

TAX RISK MANAGEMENT AND FINANCIAL REPORTING QUALITY

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Abstract

This study aims to comprehensively examine the relationship between tax risk management and financial reporting quality through a literature review approach. In a global context characterized by increasing complexity of tax regulations and demands for transparency of financial information, tax risk management has become a strategic aspect that not only influences fiscal compliance but also impacts the integrity and credibility of corporate financial reports. The method used in this study is a systematic literature review, which categorizes, compares, and synthesizes the results of previous research from various reputable scientific journals. The results indicate that effective tax risk management tends to improve financial reporting quality by reducing fiscal uncertainty, minimizing profit manipulation practices, and strengthening a company's internal oversight mechanisms. Conversely, weak tax risk management has the potential to reduce financial reporting quality due to increased tax aggressiveness and the risk of reporting errors. This study confirms that tax risk management functions not only as a tax compliance tool but also as a crucial instrument in improving the quality of corporate financial information. This study is expected to serve as a reference for further research and as a consideration for regulators and practitioners in strengthening tax governance and financial reporting.

Keywords: Tax Risk Management, Financial Reporting Quality, Tax Risk Management, Financial Reporting Quality.

INTRODUCTION

In recent decades, the dynamics of the global business environment have undergone rapid change due to technological developments, the complexity of

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tax regulations, and the increasing demand for transparency in financial information. Companies are no longer merely required to generate optimal profits but also to demonstrate reliable, relevant, and credible financial reporting for stakeholders. In this context, the quality of financial reporting is a key indicator reflecting management integrity in presenting the company's economic information. Furthermore, the increasingly complex tax systems in various countries also pose tax risks that companies cannot ignore. These risks include uncertainty regarding the interpretation of tax regulations, changes in fiscal policy, potential disputes with tax authorities, and even reputational risk resulting from tax practices deemed non-compliant (Dwitayanti & Armaini, 2024a).

Tax risk management has become increasingly important as companies face dual pressures: complying with tax regulations while maintaining tax efficiency to remain competitive (Donkor et al., 2022a). In practice, ineffective tax risk management can result in increased compliance costs, potential sanctions, and even a decline in investor confidence. Furthermore, uncertainty in tax management can also affect how financial information is prepared and presented in financial reports. This occurs because taxes are a critical component directly related to a company's net profit, so any inaccuracies in their management can impact the overall quality of financial reporting.

The quality of financial reporting has become a primary focus of modern accounting research due to its crucial role in economic decision-making. High-quality financial information must meet the characteristics of relevance, reliability, comparability, and timeliness (Ben Ali, 2025). However, in practice, the quality of financial reporting is often influenced by various internal and external company factors, including tax risk management strategies. When a company has a sound tax risk management system, the possibility of tax recording errors, profit manipulation, or inappropriate deferred tax recognition can be minimized. Conversely, weaknesses in tax risk management can open the door to earnings management practices, ultimately reducing the quality of financial information.

This phenomenon is increasingly relevant in the context of economic globalization, where multinational companies face multiple tax jurisdictions with varying regulations. These regulatory differences create complexity in tax management and increase the potential for fiscal risks that must be systematically addressed. Many companies have subsequently developed more structured tax risk management strategies, such as establishing internal tax committees, utilizing digital accounting technology, and implementing stricter

tax compliance policies. These strategies aim not only to minimize tax risk but also to increase transparency and accuracy in financial reporting (Brühne & Schanz, 2022a).

Furthermore, the development of international accounting standards has also increased attention to the relationship between tax risk management and financial reporting quality. Standards such as IFRS emphasize the importance of more transparent disclosure of information, including information related to deferred taxes, tax burdens, and the fiscal risks faced by companies. In this context, tax risk management is viewed not only as a compliance function but also as an integral part of good corporate governance. Therefore, effective tax risk management can directly contribute to improving the quality of financial reporting (Abid & Dammak, 2021).

