serve as "signals" that convey information about the firm's quality and governance integrity to external parties. Investors interpret these signals to infer the reliability and transparency of financial reporting. Tax avoidance can positively signal managerial efficiency and financial sophistication when conducted prudently within

regulatory boundaries. Conversely, aggressive or opaque tax strategies may transmit negative signals that heighten perceptions of opportunism and risk, thereby diminishing firm value.

Therefore, although tax avoidance can serve as a strategy to increase net income and mask the negative impact of earnings management, the market's perception of these actions plays an important role in determining the efficacy of such strategies. If investors view tax avoidance as a legitimate corporate efficiency strategy, this can enhance market perceptions of management, mitigating the adverse effects of earnings management (Hasan et al., 2021). However, if tax avoidance is perceived as a sign of opportunistic behavior or a high-risk action, the negative effects of earnings management on firm value may be exacerbated (Tree & Wang, 2024).

In Indonesia's growing market, the tax avoidance practices undertaken by companies may be more easily identified by the tax authorities, who have begun to tighten supervision. Therefore, management must exercise caution when carrying out tax avoidance strategies to avoid triggering negative reactions from investors or regulators. Consequently, if not managed carefully, tax avoidance can potentially exacerbate the negative impact of earnings management on firm value.

## **H<sub>2</sub>: Tax avoidance strengthens the negative effect of earnings management on firm value**

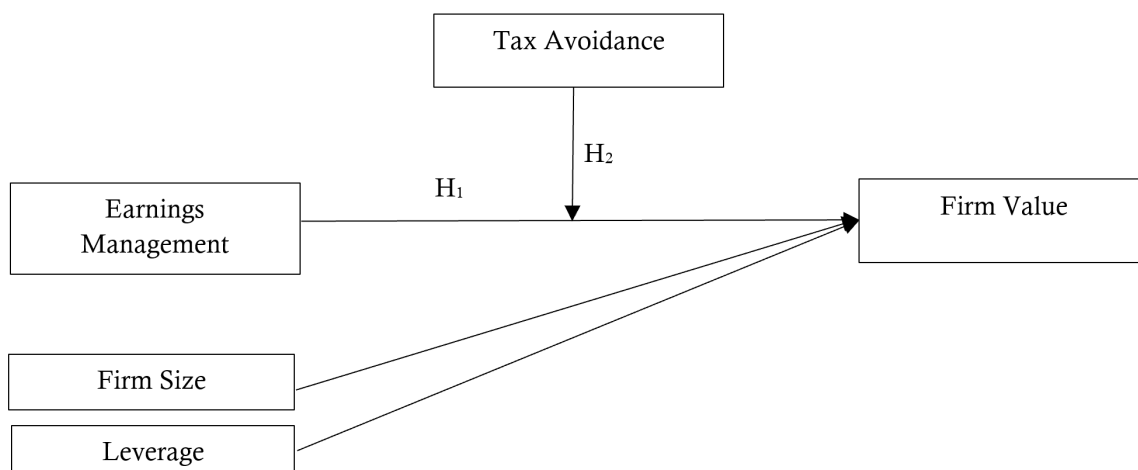
The framework (Figure 1) illustrates the relationship between earnings management (independent variable, X) and firm value (dependent variable, Y), moderated by tax avoidance (moderating variable, Z). Firm size and leverage are included as control variables.

