The Effect Of Audit Quality

by Muhammad Laras Widyanto

The Effect Of Audit Quality And Corporate Governance On Tax Evasion Practices In State-Owned Enterprises (SOEs) In Indonesia

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Abstract : This study aims to examine the effect of audit quality and corporate governance on tax evasion practices. The sample used are State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (IDX) period 2013-2016. Sampling method use *purposive sampling* with 80 sample observations. The analysis tool used is SMARTPLS 3.0. The result shows that audit quality has no significant effect on tax evasion practices in SOEs in Indonesia, while corporate governance has a significant effect on tax evasion practices in SOEs in Indonesia.

Keywords: Audit Quality, Corporate Governance , Tax Evasion Practices

INTRODUCTION

The concept of Corporate Governance is essentially an extension of the concept that regulates the relationship between owners and management companies or agency problems. The separation between ownership and management of the company (manager) does not work optimally in order to maximize the owner's wealth (Endri, 2012). The company's ability to generate profits in its operations is a key focus in the assessment of the company's achievements (fundamental analysis of the company) for profit companies apart is an indicator of a company's ability to meet obligations to persons with funds is also an element in the creation of value for companies that demonstrate the company's prospects in the future (Budihardjo, 2018).

Taxes are the largest source of state income when compared to other sources of income and are an important element for the state to sustain state revenue to meet people's welfare. However, the achievement of tax revenue target is still not optimal . This is due to the lack of awareness of taxpayers in compliance with tax obligations. Even if it is possible the taxpayer will make tax avoidance to minimize the tax expenses because it will reduce profit or income. As explained by Suandy (2011) that taxpayers will try to minimize tax expense because paying taxes will reduce the economic ability of the taxpayer.

The practice of tax evasion arises because of the loopholes of tax laws and regulations which are used by taxpayers to mitigate the tax expense. Mitigation of tax expense can be done through legal or illegal way. Legal by looking at the opportunities of tax laws and regulations, otherwise illegal by manipulating transactions. The Indonesian government requires taxpayers to calculate, report and pay their own *self-assessed* taxes *(self-assessment system)* . This will potentially trigger a difference in the amount of tax calculated and paid by the taxpayer with the tax payable.

Mazur and Plumley (2007) explain that there are three components that trigger a difference in tax expense : (1) the taxpayer reported or did not report his tax, (2) the error in tax reporting, and (3) the difference due to underpayment. This reflects the weakness of administrative related taxation and weak regulatory control in creating an optimal taxation system. As a result, the purpose of taxation to increase state revenues, reduce the income distribution gap, and regulate economic activity has not been reached optimally.

Several previous studies have revealed tax evasion phenomena that occurred since the tax legislation was issued (Andreoni et al., 1998; Uadiale et al., 2010; Verbon and Dijke, 2007). The background of this phenomenon is motivated by taxpayers to mitigate the tax expense paid because it will reduce the income or profit of taxpayers. Suppose that Enron's case avoids taxes by opening 800 subsidiaries in tax-free areas (http://www.ctj.org). In Indonesia, let's say the case of Kaltim Prima Coal (KPC) which performs transaction schemes that have a special influence with other companies to mitigate the tax expense.

The researches in the field of taxation attempt to explain the various factors that influence tax avoidance practices (Shevlin and Shackelford, 2001, Shevlin, 2007; Hanlon and Heitzman, 2010). This is because tax evasion has beneficial economic benefits for the company (Scholes et al. , 2009; Armstrong et al., 2012). These factors are institutional factors i.e, audit quality and corporate governance .

A quality audit is an audit conducted by a competent and independent person . A competent auditor is an auditor who possesses technological capabilities, understands and performs proper audit procedures, understands and uses representative sampling and so on. An independent auditor is an auditor who, if found to be a violation, will report the violation. Widiastuty and Febrianto (2010) explain that the probability of auditors reporting violations depends on their level of independence and competence. In addition, Sanjaya (2008) pointed that qualified and reputable auditors represented by the *Big Four's* Affiliated Public Accounting Firm will be able to prevent and mitigate violations by company management. Internal auditor manpowers are said to be of high value if they have experience, sufficient technical capabilities and expertise in their fields. In order for company resources to create competitive advantages, there are four attributes that must be owned by the company, namely: a) High-value resources, b) Rare resources, c) Resources that cannot be replicated perfectly, and d) There is substitution (Kurniasih & Heliantono, 2016)..

Corporate governance as part of the company's internal system is a mechanism that directs and controls the activities of firms so that the activity of the company is run in accordance with the expectations of stakeholders. According to Budiharjo (2016), Good Corporate Governance (GCG) is a pillar of market economic system because of relating to community trust against company. Implementation of GCG within a company will give protection to shareholders. Investors also feel safe on their funds, because they tend to receive return according their expectation (Nuswandari, 2009).

