The role of Internal control's elements in reducing tax evasion in Jordanian finance companies

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Abstract

This study aimed to identify the impact of the application of internal control elements in reducing tax evasion in reducing tax evasion,the study population consists of the finance companies operating in Jordan, while the study sample included(23) accountants and internal auditors working in these companies.The results were analyzed using the descriptive and inferential statistics means using the statistical package of social sciences (SPSS) and found that there was a statistically significant effect at the significance level (α≤0.05) for applying the elements of internal control in reducing tax evasion in finance companies operating in Jordan.

Keywords: internal control, finance companies operating in Jordan, tax evasion.

INTRODUCTION

The tax is one of the most important sources of treasury finance it also contributes to economic recovery and advancing development in developing countries, which seek to implement economic reform programs,likewise, the necessity of dealing with international institutions, therefore, the permanence and continuity of this concept depends on the response of taxpayers and their commitment to their tax duties.But this response is often relative, due to the controversy that has existed since ancient times between paying the tax and evading its performance by exploiting legal loopholes, which is known as tax avoidance.Or byusing fraudulent methods, which are known as tax fraud, which translates into the phenomenon of tax evasion, which takes on dangerous dimensions and negative effects on the national economy.Which by its nature leads to the resumption of resources from which the state's public treasury should benefit from in order to cover its public expenditures (Khalf, 2017).

Where the achievement of preventive measures to reduce tax evasion is related to the quality of the institution's internal control system. Where the internal control system is one of the important and basic systems that work to protect the assets and properties of the institution from any fraud, embezzlement,and by using different means such as defining the duties and responsibilities of each employee, and separating the tasks and functions assigned to the employees (Salama, Mustafa Saleh, 2010, p. 9),as this depends on how weak or strong the internal control system is in the project under review,and that the auditor has to perform a major and important process that is the primary task that begins work in the project, which is the process of evaluating the control system to determine the extent of its strength or weakness. (Al-Sabban, Muhammad Samir, and others, 1996, p. 139).

The study Problem

The process of collecting taxes from companies is the basic and vital pillar of the state, as it is considered one of the main sources of supplying the state treasury with the funds necessary to run its affairs.And recently there was a need to take a set of policies and procedures that limit the process of tax evasion by companies,and it works to reduce the methods used by companies in the

process of tax evasion. Internal control in companies is an essential part of comprehensive financial control of companies. Given the importance of internal control, several preventive measures have been issued that require internal control within companies to adhere to them. In addition to the increasing demands of government agencies to create a regulatory system that limits tax evasion.

To clarify the problem of the study in a clearer way, the following main question will be asked:

What is the effect of the internal control elements represented in (the control environment, risk assessment, control activities, information and communications, monitoring) in reducing tax evasion?

The Importance of the Study

- **Academic importance**
1. The current study is an extension of studies that have focused on tax evasion.
2. The current study is an addition to scientific knowledge in the field of tax evasion.
3. The current study is expected to lead to further studies and research on its topics and its sub-variables in light of the results, recommendations and proposals it will present.

- **Field importance**
It lies in the fact that it will diagnose the reality of tax evasion in Jordan.

The Objectives of the Study

The study seeks to achieve the following goals:
1. Knowing the effect of the internal control elements represented in (the control environment, risk assessment, control activities, information and communications, monitoring) in reducing tax evasion in finance companies operating in Jordan.
2. Knowing the extent of applying the internal control elements in finance companies operating in Jordan.
3. Clarify procedures and means for evaluating internal control systems applied in finance companies operating in Jordan.
4. Provide appropriate recommendations to the concerned authorities.

Previous Studies

Mushtaha Study (2015), entitled: "Evaluating the extent of consistency of the internal control systems in the Palestinian public shareholding companies with the COSO framework and the impact of this on the company's performance and value."

