

# Political and Military Connection, Audit Delay, and Tax Avoidance: An Evidence in Indonesia

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**Abstract.** Many political elites in Indonesia have strategic position in companies. Uniquely, in Indonesia, there are also military elites hold this position. On the contrary, the level of corruption in Indonesia is still very high, and the tax ratio is also low. Therefore, this study is conducted to determine and analyze the effect of political and military connection on tax avoidance in Indonesia. The research was conducted on mining companies listed on the IDX in 2017 – 2019, and the data were analyzed using SmartPLS. The results of this study indicate that political connection has an effect on tax avoidance through audit delay. Top management can intervene in the audit report process to get the expected result. So, the process takes longer time and it indicates the occurrence of tax avoidance efforts. Meanwhile, the military connected company has no effect, because the proportion is relatively small and they have characteristics to comply more with the rules in submitting audit reports. Ultimately, this study is expected to be a valid source of input in making regulations about tax collecting activities. Moreover, it can be taken into consideration in making decisions regarding the proportion of the top management who are connected politically and militarily.

**Keywords:** Audit Delay, Military Connection, Mining Companies, Political Connection, Tax Avoidance.

## 1 Introduction

Surprisingly, of 47 countries that became the research samples, Indonesia has the largest proportion as a country that have corporate political connections [1]. The interesting fact is that he has found that many political connections exist in countries with high level of corruption. This is reinforced by the results published by Transparency International Index related to Corruption Perception Index (CPI) in 2020, where it shows Indonesia's ranking has dropped from 85 to 102 (of 180 countries). Many research results actually show that the politically-connected corporations tend to do more earning-management and lower accounting quality than non-connected corporations [2].

Moreover, they also have higher levels of leverage and pay lower taxes. Tax payment in Indonesia is still relatively low, even in 2019, based on the data issued by the Directorate General of Taxes, tax ratio reaches the lowest point by 10.7%, and it is still far from the target [3]. This condition shows that there are many potentials of tax revenue that have not been received from the taxpayers including corporate taxpayers. Recently in Indonesia, there are several cases of tax avoidance activities with material value and involving companies with strong political connection, such as the case of PT Adaro Energy Tbk that is indicated abuse of transfer pricing [4].

Thus, Indonesia still shows a strong connection between political interests and business world. In fact, what is unique in Indonesia is about the Suharto regime to date, not only politicians, but also many military members, both active and retired, who have strategic positions in companies [5]. As top management, they can intervene the corporate action for the company's interests, especially those related to government issues, such as capital, state projects, and taxation. The company's management still often intervenes to decide, delete, and modify certain parts that will be examined by the auditor [6]. This intervention makes the audit reporting process takes a longer time and become late. Delays in audit report might indicate a large amount of financial data manipulations to maintain the value and public credibility of the company.

Companies in the mining sector are one type of industry that has strong political and military connections. Many Politically-Exposed Persons (PEPs) serve as top management in the mining companies. Mining companies, especially in the coal sector, which has grown rapidly over the last 20 years, have become the main source of funding for political activity in Indonesia [7]. Therefore, this study was necessarily conducted to find out the influence of politically and militarily connected companies on tax avoidance through audit delays on mining sector companies listed on the Indonesia Stock Exchange in 2017 – 2019.

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## 2 Literature Review

### 2.1 Signalling Theory

Signaling Theory is an action to provide company's information to investors on how management organize and project the company [8]. Signaling theory emphasizes the importance of information issued by the company on investment decisions by investors and potential investors, for example the company's financial and annual reports [9].

### 2.2 Agency Theory

Agency relationship is a contractual relationship in which the principal engages the agent to perform some services on their behalf which involves delegating some decision making to the agent [10]. Agency costs are used to carry out management duties to achieve company goals.

### 2.3 Political Connection

Political connection is part of the corporate governance structure in a company. Companies that have political connections are companies that in certain ways have political ties, political backgrounds, and approaching the politicians or the government. Companies that have political connections are believed to have more benefits for the value of the company and have a wider market share. Furthermore, companies can get easier access to strategic resources which can only be achieved with their assistance, and they can establish good relations with the government so that it is possible to avoid pressure from the government [11].

### 2.4 Military Connection

Since 1945, Indonesia has been led by a president with a strong military background for 41 years. In recent periods, Indonesian state leaders also have military backgrounds, such as Susilo Bambang Yudhoyono (SBY), Prabowo Subianto, and Luhut Binsar Panjaitan. The Indonesian government issued regulations to support and strengthen the involvement of military personnel in economic activities in Indonesia [12]. Since that year until now many former military personnel are now on the board of commissioners and directors in private company. Because their experiences in the military have taught them how to be a good leader, disciplined, and well organized.