According to Indonesian Institute for Corporate Governance (IICG, 2019), the concept of good corporate governance consist of : (1) minimize agency cost; (2) minimize cost of capital capital; (3) increase value of company share; (4) increase company image. Setiyawati (2014) explain that implementation of good corporate governance is useful for : (1) the improvement of the internal control system; (2) the increased efficiency to increase competitiveness; (3) protect the rights and interests of stakeholders; (4) increase the value of the company; (5) improve the efficiency and effectiveness of work governing board and

CEO; (6) as well asimprove the quality of governing board's relationship with the CEO (Sutojo & Aldrige, 2008).

The implementation of corporate governance aims to (1) maintain corporate *sustainability*, (2) increase company value and market confidence, (3) reduce agency costs and capital costs; (4) improve performance, efficiency and service to stakeholders; (5) protect organizations from political intervention and lawsuits, and (6) assist in the realization of *good corporate citizens*. Thus, the implementation of corporate governance is able to mitigate any violation .

Previous studies have shown that audit quality has a significant effect on tax evasion practices (Annisa and Kurniasih, 2012). Audit quality has no significant effect on tax evasion practices (Annisa, 2011; Jaya et al., 2014; and Handayani et al., 2015) . In addition, several research by Fadhilah (2011), Annisa (2011) , Annisa and Kurniasih (2012); Dewi and Jati (2014), Maharani and Suardana (2014), Winata (2014), Rachmithasari (2015) indicate that corporate governance (audit committee and independent commissioner) have a significant effect on tax evasion practices . Corporate governance (audit committees and independent commissioners) has no significant effect on tax evasion practices (Anissa, 2011; Fadhila, 2011; Kurniasih and Sari, 2013; Khoirunnisa, 2014; Prakosa, 2014; Handayani et al., 2015).

This research is conducted in State-Owned Enterprises (SOEs) as government-owned companies whether it has carried out institutional factors effectively in accordance with the applicable mechanism. Thus, this study examines the effect of audit quality and corporate governance on tax evasion practices in SOEs in Indonesia.

Research Issues

Based on the above description of the background, this research has the following problem formulation :

1. Does audit quality affect tax evasion practices in State-Owned Enterprises (SOEs) in Indonesia?
2. Does corporate governance affect tax evasion practices in State-Owned Enterprises (SOEs) in Indonesia?

Research Objectives Formulation

Based on the description of the background and the formulation of the problems described above, this study has the following objectives :

1. To test and analyze the effect of audit quality on tax evasion practices in State-Owned Enterprises (SOEs) in Indonesia.
2. To test and analyze the effect of corporate governance on tax evasion practices in State-Owned Enterprises (SOEs) in Indonesia.

MATERIAL AND METHODS

Theoretical Basis

(1) Agency theory

The agency theory explains the separation of functions between shareholders and company management. Jensen and Meckling (1976) explain that shareholders provide a mandate to the company's management to manage the company's activities and act in the interests of its shareholders. However, shareholders and company management have different interests. This triggered conflict of interest between shareholders and company management.

Sunarto (2009) explains that the motivation of company management to present financial statements based on agency theory : (1) opportunistic management behavior to earn earnings management, (2) signaling motivation as a signal for stakeholders in evaluating company performance. However, the information obtained by stakeholders often does not match to actual company conditions that lead to information asymmetry.

(2) Audit quality

The auditing function is as one of the mechanisms for reducing information asymmetry between shareholders and company management. The purpose of the audit of financial statements is to provide assurance that the management company has run the company's operational activities in accordance with applicable standards.

Audit quality is defined as the suitability between audit procedures and audits conducted by the auditor. A qualified audit is an audit that is able to fully inform the user of the financial statements and if any violation is found, the auditor will report the violation.

Audit quality can be measured through various means e.g. *"big four" Certified Public Accountant (CPA) firms and "non big four" CPA firms* and "*earnings surprise benchmark*". The big four CPA Firms category shows that there is high audit quality because the resources owned by big four CPA are capable for handling clients. In addition, *earnings surprise benchmark* which represents audit quality indicates the extent to which the auditor's ability to find violations and report such violations in the audit findings.

(3) Corporate governance

Corporate governance is defined as a system that regulates and control companies to create added value for stakeholders (Desai and Dharmapala, 2007). Corporate governance emerges to mitigate any potential agency conflict between shareholders and company management . On the one hand, shareholders hope to gain the greatest possible acceptance for their prosperity , while on the other hand, the company's management seeks to maximize its prosperity and thus trigger conflicts of interest. To mitigate conflicts of interest, good corporate governance is required to align the interests of shareholders and the interests of corporate management.

