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Creative Accounting Model for Increasing Banking Industries' Competitive Advantage in Indonesia

Supriyati, Erida Herlina

STIE Perbanas, Surabaya

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Corresponding author:
supriyati@perbanas.ac.id

ABSTRACT

Bank Indonesia demands that the national banks should improve their transparency of financial condition and performance for public in line with the development of their products and activities. Furthermore, the banks' financial statements of Bank Indonesia have become the basis for determining the status of their soundness. In fact, they tend to practice earnings management in order that they can meet the criteria required by Bank Indonesia. For internal purposes, the initiative of earning management has a positive impact on the performance of management. However, for the users of financial statements, it may differ, for example for the value of company, length of time the financial audit, and other aspects of tax evasion by the banks. This study tries to find out 1) the effect of GCG on Earnings Management, 2) the effect of earning management on Company value, the Audit Report Lag, and Taxation, and 3) the effect of Audit Report Lag on Corporate Value and Taxation. This is a quantitative research with the data collected from the bank financial statements, GCG implementation report, and the banks' annual reports of 2003-2013. There were 41 banks taken using purposive sampling, as listed on the Indonesia Stock Exchange. The results showed that the implementation of GCG affects the occurrence of earning management. Accounting policy flexibility through earning management is expected to affect the length of the audit process and the accuracy of the financial statements presentation on public side. This research is expected to provide managerial implications in order to consider the possibility of earnings management practices in the banking industry. In the long term, earning management is expected to improve the banks' competitiveness through an increase in the value of the company. Explicitly, earning management also affects the tax avoidance; therefore, the banks intend to pay lower taxes without breaking the existing legislation Taxation Provisions.

INTRODUCTION

Bank Indonesia (BI) has asked all banking industries in Indonesia to be competitive in order that they can improve their financial performance in connection with the national banks' development of products and activities. It has been noted that their financial condition and performance can be measured by means of the achievement mechanism of Good Corporate Governance (GCG). According to this GCG, the banks must disclosetheir quantitative and qualitative information. Quantitative information can be seen from the annual financial statements which have been audited by a public accountant. On the contrary, the qualitative information can be viewed from various bank policies that have been implemented so that financial transparency can be understood by their users.

Good Corporate Governance (GCG) is a system of rules used to manage, supervise and regulate mutual relations between the company and stakeholders in an effort to achieve organizational goals. GCG can be defined as structures, systems and processes used by the organization of the company in an effort to provide the companies with value-added. The Organization for Economic Cooperation and Development or OECD cited by Zarkasyi (2008) stated that of corporate governance as well as the company's goals and also as a means to achieve the objectives and monitor performance. Surya & Yustiavandana (2008) defines GCG associated with effective decision making that aims to achieve profitable business, efficiently and effectively in managing risk and responsibility having regard to the interests of stakeholders. The implementation of GCG in banking industries was marked by the publication of the circular letter or SE 13/24 / DPNP dated October 25, 2011 on Assessment for Commercial Banks which obliges commercial banks to carry out self-assessment by using a risk approach (Bank Risk-based Rating). The risk approach includes the risk of Profile, GCG, Earnings, and Capital, which is generally abbreviated as RGEC. GCG approach, therefore, is an indicator measuring the health of banks is directed at elements of Transparency, Accountability, Responsibility, Fairness and independency. It has been noted that the four elements above are composed into 11 assessment indicators of GCG such as 1) The duties and responsibilities of the board of commissioners, 2) The duties and responsibilities of directors, 3) Completion and implementation of the tasks of the committee, 4) Handling of conflicts of interest, 5) The application of the compliance function, 6) The application of the internal audit function, 7) Application of external audit functions, 8) Application of risk management, 9) The provision of funds to related parties, 10) Transparency of financial and non-financial, 11) the bank's strategic plan.

The governance systemrelated to banks in Indonesia adopts a two-chambered structure (two-tier system), which separates the commissioners who have oversight function and the board of directors acting as a corporate executive. The BoC must establish a minimum of three special committees, namely audit committee,risk monitoring committee, and the remuneration and nomination committee in order to support the effective implementation of their tasks and responsibilities. The Board of Directors is fully responsible for the implementation of the bank management. To ensure compliance, the banks are obliged to appoint a Director of Compliance that is effectively to assist implementation. Besides that, they should form a Compliance Unit that is independent of their Operation units (SKO). Banks also appointed Public Accounting Firm (KAP) registered at Bank Indonesia in the audit of Financial Statements of the Bank.

