

Income Tax Rate and Earnings Management of Firms Listed On the Indonesian Stock Exchange

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The purpose of this study is to investigate the impacts of the reduction of statutory income tax rate on management behavior in determining earnings. Financial data (2003-2009) of manufacturing firms listed in the Indonesian stock Exchange (IDX) were collected and analyzed to obtain empirical evidence. Guenther model (1994) perfected with Kothari model (2005) is used for testing the earnings management based on the prediction error obtained. The results confirm that the managements anticipated reduction in statutory income tax rate as enacted in the Income Tax Act (ITA), 2008. This anticipation was indicated by lowering current accruals in the year 2007 and 2008 (before ITA, 2008) and year 2009 (after ITA 2008). More than 80 percent companies have negative current accruals calculated from current accruals minus expected current accrual from 2007 to 2009. This Study provides evidence that firms in Indonesia did earnings management through lowering accruals. However, when firms' characteristics (i.e. size, debt and managerial ownership) introduced to explain earnings management, the study finds that none of them individually leads to earnings management.

1. Introduction

As stated on the FASB (1978), financial reporting is expected to provide information about an enterprise's financial condition and performance during a period. Financial reporting will be prepared by management as a form of stewardship responsibility to company's owner which is shareholder. In this process, management also determines the accounting choice which will be used in the financial statement. Fields et al. (2001) classify accounting choice studies into three categories: (1) accounting choice in relation to a firm's contractual arrangements; (2) accounting choice in relation to asset price; and (3) accounting choice in relation to external parties other than actual or potential owners of the firm (i.e. policy makers, government regulators, union negotiators). Because management performance also will be assessed using the financial statements, then this may lead to the manipulation of financial statements in order to increase company profit, save tax burden, or earn bonus. The manipulation of financial statements is called as earnings management. As stated by Adhikari et al.(2005) that there are several reasons for company to engage in earnings management. One reason that has been investigated is that earnings management to response changes in tax policy. Moreover, earnings management in relation to tax policy essentially falls in the third category of Fields et al. (2001) accounting choice.

There are researches have been conducted to investigate the relation between changing in tax rate and earnings management. Guenther (1994) investigates the influence of Tax Reform Act (TRA) 1986 in the US which reduced income tax rate from 46 percent to 34

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percent. The results of the study indicated there is declining accrual in the years before tax reform which reduced tax rate. While Adhikari et al. (2005) predict and find that large Malaysian firms with low effective tax rates decrease book income prior to a reduction in statutory tax in order to influence tax policy in the year 1996 to 1997. This contributes in extending understanding of the interaction between government tax policy and firm accounting choice.

In 2008, Indonesian government reformed Indonesian taxation by enacting Income Tax Act, number 36 (Income Tax Act 2008, hereafter ITA 2008). ITA 2008 reduces tax rate from 30 percent in 2008 to 28 percent in 2009 and 25 percent in 2010. Deferring Rp1,00 of taxable income from a year in which it would be taxed before ITA 2008 to a year in which it would be taxed after ITA 2008 would be equivalent to earning 3 percent [i.e. $1,00 \times (1 - 0,28) = 1,03 \times (1 - 0,3)$]. Moreover related to the statutory tax reduction, there is another ITA 2008 policy that provides incentives for firm with maximum total sales 50 billion rupiah which is additional tax incentive up to 50 percent of the rate (i.e. 50 percent x 28 percent)

This tax reform provides incentive for management to manage before tax profit through earning management mechanism. Management has opportunity to manage their earnings through accounting choice by deferring earnings from years before ITA 2008 to year post ITA 2008 and accruing expense earlier before ITA 2008 enacted to minimize tax payment. Thus, their taxable income before ITA enacted will decrease as well as the book income. If it is so, then firms successfully reach tax planning goal. This could be done by the management because ITA 2008 does not specifically regulate when revenue and expenses must be recognized. This also suggested by Plesko (2002) that timing differences can arise from different reporting rules under each system. Additionally, it also because GAAP allows managers to have greater discretion in determining the amounts of income and expense in each period than does the tax systems. For instance, GAAP allows flexibility in estimating the provision for bad debts, while tax rules allow a deduction only for accounts receivable actually written off.