Audit committees and independent commissioners are a representation of corporate governance. Audit Committee as the composition of the committee established by the Board of Commissioners has the function to conduct internal auditing and report the results of the audit to the Board of Commissioners to be evaluated whether the company's management has run the company's activities in accordance with applicable standards. With the existence of the audit committee is expected to minimize the acts of violation committed by the management company. While independent commissioner is described as someone who has a relationship with directors or commissioners, was not involved with the controlling shareholders and management position concurrently. The existence of an independent commissioner makes it possible to reduce opportunistic management behavior as it is monitored by an independent commissioner.

(4) Tax Evasion practices

The government always attempt to increase state revenue through taxes. However, taxpayers tend to try to mitigate the tax expense that will be paid to the government because it will reduce the income taxpayer earnings.

Scott (2006) explains that one of the management's earnings management is because of the tax motivation. This is done by the company's management to minimize the tax expense to be paid to the government. Suandy (2011) defines tax avoidance as engineering tax affairs which still remain within the frame of taxation provisions. This reflects that the practice of tax avoidance is legally done by taking advantage of the opportunities of taxation legislation.

(5) Development of hypothesis

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Audit quality and tax evasion practices

Transparency is required by stakeholders in assessing the performance of a company. The objective of the company to report the performance of the company through matters relating to taxation with the principle of transparency is to increase stakeholder confidence that financial management is in compliance with applicable standards . Enhancement the existence of transparency to shareholders which is related to taxes is increasingly demanded by the authorities public (Sartori, 2010). If the company performs aggressive tax behavior it will lower the image of the company and lower public confidence. Therefore, to monitor the behavior of corporate management, it is required the company's external auditor in auditing the activities of the company run by the management company.

Audited financial statements (audited by big four CPA firms) according to some references are believed to be more qualified because it is able to mitigate opportunistic behavior of company management because resources owned by big four CPA firms supporting in audit activities. In addition, the big four CPA offices are believed to be able to suppress violations committed by the company's management. The big four CPA offices are Price Waterhouse Cooper (PWC), Deloitte Touche Tohmatsu (DTT), KPMG and Ernst & Young (E & Y).

High audit quality is expected to suppress the existence of acts of violation committed by the management company. In addition can be measured through big four and non big four CPA firms , audit quality can also be measured through earnings surprise benchmark . Earnings surprise benchmarks can be used by auditors to detect whether company management is *taking a bath* or *window dressing* . If the auditor is able to detect it, then the audit is high quality.

The results of previous research pointed out that audit quality significantly influence the practice of tax evasion (Annisa and Kurniasih, 2012). In addition, audit quality has no significant effect on tax evasion practices (Annisa, 2011; Jaya et al., 2014; and Handayani et al., 2015). Based on the above description, this research proposes the following hypothesis :

H_1 : Audit Quality affects Tax Evasion Practices

Corporate governance and tax evasion practices

Corporate governance is a mechanism that regulates and control company to create added value for the stakeholders. Corporate governance emerges to mitigate any conflicts of interest between shareholders and company management . This is because shareholders and management companies try to maximize their interests hence resulting in the information asymmetry. Part of corporate governance is an audit committee and independent commissioner.

The existence of the audit committee is very important for the company as it serves to conduct the company's internal control system . In addition, the audit committee is regarded as the connector between the shareholder and the board of commissioner (Nasution and Setiawan, 2007). The results of the research conducted by Pohan (2008) indicate the existence of the audit committee is not able to mitigate the acts of violations committed by the management company. This is because the audit committee has not run the maximum function to achieve a better internal control system.

An independent commissioner is described as a person who has no relationship with the board of directors or the board of commissioners, does not hold concurrent positions, and is not involved with the controlling shareholder. The higher the percentage of independent commissioners the higher the independence, hence the policy of tax avoidance practices will be lower. Conversely, the lower percentage of independent commissioners will affect the low independence, thus providing an opportunity for higher tax evasion practices.

Research by Fadhilah (2011), Annie (2011), Anissa and Kurniasih (2012); Dewi and Jati (2014), Maharani and Suardana (2014), Winata (2014), Rachmithasari (2015) indicated that corporate governance (audit committee and independent commissioner) significantly influenced tax evasion practices. In addition, corporate governance (audit committees and independent commissioners) have no significant effect on tax evasion practices (Anissa, 2011; Fadhila, 2011; Kurniasih and Sari, 2013; Khoirunnisa, 2014; Prakosa, 2014; Handayani et al., 2015). Based on the above description, this research proposes the following hypothesis:

H_2 : Corporate Governance affects Tax Evasion Practices

Framework of thinking

The auditing function is as a mechanism to reduce information asymmetry between shareholders and company management. The purpose of the audit of financial statements is to provide assurance that the management company has run the company's operational activities in accordance with applicable standards.

Audit quality is defined as the suitability between audit procedures and audits conducted by the auditor. A qualified audit is an audit that is able to fully inform the user of the financial statements and if any violation is found, the auditor will report the violation.