The result of the measurement for the companies' performance is the basis for business decision-making on the profits yielded by the company. This is due to the importance of the predictive value. This makes the management able to manage good earnings so that the company's performance looks better as seen by external parties. In this case, earnings management is the manager's actions to improve (reduce) reported earnings at the present time, on the unit where the manager is responsible, without resulting in an increase (decrease) in long-term economic profitability of the unit (Widyaningdyah, 2004). Furthermore, earnings management is also defined as a process that is done deliberately in the range of the principles based on General Accepted Accounting (GAAP) to lead to a desired level on reported earnings. However, earnings management tends to be regarded as opportunistic behavior of managers to maximize utility (Opportunistic Earnings Management) and earnings management is viewed from the perspective of efficient contracting (Scott, 2006).

The above regulation makes the bank managers able to take the initiative to undertake earnings management of their banks in which they manage to meet the criteria required by Bank Indonesia (Nasution dan Setiawan, 2007). In addition, the action management to select accounting policies can raise or lower their corporate profits by accelerating the recognition of expenses or recognition of revenue delay. In that case, a creative step in earnings management is certainly strongly affected by the banks' condition and performance. For example, when a certain company that has been managed well, they can demonstrate good performance without having to perform earnings management. This is due to the fact that companies that are not well managed will tend to do the earnings management to maintain their reputation for the users of information. Scott (2006) found that earnings management is motivated by among others as follows: 1) get a bonus plan (bonus scheme), 2) reduce the likelihood of the company suffered a breach of contract (debt covenants), 3) obtain the ease and facility of government (political motivation), 4) minimize the amount of tax (taxation motivation), 5) maximize profit to increase his bonus, and 6) influence the decision of potential investors (initial public offering). Earnings management techniques and patterns that do exist are three techniques, namely: 1) Changes in accounting methods, 2) Playing policies accounting estimates, and 3) Shift the period expense or income.

The choice of accounting policy through earnings management is expected to affect the length of the audit process and the accuracy of the financial statement presentation on the public side (Audit Report Lag). Therefore, public accountants who perform audit process in companies, when perform earnings management, they tend to require a longer time. In addition, a compliance audit by public accountants can also affect the length of the completion of the audit report, but also it also affects an increase in the quality of the audit results. Increasingly, an audit in accordance with the standards require the longer time (Kartika, 2009). Audit or audit reporting lag delay is the length of time required by a public accountant's audit process. This is measured from the date of the financial statements until the date of publication of the financial statements audited. The audit delay or audit reporting lag can be divided into three, namely: 1) Scheduling lag, 2) Fieldwork lag, 3) Reporting lag (Knechel & Payne, 2001). The audit process is regarded as the need of time which resulted in an audit delay and this eventually and greatly affects the timeliness of financial reporting. When managers do earnings management, the manager will manipulate transactions in an effort towards increased profits benefit certain parties, although, it does not violate the existing accounting standards. The existence of earnings management certainly affects the process of audit work. In this condition, the auditor takes more time for detecting the presence or absence of earnings management.

In the long term, earnings management action is expected to improve the banks' competitiveness through an increase in the value of the company. Optimal profit is expected to increase the company's value so that more investors are interested to invest in the banking company. The company's value is determined by the investors' perception towards the company's which is often manifested in share price. The share price gain, further, demonstrates the value of the company's further increase. In addition, the company's value is determined by the strength of the profit shown on rising corporate profits. Increasing the value of the company can be described as the welfare owner of the company that sometimes, they encourage corporate managers to maximize the value of the company in various ways. There are several quantitative variables that can be used to estimate the company's value. Tobin's Q is a concept that shows the current estimates of the financial markets on the return value from every dollar of investment.