## **RESEARCH METHODS**

This study utilizes secondary financial data from Bloomberg, covering the period from 2010 to 2022, with 2010 selected as the starting point due to Indonesia's adoption of IFRS, which enhanced financial reporting transparency and influenced earnings management practices. This period also coincides with Indonesia's post-2008 financial crisis recovery, during which economic stability facilitated capital market growth and shaped corporate financial behavior. The sample consists of non-financial firms listed on the IDX, selected using a purposive sampling method to ensure data relevance. The initial dataset of 11,752 firm-year observations is refined to 3,835 observations based on specific selection criteria, excluding firms with incomplete financial data to maintain integrity, adjusting extreme financial ratios using the Winsorizing technique to mitigate outlier effects, and omitting firms in sectors with fewer than 15 listed companies to ensure sufficient sectoral representation. Financial institutions are excluded due to their distinct regulatory environment and financial structures, and companies that report consistent annual losses are removed to prevent bias in the analysis. The final dataset captures shifts in regulatory frameworks, corporate governance mechanisms, and capital market conditions, ensuring that the findings reflect Indonesia's evolving financial landscape and remain representative and relevant. Although the data collection ends in 2022, this timeframe was deliberately chosen for methodological consistency and data reliability. 2010 marks the early phase of IFRS adoption in Indonesia, significantly influencing earnings management practices and financial reporting behaviors. While more recent data may appear desirable, audited and complete financial statement data for 2023 were not yet available at the time of data extraction (early 2024). Therefore, the selected period ensures data completeness, consistency, and comparability across firms and years.

The study employs firm value (FV) as the dependent variable, with Tobin's Q as its proxy. The adoption of Tobin's Q follows prior literature emphasizing its effectiveness in firm value assessment (Yorke et al., 2016). Tobin's Q is a ratio that reflects the market value of a company relative to its accounting value. It is calculated by dividing the market price of a company's shares plus all its liabilities by the book value of the company's assets (Chen, 2016; Subanidja et al., 2016).

The independent variable in this study is Accrual Earnings Management (AEM), measured using the Kothari



**Figure 1. Conceptual Framework**



et al. (2005) model (F1), which estimates accrual-based earnings management by accounting for changes in assets and liabilities for greater accuracy.

$$\frac{TACC_{i,t}}{TASSET_{i,t-1}} = \alpha + \beta_1 \frac{1}{TASSET_{i,t-1}} + \beta_2 \frac{\Delta SALE_{i,t} - \Delta AR_{i,t}}{TASSET_{i,t-1}} + \beta_3 \frac{PPE_{i,t}}{TASSET_{i,t-1}} + \beta_4 ROA_{i,t} + \varepsilon_{i,t} \quad \text{.....F1}$$

TACC<sub>i,t</sub> represents the total accrual, calculated as the difference between net income and operating cash flow of company *ii* in year *tt*, highlighting discrepancies between profit and cash flow from operations. TASSET<sub>i,t-1</sub>, defined by He et al. (2022), represents the total assets of company *ii* in year *t-1*, serving as the basis for accrual analysis and facilitating year-to-year financial comparisons.  $\Delta SALE_{i,t}$  reflects the change in sales between year *tt* and *t-1*, indicating sales growth trends and potential accrual needs. Similarly,  $\Delta AR_{i,t}$  captures changes in trade receivables, highlighting variations in receivables collectability and their cash flow impact. PPE<sub>i,t</sub> represents the net fixed assets of company *ii* in year *tt*, which is crucial for assessing long-term asset investments and their impact on earnings. ROA<sub>i,t</sub> measures the return on assets for company *ii* in year *tt*, offering insights into profit efficiency relative to total assets. Cross-sectional regressions are conducted annually for each sector, and the residuals from these regressions serve as proxies for accrual earnings management, reflecting potential managerial practices.

Tax avoidance, as a moderating variable, is measured using the effective tax rate (F2), calculated by dividing tax payable by profit before tax, a method widely applied in previous research (Yorke et al., 2016). The effective tax rate is multiplied by -1 to facilitate analysis, where higher values indicate more aggressive tax minimization strategies. This moderation captures the extent to which tax avoidance influences the relationship between earnings management and firm value, reflecting its potential to amplify or mitigate the impact of managerial practices on corporate performance (Tree & Wang, 2024).

$$TA_{i,t} = - \frac{\text{Tax Expense}_{i,t}}{\text{Pretax Income}_{i,t}} \quad \text{.....F2}$$