### 2.5 Audit Delay

Audit Delay is the completion period of the audit process from the closing date of the company's books to the date in the audit report [13]. The deadline for submitting the annual report according to the Financial Services Authority (OJK) is no later than four months after the financial year ends, the company will be subject to sanctions in the form of fines and suspensions from the OJK, there is also a possible indication that the

company's performance is low due to delays in submitting the financial and annual report [14].

### 2.6 Tax Avoidance

Tax avoidance aims to minimize tax liability by utilizing existing regulations [15]. In essence, tax avoidance is an act that cannot be justified, especially in business ethics, because it will decrease revenue and obstruct the government's efforts to create social welfare.

### 2.7 Hypotheses

#### 2.7.1 Political Connection and Audit Delay

The more the company boards who have political connections, the shorter the audit delay of the company [16]. Another study was in Greek municipalities in 2006-2007, political factor variables which are proxied by political connection have an influence on audit delay, there is intervention from political parties which makes the audit process take a long time [17]. The board of companies that have political connections will have an impact on the level of audit delay because there are more audit interventions and processes than companies with non-political connections.

H<sub>1</sub> Political connection influences audit delay.

#### 2.7.2 Military Connection and Audit Delay

Companies with military connections will affect the audit delay, because they have special pressure to present financial reports in a timely and good manner. Companies that report losses may ask the auditor to arrange a longer audit time than usual [18]. Companies that have military connections tend to be less transparent which can increase audit delay.

H<sub>2</sub> Military connection influences audit delay.

#### 2.7.3 Audit Delay and Tax Avoidance

Audit delays often occur because of the intervention of top management. When the company's expected opinion does not match the opinion issued by the auditor, it will make a long negotiation process. In the negotiation process, it is possible that the company will do various efforts to get the expected opinion results which are in accordance with the company's goals, for example making up tax avoidance. One way to measure the transparency and quality of financial reporting is the timeliness of submitting audited financial reports [18]. The longer the submission of the audit report, the higher the indication of financial statement make-up activities, including tax reports.

H<sub>3</sub> Audit delay influences tax avoidance.

#### 2.7.4 Political Connection and Tax Avoidance

The existence of political connections owned by the company's corporate governance is a gap to be able to freely and act opportunistically, such as tax avoidance

efforts [19]. The existence of political connection, through the lobbying process, private corporate can be easier and more effective in building relationship with the government [20]. On the other hand, companies that have political connections will experience financial distress because companies can easily obtain loans from political relationships.

H<sub>4</sub> Political connection influences on tax avoidance.

### 2.7.5 Military Connection and Tax Avoidance

Companies with military connections will try to publish good information because company information will affect investor decisions and the company's credibility. Companies that report losses may ask the auditor to set the audit time longer than usual [18].

H<sub>5</sub> Military connection influences tax avoidance.

### 2.7.6 Political Connection and Tax Avoidance through Audit Delay

Companies that have a political connection will have special pressure from certain parties and are easy to experience financial distress. Companies are encouraged to commit financial statement fraud because of the political connection factor [21]. Political connection has an effect on audit delay [16, 17, 22]. Therefore, the effect of political connection on tax avoidance must go through audit delay first.

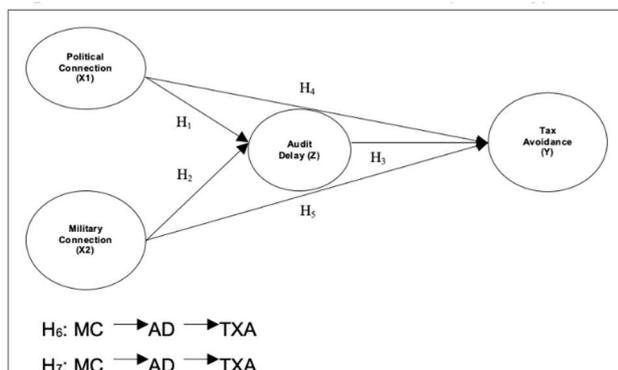
H<sub>6</sub> Political connection influences tax avoidance through audit delay.

### 2.7.7 Military Connection and Tax Avoidance through Audit Delay

Corporate governance that focuses on military connection shows that military connection has an influence on audit report lags [16]. Audit delay is related to the auditor's investigation process on the possibility of fraud by the company, so the auditor takes longer in the audit process [23].

