[22]

# Effective Tax Rate (ETR) and Audit Quality Post Adoption of IFRS on Earning Management (Study of Listed Manufacturing Companies in Indonesia Stock Exchange)

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**Abstract.** The study aims to analyze the association between the Effective Tax Rate (ETR), audit quality and magnitude of earnings management pasca IFRS adoption. Audit quality use big four auditor. The modified Jones Model used to measure discretionary accruals (the proxy for earnings management.)

The populations of this research are manufacturing companies listed on Indonesia Stock Exchange (IDX) in period 2010-2013 with total sample of 57 companies. The data are analyzed by using multiple regressions linear.

The results provide evidence that big four auditor negatif significantly influence to the earning management. Nonetheless Effective Tax Rate (ETR) wasn't significant influence to the earning management pasca IFRS adoption.

Keyword: Effective Tax Rate (ETR), audit quality, big four auditor, discretionary accruals and earnings management.

## INTRODUCTION

In the 2012 SAK KDPPLK, it is explained that the purpose of the financial statements is to provide information regarding the financial positions, performance, and changes in the financial positions of an entity that benefits a large number of users in any economic decision-making. Net income (profit) is often used as a measure of performance or as a basis for other measures such as return on investment or earnings per share. Kartikahadi *et al.* (2012) describes the usefulness of a comprehensive income statement that is to report and account for the performance of the entity. Financial statements prepared by the company in addition to being used for accountability to shareholders are also intended for tax reports. In accordance with Article 4 (1) of the Income Tax Law, operating income is an object of corporate income tax.

In practice in Indonesia, there are some differences between earnings reported to the shareholders with earnings reports for tax purpose due to different standards used. For a report to tax or often referred to as a fiscal report, the company prepares based on taxation rules. As explained in PSAK 46 (revised 2010), taxable profit or fiscal profit (tax loss or tax loss) is profit (loss) for one period which is calculated based on the rules determined by the tax authority for income tax payable (recovered). Meanwhile, the income statement is addressed to the shareholders and other users except the government is called commercial financial statements. In preparing commercial financial statements, the company must comply with the Financial Accounting Standards.

In its history, the Financial Accounting Standards in Indonesia experienced a change that since 2008 has gradually been adopting the IFRS *(International Financial Reporting Standards).* PSAK-IFRS was implemented in full in 2012 and had to be applied to the entities with public accountability such as issuers, public companies, banks, insurance companies, and government-owned companies. The purpose of this PSAK is to provide relevant information for the users of financial statements. In the latest stand, there is a change from *rule-based* to a *principle-based*.

IFRS is a principle-based standard. In this principle, it is necessary to use professional judgment and an expert. Benneth *et al* ., (2006) concluded that *principles-based* requires a professional *judgment* both at the transactional level and at the financial statements level. In addition, IFRS uses *fair value* in valuing assets. It is different from the taxation regulations that use historical value (acquisition price).

The implementation of principle-based will push more judments made by the management. It provides a great opportunity to the management to practice earnings management (Capkun *et al.,* 2013). In

addition, the application of IFRS also has the potential to affect the suitability of accounting profit with fiscal profit (*book-tax conformity*) and jointly affect the tax due to managerial managerial opportunities (Hevas *et al.,* 2013). With the increasing opportunities for the management to make earnings management, it will push the estimates made by management needs to be assessed its feasibility by the auditors. This also requires the auditors to have the ability to interpret the objectives of a standard.

The government has tried to encourage the employers to increase profits, including the incentives of declining corporate tax rates in the country as stated in the explanation of Act 36 of 2008 Section 17 Subsection (2b). In addition, the enactment of Government Regulation No. 46 of 2013 concerning the simplification of tax calculation is expected to benefit the taxpayers so that the government's target to increase revenues from tax sources increases.

Several studies related to the impact of audit quality and IFRS implementation on earnings management have been carried out including Bart *et al.,* (2012 ) which proved that companies that use International Financial Accounting Standards show low levels of income smoothing and earnings management, and there is a relationship between accounting numbers with the prices and stock return. Rudra *et al.* (2012) examined whether IFRS affected the earnings management in India and found that earnings management increased significantly with the adoption of IFRS. Fanani *et al.*(2014) proved that IFRS adoption in Indonesia has no impact on earnings management. Pambudi *et al.* (2014) examined the effect of audit quality on earnings management after IFRS adoption. The research results prove that audit quality does not affect earnings management.