However, there is still debate in the academic literature regarding the extent to which tax risk management actually impacts financial reporting quality. Some studies indicate that companies with strong tax risk management systems tend to produce more transparent financial reports with minimal manipulation. On the other hand, there is also the view that overly aggressive tax management can actually increase the risk of distortion of financial information, especially if companies attempt to reduce their tax burden through less transparent strategies. These differing findings indicate that the relationship between tax risk management and financial reporting quality remains complex and requires further study. In the context of developing countries, this issue becomes increasingly important because tax systems that are still evolving often face challenges with compliance and suboptimal law enforcement. Companies in developing countries may have greater flexibility in managing tax risks, but at the same time, they also face a higher risk of regulatory uncertainty. This condition can affect how tax information is reported in financial statements, thus impacting the quality of the resulting information (Kalina et al., 2022).

Based on this description, it is clear that tax risk management is closely linked to financial reporting quality. Effective tax risk management not only helps companies comply with regulations but also contributes to increasing the transparency and credibility of financial reports. Therefore, research on the relationship between tax risk management and financial reporting quality is highly relevant, especially in order to provide a more comprehensive understanding of how tax risk management practices can impact the quality of corporate financial information in an increasingly complex and dynamic business era.

RESEARCH METHOD

This research uses a qualitative approach with a literature review method to analyze the relationship between tax risk management and financial reporting quality. The literature review was conducted by collecting, reviewing, and synthesizing various relevant scientific sources, such as international journal articles, proceedings, academic books, and previous research reports related to tax risk management and financial reporting quality. The primary focus of this study is to identify key concepts, empirical findings, and theoretical developments that explain how tax risk management can impact the quality of corporate financial reporting.

Each collected literature is then compared to identify similarities, differences, and research gaps that require further development. Next, a narrative synthesis is conducted to build a comprehensive understanding of the relationship between tax risk management and financial reporting quality. With this approach, the research is expected to provide an in-depth conceptual overview and serve as a foundation for future empirical research without directly testing the data.

RESULT AND DISCUSSION

The Relationship between Tax Risk Management and the Quality of Corporate Financial Reporting

The relationship between tax risk management and the quality of corporate financial reporting is a crucial area of study in modern accounting and finance, particularly in the context of the increasing complexity of tax regulations and demands for transparency of financial information (Dwitayanti & Armaini, 2024b). In contemporary business practices, companies are not only required to comply with formal tax obligations but also to strategically manage tax risks to prevent negative impacts on their reputation, financial performance, or the credibility of their financial statements. Tax risk management can be understood as the process of identifying, evaluating, and controlling risks arising from a company's tax activities, including compliance risks, regulatory interpretation risks, and strategic risks related to aggressive tax planning (Donkor et al., 2022b). In this context, the quality of financial reporting is a highly relevant variable, as financial statements are the primary medium for presenting tax information and a company's financial position to stakeholders.

The quality of financial reporting itself refers to the extent to which financial statements present information that is relevant, reliable, transparent, and free from material distortion, allowing it to be used effectively in economic decision-making. The relationship between tax risk management and financial reporting quality arises from the fact that a company's tax activities have a direct impact on the recognition, measurement, and disclosure in financial statements. When a company has a sound tax risk management system, every decision related to tax planning, the recognition of deferred tax assets and liabilities, and the estimation of tax expenses will be made more carefully, structured, and in accordance with applicable accounting standards (Donkor et al., 2022b). This ultimately improves the quality of financial reporting because the figures presented are more accurate and accountable.

From a theoretical perspective, this relationship can be explained through agency theory, which emphasizes the conflict of interest between management and shareholders. Management has an incentive to minimize tax burdens to increase net income, but on the other hand, aggressive tax management can increase audit risk, sanctions, and legal uncertainty. Without adequate tax risk management, management may be inclined to engage in excessive or manipulative tax avoidance practices, which can ultimately degrade the quality of financial reporting by distorting profit and financial position information. Conversely, when a company implements effective tax risk management, an internal oversight mechanism ensures that every tax strategy remains within the scope of compliance and does not compromise the integrity of financial statements (Eastman et al., 2024).