The new regulation of corporate governance is associated with a higher stock value, but they also found that the market had valued the company with better governance. However, several studies have found no evidence to support that weak governance causes stock returns worse. Again, another study also provided evidence that the independent commissioner is more negatively related to the company's performance. The company with a dominant and independent commissioner has worse performance than other companies and companies with more independent commissioners. They have almost the same performance with a company that has fewer independent commissioners.

In addition, the company as a normative taxpayer should also be willing to pay lower taxes so that they sometimes attempt to manage their tax payments without violating the existing legislation of the Taxation Provisions. Explicitly, all the efforts undertaken by earnings management can affect tax evasion. Financial Accounting Standard No. 46 on Income Taxes Accounting has brought significant changes regarding the procedure for the presentation of a tax on financial statements. it stated changes in tax collection system from official assessment system to self-assessment has prompted financial reporting practices to start presenting income tax expense in the income statement with an estimated amount, followed by reporting the estimated income tax debt in the balance sheet. Recognition assetsand deferred tax liabilities is a recognition of the future tax consequences of temporary differences cumulative effect of income and expense recognition for accounting purposes and tax purposes. The effect of changes should be treated as expense / deferred tax incomes (deferred tax expenses / income) and reported in the income statement of the current year together with current tax expenses with a separate presentation.

GCG mechanism proposed by an independent party is capable of reducing earnings management acts that occurred in the banking company. Research conducted by Annisa & Kurniasih (2012) shows that the better corporate governance will encourage management for performing earnings management and also seeking to minimize taxes, and even tax evasion. Governance conducted aimed at achieving the optimal profit. In order to maintain the consistency of this profit, companies tend to do earnings management effort. This earnings management effort is also an effort to reduce the tax burden without violating Provisions of Taxation.

There have been some studies that have provided empirical evidence on the causality of good corporate governance, earnings management, the value of the company, the audit report lag, on tax evasion. For example, research conducted by Kusuma (2007) showed that earnings management by discretionary accrual short term proved to have no effect on the relevance of earnings and book value of the company. Another one is the research by Kamau, Mutiso & Ngui (2012) that also proved that the tax evasion into several major factors could support the creation of creative accounting practices among private sector companies. Still the same with the Blaylock, Shevlin, & Wilson (2011), they also stated strongly that large positive book taxwas due to the practice of earnings management. In addition, earnings and accrual persistence affected the fundamental characteristics of tax evasion of the company. Another study was by Sudarno & Pendriani (2008), stating that the ownership of outsiders has an influence on the accuracy of financial reporting. Some policies and the results of previous studies have proved that the risk-based measures of earnings management has become an important issue in banking industries. These can trigger an increase in the competitiveness of banking in the future. Based on some previous studies and the arguments above, this study aims to find analyze 1) the effect of GCG on earnings management, 2) the effect of earnings management on company value, the audit report lag, and taxation, and 3) the effect of audit report lag on corporate value and taxation.

METHODS

As referred to the previous studies, and as it is supported by the existing theory, this study can be categorized as a quantitative study using secondary data from audited financial statements, annual reports, GCG implementation report, and ICMD years 2003-2013. The focus of the study is to test the effect of GCG on earnings management and also itseffect on the company's value, Audit Report Lag, and Taxation. The analysis was done by using a simple regression analysis.

Equation models 1: $Y = a + b_1 X_1 + e$

Y = earnings management
a = constant
b_1 = regression coefficients
X_1 = GCG
e = error term

equation models 2: $Y = a + b_1 X_1 + e$

Y = dependen variable (company value, audit report lag, tax avoidance)
a = constant
b_1 = regression coefficients
X_1 = earnings management
e = error term

The sampleconsists of banking industries in 2003-2013. The sampling technique used was survey method. The data were collected from audited annual financial statements (website www.idx.

Table 1. GCG Indicators

No	Rated Aspect	Rate (A)	Grade (B)	Value (A) X (B)
1	Duties and responsibilities performance of the board of commissioners	10.00%	0	0.000
2	Duties and responsibilities performance of the board of directors	20.00%	0	0.000
3	Committee task performance and completeness	10.00%	0	0.000
4	Interest Conflict handling	10.00%	0	0.000
5	Compliance and function implementation of bank	5.00%	0	0.000
6	Internal audit function implementation	5.00%	0	0.000
7	External audit function implementation	5.00%	0	0.000
8	Internal Control and Risk Management function implementation	7.50%	0	0.000
9	Fund providing to related party and big debtors	7.50%	0	0.000
10	Bank Financial and non financial condition, GCG performance report and internal reports	15.00%	0	0.000
11	Bank Strategic plan	5.00%	0	0.000
	Composite Value	100.00%		0.000

co.id), GCG implementation report obtained from the website of each bank) and ICMD. There were 41 banks listed on the Indonesia Stock Exchange and 11 of them had completed the bank's data.