This research try to seek evidence whether or not management using ITA 2008 moment to manage their earnings in effort to optimize tax payments. Further this study investigates whether there was any different between actual accrual compare to predicted ones especially during years 2007, 2008, and 2009. This could be the evidence of earnings management existence. To investigate earnings management, this research follows Guenther (1994) and Kothari, et al. (2005). Their study classified accruals into current accruals which have an influence on taxable income and non-current accruals which do not influence taxable income.

Empirical results of this study show that manufacturing companies tend to manage their earnings through lowering their current accrual in anticipating ITA 2008. Most firms had negative difference on current accruals (predicted current accrual minus actual current accruals) in 2007, 2008, and 2009. Moreover, the number of firms did earnings management in 2007, 2008, and 2009. These results are consistent with prior evidence in the US provided by Guenther (1994) and in Malaysia by Adhikari et al. (2005) that firms use accounting choice to manage their earnings for obtaining economic benefits.

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Further analysis was conducted to investigate whether firm characteristics, namely size, long term debt, and management ownership influence the current accruals. The results show that individually such firm characteristics do not have significant influence towards current accruals, as a proxy of earnings management. However, altogether those variables have significant influence on current accruals. The findings provide evidence to support hypotheses. Thus, managements of manufacturing firms in the sample of this study anticipated reduction of statutory income tax rate by lowering their actual current accruals.

It is expected that this research contributes in several ways. First, this finding provides evidence on earnings management related to ITA 2008. This adds literature research on earning management in regard to respond on tax policy. Second, this study also provides evidence for policy making and regulator to anticipate affects of the policy. Third, this research supports the general proposition that accounting choice is used by management to manage earnings and earn economic benefit. Fourth, these findings also have implication for international accounting standard setter such as IASB or specifically Indonesia accounting standard setter for recognizing the correlation between tax planning and financial reporting in setting policies aimed at international convergence of accounting standards.

This paper is organized as follows. First, introduction provides background of this paper as bases why this topic is important. Second, literature review, lays theoretical background as bases for hypothesis development discussed taxable income and reported income, earning management and accrual. Third, hypothesis development, describes the logical framework for developing hypothesis. Fourth, research method, elaborates method used in addressing research questions consisted the description about population and sample, data, and operational variables. Fifth, analysis describes results and discussion of the findings. Lastly, conclusion underlying main findings and conclude the research results and offer future investigation on similar topics.

2. Literature Review

2.1 Taxable Income and Book Income

Taxable income could be defined as income reported to shareholder and other external users while taxable income is income reported to the tax authorities. The amount of income reported could be difference because Taxable income is based on local GAAP while taxable income is based on government regulation. However book income is used as basis for taxable income calculation. Thus if management have a keen of interest to manage taxable income they will manage book income in the financial statement as well.

Following Guenther (1994) although ITA provided a strong incentive for management of taxable income, the focus of this study is on management of financial statement income. The accounting issue addressed is whether management using accounting choice to defer revenue and accelerate expense for tax purposes which results in changes to financial statement book income.

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ITA 2008 regulates how firms in Indonesia recognize income for tax purpose, whereas Indonesian accounting standards guide firms to report their financial performance for general purposes, mainly investors, creditors and other parties. Thus, there are many differences between taxable income and pre-tax incomes. However, by examining the statutory rules contained in the Indonesia GAAP and the Indonesian Income Tax Act, 2008, it is apparent there will be some relation between the two sets of accruals.

Management tends to accrue expenses earlier whenever circumstances available to minimize tax (Guenther, 1994). In the same way, revenue may be recognized in later year in order to manage income and tax saving. This earnings management has two benefits: firstly manage earning to smooth income and secondly tax saving in earlier period.

2.2 Earnings Management and Accruals

Detecting earnings management is important in assessing the quality of earnings (Adhikari, 2005). Previous research focused on the difference between accounting income and cash flow operations. Healy (1985) distinguished accruals into discretionary accruals non-discretionary accruals. Discretionary accruals enable management to shift income among accounting period whereas non-discretionary accruals have been regulated in the accounting standards.