One of the objectives of the study is to assess the extent of the consistency of the internal control systems

with the (COSO) framework in the Palestinian public shareholding companies and the impact of this on the company's performance and value. The researcher used the analytical descriptive approach to collect primary data, and the researcher distributed 40 questionnaires to a sample that represented by (40) A public shareholding company listed on the Palestine Stock Exchange (one for each company) (37) were recovered, and one was excluded, where (36) questionnaires were subjected to analysis, i.e. (90%) of the study sample, the study concluded that the internal control systems applied in public shareholding companies in Palestine are consistent with the internal control framework (COSO) with a high degree, in addition to the presence of an impact in the application of the internal control components in accordance with the (COSO) framework on the financial performance indicators for companies listed on the Palestine Stock Exchange. The researcher recommended the need for the Palestinian Capital Market Authority issued a special guideit includes a framework for internal control appropriate to the Palestinian business environment, coordination with the regulatory bodies for the auditing profession and the Palestinian Capital Market Authority to keep pace with international legislation.

A study of Al-Nisour (2014) entitled: "Tax Evasion in Jordan, its Causes, Methods, and Size"

This study aimed to analyze the tax system in Jordan and the factors that affect increasing the tax burden and identify the causes and methods of tax evasion and estimate the resulting losses and the impact of all of this on the Jordanian economy. The study indicated that countries of different degrees of progress and levels of development some of its citizens strive to avoid paying the tax due to them in various ways. This deprives the state's budget of an important percentage of the revenues through which it can exercise its economic, social and environmental roles as hoped. Rather, it caused a budget deficit that quickly transformed into external and internal indebtedness that harms the most to the national economy. The study concluded that the most important reasons that drive taxpayers in Jordan to evade tax are: The complexity of the tax system and its instability due to the frequent amendments made to the tax laws, the lack of strictness in imposing penalties on tax evaders, and the lack of adequate data and information databases on taxpayer activity in some professions. And the tax reforms that have taken place in recent years have not taken sufficient care to develop the human resources working in the tax field. The study came out with a number of results, the most important of which are: the complexity of the tax system and its instability, due to the frequent amendments made to tax laws, this made it difficult to understand and abide by the legal texts related to tax, The study came out with several recommendations, most notably: developing a database for taxpayers at the Income and Sales Tax Department

and abolishing the minimum registration for the general sales tax.

A study of Marina et al. (2011) entitled: "Tax Evasion - Between Legal and Illegal "Mechanisms of the Underground Economy"

This study aimed to describe tax evasion and identify its implications and effects, as this study was conducted in Romania and the researchers used the descriptive approach to achieve the goals of the study, the study concluded that tax evasion is a special element in the infrastructure of the economy due to a special relationship between tax evasion and other important events in the general economy, Tax evasion is also a social phenomenon that is growing and increasing and has its implications and direct effects on reducing state revenues and expenditures and social dissatisfaction among members of society.

Study Hypotheses

Depending on the main question that was raised in the problem and according to the objectives of the study, the following main hypothesis was formulated. Of which five sub-hypotheses are subdivided and it is shown as follows:

HO.1 There is no statistically significant effect at the level of significance (0.05 ≥α) for applying the elements of internal control in reducing tax evasion in finance companies operating in Jordan.

The following sub-hypotheses are subdivided:

HO.1: There is no statistically significant effect at the level of significance (0.05 ≥α) of the regulatory environment on reducing tax evasion in finance companies operating in Jordan.

HO.1.2: There is no statistically significant effect at the level of significance (0.05 ≥α) of risk assessment in reducing tax evasion in finance companies operating in Jordan.

HO.1.3: There is no statistically significant effect at the level of significance (0.05 ≥α) of control activities in reducing tax evasion in finance companies operating in Jordan.

HO.1.4: There is no statistically significant effect at the level of significance (0.05 ≥α) of information and communication on reducing tax evasion in finance companies operating in Jordan.

HO.1.5: There is no statistically significant effect at the level of significance (0.05 ≥α) of Monitoring in reducing tax evasion in finance companies operating in Jordan.

Theoretical Framework

The first topic: the internal control system

The issue of protecting and preserving the company's assets is considered one of the most important things that corporate management seeks to achieve. It also seeks to achieve this protection through the application of a solid and effective control system, as the increase in the size of companies and the accompanying complications in their administrative structures, and the increase in information technology has led to a major change in the internal control systems of these companies.

Where the Internal Control Department is considered one of the most important departments in the corporate administrative structure, as it has an important role in providing recommendations and assistance to senior management to draw and plan appropriate policies, it also provides the required assurances on the correctness of administrative and accounting data and financial statement reports that assist management in decision-making processes and internal control plays an important role in ensuring the proper functioning of activities within the systems, laws and legislations prescribed by senior management correctly.

