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**THE INFLUENCE OF AUDITOR REPUTATION, AUDIT FIRM INDUSTRY SPECIALIZATION, AND AUDIT FIRM TENURE ON REAL EARNINGS MANAGEMENT WITH BOOK-TAX DIFFERENCES AS A MEDIATOR****Fandy Arman Nulhakim<sup>1a</sup>, Syahril Djaddang<sup>2b</sup>, Darmansyah<sup>3c</sup>, Harnovinsah<sup>4d</sup>**<sup>123</sup>Faculty of Economy and Business, Universitas Pancasila, Jakarta, Indonesia[<sup>1a</sup>5522220021@univpancasila.ac.id](mailto:5522220021@univpancasila.ac.id), [<sup>2b</sup>syahril@univpancasila.ac.id](mailto:syahril@univpancasila.ac.id), [<sup>3c</sup>darmansyah@univpancasila.ac.id](mailto:darmansyah@univpancasila.ac.id), [<sup>4d</sup>harnovinsah@univpancasila.ac.id](mailto:harnovinsah@univpancasila.ac.id)**ARTICLE INFO****Received:** 16 December 2025;**Accepted:** 6 February 2026;**Publish:** 6 February 2026;Volume 31. Number 1,  
January 2026, pp. 37-45<http://doi.org/10.23960/jak.v31i1.4569>**ABSTRACT**

This study examines the influence of auditor reputation, industry specialization of Public Accounting Firms (PAFs), and PAF tenure on real earnings management (REM), with book-tax differences (BTD) acting as a mediating factor. Drawing on agency, signaling, stewardship, and institutional theories, the research explores how these audit attributes interact with information asymmetry to affect corporate reporting practices. A quantitative design was employed, focusing on 72 consumer goods companies listed on the Indonesia Stock Exchange between 2021 and 2023, using purposive sampling to select 35 firms, yielding 105 firm-year observations. Data was gathered from financial statements and annual reports and analyzed through Structural Equation Modeling-Partial Least Squares (SEM-PLS) with SmartPLS 4. The findings reveal that auditor reputation and industry specialization significantly impact REM, while PAF tenure and BTD do not show direct effects. However, BTD serves as a partial mediator, linking auditor characteristics to REM, illustrating an indirect influence of audit quality on reporting practices. The model reports  $R^2$  values of 3.0% for BTD and 55% for REM, suggesting a moderate predictive ability. The study emphasizes the importance of audit quality in shaping reporting outcomes in emerging markets. Limitations include a short observation period and reliance on a single measure for several variables, suggesting areas for future research.

**Keywords:** Audit Firm Industry Specialization (AFIS), Auditor Reputation, Book-Tax Differences, PAF Tenure, Real Earnings Management (REM)

**ABSTRAK**

Penelitian ini mengkaji pengaruh reputasi auditor, spesialisasi industri dari Kantor Akuntan Publik (KAP), dan masa kerja KAP terhadap manajemen laba riil (REM), dengan perbedaan buku-pajak (BTD) berperan sebagai faktor mediasi. Berdasarkan teori agensi, signaling, stewardship, dan institusional, penelitian ini mengeksplorasi bagaimana atribut audit tersebut berinteraksi dengan asimetri informasi untuk mempengaruhi praktik pelaporan perusahaan. Desain kuantitatif digunakan, dengan fokus pada 72 perusahaan barang konsumsi yang terdaftar di Bursa Efek Indonesia antara 2021 dan 2023, menggunakan purposive sampling untuk memilih 35 perusahaan, menghasilkan 105 pengamatan perusahaan-tahun. Data dikumpulkan dari laporan keuangan dan laporan tahunan dan dianalisis melalui Structural Equation Modeling-Partial Least Squares (SEM-PLS) menggunakan SmartPLS 4. Hasil penelitian menunjukkan bahwa reputasi auditor dan spesialisasi industri berpengaruh signifikan terhadap REM, sementara Tenure KAP dan BTD tidak menunjukkan pengaruh langsung. Namun, BTD berfungsi sebagai mediator parsial, menghubungkan karakteristik auditor dengan REM, menunjukkan pengaruh tidak langsung dari kualitas audit terhadap praktik pelaporan. Model tersebut melaporkan nilai  $R^2$  sebesar 3,0% untuk BTD dan 55% untuk REM, menunjukkan kemampuan prediktif yang sedang. Studi ini menekankan pentingnya kualitas audit dalam membentuk hasil pelaporan di pasar yang sedang berkembang. Keterbatasan meliputi periode observasi yang singkat dan ketergantungan pada satu ukuran untuk beberapa variabel, yang menunjukkan area untuk penelitian di masa depan.