Accruals represent revenue and expenses in financial statements whereas earnings management for tax purpose requires taxable income reduction. This difference led Manzon (1992) and Choi et al. (1991) distinguish accruals into tax affect accruals or current accruals, i.e. account receivables and non tax affect accruals or non-current accruals, i.e. depreciation. Following Guenther (1994), this study focus on current accruals. Guenther (1994) defines current accruals of firm i , at year t as follow:

$$CACC_{it} = (CA_{it} - CA_{it-1}) - (CL_{it} - CL_{it-1}) \dots\dots\dots(1)$$

Where, CA is current assets minus cash dan CL is current liabilities. The changing current assets and current liabilities indicate the difference between net income and cash flow operation. Beyond that difference, the changes do not influence taxable income. In case no earnings management, currents assets and current liabilities at year t , are function sof sales of the year.

$$CA_{it} = \alpha_i^A + \beta_i^A SALES_{it} + \varepsilon_{it}^A \text{ and } CL_{it} = \alpha_i^L + \beta_i^L SALES_{it} + \varepsilon_{it}^L \dots\dots\dots(2)$$

Where ε_{it}^A and ε_{it}^L are random error terms. Equation (1) and (2) are substituted results in an estimate *current accrual* with no earnings managements, as indicated by equation (3)

$$CACC_{it} = \beta_i^A SALES_{it} + \varepsilon_{it}^A - \varepsilon_{it-1}^A - \beta_i^L SALES_{it} - \varepsilon_{it}^L + \varepsilon_{it-1}^L \dots\dots\dots(3)$$

$$CACC_{it} = \beta_i \Delta SALES_{it} + \varepsilon_{it} \dots\dots\dots(4)$$

$\Delta SALES_{it}$ is changing in sales of firms i at year t ; $\beta_i = \beta_i^A - \beta_i^L$; dan $\varepsilon_{it} = \varepsilon_{it}^A - \varepsilon_{it-1}^A - \varepsilon_{it}^L + \varepsilon_{it-1}^L$

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Meanwhile, Jones (1991); Dechow et al. (1995); Kothari et al. (2005) also develop model to detect earnings management by adding other discretionary accruals accounts, namely Asset, Property, Plant, Equipment (PPE), and ROA which are used as proxy performance. Jones (1991) assume that *non-discretionary accruals* is constant. Thus Jones's model is as follows:

$$TA_{it} = \beta_0 + \beta_1(1/AT_{it-1}) + \beta_2 \Delta REV_{it} + \beta_3 PPE_{it} + \varepsilon_{it} \dots \dots \dots (5)$$

Where TA_{it} is total accrual firm i at year t , AT_{it-1} is total assets of firm i at the beginning of year; REV_{it} is revenue of firm i at year t , PPE_{it} is gross *Property, Plant, and Equipment* of firm i at year t . The assumption of this model does not incorporate any policy that may influence revenue in both the estimate period and earnings management. Therefore, this model is unlikely able to detect earnings managements through revenue manipulation.

Dechow et al. (1995) modified the model, hereafter so called Modified Jones. This model adds assumption that all changes in credit sales in the event period are earnings management. This modified model is able to detect earnings management better than that of Jones model. Modified Jones model is:

$$TA_{it} = \beta_0 + \beta_1(1/AT_{it-1}) + \beta_2 (\Delta REV_{it} - \Delta AR_{it}) + \beta_3 PPE_{it} + \varepsilon_{it} \dots \dots \dots (6)$$

Kothari et al.(2005) adds ROA in the earnings management model. ROA could be in current year or one year before. However, Kothari et al.(2005) found that an ROA *current year* is better in discretionary accruals regressions. Earnings management model by Kothari et al. (2005) as follows:

$$TA_{it} = \beta_0 + \beta_1(1/AT_{it-1}) + \beta_2 (\Delta REV_{it} - \Delta AR_{it}) + \beta_3 PPE_{it} + \beta_4 ROA_{it} + \varepsilon_{it} \dots \dots \dots (7)$$

This model is considered to be the best and therefore mostly used as an earnings management model.

To detect earnings management in the declining statutory income tax year, this study uses Guenther (1994) modified using Kothari et al. (2005). Modified Guenther model used in this study is as follows:

$$CACC_{it} = \beta_0 + \beta_1(1/AT_{it-1}) + \beta_2 \Delta SALES + \beta_3 PPE_{it} + \beta_4 ROA_{it} + \varepsilon_{it} \dots \dots \dots (8)$$

This model is used to derive expected current accruals. The difference between expected current accruals and current accrual will be the earnings management indicator.

3. Hypothesis Development

The objective of this study is to investigate whether Indonesian firms use accounting choice to postpone revenue and accrue expense to influence taxable net income. This study backgrounds are (a) previous findings that firms in general use accounting choice to reduce tax expense and (b) there are a few study that investigate the relationships between ITA, earnings management, and firm characteristics. It can be seen on the

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equation (1) that declining current assets intended to defer revenue and or increasing current liability aimed to accrue expenses will lead to negative accrual. If management conducts tax planning to manage taxable income, then there is a negative current accrual at years before the year of declining tax rate. Therefore, the first hypothesis in this study is as follow.