The concept of internal control

(Al-Ayyan, et al., 1996) defined internal control as the set of procedures and methods used by the institution to maintain cash and other assets of the company, in addition to finding errors to keep records accurate.

(Metwally, 2006) defined it as an administrative organizational plan for internal control while using the production factors available for the facility in order to reach the highest possible rates of production efficiency.

The importance of internal control

The need to find and implement an internal control system varies from one company to another and according to the size of that company, as large companies need a planned, thoughtful, and organized monitoring system in which it has: the organizational structure of the project, the association of that project with a relationship with government agencies, the separation of ownership from management, and as for small-sized companies, they do not need an integrated control system (Al-Sahn, et al., 2006: 31).

Where the internal control system is of great importance because it plays an important role in shedding light on positive things within the company such as the discovery of administrative and operational competencies, by setting programs and foundations to evaluate the performance of workers within the company, and thus assess hardworking people through material and moral incentives, which leads workers to master their duties in order to reach the goals set by the administration (Awad, 2012: 22).

One of the things that obliged the management of public companies to increase interest in the subject of the internal control system is the issuance of Issue No. (33-8238) of the US Securities and Exchange Commission

(SEC) to implement Article (404-A) of the Sarbanes-Oxley Act (SOA).Which requires the management of public companies to include in its report for shareholders in those companies a comprehensive assessment of the effectiveness and quality of its internal control system, consequently, the management of these companies has become responsible for the effectiveness and quality of the internal control system applied within the companies that they manage.(Sarbanes-Oxley Act, 2002).

The objectives of the internal control system

When designing an effective control system, the administration determines the desired goals in implementing the control system, and the administration usually has several goals that differ from one company to another, these goals are appropriate for the nature of the work of each company, but the main ones can be determined from these goals to include all types of companies, as follows:

1. The credibility of the financial statements: The management of the company bears both legal and professional responsibility in ensuring that the information presented in the financial statements is correct and fair.
2. Efficiency and effectiveness of production processes: Control within the company promotes the optimal and efficient use of raw resources to achieve the desired goals of production operations and one of the most important objectives of internal control is to obtain accurate information about these operations in order to assist in making accurate decisions, whether financial or non-financial (Arens, et.al., 2014: 308).
3. Protecting company assets from damage, maintaining levels of output quality, standardizing performance, providing data and information needed by management in industry and decision-making business are all goals of effective control systems (Ghoul, 2013: 68).

Components of the internal control system

The internal control system consists of five main components, according to a COSO committee report (COSO — Committee of sponsoring organization) in 1992, it was built on the basis of assessing the efficiency of the effectiveness of the internal control structure, and these components are:

1. Regulatory environment
2. Risk assessment
3. Control activities
4. Information and communication
5. Monitoring

First: The regulatory environment

In order to have a strong and effective internal control system, the following main ingredients are required:

1. Integrity and moral values: It is through a code of conduct that focuses on integrity and moral values, while ensuring that these regulations are implemented, whether written or in the form of a letter sent by the administration periodically. (Ali, Abdel-Wahab Nasr, Shehata, Shehata, 2005/2006, p. 77).
2. The Board of Directors: where the Board of Directors exercises the responsibility of internal control by a supervisory committee and through the exercise of the company's employees their work in accordance with the powers and responsibilities assigned to them (Al-Sahn, Abdel-Fattah, et al., 2007/2008, p. 20).
3. Management philosophy and its operational style: The company aims to provide its employees with clear indications about the importance of management, so that it can make the management style and philosophy effective and supportive to achieve effective internal control (Arnis, Alvin, Lubeck, James, 2002, p. 384).

Second: Risk assessment

Management must take into account the possibility that there are transactions and files that are not recorded, or specify the material estimates recorded in the financial statements. (Nasr, Abdel-Wahab, Shehata, Shehata, 2005/2006, p. 378).

The risks can arise because the administration is unstable in terms of its employees, as it is in constant renewal of its employees and decisions, and the instructions issued by it, or the use of new systems and programs (Al-Sahn, Abdel-Fattah, et al., 2007/2008, p. 28).

Third: Control activities

Understanding the control activities that companies apply to reduce the material deviations that may appear in the financial statements prepared by these departments, so the employee who performs the process of evaluating the internal control system must possess sufficient knowledge of the control activities in order to discover errors, and work to prevent these errors. (Nasr, Abdel-Wahab, Shahatkh, Shehata, 2005/2006, p. 378).