Several firm-level characteristics are included as control variables for potential confounding effects. Firm size (SIZE) is measured using the natural logarithm of total sales, as larger firms tend to have more complex operations, increasing the likelihood of earnings management (Darminto et al., 2024; Subanidja et al., 2016). Financial leverage (LEVERAGE), measured as the ratio of long-term debt to total assets from the prior year, is also considered, as highly leveraged firms may engage in earnings management to meet debt covenants and maintain a favorable financial image for creditors (Chen, 2016). These control variables enhance the robustness of the analysis by accounting for their influence on managerial decisions and corporate financial outcomes, thereby improving the accuracy of the study's examination of earnings management and tax avoidance on firm value (Fanani & Anjelina, 2019).

This research applies multiple regression analysis using the ordinary least squares (OLS) technique (Equation 1) to examine how accrual earnings management influences firm value and to evaluate the moderating effect of tax avoidance on this association (E1).

$$FV_i = \alpha + \beta_1 AEM_i + \beta_2 TA_i + \beta_3 AEM_i \times TA_i + \beta_4 SIZE_i + \beta_5 LEVERAGE_i + \varepsilon_i \quad \text{.....E1}$$

The dataset used in this study has been made publicly available via Zenodo to support transparency, replicability, and academic collaboration. This dataset has not been used in any prior publication. It includes financial data from 3,835 firm-year observations of non-financial companies listed on the Indonesia Stock Exchange between 2010 and 2022.

## RESULTS AND DISCUSSIONS

The descriptive analysis (Table 1) reveals the distribution of 3,835 observations by sector and year. The Consumer Cyclical sector dominates with 695 observations (18.12%), followed by Consumer Non-Cyclicals (658 observations, 17.16%) and Basic Materials (621 observations, 16.19%). In contrast, the Technology sector has the fewest observations, with 65 (1.69%). Observations span from 2010 to 2022, with the highest number in 2022 (389 cases, 10.14%) and the lowest in 2010 (217 cases, 5.66%). The Energy sector represents 11.11% of the data, slightly lower than Properties & Real Estate (11.13%). The Industrial and Infrastructure sectors contribute 9.75% and 9.02%, respectively, while the Healthcare sector accounts for 3.39%, with 130 observations.

Table 2 presents the descriptive statistics for 3,835 observations, covering Firm Value (FV), Accrual Earnings Management (AEM), Tax Avoidance (TA), Firm Size (SIZE), and Leverage (LEV). FV averages 1.91, with a wide range (0.37 to 26.08), reflecting significant market valuation differences. AEM has a mean of 0.00 (SD = 0.11) and varies from -0.42 to 0.50, indicating diverse earnings management practices. TA, measured as Tax Expenses/Pretax Income, averages -0.25 (range: -1.00 to 0.00), suggesting that, on average, firms allocate 25% of pretax income to taxes. SIZE has a mean of 27.96 (range: 19.96 to 31.78), indicating relatively uniform firm sizes. LEV, measuring long-term debt to total assets, averages 0.13 (SD = 0.17) with a range of 0.00 to 1.31, showing substantial variation in debt financing.

Table 3 presents the correlations among Firm Value (FV), Accrual Earnings Management (AEM), Tax Avoidance (TA), Firm Size (SIZE), and Leverage (LEV).

**Table 1.** Sample Distribution by Year and Primary Sectors

<b>Panel A:</b> Allocation of firm-year observations across major sectors		
<b>Sectors</b>	<b>No. of Observations</b>	<b>% Obs</b>
Basic Materials	621	16.19%
Consumer Cyclicals	695	18.12%
Consumer Non-Cyclicals	658	17.16%
Energy	426	11.11%
Healthcare	130	3.39%
Industrials	374	9.75%
Infrastructures	346	9.02%
Properties & Real Estate	427	11.13%
Technology	65	1.69%
Transportation & Logistic	93	2.43%
<b>Total</b>	<b>3,835</b>	<b>100.00%</b>
<b>Panel B:</b> Allocation of firm-year observations across years		
<b>Year</b>	<b>No. of Observations</b>	<b>% Obs</b>
2010	217	5.66%
2011	231	6.02%
2012	248	6.47%
2013	239	6.23%
2014	257	6.70%
2015	234	6.10%
2016	261	6.81%
2017	309	8.06%
2018	374	9.75%
2019	406	10.59%
2020	300	7.82%
2021	370	9.65%
2022	389	10.14%
<b>Total</b>	<b>3,835</b>	<b>100.00%</b>