The variables in the first year of this study cover bank's GCG is the banking system of governance as measured by eleven indicators and expressed in the form of a composite score. The second variable is earnings management which is the effort made by the manager to optimally manage earnings measured by using proxy Discretionary Accrual (DA) and the accrual model of Beaver and Engel (1996) by reason of this model in line with the accrual basis of accounting used by the banking industry.

The above model uses the components of the allowances for loan losses and financial provision of the loan as forming part of a total accrual in the banking industries. The third variable is the company's value based on the investors'perception towards the company's which is often manifested in share price. The company's value is measured by Tobin's Q. The four models are Audit Report Lag that is a lapse of time between the completions of field work with the auditor's report, and the fifth is variable taxation (Tax Avoidance) will be proxied by calculating BOOK-TAX GAP ÷ total assets.

The analysis was done by means of linear regression. Some of stages prior to testing were done to test the classical assumption to avoid being biased. The data analysis underwent stages as follows: 1) descriptive analysis of each variable, 2) test the classical assumption, 3) testing the hypothesis that begins with coefficient determination test and partial test (t test)

RESULTS AND DISCUSSION

The data in this study were obtained from audited annual financial statements, GCG implementation report, and ICMD years 2008-2013, except for those dealing with earnings management, they were taken from 2003. It shows, from 41 banks listed in the Indonesia Stock Exchange (ISE), only 11 banks who have complete data and can be processed, totally there were 66 processed data.

The description testing of company governance (GCG) shows the results of descriptive statistics composite value of 15 sample banks in the stu-dyhave average composite score of 1.61 or Pret-ty Good category. Good Corporate Governance (GCG) implementation shows that there are 59 data (65.6% of 90 data) received below the ave-rage composite value or as many as 15 sample banks already have goodgovernance of the com-pany, while the remaining 34.4% received above average composite value which indicates that the banks still don't have good governance of the company. Banks that get less than 1.5 composite value with excellent predicate of GCG implemen-tation during the years of 2008 to 2013 were 47 data (52.2%), while the good predicate of GCG implementation were 40 data (40%), pretty well predicate were 5 data (5.6%) and not good predi-cate of company governance was in the amount of 2.2%. It can be concluded that most of the sample banks already have excellent governance of the company. This is in line with the demands of Bank Indonesia, that banks should be able to demons-trate a better level of health.

Descriptive testing of earnings management indicates that Discretionary Accrual value of sample banking companies in this study every year are positive. It shows that managers in the bank have done earnings management action by increasing profits. The profit improvement can be seen from the instrument of earnings management which is decreasing loss reserves value in 2010-2013, thus increasing profits. The figure below shows that the average value of Discretionary Accrual from sample banks increased in 2009 and decreased in the period of 2010-2013. It is as a result of changes in PSAK No. 50 (1998) and PSAK No. 55 (1999) to PSAK No. 50 (revised 2006) on the presentation and disclosure of financial instruments and PSAK No. 55 (revised 2006) on the recognition and