Fourth: Information and communication

Appropriate information must be identified and audited to help achieve corporate goals by distributing it at all levels through top-down communication channels and vice versa,(Open communication channels) to verify that information, so this information must be clear and accurate, and that it be obtained in a timely manner in order for these companies to achieve a strong and effective internal control system (Fadila, Boutoura, 2006/2007, p. 42).

Fifth: Monitoring

It is done through estimating the effectiveness of the performance of internal control within the company, to ensure the extent of its implementation of the policies and procedures set for it with the ability to amend and change them and what is compatible with the surrounding conditions.(Arnis, Alvin, Lubeck, James, 2002, p. 384).

Tax Evasion

Governments around the world gives the tax special attention as it is the main source of finance the state treasury, and it has an important impact on maintaining economic balance as well as achieving justice among the people through the distribution of income and the confrontation of public expenditure.

Tax definition: there are many definitions for the tax, where the concept of taxation evolved over time where the traditional concept defined taxation as a mandatory financial cut from the private sector to support the state treasury, but over time this definition has changed to its modern concept where taxation defined as a mandatory obligation on a private sector to provide the state treasury with the necessary funds for its various development projects. (Al-Qatawneh, 2008).

Tax evasion is defined as the taxpayer's attempt to use fraudulent, deceptive methods in order not to pay the tax in whole or in part.The Jordanian legislature has considered the process of tax evasion contrary to the law because of its impact on the decline in the volume of public revenues, which leads to confusion the economic situation of Jordan which sometimes leads to borrowing to cover the expenses of the state, which leads to the increase of public debt, and the impact on the competitiveness of companies. Therefore, there is a need to enact laws and regulations that limit and prevent the spread of this phenomenon, such as the Customs Law, the Sales Tax Law and the Income Tax Law.(Jordanian Economic and Social Council, 2014).

Types of Tax Evasion

There are several types of tax evasion such as.
1. legal evasion: Is to benefit the taxpayer from some legal gaps in the tax legislation, in order to evade the legitimate payment of the tax due, and this evasion is by using permitted methods without any violation of the legal texts (2004,135Belkaoui).
2. Illegal evasion: Is a deliberate evasion by the taxpayer in order to get rid of the tax payment and this evasion using illegal methodsor deliberately violating the provisions of the law, such as refraining from making a clear statement of profits, or the preparation of fake lists and records (Al-Samarrai and Al-Obaidi, 2012).

Reasons for Tax Evasion

The main reasons leading to tax evasion can be summarized as follows:

First: Technical and legal reasons

- The issue of complications in tax laws and legislation is one of the main reasons for tax evasion, because it is difficult for the taxpayer to understand and analyze texts that encourage him to avoid tax evasion (Obaidat, 2001).
- An encouraging factor in tax evasion is the lack of rigor in imposing deterrent penalties which prevent and deter the taxpayer from tax evasion (Haddad, 2006).
- Lack of adequate databases for the activities of many taxpayers such as doctors, engineers and other craftsmen (Haddad, 2006).

Second: Economic reasons

- The increase in the tax rate is one of the most important factors and reasons that encourage the taxpayer to evade payment.
- The country's economic conditions are one of the main reasons for tax evasion as in the case of economic recession, we find that evasion rates are high and, conversely, in cases of economic prosperity.
- Rising general price level that led to higher cost of living. (Maharmeh, 2003)

STUDY METHODOLOGY

The Study Approach

This study relied on the descriptive analytical approach and this approach is based on an explanation of the current situation of a phenomenon or problem by defining its conditions and dimensions and describing the relationships between them with the aim of completing an accurate and complete scientific description of the phenomenon or problem, it is also based on the facts associated with it, as this approach is not limited to the process of describing the phenomenon, but it includes analyzing data, measuring and interpreting it, arriving at an accurate description of the phenomenon or problem and its results, and providing solutions and proposals to address it.

The Study Population and its Sample

The study population consists of all accountants and internal auditors working in the finance companies operating in Jordan, and the sample of the study consisted of (23) accountants and internal auditors.