dance (TA), Firm Size (SIZE), and Leverage (LEV). FV shows a weak negative correlation with AEM (-0.047) and a weak positive correlation with TA (0.040), indicating that aggressive tax avoidance has a slight positive impact on firm value. The correlation between TA and AEM is negligible and insignificant (-0.019), indicating minimal direct interaction between these strategies. FV also has significant negative correlations with SIZE (-0.084) and LEV (-0.047), implying that larger or more indebted firms tend to have lower value.

This study conducted classical assumption tests, including multicollinearity and heteroscedasticity tests, while excluding normality and autocorrelation tests due to the analysis's large sample size and non-time-series nature (Gujarati & Porter, 2009). The multicollinearity test showed no variable correlations exceeding 0.8, confirming the absence of multicollinearity issues. The Breusch-Pagan-Godfrey test detected heteroscedasticity, which was addressed by incorporating residual values as variance weights.

Regression results in Model 1 (Table 4) indicate that Accrual Earnings Management (AEM) significantly reduces firm value (Tobin's Q), with  $\beta = -1.025$ ,  $t = -2.82$  ( $p < 0.01$ ). Firm size (SIZE) also has a significant negative effect on Tobin's Q ( $\beta = -0.0983$ ,  $t = -3.52$ ,  $p < 0.01$ ), while leverage (LEV) negatively impacts firm value ( $\beta = -0.401$ ,

**Table 2.** Results of Descriptive Statistical Analysis

<b>Variable</b>	<b>Obs</b>	<b>Mean</b>	<b>SD</b>	<b>Med</b>	<b>Min</b>	<b>Max</b>
FV	3,835	1.91	2.11	1.26	0.37	26.08
AEM	3,835	0.00	0.11	-0.01	-0.42	0.50
TAV	3,835	-0.25	0.16	-0.24	-1.00	0.00
SIZE	3,835	27.96	1.77	28.08	19.96	31.78
LEV	3,835	0.13	0.17	0.06	0.00	1.31



**Table 3.** Correlation Test Results

Variables	(1)	(2)	(3)	(4)	(5)
(1) FV	1.000				
(2) AEM	-0.047*	1.000			
	(0.004)				
(3) TA	0.040*	-0.019	1.000		
	(0.013)	(0.233)			
(4) SIZE	-0.084*	-0.078*	0.045*	1.000	
	(0.000)	(0.000)	(0.005)		
(5) LEVERAGE	-0.047*	0.035*	0.031	0.166*	1.000
	(0.003)	(0.029)	(0.054)	(0.000)	

Significance levels: \*\*\* 1%, \*\* 5%, \* 10%

$t = -2.26$ ,  $p < 0.05$ ). Based on 3,835 observations, the model reports an adjusted  $R^2$  of 0.0101, explaining 1.01% of the variation in Tobin's Q. The F-statistic value of 11.31 ( $p < 0.0000$ ) confirms the model's reliability.

