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MODERATING EFFECT OF EARNINGS MANAGEMENT ON FIRM-SPECIFIC ATTRIBUTES AND TAX AVOIDANCE OF LISTED OIL AND GAS COMPANIES IN NIGERIA

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ABSTRACT

This study seeks to examine whether firm-specific attributes are correlated with tax avoidance if earnings management moderates this relationship. To do so, the study employed an Ex-post facto research design. Data were obtained from secondary sources through the firm's annual reports and accounts. The research hypotheses are built upon a sample of eight (8) oil and gas companies listed on the Nigerian Stock Exchange from the years 2012 to 2020 and then tested using dynamic panel regression techniques. The results revealed that earnings management positively and significantly moderates the effect of profitability and tax avoidance practices. Furthermore, the study revealed that earnings management negatively and significantly moderates the effect of leverage and tax avoidance practices. While earnings management exerts no significant effect on the relationship between firm size and tax avoidance practices of listed oil and gas companies in Nigeria. The study recommends that the accounting oversight body, such as the financial reporting council of Nigeria FRCN) should be stricter in controlling tax avoidance practices by designing rules that address the loopholes that arise out of the flexibilities in the accounting system.

Keywords: Tax avoidance, profitability, leverage, firm size, earnings management

INTRODUCTION

Tax avoidance by companies has been a major source of concern for governments around the world. This is because governments around the world are losing $427 billion each year due to business tax avoidance (Global Alliance for Tax Justice, 2021). According to Panama paper, (2020), the Nigerian government lost N360 billion because of a hidden transaction between MRS Holdings Ltd, a Nigerian oil marketing business, and multinational oil giant Chevron, raising concerns about new tax avoidance methods by corporate companies. To Salihu, Obid, and Annuar (2014) companies tend to avoid paying taxes because they are a large business cost that reduces distributable profits. This is what has led to the issue of corporate tax avoidance.

Theoretically, the goal of tax avoidance is to lower the amount of money spent on taxes (Hanlon and Heitzman, 2010). Legal tax avoidance can be accomplished by taking advantage of loopholes in Nigeria's tax laws. According to Pratama (2017), tax avoidance can be used as a legal technique to lower the amount of tax that companies must pay. For this reason, it is important to determine the characteristics influencing the level of corporate tax avoidance practice.

Most sighted literature on the effect of firm attributes on tax avoidance in Nigeria uses different proxies such as firm size, profitability, leverage age, and liquidity on tax avoidance (Yahaya & Yusuf, 2020, Uniamikogbo, Atu, & Atu 2018; Ogbeide, 2017). Besides, these above-mentioned studies only looked at the direct relationship without considering the use of earnings management as a moderator variable. Besides one of the features that drive the managers to conduct earnings management is tax incentives (Scott, 2009). Badertscher, Katz, and Rego (2013) establish that the companies conducted earnings management to avoid taxes. Other earnings management motivations include managerial compensation debt agreement and political visibility which are all connected to firm-specific attributes of profitability, leverage, and firm size. Consequently, there is the need to examine the effect of firm-specific attributes on the tax avoidance practices by relating the activities of profitability, leverage, and firm size and the moderate effect of earnings management of those companies to determine the extent of the relationship. This study is carried out to fill this gap for the Nigerian oil and gas companies.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Firm Profitability and Tax Avoidance Moderating Earnings Management

Profitability is a mechanism used in quantifying the performance of a company by describing the company's ability to generate profits during a period. To polish the profitability maintained by the firm, it used profitability fraction which reflects the managerial performance of a company. The higher the reported profit by the company manager, the better the financial performance. It can be expected that if the firm's profitability is high then the company does not take tax avoidance action. On the other hand, a low profitability fraction is usually related to a lower effective tax rate because managers would not like to present a financial report that shows their poor performances, therefore engaging in tax avoidance practices. Also, less profitable firms engage in tax avoidance practices compared to companies with high profitability (Zimmerman, 1983). Moreover, companies with lower profitability need tax avoidance to retain some after-tax profit (Watson, 2015). Hence, management is motivated to perform earnings management with the practice of income smoothing so that reported earnings do not fluctuate. Also, Watts and Zimmerman, (1986) state that if managerial compensation is tied to accounting profit, the manager will conduct earnings management to reach the minimum level to earn a bonus.