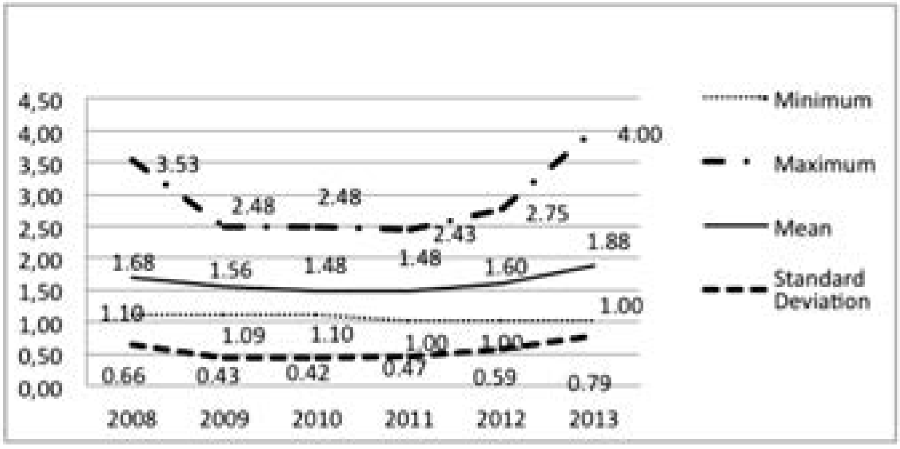

Figure 1. GCG Banking Developments Year 2008-2013
Source: GCG Implementation Reports

measurement of financial instruments which refer to the International Accounting Standard (IAS) 39 and IAS 32.

Tax evasion is an arrangement to minimize or eliminate the tax burden taking into account the tax incurred. Descriptive test results shows that the average value of the tax evasion has decreased in the period of 2008-2010, while in the period of 2011-2013 has increased. Effort in doing the act of tax avoidance is still being done although the rules in preparing the financial statements are tightened. Bank Indonesia Regulation concerning Commercial Bank health rating which is No. 13 / I / PBI / 2011 has made banks take action to improve the banking company's profits in order to obtain a good or healthy predicate from Bank Indonesia.

Audit Report Lag is the length of time of the audit completion, counted in the number of days from the date of year-end closing until the date of the independent auditor's report completed. According to regulations of the Decision of Chairman of Capital Market and Financial Institutions Supervisory Agency KEP-346 / BL / 2011 Number XK2, stating annual financial statement shall include a public accountant's report and then submitted to the Capital Market and Financial

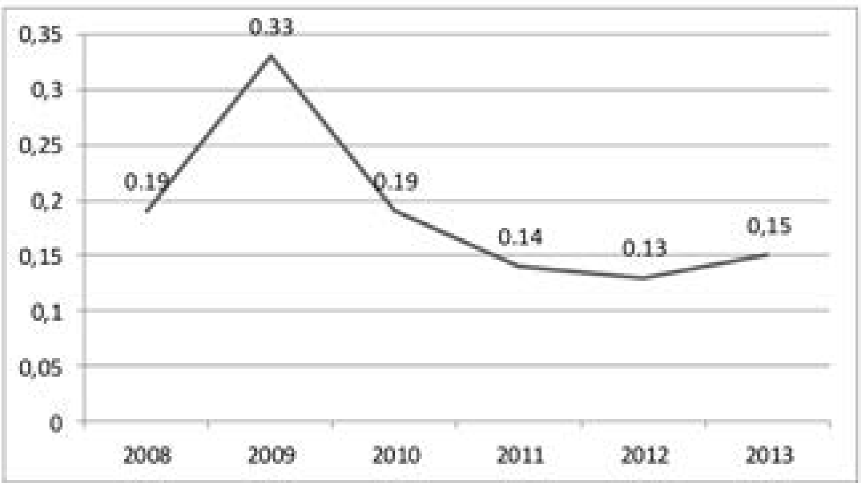

Figure 2. Banking Earnings Management Developments Year 2008-2013
Source: Financial Statements

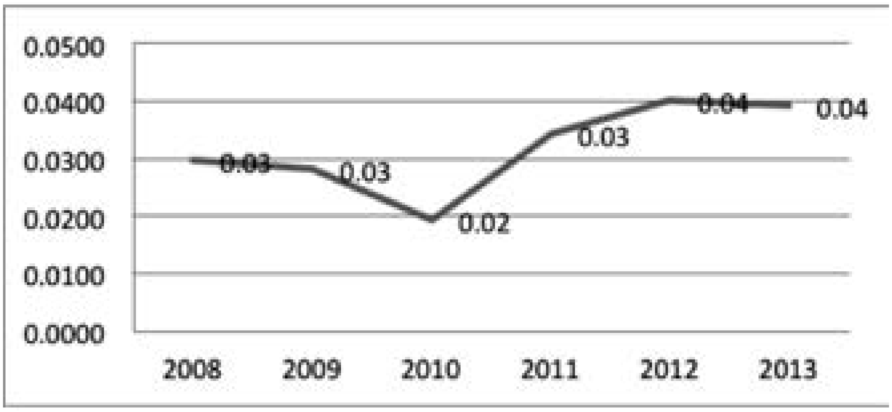

Figure 3. Development of Banking Tax Avoidance Year 2008-2013
Source: Financial Statements