H₁ : Firms have negative current accruals at years before the year in which declining statutory income tax rate enacted.

Watts and Zimmerman (1978) found that large firms are sensitive to political cost, thus management of the firms tends to choose more conservative accounting method. Firm management manages (reduce) their taxable income (conduct tax planning) and also manages (reduce) their reporting income to reduce potential political costs. Kim and Limpaphayon (1998) and Derashid and Zhang (2003) provide evidence of a negative relation between effective tax rate and firm size for East and South East Asian firms, which large firms pay lower effective taxes. Large firms tend to reduce their reported income along with taxable income in anticipating statutory tax rate reduction.

H₂: Current accruals of firms at the years before declining statutory tax rate tend to be negative commensurate with the size of firms.

Debt covenant hypothesis says that managements tend to select accounting method that increase reported income to comply with the agreement (Watts and Zimmerman, 1986). Ceteris paribus, management with higher debt to equity ratio tends to choose accounting policy which results in higher net income of the current period. This could be done through shifting net income to current year and deferring expense to following year. Thus, firms with high level of debt may maintain positive current accruals even though there is a decrease in the statutory tax rate in the following year.

H₃: Current accruals at the year before declining statutory tax rate tend to be positive commensurate with the level of firm's debt.

In firms with bonus compensation system based on reported income, deferring revenue and accruing expenses aren't likely being conducted because it is not in line with management's wealth increase, although this is beneficial for stockholders. It is expected that managerial ownership will ease or reduce this problems. Therefore the last hypothesis is firms with managerial ownership tends to manage taxable income.

H₄: Current accrual at the year before declining statutory tax rate tend to be negative commensurate with the managerial share ownership.

4. Research Method

4.1 Population and Sample

This study uses population of Industry Groups and Manufacturing listed in 2003 to 2009 on the Indonesian Stock Exchange (IDX). Financial data companies year 2003 to 2006 is

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used for calculating coefficient used for predicting expected current accrual year 2007 to 2009. Whereas financial data companies year 2007 to 2009 is used for calculating current accrual. Year 2007 to 2009 are chosen because in this period major change in statutory tax rate was debated and implemented in Indonesia.

Industry classification is based on Jakarta Stock Industrial Classification (JASICA). Firms selected based on the fact that they are listed in the IDX and representation of three sectors: basic industry and chemicals, miscellaneous industry, and consumer goods industry. These three industries consist of 20 sub sectors and are expected to be representative of the like industry. Moreover, manufacturing industry was chosen as sample because previous researches showed that manufacturing companies tend to conduct earnings management through accruals component and this industry has relatively greater working capital component than other companies group (Utpala2007). The sample of this study taken from the population based on *purposive sampling* with characteristics of sample as follows:

1. Firms are in industry and manufacture and listed continuously from 2003 to 2009 at the Indonesian Stock Exchange (IDX)
2. Firms do not acquire or merge other firms
3. Firms provide complete financial statement as required in this study
4. Firms use Rupiah (Indonesian currency) in their financial statements.

Firms listed before 2003 in IDX are not used because after Indonesia financial crisis in 1988 the economic condition has not recovered yet and many firms delisted in the period of 1998 to 2002. Thus, if the based year is earlier than 2003 then the research sample would be so small. As mentioned above, the sample of this research must be firms which listed continuously from the based year till 2009.

4.2. Data

This study uses financial statements data of firm sample obtained from OSIRIS (a data base subscribed by Faculty of Economics and Business, UGM). The data of the first regression which is used to derive expected current accrual consists of current accrual as dependent variable while total assets, net sales, property, plant and equipment (PPE) and Return on Asset (ROA) are used as independent variables. Then, the second regression which used to analyze the effect of firms' size, long term debt, and managerial ownership is using the difference between expected current accrual minus current accrual as dependent variable while total asset, long term debt, and the percentage of shares owned by management as independent variables.

4.3. Operational Variable

4.3.1. Dependent Variable

Current accrual is used as dependent variable in this study. Current accrual in this study is based on Jones (1991) which is also used by Guenther (1994).