Studies on the interaction between firm profitability and tax avoidance moderating earnings management have revealed inconclusive results. Lukman, Mamman, and Habib, (2020) examined the moderating effect of earnings management on the relationship between tax avoidance and the financial performance of listed oil marketing companies in Nigeria. General Least Squares (GLS) regression technique of data analysis was used. The study reveals that earnings management positively and significantly moderates the relationship between tax avoidance and financial performance.

Ahmad, Noorhayati, and Wan (2020) examined the effects of corporate tax avoidance and free cash flow on real earnings management in Nigeria. The analyses involve a sample of 72 non-financial firms with 360 firm-year observations for five years (2014-2018). Multiple regression techniques were used to test the model studied. The results show that both corporate tax avoidance and free cash flow increase management's real earnings manipulation activities.

Fazliza and Natrah, (2019) examined the determinants of tax avoidance strategies in Malaysia quoted companies for 2018. The study employed pooled independent regression. The findings show that profitability affects tax avoidance practice

Sasiska, Luk, and Fuadahc, (2018) examined the effects of the firm characteristics on tax avoidance and analyze the effects of moderation of earnings management using manufacturing companies listed on the Indonesia Stock Exchange of the period 2012-to 2016 The result of the panel data regression as a technique of analysis. The study reveals that earnings management moderates the relationship between profitability and tax avoidance.

Zevenbergen, (2018) examined the relationship between firm performance and tax avoidance for firms in European countries from 2011 to 2016. using regression as a technique for analysis. The results show that firm performance and tax avoidance are positively and significantly related.

Bambang, Yudha, and Abim, (2017) examined the factors that affect the company tax avoidance in manufacturing companies listed on the Indonesian Stock Exchange from 2013-to 2015. Multiple regression was employed as a technique of data analysis.

Sally, Yorke, and Cletus (2016) studied the consequences of earnings management and corporate tax avoidance on firm performance. Using a sample of non-financial firms listed on the Ghana Stock Exchange over ten years (2003–2012). The panel regression technique was used to analyze the data and findings show that earnings management and tax avoidance negatively and insignificantly affect firm characteristics.

The results showed that profitability does not significantly influence tax avoidance. Based on the literature review, the hypothesis is stated as

H_1: *Earnings management does not significantly moderate the relationship between firm profitability and tax avoidance of listed oil and gas companies in Nigeria*

Firm Leverage and Tax Avoidance Moderating Earnings Management

Leverage is the ratio between total liabilities and total assets. Firms with a large debt ratio in their capital structure are prone to higher agency costs. Hence, managers of such firms have an incentive to reduce agency costs and may be tempted to do so using earning manipulation which usually comes in form of earnings management. Consequently, high leverage is an indication of potentially higher earnings management Minnick and Noga (2010) argue that companies with higher leverage use the interest costs of liabilities to reduce the amount of income tax payable.

Heriyah, (2020) examined the effect of firm characteristics on tax avoidance of listed manufacturing companies in Indonesia for the period 2015 until 2018. The study employed partial least squares as a method of data analysis. Results showed that leverage insignificantly affects tax avoidance.

Tjondro and Permata, (2019) studied the effect of total debt and long-term debt on the company's management decisions regarding the preference to focus on accounting or tax reporting. The research sample was manufacturing companies with observation years of 2012 - 2016 with 175 observations. The data of this study was obtained from Bloomberg databases and audit reports published by the Indonesia Stock Exchange. The statistical tool used is logistic regression The results showed that there was a non-linear relationship between debt ratios and earnings management.

Uniamikogbo, Atu, and Atu (2018) Investigated the effect of firm attributes on tax aggressiveness in Nigeria. The specific objectives were to assess the effect of firm size, profitability, liquidity, and leverage on tax aggressiveness in the Nigerian banking sector. The population of the study consists of fifteen (15) Deposit Money Banks (DMBs) whose shares were listed on the Nigerian Stock Exchange as of 31st December 2017, from which a sample size of ten (10) banks was selected using the judgmental technique based on Banks with international authorization. The secondary source of data collection method was used to generate data from the ten (10) annual reports and accounts of the sampled banks for a period of five years (2013- 2017). Ordinary Least Square (OLS) regression analysis was used, and the findings revealed that firm size and leverage have a significant impact on tax aggressiveness while profitability has an insignificant impact on tax aggressiveness in the Nigerian banking sector.