Hevas *et al.,* (2013) examined the impact of IFRS on tax incentives through earnings management as measured by discretionary accruals. The study shows that in the pre-IFRS, the tax pressure as measured by ETRCFO has a negative effect on the discretionary accruals, but after post period IFRS the effect becomes nonexistent. Tang (2014) conducted a research related to book-tax conformity by using financial statements in 1994-2007 for 16,739 companies in 32 countries by establishing the proxies that high book-tax conformity is associated with the low levels of earnings management and tax avoidance. The studies proved that high book-tax conformity after the implementation of IFRS indicates a low level of earnings management and tax evasion, but it is not proven in a country that adheres to code-law whether the country applies IFRS or not.

Based on the background and results of previous studies that show different results in looking at the effect of the ETR and audit quality on earnings management, as well as the lack of research that addresses this matter motivates the author to conduct a research on the effect of the ETR and audit quality after IFRS adoption of earnings management on the manufacturing companies listed on the Indonesia Stock Exchange during 2012-2013.

This study uses a model in the study conducted by Hevas *et al* (2013) which tested the tax pressure after IFRS adoption of earnings management. In contrast to the research of Hevas *et al.* (2013), firstly the study uses ETR measures to look at management behavior in doing earnings management that is associated with *discretionary accruals* because of Indonesia's different conditions from Greek's. Secondly, this study only conducts post- adoption IFRS testing.

## THEORETICAL FRAMEWORK AND DEVELOPMENT of HYPOTHESES

### Agency Theory

In agency theory, agency relationships arise when one or more people (principals) employ other people (agents) to provide a service and then delegate the decision-making authority to the agent (Jensen *et al.* 1976). Management as a company manager knows more about the internal information and prospects of the company in the future than the owners (shareholders).

Scott (2012) states that companies have many contracts, for example employment contracts between managers and their companies and loan contracts between companies and their creditors. The agent and principal want to maximize their utility with the information they have. However, here the agent has more information (full information) than the principal, giving rise to information asymmetry. Information that is more owned by managers can trigger to take actions in accordance with the wishes and objectives to maximize their utility. As for the owners of capital, in this case investors, it will be difficult to effectively control the actions that will be taken by management because of the lack of information available.

In relation to taxation, the agency relations arises because of the conflict between the government as a tax collector and the management as taxpayers. The government hopes that to get as much

revenue as possible from taxes, while the management hopes to pay taxes as low as possible but still get significant profits.

***Book-Tax Conformity***

Book-tax conformity is the conformity between accounting profit and fiscal profit. The researches related to book-tax conformity have been carried out such as Hanlon *et al.* (2008) and Atwood *et al* (2010 ). Book-tax conformity contains the same meaning as the *book-tax difference* but has a different perspective. Atwood *et al.* (2010 ) explained that the higher the *book-tax conformity* or the higher the suitability between accounting profit and fiscal profit, it will reduce earnings quality. This is because the company chooses an accounting method that is very concerned about the taxation rules, so that the financial statements do not provide information to users of financial statements outside the government.

***Effective Tax Rate* (ETR)**

*Effective tax rate* (ETR) is the proxy most widely used in studies related to tax aggressiveness. Low value of an ETR can be an indicator of tax aggressiveness. Overall, the companies that avoid corporate taxes by reducing their taxable income while maintaining financial accounting profits have a lower ETR value. Frank *et al* (2009) use ETR to reflect the difference between accounting profit calculation and fiscal profit. Hanlon *et al* (2010) defines ETR as the effectiveness of tax payments made by the company calculated by dividing *tax expense (tax liability)* with profit before tax or with cash flow. Gufta *et al.* (1997) conducted an ETR study after the application of TRA-86. The results showed that ETR increased after the application of TRA-86.

**Audit Quality**

Dopuch *et al.* (1980 ) stated that investors perceive that Big-6 accounting firms has higher quality than Non-Big-6 accounting firms, because the Big-6 have characteristics that are related to the audit quality that are more observable such as specialized training and peer review than non-Big-6. The audit quality can be measured using a ACCOUNTING FIRMS size proxy, whether the accounting firms are included in the Big Four or not, Pambudi *et al.* (2014) uses the Big-4 proxy for audit quality. However, on the research related to auditor expertise related to taxes, Wang *et al.* (2012) found that the auditor expertise influences the tax avoidance by companies.