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**Kata Kunci:** Book-Tax Differences, Manajemen Laba Riil (REM), Reputasi Auditor, Spesialisasi Industri Kantor Akuntan Publik (KAP), Tenure KAP



## A. INTRODUCTION

Financial statements serve as the primary instrument through which companies communicate information to their stakeholders. They disclose the financial condition, performance, and prospects of an entity, enabling both internal and external users to make informed economic decisions. One of the most critical elements in financial statements is information on earnings, which functions as a central indicator of financial performance and reflects the company's ability to sustain operations in the future. High-quality earnings are those that not only portray current performance accurately but also provide a reliable depiction of long-term economic prospects (Anderson & Rahiminejad, 2025).

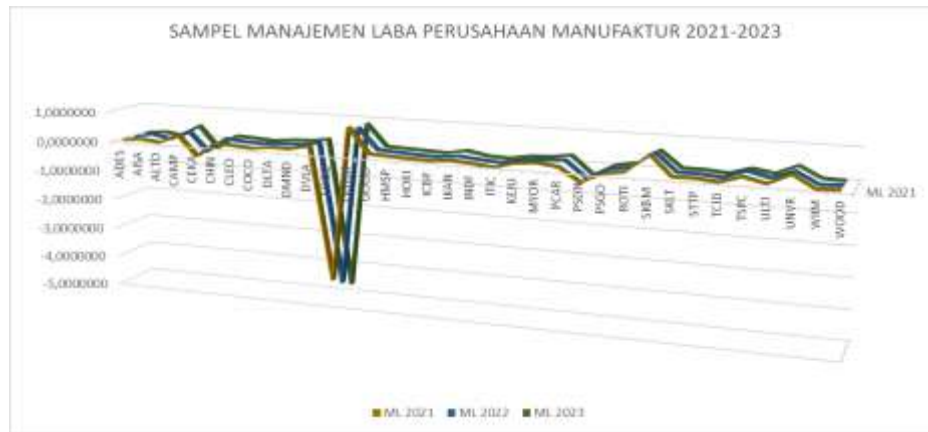
The Indonesian Financial Accounting Standards (PSAK) No. 1 (Revised 2023) emphasize that general purpose financial statements must be prepared in a structure and format that ensure comparability across entities. The primary intention behind such standardization is to enhance transparency, reliability, and interpretability of the information presented. However, despite the existence of these standards, deviations from proper reporting practices frequently arise due to managerial incentives to portray a more favorable financial position. Companies sometimes exploit the flexibility embedded within accounting standards by altering certain components in the financial statements to generate more attractive earnings figures (Chyntia Tessa & Harto, 2016).

Such deviations are closely linked to earnings management practices. Earnings management occurs when managers select specific accounting methods or engage in operational actions designed to achieve targeted earnings figures (Astvansh, Wang, Chen, & Qu, 2024). Although these actions might still fall within the permissible boundaries of accounting standards, they often satisfy the conversion and concealment elements of fraudulent behavior because managerial decisions alter the structure of transactions and obscure the company's actual condition (Aljifri & Elrazaz, 2024). Consequently, earnings management can be considered a form of manipulation that has the potential to harm investors, creditors, and other users who rely on financial statements for decision-making.

The implications of earnings management are far-reaching. It diminishes earnings quality, reduces the reliability of financial information, and weakens investors' confidence (Beyer, Guttman, & Marinovic, 2019). Stakeholders may form misguided assessments of risk and performance due to distorted earnings reports, resulting in suboptimal economic choices. Over time, the erosion of financial reporting credibility can disrupt the allocation of capital in financial markets and generate broader economic inefficiencies.

The significance of earnings management becomes more apparent when examining empirical evidence from manufacturing companies in the consumer goods sector during the 2021–2023 period. Based on data from the Indonesia Stock Exchange and statistical processing, the analysis of 35 sampled firms reveals notable variation in real earnings management (REM) as measured through abnormal discretionary expenses (ABSDISX). For instance, in 2021, PT Gudang Garam Tbk recorded a management earnings ratio of 0.951, indicating a strong use of discretionary expenditure adjustments relative to the prior year. Meanwhile, PT Sentra Food Indonesia Tbk posted a value of -4.694, reflecting weaker earnings management efforts through discretionary spending.