Ahmad and Amrie (2018) studied the effects of tax avoidance, Accrual Earning Management, Real Earning Management, and Capital Intensity to Equity Costs on manufacturing companies listed on the Indonesia Stock Exchange for 2017. This investigation was quantitative research with secondary data. The study used multiple regression as a technique of analysis. The study fails to establish any relationship between tax avoidance and earnings management.

Ogbeide (2017), Examined firm characteristics and tax aggressiveness of listed firms in Nigeria using pool and panel data for the period 2012 to 2016. The study proxies firm characteristics by firm size, external audit quality, leverage, and interest charges, while tax aggressiveness was proxies by ETR. The data used was sourced from the annual reports of the selected firms. Both the panel and dynamic panel methods were used to analyze the data generated. Findings from the study revealed that firm size exerts positive and significant effects on tax aggressiveness, while leverage has no significant effects on tax aggressiveness

This suggests the following hypothesis stated as

H_2: *Earnings management does not significantly moderate the relationship between firm leverage and tax avoidance of listed oil and gas companies in Nigeria*

Firm Size and Tax Avoidance Moderating Earnings Management

Jensen and Meckling (1976) mentioned that agency cost increases when the firm size increases, with managers' discretion being greater. Therefore, the bigger the company the more likely the more managers will try to lower the reporting earnings by using accounting standards to not draw the attention of the politicians (Watts & Zimmerman, 1986).

Sasiska, Didik, and Luk, (2018) studied the effects of the corporate characteristics on tax avoidance and analyze the effects of moderation of earnings management on the relationship between the corporate characteristics and tax avoidance. The corporate characteristics in this study are proxied by profitability, leverage, and size. This study selected 49 manufacturing companies listed on the Indonesia Stock Exchange between 2012 and 2016 as samples that were selected by using the cluster random sampling technique. The result of the panel data regression shows that the characteristics of a company, namely the profitability and the size have a significant negative effect on tax avoidance, whereas leverage has a significant positive effect on tax avoidance. The action of the earnings management can moderate the effects of the profitability and the leverage on tax avoidance. However, the action of the earnings management is unable to moderate the effects of the size on tax avoidance

Ribeiro, Cerqueira, and Brandao (2015) examined the effect of firm characteristics on tax avoidance in non-financial firms listed on the London stock exchange between 2011 and 2013. Firms' characteristics were proxy by firm size, profitability, leverage, capital intensity, and research and development expenses. The study made use of Generalized Leased Square (GLS) cross-section weights to analyze the data collected. The study results showed that firm size has a positive effect on tax avoidance.

Zemzem and Ftouhi (2013), examined the effect of firm characteristics on tax avoidance in France-listed companies between 2006 and 2010. Using Regression analyses on 76 sample French listed companies. The study results also revealed that firm size has a positive significant effect on tax avoidance.

Shiwei and Siyu (2012) studied the relationship between earnings management and tax avoidance of listed Chinese companies. This study uses the data of Chinese A-share non-financial listed companies from annual reports during 2004-to 2006. Using regression analysis, the study reveals that earnings management positively and significantly influences tax avoidance. This suggests the following hypothesis stated as

H_3: *Earnings management does not significantly moderate the relationship between firm size and tax avoidance of listed oil and gas companies in Nigeria*

This study is hinged on positive accounting theory. Positive accounting theory was developed by Watts and Zimmerman (1978). Watts and Zimmerman (1990) put forward three hypotheses of positive accounting theory, namely, the bonus plan, debt covenant, and political cost. The bonus plan hypothesis suggests that managers will choose accounting procedures that will shift future income to the present period to get a bonus. The debt agreement hypothesis suggests that for companies that would violate a debt agreement, the manager would have the possibility to choose accounting procedures that shift future income to the current period to increase net income and ultimately avoid technical errors. The political cost hypothesis suggests that businesses that have high profits will tend to shift their income from this period to the coming periods to avoid political costs.