***Earnings Management***

According to the *General Accepted Accounting Principles* (GAAP), earnings management is a process of taking deliberate steps within the limits of generally accepted principles both within and outside the limits. Schipper (1989 ) states that earnings management is an intervention which has a purpose in the process of financial reporting to the external parties with the intention to obtain personal benefits for management. Whereas Healy *et al.* (1999) states that earnings management arises when managers use judgment in the financial reporting and in structuring transactions to influence financial statements and also trick stakeholders into the economic performance of the company or to influence the outcome of contracts that depend on accounting numbers.

According to Merchant *et al.* (1994), earnings management is any action taken by the company management to influence the reported earnings so that can provide information about *economic advantages* that are actually not experienced by the company. In the long run these actions are detrimental to the company.

***Effective Tax Rate* and Earnings Management**

In Indonesia PSAK-IFRS must be applied by the companies listed in the stock exchange. With the application of IFRS-PSAK, there are some changes from *rule-based* to *principle-based*. In addition, IFRS uses *fair value* in valuing assets. It is different from the taxation regulations that use historical value (acquisition price). *Principle-based* minimizes the level of earnings management carried out by the management by tightening the rules and fair value approaches in the presentation of financial statements. Bart *et al* . (2008) proved that companies that apply IFRS show low levels of income smoothing and earnings management. But Capkun *et al.* (2013) explained that with the application of the *principle-based* , more *judment* made by management would provide a great opportunity for management to do earnings management.

The application of IFRS also has the potential to affect the suitability of accounting profit with fiscal profit (book-tax conformity) and together have an impact on tax due to managerial managerial profit (Hevas *et al.*, 2013). With the increasing difference in Financial Accounting Standards and tax rules, it will reduce the suitability between books and taxes (book-tax conformity). Hanlon *et al.* (2008) shows that the suitability of high accounting earnings with fiscal profit (book-tax conformity) will reduce the informativeness of financial statements.

Hevas *et al.* (2013) examined the impact of IFRS on tax incentives through earnings management as measured by discretionary accruals. The results of the study showed that in the pre-period IFRS, *tax pressure* as measured by ETRCFO has a negative effect on *discretionary accruals*, but after post period IFRS the effect becomes nonexistent. Hevas *et al.* (2013) used the ETR CFO because the tax rules in Greece do not allow deferred taxes.

Several studies measuring ETR are associated with the application of new standards to obtain evidence of the influence of standard implementation on increasing ETR, including Gufta *et al* . (1997) which conducted an ETR research after the implementation of TRA-86 which is related to firm size. The results of the study showed that ETR increased after the TRA-86 adoption. ETR is a proxy that is most widely used in studies related to tax aggressiveness. A low value of ETR can be an indicator of tax aggressiveness. Overall, the companies that avoid corporate taxes by reducing their taxable income while maintaining financial accounting profits have a lower ETR value.

According to Scott (2012 ), one of the motivations for the managers to make earnings management is tax motivation. In principle, earnings management is the method chosen in presenting information on corporate financial statements to the public that has been adjusted to the interests of managers or profitable for the company.

Based on the explanation above, it can be concluded that with the implementation of IFRS, book-tax conformity will be lower due to the higher differences between the rules set by Financial Accounting Standards (SAK) and the tax rules, with low book-tax conformity the more informative are the financial statements. The application of IFRS improves the quality of financial report information . The application of IFRS lowered the ETR due to increasingly lower tax book conformity. This shows that accounting profits are reported to be higher than the reported fiscal profits. The large differences between the fiscal profits and accounting profits show the existence of earnings management due to the management applied a judment on accounting method, so the author can take the hypothesis that:

H1: *Effective Tax Rate* **(** ETR ) after IFRS adoption has a negative effect on earnings management.