Audit quality can be measured through various means e.g. *"big four" Certified Public Accountant (CPA) firms and "non big four" CPA firms* and *earnings surprise benchmark.* The big four CPA Offices category shows that there is high audit quality because the resources owned by big four CPA are capable of handling clients. In addition, earnings surprise benchmark which represents audit quality indicating the extent to which the auditor's ability to find violations and report such violations in the audit findings.

Corporate governance is defined as a system that regulates and controls companies to create added value for stakeholders (Desai and Dharmapala, 2007). Corporate governance emerges to mitigate agency conflicts between shareholders and company management. On the one hand, shareholders hope to gain the greatest possible acceptance for their prosperity, while on the other hand, the company's management seeks to maximize its prosperity and thus trigger conflicts of interest. To mitigate conflicts of interest, good corporate governance is required to align the interests of shareholders and the interests of corporate management.

Audit committees and independent commissioners are a representation of corporate governance. Audit Committee as the composition of the committee established by the board of commissioners has the function to conduct internal auditing and report the results of the audit to the board of commissioners to be evaluated whether the company's management has run the company's activities in accordance with applicable standards. With the existence of audit committee is expected to minimize acts of violation committed by company management. An independent commissioner is described as a person who has relationships with the board of directors or board of commissioners, is not involved with the controlling shareholder and does not hold concurrent positions. The existence of an independent commissioner makes it possible to reduce opportunistic management behavior as it is monitored by an independent commissioner. Figure 1 shows the framework of this research thinking.

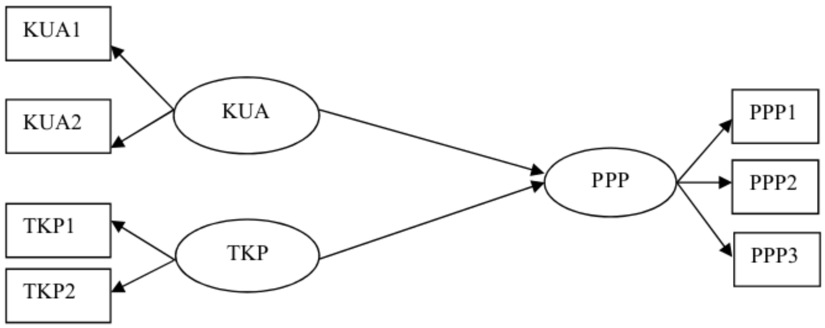

Figure 1. Framework of Thinking

Description :
KUA1 = Audit Quality 1 = *Big Four* and *Non Big Four CPA Firms*
KUA2 = Audit Quality 2 = *Earnings Surprise Benchmark*
TKP1 = Corporate Governance 1 = Audit Committee
TKP2 = Corporate Governance 2 = Independent Commissioner
PPP1 = Tax Evasion Practice 1 = *Cash* ETR
PPP2 = Tax Evasion Practice 2 = *GAAP* ETR
PPP3 = Tax Evasion Practice 3 = *Current* ETR

Data and sample selection

The data used in this study was obtained from the company's financial statements published by the Indonesia Stock Exchange (IDX) through the site *www.idx.co.id* . The sample in this research are State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (BEI) period 2013 -2016. The sampling technique use *purposive sampling* with the following criteria :

a. SOEs consecutively publish financial statements for the period of 2013 -2016.
b. Sampled data must be complete for all variables used in this study include information on audit quality, corporate governance and tax evasion practices .

Operational definition

This study uses three constructs to test the proposed hypothesis . These three constructs are among audit quality, corporate governance and tax evasion practices.

(1) Audit quality

According to Watkins et al. (2004) audit quality is the suitability of audit performed by the auditor with the auditing standard. This research uses two parameters (proxies) to measure audit quality : *big four Certified Public Accounting (CPA) Firms* and *earnings surprise benchmark* . The *big four* and *non big four* CPA Firms parameters were adopted from Anissa (2012) research and the *earning surprise benchmark* parameters were adopted from Carey and Simnett (2006) research . CPA Firms categorized as *big four* CPA Firms are PWC, KPMG, Deloitte, and EY. By using the *dummy* variable , then if the sample company is audited by *big four CPA* then it will be assigned a value of 1 and vice versa. *Earnings Surprise Benchmarks* is used to measure the auditor's ability to disclose earnings management performed by company management (avoiding loss reporting). The formula used is ROA (Return On Assets). *The Benchmark* is $\mu - \sigma <$ ROA $< \mu + \sigma$, μ is the average ROA and σ is the standard deviation. ROA $> \mu + \sigma$ indicates that the auditor provides an opportunity for company management to do *window dressing* . The definition of *windows dressing* is a management efforts to avoid corporate losses and make financial reporting are good for management to get present bonuses. While ROA $< \mu - \sigma$ indicates that the auditor gives an opportunity to the management company to take *a bath.* The definition of *taking a bath* is a management effort to create loss in the hope of management getting a bonus in the future because of profit increases. Using the *dummy* variable , the decision of *Earnings Surprise Benchmark* as follows:

a. If the research sample meets the criteria $\mu - \sigma <$ ROA $<\mu + \sigma$, then it is given a value of 1 because it indicates a high audit quality.
b. If the research sample meets the criteria of ROA $> \mu + \sigma$ or ROA $< \mu - \sigma$, then it is given a value of 0 because it indicates a low audit quality.