The Study Tool

A questionnaire was developed as a tool for the study, as it was developed in proportion to the variables of the study,

through looking at previous studies related to the subject of the study where the questionnaire consisted of the following parts:

First: Questions related to demographic information (gender, age, educational qualification, job experience, job title).

Second: Questions related to the study variables: Questions related to the independent variable (internal control). The researcher adopted a Likert five-measure scale in the questionnaire to give more flexibility to the sample members in the selection, where the values ranged between (1-5).

The Reliability of the Study Tool

The reliability of the instrument used to measure the variables included in the questionnaire was confirmed by calculating the value of the Cronbach Alpha factor, where the result is statistically acceptable if its value is greater than (0.60), and the closer the value is to one (1), i.e. 100%, this indicates higher reliability degrees for the study tool (Sekaran, 2010).And the result of Cronbach Alpha was (97%), so the tool for this study can be described with reliability, and that the data obtained through it are appropriate to measure the variables, and are subject to a high degree of reliability.

RESULTS OF THE STUDY

Study Hypotheses Test

This part of the study relates to testing the main study hypotheses and the sub-hypotheses that derive from them in order to define impact relationships in order to reach the presentation of results and clarify the behavior of the relationships between the study variables. The significance level (α≤0.05) has been adopted as a rule for rejecting or accepting hypotheses, meaning if the value of α is equal to or less than 5% we reject the null hypothesis, and if it is higher than 5% we accept the null hypothesis.

In order to test the main study hypotheses that are concerned with determining the effect of the independent variable (internal control elements)On the dependent variable (reducing tax evasion) the closest means are appropriate to determining that effect Parametric means being the most appropriate to the nature of the data, and their use implies that there is no high correlation and multi co linearity between independent variables.And to ensure the availability of the mentioned condition, (VIF) and (Tolerance allowed variation) were extracted and after performing the statistical treatment,Table No. (1) indicates that the allowed variance coefficient for independent variables was less than (1) and greater than (0.01), and the values of variance inflation coefficient were less than (5)this is an indication of the absence of a high correlation between the independent variables and this indicates the acceptance of the values and that it is suitable for performing a linear regression analysis and thus testing the main hypothesis (Hair et.al.2011).

Table 1: Variance Inflation Factor (VIF). Tolerance allowed for internal control

Elements of internal control in accordance with International Auditing Standard 315	VIF Variance Inflation Factor	Tolerance (Allowed variance)
Regulatory environment	2.154	0.465
Risk assessment	2.911	0.345
Control activities	3.775	0.266
Information and communication	3.145	0.319
Monitoring	2.576	0.389

Main hypothesis test results

The main study hypothesis states: "There is no statistically significant effect at the level of significance (0.05 ≥α) for applying the elements of internal control in accordance with International Auditing Standard (315) in reducing tax evasion in finance companies operating in Jordan"

This hypothesis was tested using a multiple linear regression test and its results were as shown in Table 2.

Table 2: Results of testing the effect of applying internal control elements in reducing tax evasion in finance companies operating in Jordan.

Dependent variable	Model Summery		Contrast analysis ANOVA			Transaction table Coefficient				
	R Correlation coefficient	R² The coefficient of determination	F	F Sig	Degree of freedom Df	Statement	Standard error	β	T	T Sig
Reducing tax evasion	0.887	0.786	62.723	*0.000	87/5	Regulatory environment	0.101	0.148	2.002	*0.049
						Risk assessment	0.105	0.272	3.181	*0.003
						Control activities	0.103	-0.074	0.753	0.455
						Information and communication	0.092	0.496	5.578	*0.000
						Monitoring	0.094	0.179	2.213	*0.031
* significant at level of significance 0.05≥α										
Tabulated F value= (2.28)					Tabulated T value= (1.9865)					