**Audit Quality and Earnings Management**

DeAngelo (1981) mentions that larger accounting firms do better audits because they have a better reputation. And because the larger accounting firms hire more human resources, they can get more skilled employees. The Big Four auditors are often associated with higher quality audits of the non-Big Four auditors. Welvin (2010) in Pambudi *et al.* (2014) states that auditors working in the Four accounting firms are seen as more qualified because these auditors obtain a series of training and procedures and have audit programs that are more accurate and effective than auditors from non-Big-4. Based on the explanation and results of several studies above, the author can take the hypothesis that:

H2: Audit quality after IFRS adoption has a negative effect on earnings management .

## RESEARCH METHODS

### Population and Samples

The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange for the period 2012-2013. The samples in this study were chosen using the purposive sampling method. The criteria used to determine the samples are: All registered manufacturing companies listed on the Indonesia Stock Exchange in 2012 and remain registered until 2013, have issued and published financial statements as of 31 December 2012 and as of 31 December 2013 audited, have positive earnings and the company is actively traded during 2012 and 2013.

After taking the samples with the criteria above, there are 52 companies that meet these criteria.

This study uses secondary data. The data used in this study are published in the annual financial statements and audited in 2012 and 2013. Data about the number of net income, assets and liabilities acquired from the data in PDEB University of Indonesia, while the figure for profit before tax, tax expense, cash flow operating activities and auditor information are obtained through annual reports issued by the Indonesia Stock Exchange obtained from the STIE Kesatuan Exchange Corner. The sample selection process is as follows:

Table 1 Sample Selection

| Information | Amount |
|---|---|
| Number of manufacturing companies listed on the IDX registered in 2012 and | 133 |

| 2013 | |
|---|---|
| Number of companies that have negative earnings, negative ETR and incomplete financial statements | 81 |
| Number of model samples used in the study | 52 |

**Research Model**

The equation used for hypothesis testing is as follows, a model based on research conducted by Hevas *et al.* (2013 ). The following linear regression model is used to test the hypothesis in this study:

$DAC_{it} = \alpha + _{\beta 1} ETR_{it} + _{\beta 2} BIG4_{it} + _{\beta 3} SIZE_{it} + _{\beta 4} LEV_{it} + _{\beta 5} CURRENT_{it} + _{\beta 6} CFO_{it} + \varepsilon_{it}$

In this case:

$DAC_{it}$ = *Discretionary Accruals* company i period t

$ETR_{it}$ = *Effective Tax Rate* period i company t

$AUDIT_{it}$ = Auditors, with a value of 1 if ACCOUNTING FIRMS are Big Four and 0 if they ares non-Big Four

$SIZE_{it}$ = Natural log of total assets of company i period t

$LEV_{it}$ = Debt to total assets ratio of company i period t

$CURRENT_{it}$ = Liquidity ratio (current assets divided by current liabilities) company i period t

$CFO_{it}$ = Operating cash flow is divided by the total assets of the company i period t

**Variable Measurement**

The dependent variable in this study is *DAC (discretionary accruals)*. In this study *discretionary accruals* calculated by using Modified Jones Model (Sulistyanto, 2008):

1. TAC = Nit - CFO it
2. The total accrual (TA) value that is estimated by the OLS regression equation is as follows:
   $TACit = \beta_1 (1 / Ait\text{-}1) + \beta_2 (evRev / Ait\text{-}1\text{-} \Delta it\text{-}1) + \beta_3 (PPEt / Ait\text{-}1)$
3. Using regression coefficients above, the value of non-discretionary accruals (NDAC) can be calculated by formula
   $NDACi_t = \beta_1 (1 / Ai_{t-1}) + \beta_2 (evRev / Ait\text{-}1\text{-} \Delta Rec / Ait\text{-}1) + \beta_3 (PPEt / Ait\text{-}1)$
4. Discretionary Accrual (DA), can be calculated as follows:
   DACit = TACit - NDAit

Independent variables are the variables that affect the dependent variable. The independent variables in this study include ETR (*effective tax rate), audit quality,* company size, leverage, liquidity and operating cash flow. The measurements for independent variables are as follows:

1. ETR *: Effective Tax Rate*
   According to Rodriguez and Aras in Ardiansyah, an *effective tax rate* can be calculated from the tax burden divided by profit before tax and does not distinguish between current tax expense and deferred tax expense. So that it can be formulated as follows:
   ETR = (Total income tax / profit before tax) x 100%
2. AUDIT: Audit quality is measured using a proxy of the *Big Four auditors*, is a dummy variable given the number 1 if the company is audited by the Big Four auditors, and given a number 0 if audited by the Non-Big Four auditors .
3. SIZE: Company Size
   Company size is measured by the total amount of company assets that are transformed in the form of natural logarithms (Hevas *et al.,* 2013).
4. LEV: Leverage
   Leverage is measured by dividing total debts by total assets.
5. CURRENT : Liquidity
   Liquidity is measured by dividing total current assets with current liabilities (Hevas *et al.,* 2013).
6. CFO: Cash from operating activities
   CFO is obtained by dividing cash from operating activities with the company's total assets (Hevas *et al.*, 2013).

Company size, leverage, liquidity, and cash from operation are the control variables used in this study. Some researchers have conducted research related to these variables and obtained different results. Hevas *et al* (2013) obtained the results of the influence of liquidity on earnings management, Pambudi *et al* (2014 ) and Siregar *et al.* (2005) found that firm sizes have negative effects on earnings management.

**Data Processing Techniques**

This research will use regression modeling because the goal of this study was to determine the relationship between the dependent variable by one or more independent variables. The research model was regressed using the aid of Eviews 6 software. To analyze the data, the author conducted a descriptive statistical analysis to determine the limits of the regression model, test $R^2$ and test hypotheses on the regression results using t-statistics and F test.

**RESULTS AND DISCUSSION**

**Research Results**

The research has conducted on the selected 52 companies listed on the Indonesia Stock Exchange, except the companies in financial industry for 2012 and 2013. The determination of 52 companies based on the criteria that the companies have complete financial statements, have positive value in the statement of income for the year (net profit) in 2012 and 2013, the ETR is positive and has been audited.

Based on Table 1, the descriptive statistics for the variables used explains the relationship between earnings management and ETR, audit quality and other variables. It is known that all variables have a positive mean value.

**Table 1 Descriptive Statistics**

$DAC_{it} = \alpha + _{\beta 1} ETR_{it} + _{\beta 2} AUDIT_{it} + _{\beta 3} SIZE_{it + \beta 4} LEV_{it} + _{\beta 5} CURRENT_{it} - _{\beta 6} CFO_{it} + \varepsilon_{it}$

| Variable | Mean | Maximum | Minimum | Std. Dev |
|---|---|---|---|---|
| DAC | 4.21 | 11. 8 0 | -1.85 | 1.40 |
| ETR | 0.38 | 3.01 | 0.0002 | 0.50 |
| AUDIT | 0.42 | 1.00 | 0 | 0.49 |
| SIZE | 9.12 | 11.32 | 8.12 | 0.65 |
| LEV | 0.44 | 1.33 | 0.02 | 0.21 |
| CURRENT | 2.22 | 10.17 | 0 . 40 | 1.61 |
| CFO | 0.09 | 1 .39 | - 0 . 1 3 | 0.06 |

DAC *is a discretionary accruals* company i period t; $ETR_{it}$ *is the effective tax rate for* a period of time; $AUDIT_{it}$ is Auditor, with a value of 1 if ACCOUNTING FIRMS is Big Four and 0 if ACCOUNTING FIRMS is non-Big Four; $SIZE_i$ is a natural log of total assets of the company i period t; $LEV_{it}$ is debt ratio to total assets of the company i period t;$CURRENT_{it}$ is the liquidity ratio (current assets divided by current debt) company i period t. ; $CFO_{it}$ is operating cash flow divided by total assets of the company in period t

*Source: Eviews 6.01 output*

Before regressing, a classic assumption test is performed to see whether the data is free from problems of multicollinearity, heterocedasticity, and autocorrelation. The classic assumption test is important to produce a linear unbiased estimator with a minimum variant of the *Best Linear Unbiased Estimator* (BLUE), which means the regression model does not contain problems. In using the forecasting model, there are several assumptions that underlie the forecasting model, including:

1. Autocorrelation test. Autocorrelation test was carried out using the LM serial correlation facility, based on the results of the Eviews 6.1 data obtained the value of obs * R-squared ($X^2$ count) of 2.186 and $X^2$ tables with α = 5% adjusted to lag of 5.99 because 2,186 <5,99, it can be concluded that the model is free from autocorrelation problems. This is also evidenced by the probability $R^2$ of 0.33 greater than 0.05.
2. Multicollinearity test. Multicollinearity test was carried out using Eviews with partial correction approach, and obtained $R^2 1 > R^2 2$, $R^2 3$, $R^2 4$, $R^2 5$, $R^2 6$, and $R^2 7$: 0.64 > 0.58;0.54; 0.40; 0.38; 0.16 and 0.02. It can be concluded that the model is free of multicollinearity problems.
3. Heteroscedasticity tes. Heteroscedastic test was conducted to determine whether the variance of the error is constant or not. Heteroscedasticity problems occur in the model. The problem of heteroscedasticity is corrected using the white heteroskedasticity consistent standard error and covariance facility.

**Table 2 Summary of Model Regression Results**

| Variable | Expected Sign | Coefficient | t-stat | Probability |
|---|---|---|---|---|
| (Constant) | | -0.805 | -5,002732 | 0.0000 |

| | | | | |
|---|---|---|---|---|
| $ETR_{it}$ | (- ) | 0.125 | 0.497344 | 0.6201 |
| $AUDIT_{it}$ | (- ) | -0.499 | -2,211246 | 0.0294 *** |
| $CFO_{it}$ | (+) | 0.623 | 3,968178 | 0,0001 *** |
| $CURRENT_{it}$ | (+) | 0.275 | 0,535440 | 0.5936 |
| $LEV_{it}$ | (+) | 0.354 | 0.712986 | 0.4776 |
| $SIZE_{it}$ | (+ ) | 0.860 | 4,842439 | 0.0000 *** |

N 104
R-squared 0.641843
Adjusted R-squared 0,619689
F-stat 28,97180
Prob F-stat is 0.000000
DW-Stat 1.731372
*** = Significant at 1% level
** = Significant at level 5%
* = Significant at 10% level
DAC *is* discretionary accruals company i period t; $ETR_{it}$ is effective tax rate for a period of time; $AUDIT_{it}$ is Auditor, with a value of 1 if the ACCOUNTING FIRMS are Big Four and 0 if ACCOUNTING FIRMS are non-Big Four; $SIZE_{i}$ is natural log of total assets of the company i period t; $LEV_{it}$ is debt ratio to total assets of the company i period t; $CURRENT_{it}$ is the liquidity ratio (current assets divided by current debt) company i for the period t; $CFO_{it}$ is operating cash flow divided by total assets of the company i in period t

*Source: Eviews 6.01 output. Data has been reprocessed*

From the table, it can be seen that $R^2$ has a value of 0.64 which can be concluded that the regression model is able to explain the effect of ETR variables, audit quality, CFO, liquidity, leverage and company size on discresionary accruals (earnings management) of 64% while the contents 36% cannot be explained by the regression equation. In other words, there are many other factors that affect the discresionary accruals (earnings management) .

F test is conducted to show how much influence ETR, audit quality, CFO, liquidity, leverage, and company size together on the discresionary accruals (earnings management) . The results of hypothesis testing as can be seen from Table 2 shows the calculated F value of 28.97 with a significance level of 0.000 which means smaller than 0.05. So, it can be concluded that there is proven to be a joint effect between ETR variables, audit quality, CFO, liquidity, leverage and company size on the discresionary accruals (earnings management).

To see the significance of the partial effect of each variable on the discresionary accruals (earnings management) , the t test is carried out. From Table 3 above, it can be explained that:

**Table 3 Summary of Results of Proving the Research Hypothesis**

| | | **Accept / Refuse** |
|---|---|---|
| H1 | ETR has a negative effect on earnings management (*discresionary accruals)* | Refuse |
| H2 | Audit culture negatively affects earnings management (*discresionary accruals)* | Accept |

*Source: Eviews 6.01 output. Data has been reprocessed.*

**Discussion**

The purpose of this study is to look at the effect of ETR and audit quality on earnings management (*discresionary accruals),* with control variables of company size, leverage, CFO and liquidity which are done empirically.