(2) Corporate governance

Corporate governance is a mechanism that regulates and controls companies to create added value for stakeholders . This study uses two parameters (proxies) to measure corporate governance : audit committee and independent commissioner. The audit committee is measured by the number of audit committees present in the sample company. Independent commissioners are measured by the number of independent commissioners divided by the number of commissioners.

(3) Tax evasion practices

Suandy (2011) defines tax evasion as engineering *tax affairs* which still remain within the frame of taxation provisions . This study uses three parameters (proxies) in measuring the practice of tax evasion : *Cash* ETR, GAAP ETR and *Current* ETR. *Cash* ETR is obtained by comparing taxpayer payments with pre-tax profits. GAAP ETR is obtained by comparing the tax expense with the profit before tax. The *Current* ETR is obtained by comparing the current tax expense with the profit before tax. The parameters of tax avoidance practices are adopted from the research of Hanlon and Heitzman (2010). (ETR = Effective Tax Rate).

Analysis technique

The analytical tool used in this study is SMARTPLS 3.0. According to Abdillah and Hartono (2016) the PLS (Partial Least Square) tools is the powerful analysis method because no need many assumptions basis. The strength of PLS can support modelling for many dependent variables and independent variables (complex model), and can handle multicollinearity problem amongst independents variables (Hartono, 2011). There are two stages of the model used to test the hypothesis in the structural equation model : the measurement model (*outer model*) and the structural model (*inner model*). The Measurement model (*outer model*) is a model test to measure the validity and reliability of a research model through the algorithm iteration process. The structural model (*inner model*) is a model test to predict the causality relationship between variables through the *bootstrapping* process .

The measurement model (outer model) is used to measure the convergence validity, discriminant validity and reliability. Convergent validity is measured through the *loading factor* and AVE (Average Variance Extracted) score. According to Hartono (2008) to meet the convergent validity then the *loading factor* for each parameter > 0.50. While *Rule of thumbs* score AVE > 0.50. Discriminant validity is measured through *cross* *loading* .When *cross loading* > 0.60 and does not highly correlate among different parameters in explaining different constructs, then discriminant validity is met. Furthermore, the reliability test using *cronbach alpha* and *composite reliability* . *Rule of thumbs* for *Cronbach alpha* and *Composite Reliability* > 0.70.

The structural model (inner model) is used to test the research hypothesis by using R *Square* for the dependent construct, path coefficient and t-statistic or *p-value* to test the significance of inter-constructs in the structural model. R *Square is* used to explain the percentage of independent constructs in explaining dependent constructs. The T-statistics used is 1.96 or *p-value*0.05.

RESULT AND DISCUSSION

(1) Overview of research samples

This research sample is a State-Owned Enterprises (SOEs) listed on the Indonesia Stock Exchange (IDX). Tabel 1 shows the sample selection process used in this study for 4 year period from 2013 -2016:

Table 1. Research Sample Selection Process

No.	Sample Criteria	Number of Samples
1.	SOEs listed on the IDX 2013 -2016	20
2.	Incomplete data	(0)
3.	Research sample	20
4.	Sample Observation study (20 x 4 years)	80

Source: www.idx.co.id

(2) Descriptive statistics

Descriptive statistics aim to provide a brief overview of research variables. Table 2 shows the description of the variables used in this study.

Table 2. Descriptive statistics.

No	Variables	N	Mean	Std. Deviation
1	Audit Quality (KUA 1)	80	0.6125	0.49025
2	Corporate Governance (TKP 1)	80	4.2125	1.03964
3	Corporate Governance (TKP 2)	80	0.3812	0.12385
4	Tax Avoidance Practices (PPP1)	80	0.1217	1.98060
5	Tax Avoidance Practices (PPP2)	80	0.1668	0.51721
6	Tax Avoidance Practices (PPP3)	80	0.1849	0.26453

Source: secondary data processed, 2018

Table 2 shows that the average tax evasion practices undertaken by the SOEs sampled in this study is positive and highest is PPP3 (Tax Avoidance Practices 3) or *Current* ETR . This reflects the trend of tax evasion practices undertaken by SOEs through Current ETR when compared to *Cash* ETR and GAAP ETR. In addition, the standard deviation of these variables shows the volatility of tax evasion practices undertaken by corporate management. (TER = Tax Effective Rate).