Model 2 examines the impact of Accrual Earnings Management (AEM) on firm value (Tobin's Q) with Tax Avoidance (TA) as a moderating variable. The results indicate that AEM negatively affects firm value ( $\beta = -1.033$ ,  $t = -1.91$ ,  $p < 0.1$ ), while the interaction term (AEM $\times$ TA) is not significant ( $\beta = -0.0950$ ,  $t = 0.45$ ,  $p > 0.1$ ). TA positively affects Tobin's Q ( $\beta = 0.455$ ,  $t = 2.43$ ,  $p < 0.05$ ), suggesting that tax avoidance enhances firm value. Firm size (SIZE) and leverage (LEV) consistently show negative effects, highlighting challenges for larger and more indebted firms. The model reports an adjusted  $R^2$  of 0.0108 and a significant F-statistic (8.190,  $p < 0.0000$ ). Industry-level analyses reveal sectoral variations in the effects of AEM and TA. Neither variable nor their interaction significantly impacts firm value in basic materials, consumer cyclical, infrastructure, or real estate. Conversely, in consumer non-cyclical and energy, TA increases firm value, though AEM's moderation remains insignificant. In healthcare, the AEM $\times$ TA interaction is significantly positive, suggesting that investors perceive their combination favorably. Industrial and technology sectors show a positive TA effect on firm value but no moderation by AEM, indicating investor preference for tax efficiency over earnings manipulation. In transportation and logistics, neither AEM nor TA significantly influences firm value. These findings highlight industry-specific investor responses to earnings management and tax avoidance.

The regression analysis demonstrates a statistically significant negative relationship between earnings management and firm value, confirming the first hypothesis. This result implies that the market reacts unfavorably when managers use discretionary accrual practices to influence reported earnings. Such manipulation reduces the credibility of financial information, weakens investor trust, and ultimately lowers firm valuation. This finding is

**Table 4.** Regression Results for All Observations

	(1)	(2)
	Tobin's Q	Tobin's Q
AEM	-1.025***	-1.033*
	(-2.82)	(-1.91)
AEM*TA		-0.0950
		(0.05)
TA		0.455**
		(2.43)
SIZE	-0.0983***	-0.0966***
	(-3.52)	(-3.45)
LEVERAGE	-0.401**	-0.391**
	(-2.26)	(-2.21)
_CONS	4.705***	4.770***
	(5.98)	(6.08)
N	3,835	3,835
R <sup>2</sup> -Adj	0.0101	0.0108
F_Stat	11.31	8.190
Prob > F	0.0000	0.0000

*t*-statistics in parentheses\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

consistent with Healy & Wahlen (1999), definition of earnings management is an intentional intervention in the financial reporting process to shape financial outcomes. Similarly, Khan & Shoaib (2024), and Scott (2015) highlight that earnings management increases information asymmetry and reduces financial statement reliability, particularly in environments with limited regulatory oversight.

From the perspective of agency theory, this result aligns with the argument of Jensen & Meckling (1976), who assert that separating ownership and control enables managers to exploit informational advantages for personal gain. Leung (2016) adds that such behavior intensifies when managerial compensation is tied to short-term financial performance and external monitoring is weak. In Indonesia, agency conflicts tend to be more structural, as many listed firms exhibit concentrated ownership and limited board independence (Abigail & Dharmastuti, 2022; Subanidja et al., 2016). These institutional features restrict monitoring capacity and create room for opportunistic earnings manipulation. Hence, the observed decline in firm value can be interpreted as a market penalty for managerial opportunism and weak governance discipline.

Empirical studies from both global and Indonesian contexts reinforce this interpretation. Al-Shouha et al. (2024) and Hernawati et al. (2021) find that earnings management practices erode firm value by signaling unreliability in financial performance and increasing investors' risk perception. Darminto et al. (2024), and Folajimi et al. (2023) also reveal that the adverse market response is more pronounced in non-financial sectors where disclosure regulations are relatively lax compared to the banking industry. This pattern resonates with the present study's findings, focusing on non-financial companies listed on the Indonesia Stock Exchange.

The persistence of earnings manipulation in Indonesia can also be explained by the structural characteristics of its capital market as an emerging economy. Firmansyah et al. (2020) emphasize that Indonesia's capital market remains characterized by limited transparency, concentrated ownership, and underdeveloped derivative markets, which weaken risk management and information efficiency. The study also notes that investors' understanding of complex financial instruments remains limited, reducing market discipline and corporate reporting behavior. As a result, opportunistic earnings management practices can persist without immediate market correction.