Institutions Supervisory Agency by the end of the third month or March 31 (90 days) after the date of the annual financial statement. The descriptive testing results showed Audit Report Lag average is 66 days. There are as many as 56% of banking year 2008-2013 at above average and below average as much as 44%. This shows the banking companies are likely to report their financial statements in a timely manner. The faster delivery of financial statements will be helpful in decision making.

The company's value in this study demonstrates the value of companies has an average value for the Tobins-q for all samples is 1.165663 for four years with a standard deviation of 0.6036908. Banking has the tendency to have high market share price or company's value better in the eyes of investors so that investors prefer to plant a stake in the bank. The banking industry appears to have better prospects. Ease of transactions, improvementof services quality, and increasein the number of customers, making the banking industry increasingly in demand by investors. This condition is expected to provide favorable outcome for investors.

The normality test results show that data are normally distributed with a summary of the test results as follows:

Table 1. Result of Normality Test

Variables	Test Results
GCG towards Earnings Management	0.249
Earnings management towards company's value	0.970
Earnings management towards *Audit Report Lag*	0.580
Earnings management towards Tax avoidance	0.573
*Audit Report Lag*towardsTax avoidance	0.916
*Audit Report Lag*towards company's value	0.810

The researcher tested the classical assumptions to determine whether there is a problem of multicollinearity, autocorrelation, heterocedasticity and normality. The next is the results of regression testing, stating that there are only two hypotheses are acceptable and have significant value under 0.05, meaning that GCG has an effect on earnings management and this earnings management also affects the company's value. Meanwhile, earnings management has no significant effect on the audit report lag and tax avoidance or tax evasion. Similarly, the audit report lag has no significant effect on the company's value and tax evasion.

Table 2. Result of Hypothesis Testing

Variables	Sig
GCG towards Earnings Management	0.003
Earnings management towards company's value	0.258
Earnings management towards *Audit Report Lag*	0.774
Earnings management towards Tax avoidance	0.016
Audit Report Lag towards Tax avoidance	0.244
Audit Report Lag towards company's value	0.219

The GCG Implementation indicates that the bank is healthy. The condition drives the banks to meet the requirements of governance and report on the GCG implementation well with self assessment. Governance as set by Bank Indonesia for the banking industry isobligatory requirements that must be met by all banks in Indonesia. It is intended to keep the banking operations and the other parties' funds that are deposited into the bank. The numbers of banking cases that occurred are suspected because of the irregularities in its governance, which can harm others, especially customers and investors.

Efforts to maintain consistency in the management of public funds with better implementation of governance, seems to affect the efforts to perform earnings management. Banking seeks to keep healthier financial condition and because of that, various accounting policies are directed to increase the maximum profit. Leeway in the selection of accounting policies is a strategy to perform earnings managements. This means that the financial statements are free of material misstatement. Moreover, it seems that this accounting policy is also geared to meet the interests of tax payments. Efforts to minimize tax payments without violating tax laws can be done with the selection of appropriate accounting policies, for example enlarging deductible expense or reducing taxable income. The reliability presentations of financial statements can increase the levels of public confidence in the banking industries. It is also proven that the societies have no doubt towards the financial performance of banks and this eventually makes them more enthusiastically invest their funds. This condition causes the measured value of the company to give better stock price which can be responded by the community.

On the contrary, earnings management as undertaken by the banking industries does not have effect on the duration of the audit process conducted by auditors and company's value. The duration of the conducted audit process is purely caused by the internal auditor or public accounting firm (KAP) among others: 1) The KAPs in particular that have been affiliated with the Big Four must be very strict in compliance with auditing standards. Several series of procedures should be run and must be met when auditing banks have been published in ISE. This must make the audit process that is longer. 2) Low levels of competence in audit controls, especially the banking industry business processes and this also causes the longer audit process. 3) Every bankshave appointed an audit committee which regularly perform operational control of the bank.