The average of corporate governance shows the positive and highest average score on the audit committee. This means that corporate governance is a mechanism used by internal companies in overseeing the performance of the company. In addition, the standard deviation of these variables indicates the volatility of corporate governance.

The average of audit quality shows a positive average score. This means that audit quality is a mechanism used by stakeholders as supervision of corporate management activities . In addition, the standard deviation of this variable showed a audit quality volatility.

(3) Results of data analysis

There are two types of structural equation models : the measurement model (*outer model*) and the structural model (*inner model*) . The measurement model (*outer model*) is a model test to measure the validity and reliability of a research model through the algorithm iteration process. The structural model (*inner model*) is a model test to predict the causality relationship between variables through the *bootstrapping* process.

(4) Evaluation of measurement model (Outer Model)

Evaluation of the measurement model (*Outer Model*) aims to test the validity and reliability of a construct. Validity test is done to know the ability of research parameter in measuring what should be measured based on conceptual study. While the reliability test is used to measure the consistency of measuring instruments in measuring a concept . This study uses a measurements model test (validity and reliability) to determine whether the parameters that was built based on the conceptual has accurately measure the construct to obtain the robust (solid) prediction results. Validity testing uses convergent validity and discriminant validity. While reliability testing using *cronbach alpha* and *composite reliability* .

(a) Convergent validity

Convergent validity test aims to measure the scores obtained from the parameters used to measure the same construct has a high correlation (Hartono, 2008). The following is Figure 2 shows result of the path analysis diagram (PLS algorithm iteration) and Table 3. *overview of* the PLS iteration algorithm.

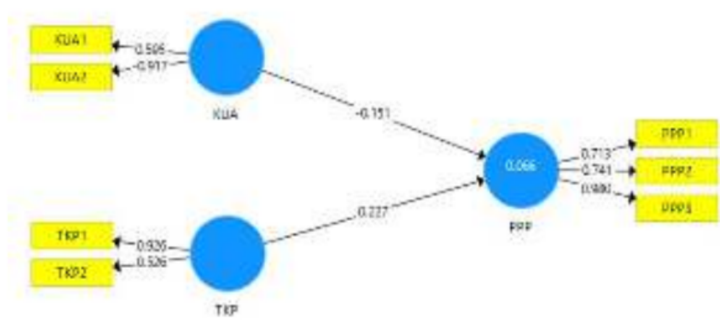

Figure 2. Path Analysis Diagram (PLS Iteration Algorithm)

Table 3. Overview of PLS Algorithm Iteration

No	Variables	AVE[1)]	Composite Reliability	Cronbach Alpha	R Square
1	Audit Quality (KUA)	0.598	0.114	-0.582	0.000
2	Corporate Governance (TKP)	0.567	0.709	0.286	0.000
3	Tax Evasion Practices (PPP)	0.673	0.858	0.774	0.066

Source: secondary data processed, 2018 ([1]AVE = Average Variance Extracted)

Figure 2 shows that the *loading factor* for the KUA2 parameter that measures the KUA construct has a *loading factor* <0.50. While KUA1, TKP1, TKP 2, PPP1, PPP 2, and PPP3 have *loading factor* > 0.50. Based on statistical tests using existing data, KUA2 (*earnings surprise benchmark*) has not been able to measure audit quality constructs. Therefore, the KUA2 parameter will be eliminated in this study through the revised model.

Table 3 shows the AVE (Average Variance Extracted) score > 0.50. This points out that constructs of audit quality, corporate governance, and tax evasion practices are capable of measuring what should be measured. The highest AVE score is the practice of tax evasion practice (0.673) and the lowest AVE score is a corporate governance construct (0.567).