Table 2 indicates that there is a statistically significant effect of applying the elements of internal control in reducing tax evasion through the value of F of (62.723).It is greater than its tabular value and significant at the level of significance (α≤0.05), which also represents the significance of this model at the degree of freedom (5/87) and indicates the value of R2 of (0.786)that the elements of internal control have interpreted a rate of (78.5%) in reducing tax evasion in the telecommunications companies in Jordan. The correlation coefficient R = (88.7%), which indicates a strong relationship between the elements of internal control and the reduction of tax evasion. And it appears from the results of the partial analysis of this hypothesis that the element (information and communication) had the greatest impact among the five internal controls on the dependent variable (reducing tax evasion),As the value of its beta coefficient reached (β = 0.496), This effect is strengthened by the calculated value of (T) of (5.578) which is greater than its tabular value, With a significant level (Sig = 0.00), then it came in second place in terms of the effect of the (risk assessment) component, as the value of the beta coefficient of it (β = 0.272). And this effect is enhanced by the calculated value of (T) of (3.181)It is greater than its tabular value, and with a significant level (Sig = 0.003) after that came in third place in terms of impact (control) component, as the value of its beta coefficient reached (β = 0.179)This calculated effect is enhanced by a calculated (T) value of (2.213) which is greater than its tabular value, and with a significant level (Sig = 0.031)after that came the fourth element (control environment) in terms of impact, as the value of its beta coefficient reached (β = 0.148) this effect is reinforced by the calculated value of (T) of (2.002) which is greater than its tabular value. At a significant level (Sig = 0.049)finally, the element (control activities) came in the last place, as the value of its beta coefficient (β = -0.074),and the calculated value (T) of (0.753) is less than its tabular value, and at an unimportant level (Sig = 0.455), and based on the foregoing, we reject the null hypothesis (HO), and accept the alternative hypothesis (H1) Where there was a statistically significant effect at the significance level (0.05≥α)to implement the elements of internal control in reducing tax evasion in finance companies operating in Jordan.

The results of testing the hypotheses stemming from the main hypothesis

The sub-hypotheses stemming from the main hypothesis were tested using a simple linear regression test that measures the effect of one independent variable on one dependent variable and the results were as shown in Table 2.

Table 3: Simple Regression Test Results for Sub-Hypotheses stemming from Main Hypothesis.

Dependent variable ⟋ Independent variable	Regulatory environment		Risk assessment		Control activities		Information and communication		Monitoring	
Reducing tax evasion	T	T Sig	T	T Sig	T	T Sig	T	T Sig	T	T Sig
	8.677	*0.00	10.642	*0.00	10.255	*0.00	13.596	*0.00	10.368	*0.00
R correlation coefficient	0.676		0.747		0.735		0.821		0.739	
R2 coefficient of determination	0.456		0.558		0.540		0.674		0.545	
Freedom Degree (Df)	1		1		1		1		1	
* (Significant level at 0.05≥α level)										
Tabular T Value= (1.9865)										

Table 3 represents the results of the statistical test for the sub-hypotheses emanating from the first sub-hypothesis whose results indicated the following:

It was found that there was a statistically significant effect at the level of significance (α≤0.05) of the elements of internal control when measuring each component separately in reducing tax evasion in finance companies operating in Jordan. As the calculated value of T for all elements reached values greater than the tabular value and all of them are significant at the level of significance (α≤0.05), this means the rejection of HO and the acceptance of H1 of all sub-assumptions stemming from the main hypothesis.

Results related to the study hypotheses

1. It was found that there was a statistically significant effect at the significance level (α≤0.05) for applying the elements of internal control in reducing tax evasion in finance companies operating in Jordan.
2. It was found that there was a statistically significant effect at the level of significance (α≤0.05) that the regulatory environment reduces tax evasion in finance companies operating in Jordan.
3. It was found that there was a statistically significant effect at the level of significance (α≤0.05) for assessing risks in reducing tax evasion in finance companies operating in Jordan.
4. It was found that there was a statistically significant effect at the level of significance (α≤0.05) for control activities, in reducing tax evasion in finance companies operating in Jordan.
5. It was found that there was a statistically significant effect at the level of significance (α≤0.05) of information and communication in reducing tax evasion in finance companies operating in Jordan.
6. It was found that there was a statistically significant effect at the significance level (α≤0.05) of the monitoring in reducing tax evasion in the finance companies operating in Jordan.

RECOMMENDATIONS

Based on the previous results, the study recommends the following:

1. Work to clarify what control procedures are expected to be followed by employees at different administrative levels.
2. The necessity of working to adopt internal control procedures as the first line of defense to face the risks related to each job.
3. Taking into consideration the necessity for the company to pay attention to complaints submitted as a control tool.
4. Urging the need for an internal information network for managers to provide them with the necessary information.
5. The importance of considering the mechanism of using the monitoring reports in order to develop systems and strategies for internal control in the future.

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