The achievement of the company's value in the banking industry is purely due to a better banking image and not because of the earnings management elements conducted in the banking system. Society assumes that banks are the only financial institution able to accommodate their funds and distribute funds legally, and banking is able to ensure the safety of their funds. Likewise, investors are very interested to invest their funds in the banking industry because banks have better prospects in the future, let alone supported by transparent accountability.

MANAGERIAL IMPLICATIONS

The health rate of the banking industry seems to be in line with the demands of society. Society as funders needs information that is transparent and accountable for the management of those funds that can be used as a basis for consideration and decisions regarding their funds. On the other hand, that high demand for Bank Indonesia and the people make the banking industry seeks to be able to present the financial statements on a timely basis and also to show a good performance.

The implication of this study is that the banking industry has made continuous efforts to improve governance in order to achieve better health rates. The banking industry will seek to achieve better performance with, among others 1) choose accounting policies that have an impact on improved earnings and banks' performance as set forth in Financial Accounting Standards, 2) choose accounting policies that are tailored to the Legislation of Taxation in order to save on tax payments without having to violate it, 3) enhance the role of internal audit committee to oversee the banking operations so it will be able to achieve good governance and better performance, 4) the banking industry must constantly improve their service and expand the excellent products to the society to be able to attract funds from them.

Implementation of Good Corporate Governance is still a major concern in the banking sector. This research is expected to provide managerial implications in order to consider the possibility of earnings management practices in the banking industry. This is because that the health of banks is measured on the size of financial reporting in addition to the risks faced. Management should implement GCG as supporting the soundness of the banking system. For banking industries the management should determine accounting policies to maximizing the company's value so that in the long term. In this case, it can affect the quality of reported earnings. Another creative step in earning management must have been influenced by the condition and performance of the banks.

CONCLUSION

It can be concluded that Bank Indonesia still demands the banks that they should improve the transparency of financial condition and performance for the public in line with the development of products and activities of national banks. For that reason, their financial condition and performance must be measured using a mechanism of achievement of Good Corporate Governance (GCG) and they should also disclose their quantitative and qualitative information. In terms of quantitative information, it can be seen from the annual financial statements that must be audited by a public accountant.

Bank Indonesia uses the financial statements as the basis for determining the status of a bank. For example, they use it to see whether a bank is healthy or not. The management should choose accounting policies with the aim of maximizing the company's value so that in the long term, it can affect the quality of reported earnings. Another creative step in earning management must have been influenced by the condition and performance of the banks. In order that the banks can get their soundness, their management has to do earnings management well. This effort is said to be an attempt for earnings management. This earnings management has a good impact on several factors such as the company's value, the length of the audit process, and the presence or absence of tax evasion.

This is a quantitative research using secondary data in the form of annual audited financial statements, GCG implementation report and ICMD starting in 2003-2013. It has 66 of the 11 banks and these data were processed. The normality test results stated all data were normally distributed. The results of regression testing stated that GCG has a significant effect on earnings management. Besides that, earnings management also has an effect on the tax evasion. Banking wants to able to produce a good performance which will be shown on the achievement of maximum profit, so banking attempts to choose accounting policies that will generate maximum profit. However, earnings management effort is actually also has an impact on efforts to save on tax payments, but do not violate tax laws.

This study also proves that the efforts of banks to perform earnings management has no effect on the company's value and timeliness of financial statement presentation. The high interest of investors in the banking industry is not solely due to the achievement of maximum profit, but rather on the image in both management and distribution of public funds that had been established when compared to other financial institutions. Good governance mechanisms that impact on the precise presentation of financial statements is expected by the society. This will increasingly add public confidence in the banking industry.

There are some limitations in this study concerning the research data such as 1) some banks did not publish periodic reports, 2) there's still no standardization in the implementation of GCG reports.The researchers suggest that further research be made better by seeking a referral from another sourcessuch as from Bank Indonesia and Indonesia Stock Exchange directly, and also looking for the subject of observations in addition to the banks so that they can get more data. ■

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