METHODOLOGY

This study adopted an Ex-post facto research design to address the research problem. The population of the study consists of the ten (10) oil and gas companies on the Nigerian stock exchange as of 31 December 2020 which is not

delisted as of 31 December 2020. The number of firms was reduced to a working population of eight (8). Afroil Plc and Beco Petroleum Products Plc were excluded from the study population because it was delisted in 2014 and 2017. Therefore, the entire working population of eight (8) oil and gas companies in Nigeria

Table.1 Population and Sample size of the study

S/N	Name of Company
1	Forte Oil Plc
2	MRS Oil Nigeria Plc
3	Total Nigeria Plc
4	Mobil Oil Nigeria Plc
5	Conoil Plc
6	Afroil Plc
7	Oando Plc
8	Eterna Oil & Gas Plc
9	Japaul Oil & Maritime Services Plc
10	Beco Petroleum Products Plc

Source: Authors' computation (2021)

This study employed a secondary source of data collection. The data was collected from the annual reports and accounts of the sampled oil and gas companies, and other relevant sources for a period of nine (9) years (2012 to 2020). Given the dynamic nature of the panel data, this study employed dynamic panel regression or the Generalized Method of Moments (GMM).

Model Specification

$$ETR_{it} = \beta 0+\gamma ETR_{it}+\beta_1 FP_{it}+\beta_2 LEV_{it}+\beta_3 FS_{it}+\beta_4 FP*EM_{it}+\beta_5 LEV*EM_{it}+\beta_6 FS*EM_{it}+ \varepsilon_{it}$$

Where:

ETR= Effective Tax Rate

β0= Intercept

ETRit-1 = One period lagged value of ETR

β1to β6 = coefficient of slop or regression coefficient

FP= Firm Profitability

LEV= Leverage

FS=Firm size

FS* EM = Earnings management moderating firm size

LEV* EM = Earnings management moderating leverage

PROF* EM = Earnings management moderating profitability

ε = error term

it = i cross-sectional t time

Variables and their Measurements

Table 2 Variables Measurement

Variables	Type	Measurement
ETR	Dependent	Income tax expense divided by accounting income before tax (Bouassidi & Hamed, 2015)
FP	Independent	Net income divided by total asset
LEV	Independent	Total debt divided total asset
Fs	Independent	Natural Log of Total assets (Salaudeen&Ejeh, 2018)
	Moderator	
FS*EM	Earnings management moderating firm size	performance Adjusted Current Discretionary Accrual * Natural Log. of Total Assets (Sasiska, Didik & Luk 2018)
LEV*EM	Earnings management moderating financial leverage	performance Adjusted Current Discretionary Accrual * Profit after tax /Total assets (Sasiska, Didik & Luk 2018)
PROF*EM	Earnings management moderating profitability	Performance Adjusted Current Discretionary Accrual * Profit after tax /Total assets (Sasiska, Didik & Luk 2018)

RESULTS AND DISCUSSIONS

Table 1: Descriptive Statistics

Variables	Mean	SD	Min	Max
ETR	.1906439	.1089795	-.1475198	.612316
FP	.1027704	.1296731	-.07134	.767471
LEV	.4272561	.2334574	.18773	.88668
FS	8.233294	.7687179	5.86062	10.0158
EM	.1175341	.1042302	.000026	.653147
FP*EM	.8118217	.7517252	.0001676	5.343969
LEV*EM	.0519578	.0608953	.0000356	.4938393
FS*EM	.01417	.0282862	-.0876996	.2669635

Source: STATA Output, 2021

The summary statistics in table 1 depict that tax avoidance (ETR) has an overall mean of .1906439 with a standard deviation of.1089795. However, the minimum and maximum values are -.1475198 and .612316 respectively. Table 1 also showed that the average firm profitability as indicated by the mean is .1027704 (10%) with a standard deviation is .1296731 (12%) The minimum and the maximum as shown in the table are -.07134 and .767471 (77%) respectively. Table 1 further shows that the mean for leverage is .4272561 with a standard deviation of.2334574 The minimum and maximum are .18773 and .88668 respectively. The average firm size is 8.233294 with a standard deviation of .7687179. The minimum and the maximum firm size are 5.86062 and 10.0158 respectively. Finally, the moderating variable earnings management has meant a value of .1175341 for all the firms

within the study period implying that the majority of the firms have less than 13% earnings management in the organization. The minimum value for earnings management stood at .000026 implying that there was a firm where the level of earnings management was at its lowest, while the maximum value stood at .653147. Its standard deviation is lower than the mean which indicates that the mean does represent the true average for the firms.