H<sub>7</sub> Military connection influences tax avoidance through audit delay.

## 2.8 Research Framework



**Fig.1** The Framework of Research Concept and Hypotheses

## 3 Research Method

This research uses quantitative method and the data sourced from corporate annual reports and financial statements downloaded from Indonesia Stock Exchange website or the corporate official website. The data are manually categorized and matched with the politically and military connected corporate from annual report. The population are mining companies listed on the IDX for three consecutive years from 2017 to 2019. Purposive sampling method is used to find the most representative sample. The data analysis technique uses component based Structural Equation Modeling (SEM). Hypothesis testing will use quantitative method with statistical test. Calculation is performed using statistical software, smartPLS Version 3.2.9.

Proxies to capture dependent variable, tax avoidance using ETR. ETR is calculated by using the following formula [24]:

$$ETR = \frac{\text{Corporate Income Tax Payable}}{\text{Income before Tax}} \quad (1)$$

Political and military connection is measured using proportion of Board of Commissioners (BoC) and Board of Directors (BoD) who are connected politically and militarily. The political connection proportion is denoted in the following formula:

$$\text{Political Connection} = \frac{\text{Amount of BoC + BoD who are Connected Politically}}{\text{Total of BoC + BoD}} \quad (2)$$

The military connection proportion is denoted in the following formula:

$$\text{Military Connection} = \frac{\text{Amount of BoC + BoD who are Connected Militarily}}{\text{Total of BoC + BoD}} \quad (3)$$

Audit delay as intervening variable is calculated using Natural Log of Date of Auditor's Report – Date of Fiscal Year-End of Financial Report.

$$\text{Audit Delay} = \text{LN} (\text{Date of Auditor's Report} - \text{Date of Fiscal Year-End of Financial Report}) \quad (4)$$

## 4 Results

### 4.1 Research Overview

The population of this study are public mining companies listed on Indonesia Stock Exchange in 2017-2019, i.e., 47 companies or 141 data observations. In this study, the number of observations was 80 data.

**Table 1.** Research Sample

No	Sample Criteria	Number of Observations
1	The mining companies listed in IDX within 2017-2019	141
2	The companies which are not connected politically and militarily	(34)
3	The companies got losses during the observation period, 2017–2019	(27)
Total		80

**Table 2.** R-Square Value

Model	Dependent	Independent	R-Square
I	Audit Delay	PC-MC	0.047
II	Tax Avoidance	PC-MC-AD	0.198

**4.2 Descriptive Statistics Test**

Table 3 shows descriptive statistics from 80 data observations in 2017–2019. The average of political connections in the mining companies listed on the IDX

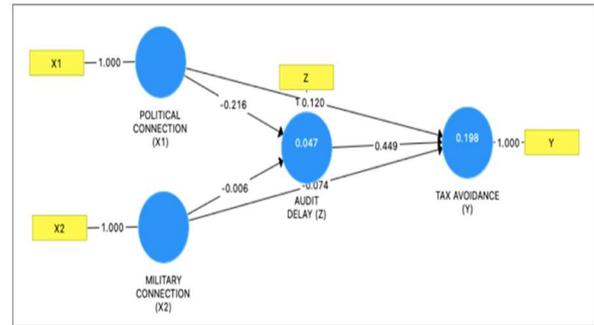
**Table 3.** Descriptive Statistics Test

Variable	N	Min.	Max.	Average	Std. Deviation
Political Connection	80	0.0769	0.7778	0.2449	0.1394
Military Connection	80	0.0000	0.2222	0.0379	0.0686
Audit Delay	80	3.0910	5.2883	4.3569	0.3585
Tax Avoidance	80	0.0034	0.3585	0.3760	0.2550

Had reached 24.49%; Thus, it can be interpreted that the top management who has political relations in the sample companies has a fairly large proportion in the number of top managements. However, military connected companies only reached 3.79%. Audit delay has an average of 94 days which shows that on average mining companies still meet the deadline for submitting audit reports, which is before four months after the end of the closing year. Meanwhile, the average tax avoidance activity measured by ETR was 37.60%. This indicates a low tax avoidance effort.

**4.3 Partial Least Square (PLS) Model Schematic**

In this study, hypothesis testing was carried out using the Partial Least Square (PLS) analysis technique with the smartPLS 3.2.9 program. The schematic of the tested PLS model is in Figure 2.