The use of abnormal discretionary expenses as an indicator of REM is grounded in strong theoretical and methodological justification. Firas and Kuncoro (2026) posits that operational manipulation through reductions in discretionary costs—such as advertising, research and development, and administrative expenses—is one of the primary forms of real earnings management. Such reductions elevate short-term income but may undermine long-term financial health, as these expenditures typically support sustained growth. Research by Aggianti and Novita (2024) corroborates that low ABSDISX values indicate a high degree of real manipulation. In the context of the manufacturing sector, this indicator is particularly relevant because discretionary costs constitute a substantial proportion of total expenses and are highly sensitive to managerial decision-making.



**Figure 1.** Sample Real Earning Management Manufacture Corporate 2021-2023

Source: (IDX Team, 2024) data proceed SPSS ver 23

Empirical observations further show that in 2023, REM levels exhibited improvement compared to 2022, as reflected by ABSDISX values trending closer to zero. This suggests adjustments in business strategies and financial reporting behavior following earlier economic disruptions. Manufacturing companies in the consumer goods sector appear to be returning to more stable and rational earnings reporting practices, in line with increased national economic activity and rising domestic demand.

Despite signs of improvement, fundamental challenges remain in understanding the incentives and determinants that drive earnings management practices. These determinants include not only internal managerial decisions but also external governance mechanisms such as audit quality and regulatory components represented through Book Tax Differences (BTD) (Machdar & Nurdiniah, 2018). Within the lens of agency theory, managers possess incentives to maximize their personal utility, whereas shareholders seek accurate financial information. This information asymmetry underscores the necessity of high-quality external audits to monitor managerial behavior.

Auditor quality is consistently identified in the literature as one of the pivotal factors affecting earnings management (Arif & Lastanti, 2023). Auditors from reputable firms—particularly Big Four audit firms—are considered more capable of maintaining independence and providing high-quality audit services (Hapsoro & Santoso, 2018; Umniyah & Umainah, 2025). Since the loss of a client does not significantly impact their operations, Big Four auditors face reduced pressure to comply with managerial preferences. Studies by Sitanggang, Karbhari, Matemilola, and Ariff (2020) and Marlisa and Fuadati (2016) provide evidence that auditor reputation exerts a negative influence on earnings management, implying that firms audited by prestigious auditors are less likely to engage in manipulation due to the auditors' strong enforcement power.

Industry specialization is another factor widely recognized for its role in enhancing audit quality (Carp & Istrate, 2021). Auditors who frequently serve clients within the same industry develop superior knowledge of the industry's characteristics and reporting patterns (Bawuah, 2024). This specialized expertise enables auditors to identify irregularities and detect manipulation more effectively. Empirical findings by Yasmin, Yudha, and Saif (2024), Sari and Wahidahwati (2016), and other scholars reinforce the conclusion that auditor industry specialization negatively correlates with earnings management.

Audit tenure, referring to the length of the auditor-client relationship, also influences audit quality and earnings management (Liao, Chen, Sang, & Tseng, 2020; Suwaldiman & Rheina, 2023). Longer tenure may contribute to a deeper understanding of the client's operations, thereby improving detection capabilities. However, extended relationships may also compromise auditor independence. Prior studies yield mixed results. Lathifannisa, Ekawati, and Syarif (2026) and Al-Thuneibat et al. (2011) indicate that audit tenure affects audit quality and may be associated with increased discretionary accruals when excessively prolonged. Thus, audit tenure remains a variable warranting further investigation in relation to REM (Lennox, Li, & Ou, 2025).

Book Tax Differences also play an important role in indicating potential manipulation and aggressive financial reporting (Nurseto & Bandiyono, 2021). BTD represents disparities between accounting profit and taxable profit arising from temporary and permanent differences. Palupi (2025) reveal that both positive and negative BTD significantly influence earnings management. Conversely, studies such as Ramadhani, Wiryaningtyas, and Subaida (2022), focusing on the banking industry, report no significant relationship due to the heavily regulated nature of

the sector. In the manufacturing industry, however, BTD may serve as a meaningful proxy for detecting both accounting-based and tax-based manipulations, making it a suitable mediating variable for understanding REM (Nebie & Cheng, 2023).