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$$CACC_t = [\Delta \text{Current Assets}_t - \Delta \text{Cash}_t] - [\Delta \text{Current Liabilities}_t - \Delta \text{Current Maturities of Long-Term Debt}_t - \Delta \text{Income Taxes payable}] \dots \dots \dots (9)$$

Change (Δ) is calculated by subtracted t-1 from t period.

Furthermore, to control non-discretionary accruals, measures of earnings management is the difference between actual current accruals period t and expected current accruals in equation (8). All variables in equation (8) are divided by total assets in the early year (AT_{it-1}) to avoid heteroscedasticity.

$$CACC_{it}/AT_{it-1} = \beta_0 + \beta_1(1/AT_{it-1})/A_{it-1} + \beta_2 \Delta SALES/AT_{it-1} + \beta_3 PPE_{it}/AT_{it-1} + \beta_4 ROA_{it}/AT_{it-1} + \varepsilon_{it} \dots \dots (10)$$

Equation (10) is estimated using OLS for each firms for four years: 2003-2006. Estimated parameter from equation (10), then used to derive expected current accrual for three year predictions, 2007, 2008 and 2009. The difference between actual and expected current accrual (u_{ip}) which being indicator for earnings management from this model is calculated as follows:

$$U_{ip} = CACC_{it}/AT_{it-1} - b_1(1/AT_{it-1})/AT_{it-1} + b_2 \Delta SALES/AT_{it-1} + b_3 PPE_{it}/AT_{it-1} + b_4 ROA_{it}/AT_{it-1} \dots \dots (11)$$

4.3.2 Independent Variables

This study uses three independent variables:

1. **Firm size:** Firm size (SIZE) is measured by log total assets.
2. **Debt:** Debt (DA) is measured by long term debt divided by total assets.
3. **Management ownership:** Management (MGT) ownership is measured by the percentage of managerial share ownership: the number of outstanding stock owned by management divided by total outstanding stock.

5. Analysis

Empirical analysis was conducted by multiple regressions. Current accruals as dependent variable and three independent variables: firm size, debt and managerial ownership.

$$CACC_{it} = \gamma_0 + \gamma_1 SIZE_{ip} + \gamma_2 DA_{ip} + \gamma_3 MGT_{ip} + e_{ip} \dots \dots \dots (12)$$

Where $CACC_{ip}$ is current accruals, SIZE is firm size total asset, and DA is book value of long term debt divided by total assets, MGT is the percentage of managerial ownership on outstanding stocks.

5.1 Testing Earnings Management

Testing earnings management in this study utilizes expected current accrual from earnings management model by Guenther (1994), then combined with Kothari et

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al.(2005). Dependent variables current accrual (CACC) whereas independent variables are Total Assets, Sales, PPE, dan ROA. The equation is estimated using pool cross sectional for 2003-2006. The number of firms in the sample is 356 firms.

Table 1: Descriptive Statistics For Expected Current Accruals Estimation

Description	CACC	ASSET	SALES	PPE	ROA
Mean	0.129	3.69E-09	0.142	0.453	0.050
Median	0.037	1.9E-09	0.077	0.410	0.025
Maximum	3.467	4.26E-08	6.262	2.488	4.684
Minimum	-2.105	4.51899E-11	-2.820	0.000	-0.552
Deviation Standard	0.370	5.75E-09	0.504	0.271	0.282
Sum	45.848	0.00000131	4.754	161.431	17.689
N	356	356	356	356	356

Table 1. shows descriptive statistics of the data, whereas table 2 shows the results regression to estimate *expected current accrual*. The results indicate that CACC is significantly related to Asset, Sales, PPE, and ROA, thus this prediction model is valid (F statistic is 0,00).

The coefficient Estimate from the regression in Table 2 is used to calculate expected current accrual in 2007, 2008, and 2009. Then the predicted current accrual is subtracted from actual current accrual in 2007, 2008, 2009. Firms with negative results of the subtraction (expected current accruals are bigger than actual current accruals) are assumed to manage their earnings by lowering income as part of tax planning. This is done by lowering current assets to postpone income and recognize current liabilities to accrue expenses.