**Fig. 2** The Framework of Partial Least Square Model

**4.4 Data Quality Test Results**

**4.4.1 Path Coefficient Test**

The results of the path coefficient test can be seen from the value of the coefficient determination (R-Square) to measure how much the endogenous variable is influenced by other variables. Table 3 shows the results of the R-Square values.

The R-Square value in Table 3 shows the influence of political connection and military connection on audit delay of 4.7%, and the rest is influenced by other variables outside of this study. Furthermore, it is known that the effect of the political connection and military connection variables on tax avoidance is 19.8% and the rest is influenced by variables outside this study.

**4.5 Hypothesis Testing Results**

The results of hypothesis testing that have been carried out using the Bootstrapping SmartPLS 3.2.9 Test. The results of hypothesis testing can be seen from the parameter coefficient values and P Value based on the results of bootstrapping in SmartPLS. The test results of the parameter coefficients show the influence of the variables in the positive and negative directions. Bootstrapping with a significance level of 5% indicates that the hypothesis is unsupported if the P values  $\geq 0.05$ . The interpretation of the results of the direct hypothesis testing proposed in this study is described in Table 4.

**Table 4.** Bootstrapping Test Results for Direct Effect

Hypothesis	Model	Parameter Coefficient	P-Values	Result
H <sub>1</sub>	PC-AD	-0.216	<b>0.035</b>	<b>Supported</b>
H <sub>2</sub>	MC-AD	-0.006	0.954	Unsupported
H <sub>3</sub>	AD-TXA	0.449	<b>0.000</b>	<b>Supported</b>
H <sub>4</sub>	PC-TXA	0.120	0.194	Unsupported
H <sub>5</sub>	MC-TXA	-0.074	0.417	Unsupported

This study examines two effects, direct and indirect effects. Indirect effect is an effect that appears through an intervening variable. Table 5 shows the results of the indirect effect test.

**Table 5.** Bootstrapping Test Results for Indirect Effect

Hypothesis	Model	Parameter Coefficient	P-Values	Result
H <sub>6</sub>	PC-AD-TXA	1.992	0.047	Supported
H <sub>7</sub>	MC-AD-TXA	0.057	0.954	Unsupported

## 5 Discussion

### 5.1 The Influence of Political Connection on Audit Delay

Based on the first hypothesis test, the political connection variable has an influence on audit delay. Furthermore, based on the parameter coefficient values, PC has a negative effect on AD. This shows that when the PC value is high, the AD will be low or the more the top management is politically connected, the shorter the audit result reporting time will be.

Based on signaling perspective, companies that have a political connection will comply more with existing regulations because they are under the higher public scrutiny so that the audit delay rate is low. This study is in accordance with research conducted by Habib and Muhammadi (2018), companies that have political connections have a shorter audit delay value.

Top management with a political background and/or having a political connection will try to force their company's internal parties to act transparently, such as, by accelerating the publication of financial reports to convey a good signal to investors. Companies that publish financial reports in accordance with OJK standards and rules are an indication of the quality of the reports and the company's financial performance is good. Based on the results of the study, it can be concluded that the political connection variable has an influence on audit delay.

### 5.2 The Influence of Military Connection on Audit Delay

Based on the second hypothesis test, the military connection variable has no influence on audit delay. People with military backgrounds have a high level of discipline [25]. This level of discipline makes people with military backgrounds obey the rules that have been set.

Most of the top management members in this study who have military connections are members of the board of commissioners. The duties of the board of commissioners in the company are more about the company's GCG issues. The existence of a military connection on the company's board of commissioners acts as a warning to ensure and encourage the company to take action according to the rules as well as to ensure the implementation of GCG principles among the company's board.

Top management in mining companies in this research sample that is connected militarily is only 3.79%. This amount is still very small in proportion to top management. The company with a high proportion of the military in this research is only PT Delta Dunia Makmur Tbk (DOID) with 22.2%. Thus, it can be concluded that the military connection has no influence on audit delay.

### 5.3 The Influence of Audit Delay on Tax Avoidance

Based on the third hypothesis test, the audit delay variable has an influence on tax avoidance. The parameter coefficient test results show a positive influence, this means that the longer the audit reporting process, the higher the indication of tax avoidance efforts.

Companies in Indonesia are more inclined to the signaling perspective, companies are more concerned with maintaining the company's image and public credibility. The company also tries to give a signal about the actions taken to investors, one of which is by presenting good financial reports. The number of efforts made to make up financial statements, both for the benefit of investors and the government, makes the audit report process take longer, and ultimately resulting the audit delays.