Furthermore, tax risk management also plays a role in increasing the transparency of tax disclosures in financial statements. Companies with a sound tax risk management system tend to be more transparent in disclosing tax policies, estimated deferred taxes, and potential future fiscal risks. This adequate disclosure is an important indicator of the quality of financial reporting, as it provides investors and creditors with a more complete picture of the company's true financial condition. Therefore, tax risk management impacts not only compliance but also the quality of the information presented in financial statements (Brühne & Schanz, 2022b).

Furthermore, the relationship between these two variables can also be viewed from an internal control perspective. A strong internal control system is an integral part of tax risk management, where companies establish procedures, policies, and evaluation mechanisms to ensure that all tax transactions are recorded correctly and in accordance with financial accounting

standards. Effective internal controls can reduce the likelihood of tax recording errors, profit manipulation through aggressive tax strategies, and discrepancies between fiscal and commercial reports. Therefore, the better the tax risk management implemented, the higher the quality of the resulting financial reporting.

In practice, companies operating in a global business environment face increasingly complex challenges in managing tax risk. Differences in regulations between countries, dynamic changes in tax policies, and increased oversight from tax authorities require companies to have an adaptive and responsive tax risk management system. Inability to manage these risks can lead to inaccuracies in financial reporting, such as errors in the recognition of deferred taxes or understatement of tax liabilities. This situation not only impacts the quality of financial reports but can also damage the company's reputation with investors and regulators.

On the other hand, companies that implement tax risk management strategically can also benefit from increased financial reporting efficiency. With an integrated system between tax and accounting functions, the financial reporting process is faster, more accurate, and requires fewer revisions. This is because every transaction is analyzed from a tax perspective from the outset, reducing the likelihood of major adjustments at the end of the reporting period. This efficiency directly contributes to improved financial reporting quality, particularly in terms of timeliness and reliability.

Furthermore, the role of external auditors is also a crucial factor in strengthening the relationship between tax risk management and financial reporting quality. Auditors tend to provide more positive assessments of companies with strong tax risk management systems, as the risk of material misstatement in the financial statements is lower. Conversely, companies with weak tax risk management will face higher levels of audit skepticism, which can influence the audit opinion and ultimately affect market perceptions of the quality of the company's financial statements.

The Role of Corporate Governance in Improving the Effectiveness of Tax Risk Management

The role of corporate governance in improving the effectiveness of tax risk management is a crucial aspect of increasingly complex and dynamic modern business practices (Choi & Park, 2022). In the context of globalization, evolving tax regulations, and increased oversight by tax authorities in various countries, companies are required to focus not only on tax compliance but also

on strategic and integrated tax risk management. Good corporate governance is the primary foundation for ensuring that every tax-related decision not only complies with legal provisions but also aligns with the company's long-term goals, including sustainability, transparency, and corporate reputation.

Corporate governance essentially encompasses the systems, structures, and processes that direct and control a company. In the context of tax risk management, governance serves as an oversight and control mechanism that ensures that risks arising from tax activities can be effectively identified, analyzed, and mitigated. Tax risks themselves can arise from various sources, such as regulatory changes, differing interpretations of tax regulations, reporting errors, and overly aggressive tax planning strategies (Koay & Sapiei, 2024). Therefore, the role of corporate governance is crucial in creating a balance between optimizing tax burdens and complying with applicable regulations.

One key element of corporate governance that influences tax risk management is the role of the board of directors and the audit committee (Rasyid, 2023). The board of directors is responsible for establishing strategic tax policies and ensuring that tax risk management is integrated into the company's overall risk management framework. Meanwhile, the audit committee acts as an independent supervisor, evaluating the effectiveness of the internal control system, including controls related to tax reporting. With strong oversight from these two bodies, companies can minimize the potential for tax reporting errors and reduce the risk of sanctions from tax authorities.