This research extends the framework of Sitanggang et al. (2020), who examined audit quality and real earnings management in the UK manufacturing sector, by introducing Book Tax Differences as a mediating variable in the Indonesian context. Manufacturing firms are selected due to their complex cost structures, substantial discretionary expenditures, and heightened exposure to reporting and regulatory pressures, all of which render them susceptible to earnings management.

To address this gap, the present study strategically selects auditor reputation, audit firm industry specialization, and audit firm tenure as core audit variables, as these dimensions collectively capture the multidimensional nature of audit quality from both competence and independence perspectives. Auditor reputation—commonly associated with Big Four affiliation—serves as a signal of audit credibility, independence, and enforcement strength, which is expected to limit managerial discretion in manipulating real activities. Audit firm industry specialization reflects auditors' sector-specific expertise, enabling superior detection of abnormal operational patterns and industry-specific manipulation techniques. Meanwhile, audit firm tenure captures the dynamic trade-off between accumulated client knowledge and potential familiarity threats, making it a critical yet inconclusive determinant of earnings management behavior.

Therefore, this study aims to rigorously examine the influence of auditor reputation, auditor industry specialization, and audit tenure on real earnings management, while also assessing the mediating role of Book Tax Differences. The findings are expected to contribute meaningful theoretical and empirical insights to the accounting literature, enhance understanding of REM determinants, and offer policy recommendations for regulators, auditors, and investors in mitigating financial reporting manipulation.

## B. LITERATURE REVIEW

Agency Theory explains the contractual relationship between principals (shareholders or investors) and agents (managers), where decision-making authority is delegated to managers to operate the firm on behalf of owners (Jensen & Meckling, 1976; Jao & Pagalung, 2011). This separation between ownership and control creates potential conflicts of interest, as managers may not always act in the best interests of shareholders. Such conflicts are intensified by information asymmetry, where managers possess superior information about firm operations compared to principals (Auliya & Januarti, 2015). As a consequence, agency problems and risk-sharing issues arise due to differences in objectives, risk preferences, and monitoring costs between principals and agents (Wiyarsi, 2012). These conditions provide incentives for earnings management, as managers may manipulate reported earnings to maximize personal benefits such as bonuses, reputation, or job security (Beneish, 2008; Healy & Wahlen, 1999).

Earnings management refers to managerial discretion in financial reporting used to influence reported earnings without violating accounting standards (Pambudi & Ghozali, 2013). It can be opportunistic, aiming to mislead stakeholders, or informative, serving as a communication tool to convey private information to investors (Scott, 2019). Prior studies identify several earnings management patterns, including taking a bath, income minimization, income maximization, and income smoothing (Scott, 2019). Furthermore, earnings management is classified into cosmetic (accrual-based) and real earnings management. Cosmetic earnings management manipulates accruals without affecting cash flows, while real earnings management alters actual business activities, such as sales manipulation, overproduction, and reductions in discretionary expenditures, often with long-term economic consequences (Astvansh et al., 2024; Srivastava, 2019).

In the context of financial reporting credibility, auditor reputation plays a critical role in mitigating information asymmetry. Reputable auditors, particularly Big 4 firms, are perceived to provide higher audit quality and stronger assurance, thereby constraining earnings management and enhancing investor confidence (Kanagaretnam et al., 2010; Lennox et al., 2025). Auditor industry specialization further strengthens audit quality, as specialized auditors possess deeper knowledge of industry-specific risks and accounting practices, leading to more effective audits (Balsam et al., 2003; Reichelt & Wang, 2010).

Signaling Theory suggests that firms use external mechanisms such as auditor reputation, industry specialization, and book-tax differences (BTB) to signal financial reporting quality to the market (Christensen et al., 2016). Large BTBs may indicate aggressive earnings management, although they may also reflect

legitimate tax planning strategies (Donohoe & Knechel, 2014). Complementing this perspective, Stewardship Theory assumes managers act as responsible stewards motivated to achieve organizational goals, with high-quality auditors supporting transparency and accountability (Dunn & Mayhew, 2004; Jide et al., 2025). Lastly, Institutional Theory highlights that auditing practices are shaped not only by regulations but also by professional norms and institutional pressures within the audit environment (Scott, 2019).