This argument is consistent with Firmansyah & Purnama (2020), who demonstrate that the Indonesian market's inefficiency is evident even in derivative ownership decisions, investors tend to rely on traditional accounting indicators rather than comprehensive financial risk measures. These findings collectively suggest that in Indonesia, investors are highly sensitive to the credibility of earnings information. At the same time, systemic institutional weaknesses reduce their ability to distinguish between genuine performance and manipulated results. Consequently, when managers engage in earnings management, the market tends to interpret such behavior as a signal of poor governance and increased investment risk, leading to a significant decline in firm value.

Although Indonesia has adopted IFRS since 2012 to enhance financial reporting quality, this study's extended observation period (2010–2022) shows that earnings manipulation remains persistent. This persistence indicates that regulatory convergence alone is insufficient without effective enforcement and investor protection mechanisms. As highlighted by Tree & Wan (2024), and Yoon et al. (2024), rule adoption must be complemented by institutional and market-based governance reforms to ensure credibility in financial reporting. Therefore, the evidence from this study supports the agency theory framework and demonstrates the contextual challenges faced by emerging markets like Indonesia, where weak monitoring, limited investor sophistication, and institutional inefficiencies collectively exacerbate the negative impact of earnings management on firm value.

In contrast, the second hypothesis is unsupported, as the interaction between earnings management and tax avoidance yields an insignificant coefficient. This result indicates that tax avoidance does not significantly strengthen or alter the negative effect of earnings management on firm value. While prior studies such as Amidu et al. (2019), and Martin et al. (2016) suggest that both practices may be used concurrently to influence reported performance, the findings of this study imply that investors in Indonesia do not perceive them as complementary signals. Similarly, Folajimi et al. (2023) and Ibrani et al. (2019) document that markets often treat earnings management and tax avoidance as separate phenomena, particularly in contexts where financial transparency and enforcement are limited.

Several contextual explanations support this non-significant interaction. First, tax avoidance's complexity and lower visibility reduce its immediacy in investor evaluations. Discretionary accruals can be more readily identified through accounting-based indicators, whereas tax planning involves deferred and opaque mechanisms that do not immediately affect firm valuation (Tree & Wang, 2024; Xu et al., 2022). Second, managerial incentives in emerging markets often prioritize short-term profit reporting over long-term tax efficiency, leading to the implementation of these two practices in isolation rather than simultaneously (Ibrani et al., 2019; Khan & Shoaib, 2024). This behavioral tendency reduces the likelihood that investors perceive tax avoidance as reinforcing the effects of earnings manipulation.

From a theoretical standpoint, these findings suggest that agency theory adequately explains the negative impact of earnings management on firm value but may not fully capture its interaction with tax avoidance. According to signaling theory (Spence, 1973), corporate financial decisions act as signals that convey information about management integrity and firm quality to external stakeholders. In this context, tax avoidance may serve as an ambiguous or mixed signal: when implemented transparently and within regulatory limits, it can be interpreted as a sign of managerial efficiency and financial optimization; however, when perceived as aggressive or opaque, it sends a ne-

gative signal that increases investor suspicion and perceived risk. To complement this, signaling theory provides an additional perspective: in markets with evolving institutional quality, tax avoidance may be interpreted as a neutral or efficiency-driven strategy rather than a deceptive action (Alharbi et al., 2022; Geng et al., 2021). Consequently, tax avoidance fails to intensify the negative market perception associated with opportunistic earnings management.