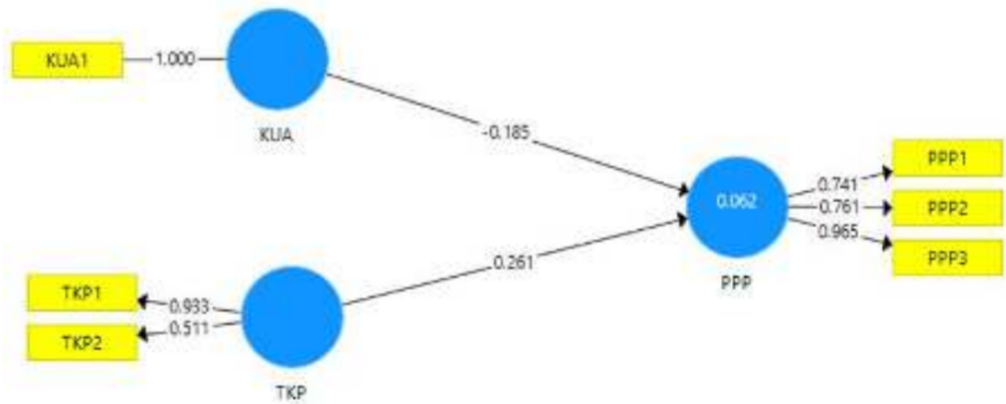

Figure 3. Path Analysis Diagram (PLS Algorithm Iteration) *(Revised Model)*

Table 4. Overview of PLS Algorithm Iteration *(Revised Model)*

No	Variables	AVE[1)]	Composite Reliability	Cronbach Alpha	R Square
1	Quality Audit (KUA)	1,000	1,000	1,000	0.000
2	Corporate Governance (TKP)	0.565	0.706	0.686	0.000
3	Tax Evasion Practices (PPP)	0.686	0.866	0.774	0.062

Source: secondary data processed, 2018 ([1)]AVE = Average Variance Extracted)

Figure 3 (revised model) shows that the *loading factor* for KUA1, TKP1, TKP2, PPP1, PPP2, and PPP3 has a *loading factor* > 0.50. This shows that the correlation between the item score and the construct score satisfies the validity test. It means that the parameters used in this study are able to measure constructs conceptually and statistically.

Table 4 shows the AVE score > 0.50. This means that audit quality, corporate governance, and tax evasion practices constructs are capable to measure what should be measured. The highest AVE (Average Variance Extracted) score is the practice of tax evasion practice (0.686) and the lowest AVE score (0.565) is a corporate governance construct. Thus, the constructs used in this study have met the convergence validity test.

(b) Discriminant validity

The discriminant validity test aims to measure the absence of high correlation between different parameters that measure different constructs. The following is Table 5. *cross-loading* results :

Table 5. *Cross Loading*

No	Indicator	KUA	PPP	TKP
1	KUA1	**1,000**	-0.075	0.421
2	PPP1	-0.092	**0.741**	0.032
3	PPP2	-0.134	**0.761**	0.047
4	PPP3	-0.020	**0.965**	0.261
5	TKP1	0.409	0.179	**0.933**
6	TKP2	0.176	0.075	**0.511**

Source: secondary data processed, 2018

Table 5 shows that each parameter for each construct in the measurement model has met the discriminant validity because each parameter has a different score and a score > 0.50.

(c) Reliability test

Reliability test aims to measure the accuracy and precision of a measurement tools or parameters in conducting measurement. Reliability test uses *cronbach alpha* and *composite reliability* .

Table 4 shows that the *cronbach alpha* score of each construct > 0.60 and the *composite reliability* score *of* each construct > 0.70. Thus, the constructs used in this study have met the reliability test.

(d) Evaluation of structural models (inner model)

The evaluation of structural model (*inner model*) aims to predict the relationship of causality inter-constructs. The evaluation of this structural model (*inner model*) uses R *Squared* for dependent construct, path coefficients and t-statistic or *p-value* to test the significance inter-constructs in the structural model. Table 4 shows that R *square* is 0.062. This means that the tax evasion practices can be explained by audit quality and corporate governance of 6.2% and the remaining 93.8% explained by other factors outside the model. The following is Figure 4. The structural model *bootstrapping* diagram and Table 6. Result of path coefficient :

Figure 4. Bootstrapping Diagram - Evaluation of Structural Models

Table 6. Path Coefficient

Variable	Original Sample	Sample Mean	Std. Deviation	T Statistics	P Values
Quality Audit → Tax Evasion Practices	-0.185	-0.180	0.103	1.795	0.073
Corporate Governance → Tax Evasion Practices	0.261	0.281	0.107	2.441	0.015

Source: secondary data processed, 2018

Figure 4 and Table 6 show the results of the structural model used to test the hypothesis. This research proposes two hypotheses using PLS 3.0 analysis tool.

The first hypothesis (H_1) proposed that the quality of audit affect the tax evasion practices. The results showed that coefficient value -0.185, t-statistics 1,795 (<1.96) and *p-value* 0.073 (> 0.05) . Thus, the first hypothesis (H_1) is not supported. The meaning is that audit quality has no significant effect on tax evasion practices in SOEs in Indonesia.

The second hypothesis (H_2) proposed that corporate governance affect the tax evasion practices. The results showed that the coefficient value 0.261, t-statistics 2.441 (> 1.96) and *p-value* 0.015 (< 0.05). Thus, the second hypothesis (H_2) is supported. It means that corporate governance affects significantly to the tax evasion practice in SOEs in Indonesia.

Discussion Analysis

(1) Audit quality and tax evasion practices

Hypothesis 1 indicates audit quality has an effect on tax evasion practice . The results showed that coefficient value -0.185, t-statistics 1,795 (<1.96) and *p-value* 0.075 (> 0.05) . Based on the test results, the audit quality has no effect on tax evasion practices .