At its core, the tension within corporate governance stems from Agency Theory, which describes the friction inherent when shareholders (principals) delegate decision-making power to managers (agents). This separation of ownership and control often leads to a "clash of interests," exacerbated by information asymmetry—a situation where managers hold the upper hand in operational knowledge. When managers prioritize personal gains like bonuses or job security over shareholder wealth, they may engage in earnings management. This practice ranges from "cosmetic" accrual manipulations to "real" interventions in business activities, such as overproduction or cutting essential R&D, which can jeopardize a firm's long-term health.

To counter these opportunistic behaviors, firms rely on external validation and signaling mechanisms to restore investor trust. Signaling Theory posits that hiring high-reputation auditors, particularly from the Big 4, or utilizing industry specialists serves as a "green flag" to the market, suggesting high-quality financial reporting and constrained management discretion. While large book-tax differences (BTD) can sometimes signal aggressive accounting, the presence of a reputable auditor acts as a crucial filter. This perspective is further enriched by Stewardship Theory, which views managers as inherently motivated to act in the organization's best interest, and Institutional Theory, which suggests that audit quality is not just a regulatory hurdle but a product of professional norms and environmental pressures. Together, these frameworks illustrate a complex ecosystem where rigorous auditing serves as the primary bridge over the transparency gap created by agency conflicts.

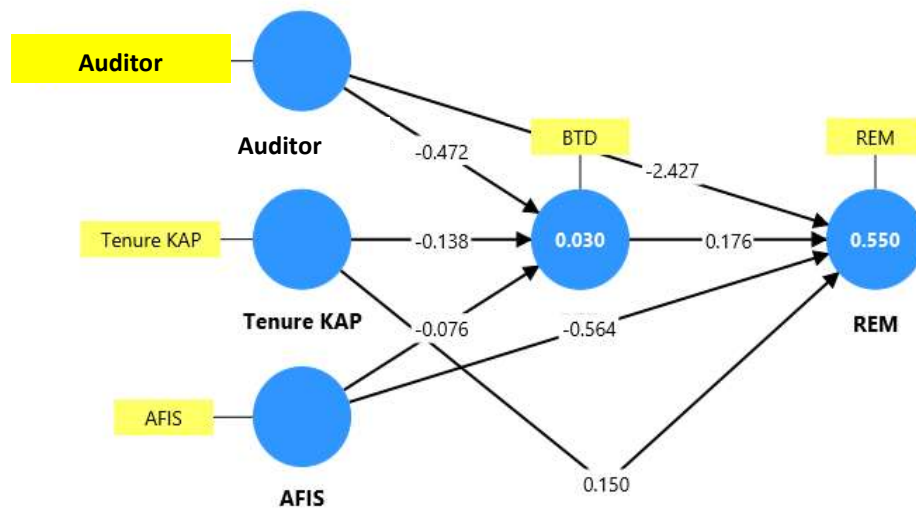
### **C. RESEARCH METHODOLOGY**

The type of research used is descriptive with a quantitative approach, using analysis methods on financial statements. This research essentially uses a deductive-inductive approach. This research uses an analysis type on financial statements that can explain 3 independent variables (auditor reputation, audit firm industry specialist, and audit firm tenure) to one dependent variable (real earnings management) with one variable, namely BTD, as a mediating variable. The study employs literature review and documentation to gather secondary data from journals, reports, and corporate documents. Financial statements and annual reports of 35 manufacturing issuers (105 samples) were sourced from the Indonesia Stock Exchange for 2021–2023. Additional references from magazines, online sources, and relevant literature supported the analysis, enabling comprehensive coverage of the research context.

### **D. RESULT AND DISCUSSION**

The inner model analysis aims to test the structural relationships between latent variables in the research model, both direct and indirect effects, as well as to assess the predictive strength of the model through the R-Square ( $R^2$ ) value. Based on the data processing results visualized in the image above, this model consists of three exogenous variables, namely Auditor Reputation, KAP Tenure, and AFIS, and two endogenous variables, namely BTD (Book-Tax Differences) and REM (Real Earnings Management).





**Figure 2.** Data Processing Results Using SMART PLS Ver 4

The  $R^2$  results reveal contrasting model strengths. BTD shows weak explanatory power at 3%, indicating substantial influence from external factors. Conversely, REM achieves a robust 55%, reflecting strong predictive capacity. These findings suggest that while earnings management is well-captured by the model, variations in book-tax differences remain driven largely by factors beyond the specified pathways.