Table 2. Expected Current Accruals Estimation

$$CACC_{it}/A_{it-1} = \beta_0 + \beta_1(1/AT_{it-1})/A_{it-1} + \beta_2 \Delta SALES/A_{it-1} + \beta_3 PPE_{it}/A_{it-1} + \beta_4 ROA_{it}/A_{it-1} + \varepsilon_t$$

Description	Constant	Asset	Sales	PPE	ROA
Coefficient Estimate	0.112562	3947331	-0.025337	-0.0608	0.661693
Standard Error	0.034808	2978198	0.034356	0.063378	0.060161
P-Values	0.0013	0.1859	0.4613	0.3380	0.0000
R-squared	0.260689				
Adjusted R-squared	0.252264				
Durbin-Watson	1,379,405				
Probability (F-statistic)	0.000				

In 2007, from 89 firms in the sample, 74 have negative difference current accruals (83 percent). In 2008, from 89 firms sample, 83 have negative difference current accruals (91

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percent). Furthermore, in 2009, from 78 firms in the sample, 73 have negative difference current accruals (94 percent). The findings indicate that management anticipated statutory income tax rate reduction by managing their earnings for two years before the year statutory income tax reduction (ITA 2008). These findings confirm the hypothesis.

Some characteristics of firms are expected to explain earning management such as firm size (SIZE), debt (DA), and managerial ownership (MGT). Therefore this study estimates the influence of those three variables on current accruals (CACC). Table 3 contains descriptive statistics of the variables.

Table 3: Descriptive Statistics for Regression of CACC on Explanatory Variables

Description	CACC	SIZE	MGT	DA
Mean	0.041	8.9251	0.017	6.081
Median	0.009	8.8645	0.000	7.633
Maximum	6.270	10.6062	0.256	10.024
Minimum	-46965.000	5.9547	0.000	0.000
Deviation Standard	0.555	0.6659	0.045	3.375
Sum	10.467	2266.986	4.179	1544.436
N	254	254	254	254

Further analysis was conducted to investigate whether firm characteristics, namely size, long term debt, and management ownership influence the current accruals. The results show that individually such firm characteristics do not have significant influence on earnings management, as surrogated by current accruals. However, altogether those variables have significant influence on current accruals. The findings provide evidence to support hypotheses. Thus, managements of manufacturing firms in the sample of this study manage their earnings by lowering current accruals.

Table 4: Multivariate OLS regression Of CACC on Explanatory Variables

$$CACC_{it} = \gamma_0 + \gamma_1 SIZE_{ip} + \gamma_2 DA_{ip} + \gamma_3 MGT_{ip} + \varepsilon_i$$

Description	Constant	SIZE	MGT	DA
Coefficient Estimate	1.8617	- 0.2056	- 0.8936	0.0048
Standard Error	1.6055	0.1755	1.063	0.007
P-Values	0.2473	0.2425	0.4013	0.4933
R-squared	0.0502			
Adjusted R-squared	0.0388			
Durbin-Watson	1.92			
Probability (F-statistic)	0.004			

6. Conclusions

This study investigates whether accounting earnings of Indonesian manufacturing firms are managed in response to changes in the statutory income tax rate as enacted in the Indonesian Tax Act, 2008. Evidence of the existence of earnings management is examined using accounting accruals.

This research develops hypotheses that accruals in the year prior to the tax rate reduction will decrease because management intended to earn tax saving benefits. Further hypotheses predict that these accruals decreasing will be greater for firms with large size and firms with high level of manager ownership. Conversely, accruals decreasing will be lesser for firms with high debts. This study uses expected current accruals model from Guenther (1994) which is modified using Jones (1991), Dechow et al. (1995) and Kothari et al. (2005) models. Thus, time series regression model is developed. The difference between the expected current accruals and current accruals could be calculated and used to detect the existence of earnings management. A negative difference between expected current accruals and current accruals (expected current accruals is greater than current accruals) means that management lowering its accruals for anticipating changes in the declining statutory income tax rate and thus the earnings management exists.

This research confirms that there is a significant negative difference between expected current accruals and current accruals prior to the tax rate reduction. However, firm size, debt level, and managerial ownership do not influence management to manage earnings. Altogether those variables could influence management to manage earnings through lowering accruals.

This research contributes to the literature by adding new evidence about the association between tax policy and earnings management in an emerging market, Indonesia. This research also suggests that accounting choice is used in relation to respond regulatory policy for maximizing economic benefits of the company.

The above conclusions are subject to limitations. First, because of the data availability this research is only able to develop expected current accrual using data from 2003 to 2006. Longer period estimation would give better estimation. Second, there are potential omitted variables in model because of many another detailed specification of government policy which have not captured yet in the model.

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