In addition to the oversight structure, organizational culture also plays a crucial role in supporting effective tax risk management. A strong compliance culture will encourage every individual within the organization to act in accordance with ethical standards and applicable regulations (Suharto, 2023). In companies with good governance, awareness of the importance of tax compliance is not only at the top management level but also flows throughout all operational lines. This creates a work environment that supports transparency and accountability in every process related to tax reporting and planning.

On the other hand, corporate governance also plays a role in ensuring that the tax function within an organization has adequate resources and independence. An effective tax function serves not only as an administrative unit that calculates and reports taxes, but also as a strategic partner in business decision-making. In many modern companies, the tax function has evolved into an integral part of corporate risk management. With strong governance

support, the tax function can provide more comprehensive input regarding the tax implications of each business decision, thereby helping the company avoid unwanted tax risks in the future.

Furthermore, transparency is a key principle of corporate governance that has a direct impact on tax risk management. Companies that implement high transparency in financial and tax reporting tend to command a higher level of trust from stakeholders, including investors, regulators, and the public. This transparency also helps companies mitigate reputational risk that often arises from negative perceptions of aggressive tax avoidance practices. Thus, good corporate governance focuses not only on formal compliance with tax regulations but also on managing public perception of the company's tax practices.

In practice, the implementation of effective corporate governance in tax risk management also relies heavily on the use of information technology and an adequate internal control system. An integrated accounting information system enables companies to collect, process, and analyze tax data more accurately and efficiently. This is crucial in reducing the risk of human error and increasing the speed of tax decision-making (Efunniyi et al., 2024). Furthermore, the use of technology also enables companies to monitor tax risks in real time, allowing potential issues to be identified and addressed early before they escalate into greater risks.

Undeniably, the complexity of tax regulations in various countries also demands that companies have adaptive and responsive governance. Rapid regulatory changes, particularly in the era of economic digitalization and increased international cooperation in the exchange of tax information, require companies to continually update their internal policies and procedures. In this regard, corporate governance acts as an adaptive mechanism that enables organizations to adapt to changes in the external environment without compromising compliance and operational efficiency.

Beyond internal aspects, corporate governance also influences a company's relationships with external parties, particularly tax authorities. Companies with good governance tend to build more cooperative relationships with tax authorities through a transparent approach and constructive dialogue. This positive relationship can help companies reduce tax uncertainty and increase legal certainty in business decision-making. In the long term, this will have a positive impact on the company's financial stability and business sustainability.

The Impact of Tax Aggressiveness on Transparency and Information Quality in Financial Reports

Tax aggressiveness is a strategy frequently used by companies to minimize their tax burden to the state through various tax planning schemes, both those that remain within the legal framework and those that tend to exploit more complex regulatory loopholes. In practice, tax aggressiveness not only impacts the amount of tax paid but also has broader implications for the quality of a company's financial reporting, particularly regarding the transparency and relevance of the information presented to stakeholders. The relationship between tax aggressiveness and the quality of financial information is a significant concern in modern accounting and finance literature because both are closely related to the principles of good corporate governance, which emphasize openness, accuracy, and accountability (Adegbite, 2025).

In the context of financial reporting, transparency refers to the extent to which the information presented by a company reflects the true economic conditions honestly, openly, and understandably to users of the financial statements. When companies engage in tax aggressiveness, there is often an incentive to manipulate or reconstruct accounting figures to create discrepancies between accounting and taxable profits. These differences are generally normal, but at high levels of aggressiveness, they can indicate earnings management practices that have the potential to reduce the transparency of financial reports (Liu, 2021).

Tax aggressiveness often encourages companies to selectively use more flexible or conservative accounting policies to achieve tax savings. For example, companies may delay revenue recognition, accelerate expense recognition, or use more aggressive accounting estimates in establishing loss reserves. While these practices do not necessarily violate accounting standards, they can reduce the quality of economic information, which should be presented neutrally and objectively. As a result, the resulting financial reports do not fully reflect the company's fundamental condition, thus reducing the level of transparency expected by investors, creditors, and regulators (Masri et al., 2025).