The long process of completing the financial statements can be an indication to evaluate the company's financial performance during a certain period. Based on data released by OJK, in 2019, there were two companies in the mining sector were sanctioned for not submitting audited financial reports, namely PT Apexindo Pratama Duta Tbk (APEX) and PT Borneo Lumbang Energi & Metal Tbk (BORN). Based on the study results, it can be concluded that audit delay has an influence on tax avoidance.

### 5.4 The Influence of Political Connection on Tax Avoidance

Based on the fourth hypothesis test, the political connection variable has no influence on tax avoidance. Political Connection in the Top Management of companies that are sampled tend to motivate and encourage companies to be more obedient to regulations because they exist with stricter public supervision. Obedience to government regulations will maintain credibility and both personal and corporate image.

When top management with a political connection take tax avoidance effort, it will threaten their career in the world of government politics, because basically tax avoidance will harm the government as a national budget controller which will later be used for the interests and welfare of the people. Based on the results of the study, it can be concluded that political connection has no influence on tax avoidance.

### 5.5 The Influence of Military Connection on Tax Avoidance

Based on the fifth hypothesis test, the military connection variable has no influence on tax avoidance. People who have education, position, and military experience have a constructive authoritarian character, i.e., discipline, firmness, and obedience. This is what encourages top management boards in Indonesia, which have a military connection, to always obey existing rules and not take tax avoidance efforts.

Violations committed, for example committing and supporting fraud, will also be subject to strict sanctions from the military organization if proven. One of the sanctions is the release of all positions that have been achieved. Based on the study result, it can be concluded that the military connection has no effect on tax avoidance.

### 5.6 The Influence of Political Connection on Tax Avoidance through Audit Delay

Based on the sixth hypothesis test, the political connection variable has an influence on tax avoidance through audit delay. The existence of a board that has a political connection makes the company's audit delay level lower because top management who has a political connection in particular has tighter public supervision so that every action they take will have an impact on their political career. The company's audit delay level can affect the company's financial statements, i.e. tax avoidance efforts. Thus, it can be concluded that tax avoidance can be influenced by political connection through mediation of audit delay.

### 5.7 The Influence of Military Connection on Tax Avoidance through Audit Delay

Based on the seventh hypothesis test, the military connection variable has no influence on tax avoidance through audit delay. Top management members who have military connections in the company have not been able to encourage the tax avoidance efforts. Even though they are no longer members of the military, top management with military connections who are proven to support and commit fraud will receive sanctions in the form of releasing all positions achieved so that they try to maintain their positions by obeying existing rules [25].

Members of top management who have a military connection not only play a role in making the company respected by outsiders but also act as a warning in the company to encourage companies to comply with regulations and the level of audit delay that can affect tax avoidance. It can be concluded that the military connection does not directly influence the indication of tax avoidance through audit delay.

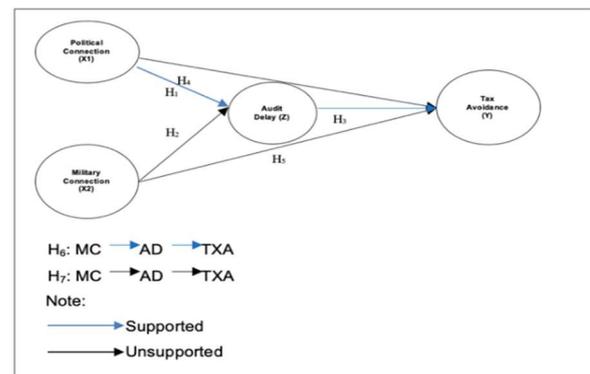


Fig. 3 Path Diagram of Hypothesis Testing Results

## 6 Conclusion

Based on the data analysis and discussion that has been done previously, it can be concluded that political connection influences audit delay, audit delay influences tax avoidance. The political connection variable does not influence tax avoidance directly but through audit delay as an intervening variable. Military Connection has no influences on audit delay and indication of tax avoidance. The military connection variable has no direct influence on tax avoidance and also does not go through audit delay.

Political connection has an influence on audit delay. In Indonesia, companies that have a political connection are more towards a signaling perspective. The existence of a board that has a political connection will make the average level of audit delay in a company becomes low, because it gets stricter supervision by the public so that a board that has a political connection is more careful in taking actions within the company because all actions taken have an impact on the company and the career in politics.

Audit Delay has an influence on tax avoidance. The high and low level of audit delay in the company will influence tax avoidance efforts. The results of this study also show that the existence of a political connection in the company can lead to tax avoidance efforts but through an audit delay first.

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