Evidence from Indonesia further reinforces this interpretation. Firmansyah et al. (2022) found that tax avoidance has limited value relevance in the Indonesian capital market, indicating that investors pay minimal attention to tax-related information when assessing firm performance. Likewise, Azalia et al. (2024) revealed that earnings management mediates rather than amplifies the relationship between tax avoidance and firm value, suggesting that investors perceive these strategies as distinct rather than jointly manipulative. Meanwhile, Widodo & Firmansyah (2021) observed that investor responses to tax avoidance vary across industries, where some view it as an efficiency signal when executed within regulatory boundaries. This pattern aligns with signaling theory, as investors decode tax avoidance behavior differently depending on the perceived credibility and transparency of managerial intent. These variations support the notion that investor interpretation of tax avoidance remains highly contextual and dependent on perceived transparency.

Thus, this finding underscores that investors are more sensitive to accounting-based opportunism signals than tax-related decisions. Consequently, while earnings management continues to erode firm value, tax avoidance operates as an independent corporate policy with limited influence on market perception. In sum, signaling theory helps explain why investors in emerging markets may not treat tax avoidance as a reinforcing signal of opportunism but rather as a neutral or context-dependent action, shaped by disclosure quality and regulatory trust. This outcome reaffirms the contextual nature of investor behavior in emerging markets, where information asymmetry, institutional quality, and disclosure practices jointly shape how discretionary financial strategies are interpreted.

## CONCLUSIONS

This study examines how managerial discretion in financial reporting affects corporate valuation in an emerging market context where governance mechanisms and investor protection are still evolving. The findings confirm that earnings management significantly weakens firm value by reducing financial transparency and corporate credibility, increasing investor risk perception, and diminishing market confidence. However, tax avoidance does not amplify this negative effect, indicating that investors in Indonesia tend to assess tax-related strategies separately from earnings manipulation. Both practices reflect underlying agency conflicts, where managerial incentives diverge from shareholder interests, influencing how the market perceives firm performance.

Theoretically, this study contributes to the literature by confirming the relevance of agency theory in explaining how opportunistic financial reporting erodes firm value while introducing signaling theory to interpret why tax avoidance is not perceived as an amplifying factor. The findings extend previous evidence by demonstrating that investors in emerging capital markets, such as Indonesia, are more sensitive to accounting-based earnings signals than to tax planning behavior. Thus, this study contextualizes how institutional quality and investor sophistication shape the interaction between managerial discretion and market valuation.

Several limitations should be acknowledged. The sample, consisting of 3,835 firm-year observations from non-financial companies, may not capture dynamics in sectors with distinct regulatory frameworks or governance structures. The reliance on accrual-based earnings management models and the effective tax rate (ETR) as a proxy for tax avoidance may not fully reflect real earnings manipulation or aggressive tax strategies. External factors such as macroeconomic fluctuations, fiscal reforms, and investor sentiment were also not explicitly controlled, which may influence firm valuation.

Future research could expand these findings by incorporating financial institutions or cross-industry analyses to enhance external validity. Employing alternative proxies, such as real earnings management or tax aggressiveness measures, may deepen empirical robustness. Comparative studies across ASEAN markets could also reveal how institutional enforcement moderates the earnings management–firm value relationship. Furthermore, integrating corporate governance variables, such as board independence, ownership structure, and audit committee effectiveness, could provide deeper insights into how firms mitigate agency conflicts and improve transparency.

This study provides practical implications for regulators, investors, and corporate policymakers based on the findings. The Financial Services Authority (OJK) and the Directorate General of Taxes (DJP) should strengthen financial reporting and tax oversight, as the results indicate that weak monitoring allows earnings management to reduce firm value while tax avoidance remains less scrutinized. Enhancing disclosure standards, independent audits, and enforcement mechanisms will mitigate financial misreporting and improve transparency. For investors, greater access to clear financial and tax information can enhance confidence and promote market discipline. Firms are encouraged to reinforce internal governance mechanisms—particularly audit committee effectiveness and board independence—to reduce information asymmetry and managerial opportunism. Promoting ethical financial conduct and emphasizing long-term value creation over short-term earnings targets will help sustain investor trust and strengthen the credibility of Indonesia's capital market.



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