In addition to impacting transparency, tax aggressiveness also has a significant impact on the quality of information in financial reports. The quality of information in financial reports is generally measured through several key dimensions, such as relevance, reliability, comparability, and timeliness. When companies employ complex tax avoidance strategies, the complexity of

transactions and business structures often increases, including the use of special entities, related-party transactions, and transfer pricing schemes. This complexity can make it difficult for users of financial statements to understand the true economic substance, thereby reducing the relevance of the information presented (Fitri et al., 2023).

Furthermore, tax aggressive practices can create uncertainty regarding the reliability of accounting information. Reliability in this context means that the information presented is free from material bias and can be objectively verified. However, when companies have strong incentives to minimize taxes, management may be encouraged to make more subjective or even opportunistic estimates when preparing financial statements. This has the potential to lead to information distortions that can reduce the level of confidence that financial statement users have in the figures presented.

From an agency theory perspective, tax aggressiveness can be understood as part of a conflict of interest between management and owners or stakeholders (Lewellen, 2023). Management has an incentive to increase net profit after tax because this can improve performance, both internally and externally. However, on the other hand, management also has an incentive to reduce the tax burden in order to increase the company's cash flow. The tension between these two objectives can encourage reporting practices that do not fully reflect the true economic conditions, thereby degrading the quality of information in financial statements.

Furthermore, tax aggressiveness can also impact market perceptions of a company. Investors and financial analysts generally view aggressive tax avoidance practices as a signal of higher risk, particularly risks related to corporate governance and earnings sustainability. When financial information is not fully transparent, uncertainty about earnings quality increases. This can lead to an increased cost of capital as investors demand a higher risk premium to compensate for the information uncertainty.

In the long term, companies that are overly aggressive in their tax strategies also risk facing increased scrutiny from tax authorities and capital market regulators. Intensive tax audits or significant fiscal adjustments can reveal discrepancies between accounting reporting and tax compliance, ultimately damaging the company's reputation. A poor reputation not only impacts relationships with regulators but can also erode investor and other stakeholders' confidence in the quality of the company's information.

However, the relationship between tax aggressiveness and financial reporting quality is not always strictly negative. In some cases, efficient tax

planning can reflect sound managerial ability in managing company resources. Companies that are able to optimize their tax structure legally and transparently can improve cash flow efficiency without sacrificing the integrity of their financial statements. Therefore, the impact of tax aggressiveness on information quality depends heavily on the level of transparency accompanying the practice and the extent to which the company adheres to applicable accounting principles.

Therefore, it can be concluded that tax aggressiveness has complex implications for transparency and information quality in financial reports. On the one hand, this strategy can improve a company's financial efficiency through tax savings. However, on the other hand, if not managed properly, tax aggressiveness can reduce transparency, diminish the reliability of information, and weaken the relevance of financial reports for external users. Therefore, a balance is needed between an efficient tax strategy and a commitment to quality financial reporting to ensure companies maintain market trust and support good corporate governance.

CONCLUSION

The conclusion of the study on Tax Risk Management and Financial Reporting Quality indicates that tax risk management plays a significant role in improving the quality of a company's financial reporting. The better a company is at identifying, evaluating, and controlling tax risks, the higher the level of transparency and accuracy of its financial reports. This occurs because effective tax risk management encourages compliance with tax regulations and reduces the potential for material errors and aggressive tax reporting practices that can undermine the credibility of financial reports.

Furthermore, this study confirms that the quality of financial reporting is influenced not only by compliance with accounting standards but also by how a company strategically manages its tax risks. Companies with a structured tax risk management system tend to produce more reliable, relevant, and comparable financial reports. Thus, tax risk management can be viewed as a crucial factor in strengthening the integrity of financial information and increasing stakeholder confidence in the company's overall performance.

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