From the results of statistical tests that have been partially tested, it shows that 5% alpha exists one main variable and two control variables that influence on earnings management that are the audit quality, company size, and CFO. The audit quality is a negative influence on earnings management. It means that the better the quality of external auditors, the smaller the earnings management carried out by the company. This proves that with the implementation of IFRS, a qualified auditor is needed because of the increasing number of agreements made by management. With the audit of a qualified ACCOUNTING FIRMS, the earnings management carried out by the company is expected to be smaller, it is in line with IFRS's aim that with the implementation of IFRS, the financial reports will be of higher quality. This finding

is not in line with the research conducted by Pambudi *et al.* (2014) who did not find the effect of audit quality on earnings management after the adoption of IFRS.

Firm size has a positive effect on earnings management. The results are not in line with expectations that company size has a negative effect on earnings management. This shows that after the adoption of IFRS large companies tend to practice earnings management, with the *principle-based* and the use of fair value in the preparation of financial statements. This finding is not in line with Siregar *et al.* (2005) and Pambudi *et al.* (2014) which showed the negative influence of firm sizes on earnings management. However, this is in line with the findings of Rudra and Bhattacharjee (2012) examining whether IFRS affects earnings management in India and found that earnings management increases significantly with the adoption of IFRS .

Cash flows from operation have positive effects on earnings management. This finding is in line with Hevas *et al.* (2013) who found a positive influence between CFO and earnings management. Cash flows from operating activities show the company's performance so that management will make earnings management in order the company's operating cash flows look good.

The results of statistics testing show one major variable that does not have the influence that ETR and the control variables that do not have the influence, that is leverage. This is in line with research by Hevas *et al.* (2013) who found that the effect of ETR will be lost in the aftermath of the adoption of IFRS. The ETR has no effect on the period after the adoption of IFRS due terdapat differences between tax and IFRS, including the method of calculation of fixed assets. Tthere are several items that are not recognized by the tax authority in the comprehensive income statement such as the disclosure of related parties, the effect of changes in foreign exchange rates, *operating lease* , and so on

Although the companies apply earnings management by lowering income, the practice does not affect taxable income for their fiscal correction made to the profit as the company's tax base. IFRS convergence does not have an effect on tax reporting because fiscal financial reports refer to the tax rules (Laws, Minister of Finance Regulations, Directorate General Regulations, etc.) that are different from SAK-IFRS.

Leverage does not affect earnings management. This is in line with the research of Hevas *et al.* (2013) and Pambudi *et al.* (2014), who found no influence of leverage on earnings management. But the results of this study are not in line with Guna's (2010) and Chin *et al.* (2009) in Pambudi *et al.* (2014) which show the influence of leverage on earnings management.

## CONCLUSIONS AND RECOMMENDATIONS

This study aims to see the effect of ETR, audit quality, company size and leverage on earnings management *(discrenesary accruals)* on manufacturing companies listed on the Indonesia Stock Exchange in 2012 and 2013. Based on the results of the analysis, it can be concluded that there is a significant relationship or influence between the audit quality and company size and CFO on earnings management. This shows that after the adoption of IFRS, audit quality is able to detect the existence of earnings management in the company, and there is an indication of earnings management increased after the implementation of IFRS in large companies. But after the implementation of IFRS there was no ETR effect on earnings management because by applying IFRS there are many different rules between tax and IFRS so that the book-tax conformity is lower.

### Research Implications

From the significant value of the dependent variable, which is earnings management, there are only three variables that have significant influence, namely the audit quality, CFO and company size. Meanwhile, the ETR does not have an effect. This implies that the application of IFRS-SAK means that the expertise of non-Big Four accounting firms must be further enhanced in order to compete with the Big Four. There must be an effort from the government in relation to the implementation of IFRS, although the differences between IFRSs and Tax Regulations will never be eliminated. The tax regulator should continue to take measures to minimize the differences between the existing IFRS and the tax regulations .

## LIMITATIONS

The limitations in this study are related to the small amount of data. Besides, the research period used is only 2 years of observation. Further, this causes lower comparability compared to the study of Hevas *et al* (2013 ). This study does not compare the data with other data before the application of IFRS because of the limited time in conducting research so that it can cause bias in drawing the conclusions.

Based on the limitations of the study, suggestions that can be given to further research related to the results of this study are firstly to extend the observation period. Secondly, comparing the data with other data before IFRS implementation. Third , to use company data from other developing countries so that the results can be comparable with the conditions in Indonesia.

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