Table 2: Model Diagnostics

Arellano-Bond test for AR(1) in first differences:	z = -0.26	Pr > z = 0.812
Arellano-Bond test for AR(2) in first differences	z = -0.61	Pr > z = 0.543
Sargan		
Sargan test of overid. restrictions: chi2(36)	= .80	Prob > chi2 = 0.213

Source: STATA Output, 2021

The AR (1) and AR (2) test results reported coefficients of -0.26 and -0.61 respectively. While the p-value of 0.812 for the AR (1) and AR(2) 0.543 is statistically insignificant suggests that there are no first and second-order serial correlations, in the model. Therefore, the non-existence of serial correlation of the error terms provides no evidence of misspecification. As also shown in Table 2, the results of the p-value of the Sargan test for the total sample is 0.213. This non-significant p value emphasizes the overall validity of the instruments and the tested determinants of tax avoidance practices.

Table 3: Summary of Dynamic Panel Regression Result (GMM)

	Coef.	Robust Std. Err	z	P>|z|
ETR |				
L1.				
FP	-.6718344	.3210324	-2.09	0.038
LEV	.0040737	.0058907	0.69	0.491
FS	.2129631	.0639281	3.33	0.001
FP*EM	.2707764	.1119123	2.42	0.017
LEV*EM	-.1573394	.022371	-7.03	0.000
FS*EM	-.0003291	.0025616	-0.13	0.898
Wald chi2(8) = 78.31				
Prob > chi2 = 0.000				

Source: STATA Output, 2021

From the results, the Wald chi-square statistic is 78.31 with a p-value of 0.000. This indicates that the model is fitted, and the explanatory variables are properly selected, combined, and used as the substantial value of the firm characteristics and its moderator variable. Hence, the finding of the study is relied upon.

Hypothesis I

The GMM results revealed that firm profitability as shown in Table 2 has a t-value of -2.09 and a coefficient value of -.6718344 which is significant at 5% (0.038) in the model before moderation. However, for the moderated

earnings management, it recorded a t-value of 2.42 and a coefficient value of .2707764 which is also significant at the 5% level (0.017). This indicates that the higher the level of firm profitability resulting from earnings management, the lower the tax avoidance The study, therefore, rejects the null hypothesis (Ho1). This is in line with the bonus plan hypothesis in positive accounting theory which states that the company's management will tend to maximize its financial performance by increasing earnings. The findings supported those of Sasiska, Luk and Fuadahc, (2018) but contradicted those of Ahmad , Noorhayati and Wan (2020).

Hypothesis II

Leverage before moderation has a t-value of 0.69 and a coefficient value of .0040737 but it is not significant at 5% level (0.491). This shows that leverage has an insignificant positive effect on tax avoidance before moderation, while after moderation, it was documented that earnings management moderates the negative effect of leverage on tax avoidance of listed oil and gas firms in Nigeria. This is substantiated by the values recorded from the regression result, where the t-value is -7.03 and the coefficient value of -.1573394 with a significant value of 5% (0.000). it is understood that the higher the level of leverage as the result of earnings management, the higher tax avoidance practices. The study, therefore, rejects the null hypothesis (Ho2). This is in line with the debt-equity hypothesis in the positive accounting theory. This finding is consistent with that of Tjondro and Permata, (2019)

Hypothesis III

The results further demonstrate clearly that the firm size without interaction with earnings management has a positive t-value of 3.33 and is significant at 5%, compared with the positive t-value of -0.13 which is significant (0.898) after FS interaction with EM (FS*EM). This shows that EM has no moderating effect on firm size and tax avoidance. The findings, therefore, fail to reject the null hypothesis (Ho3). The finding backs the political cost theory, which states that larger companies are supervised and controlled by the government, resulting in higher taxation. This finding also tallies Sasiska, Didik, and Luk, (2018).

CONCLUSION AND RECOMMENDATIONS

This study examines the moderating effect of earnings management on firm-specific attributes and tax avoidance of listed oil and gas companies in Nigeria. The results are in line with the predictions of the positive accounting theory. The overall conclusion is that earnings management does appear to play an important role in moderating firm specifics attributes and tax avoidance practices. The study specifically concludes that the higher the profitability resulting from earnings management, the lower the tax avoidance. The study further concludes that the higher the level of leverage resulting from earnings management, the higher the tax avoidance practice. The study's findings also show that earnings management does not affect the size-tax avoidance relationship. The study therefore, recommends that the accounting oversight body, such as the Financial Reporting Council of Nigeria (FRCN) should be more strict in controlling tax avoidance practices by designing rules that address the loopholes that arise out of the flexibilities in the accounting system

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