Transparency is needed by stakeholders in assessing a company's performance. The purpose of the company reports the performance of the company. One of the reports relate to taxation with the transparent principle in order to increase stakeholder confidence that the financial management comply with applicable standards . Increasing the transparency to shareholders relating to the tax increasingly demanded by public authorities (Sartori, 2010).

The financial statements audited by *big four CPA Firms* according to some references are believed more qualified because of the capability to mitigate opportunistic company management behavior. It because the resources owned by *big four CPA Firms* support in audit activities. In addition, the *big four CPA Firms* are believed to be able to suppress violations conducted by the company's management. *Big four CPA Firm* : Pricewaterhouse Coopers (PWC), Deloitte Touche Tohmatsu (DTT), KPMG and Ernst & Young (E & Y). However, the results show that audit quality is not able to mitigate tax evasion practices. This is because of the possibility of a better auditor reputation that will be used by clients to have high-risk projects. In addition, the selection of highly reputable auditors is used by clients to give signal to shareholders that the published financial statements are of high quality. Consistent with previous researchs that audit quality has no significant effect on tax evasion practices (Annisa, 2011; Jaya et al., 2014; and Handayani et al., 2015).

(2) Corporate governance and tax evasion practices

Hypothesis 2 proposed how corporate governance affects tax evasion practices . The results showed that the coefficient value 0.261, t-statistics 2.441 (> 1.96) and *p-value* 0.015 (<0.05). Based on the test result, corporate governance has a positive and significant effect on tax evasion practices .

Corporate governance is a mechanism that regulates and controls companies to create added value for stakeholders. Corporate governance emerges to mitigate any conflicts of interest between shareholders and company management. This is because company shareholders and management try to maximize their interests hence creating the information asymetry. Part of corporate governance is audit committee and independent commissioner.

The result shows that corporate governance positively affects tax evasion practices . This is due to the existence of the audit committee and independent commissioner that have not fully performed the supervisory function maximally and unable to mitigate the tax evasion practice. Researchs by Fadhilah (2011), Annisa (2011), Anissa and Kurniasih (2012); Dewi and Jati (2014), Maharani and Suardana (2014), Winata (2014), Rachmithasari (2015) indicate that corporate governance (audit committee and independent commissioner) have a significant effect on tax evasion practices .

CONCLUSION, LIMITATIONS AND RECOMMENDATIONS

Conclusion

This study aims to examine and analyse the effect of audit quality and corporate governance on tax evasion practices. The sample of this research is State-Owned Enterprises (SOEs) that listed in Bursa Efek Indonesia (BEI) period 2013-2016.

The financial statements audited by *big four CPA Firms* according to some references are believed more qualified because of the capability to mitigate opportunistic company management behavior. It because the resources owned by *big four CPA Firms* support in audit activities. In addition, the *big four CPA Firms* are believed to be able to suppress violations conducted by the company's management. *Big four CPA Firm* : Pricewaterhouse Coopers (PWC), Deloitte Touche Tohmatsu (DTT), KPMG and Ernst & Young (E & Y). However, the results show that audit quality is not able to mitigate tax evasion practices. This is because of the possibility of a better auditor reputation that will be used by clients to have high-risk projects. In addition, the selection of highly reputable auditors is used by clients to give signal to shareholders that the published financial statements are of high quality.

Corporate governance is a mechanism that regulates and controls companies to create added value for stakeholders. Corporate governance emerges to mitigate any conflicts of interest between shareholders and company management. This is because shareholders and management companies try to maximize their interests hence creating the information asymetry. Part of corporate governance is the audit committee and independent commissioner.

The result shows that corporate governance has a positive effect on tax evasion practices. This is due to the existence of the audit committee and independent commissioner that have not fully performed the supervisory function maximally and unable to mitigate the tax evasion practice.

Contribution of this study for :

(a) The companies (State-Owned Enterprise Companies) : the audit quality can't afford to mitigate tax evasion practices, because better reputable auditors are used by auditee for winning high risk projects tender. Moreover reputable auditors selection is used by auditee to give sign to shareholders (owners) that published financial reports having a high quality standard.

(b) The researchers : corporate governance is a mechanism to manage and control the company to provide value creation for stakeholders. Corporate governance is established to mitigate conflict of interest between shareholders (owners) and company management.

Limitations

This study has several limitations that need to be the attention of further research, as follow :

a. This study is limited to the use of proxies that explain audit quality variables, corporate governance and tax evasion practices .
b. The testing of factors affecting tax avoidance practices is limited to audit quality and corporate governance without looking at other factors.

Suggestion

The suggestions for further research are as follows.

a. Future research is expected to use other proxies that explain audit quality, corporate governance and tax evasion practices to obtain more comprehensive results.
b. Subsequent research can use other factors that contribute to tax evasion practices .

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