### Indirect Effect

**Table 1.** Indirect Effect Between Variable

	Path coefficients
AFIS -> BTD	-0.076
AFIS -> REM	-0.564
BTD -> REM	0.176
Audit Reputation -> BTD	-0.472
Audit Reputation -> REM	-2.427
Tenure KAP -> BTD	-0.138
Tenure KAP -> REM	0.150

Source: data proceed by SEMPLS version 4

The findings of this study provide a comprehensive overview of how auditor characteristics and book-tax differences (BTD) shape earnings management (REM) practices within firms. The first result shows that auditor reputation has a strong negative effect on BTD ( $\rho = -0.472$ ), indicating that highly reputable auditors are able to tighten reporting practices, thereby reducing the gap between commercial and fiscal profits. This influence is statistically significant, thus supporting the proposed hypothesis. Auditor tenure also demonstrates a negative effect on BTD ( $\rho = -0.138$ ), although with a smaller coefficient. This suggests that longer auditor-client relationships may enhance monitoring effectiveness, even if the magnitude is not as substantial as the effect of auditor reputation. In addition, auditor industry specialization (AFIS) contributes to a reduction in BTD ( $\rho = -0.076$ ), with a consistently negative and statistically significant relationship.

Meanwhile, the relationship between BTD and REM shows a positive direction ( $\rho = 0.176$ ), implying that larger book-tax differences may correspond with a higher likelihood of real earnings manipulation. However, this relationship is statistically insignificant, meaning the proposed hypothesis is not empirically supported. At the auditor level, reputation again plays an important role in mitigating earnings management, as reflected in a large and significant negative coefficient ( $\rho = -2.427$ ). Conversely, auditor tenure exhibits a positive influence on REM ( $\rho = 0.150$ ), suggesting the possibility of declining auditor independence in long-term relationships, although the effect is statistically insignificant. Finally, AFIS displays a negative influence on REM ( $\rho = -0.564$ ) and is statistically significant, indicating that the adoption of audit-related technology strengthens audit quality and reduces opportunities for earnings manipulation.

### Direct Effect

**Table 2.** Direct Effect Between Variable

	Specific Indirect Effects
AFIS -> BTD -> REM	-0,013
Reputasi Auditor -> BTD -> REM	-0,083
Tenure KAP -> BTD -> REM	-0,024

Source: Data proceed by SEM-PLS version 4

The results of this study illustrate the dynamics among variables that influence real earnings management (REM), with particular emphasis on the mediating role of Book–Tax Differences (BTD). These findings reveal how audit quality, the auditor–client relationship, and audit firm industry specialization operate like interlinked control levers that shape a company’s tendency to engage in real activity manipulation, both directly and indirectly.

First, the indirect effect of auditor reputation on REM through BTD demonstrates a consistent and statistically significant mediation pattern. Auditor reputation reduces BTD through stricter monitoring mechanisms. When highly reputable auditors conduct the audit, companies tend to limit accounting choices that could widen the gap between book income and taxable income. Because BTD is found to have a positive effect on REM, any reduction in BTD automatically decreases the likelihood of real earnings manipulation. The p value of  $-0.083$  confirms that this mediation effect is statistically significant, thus supporting hypothesis 8. This finding strengthens the literature suggesting that high-reputation auditors impose a disciplining effect that deters firms from engaging in income smoothing through operational activities.

Second, audit tenure also demonstrates a significant indirect effect on REM through BTD, although its magnitude is relatively small. Longer auditor–client tenure is associated with lower BTD, reflecting that a more stable working relationship can enhance audit quality and deepen the auditor’s understanding of the client’s characteristics. This effect reduces the firm’s opportunities to exploit BTD as a pathway for manipulating real earnings. With an indirect p value of  $-0.024$ , hypothesis 10 is accepted, indicating that—even with minimal effect size—consistent audit engagement contributes to curbing earnings manipulation through its mediating influence.

Third, audit firm industry specialization (AFIS) is also shown to have a negative indirect effect on REM through BTD. Industry-specialist auditors, equipped with deeper knowledge of sector-specific patterns, are better able to detect accounting irregularities that may inflate BTD. This reduces the strategic space available to managers seeking to use BTD as a tool for real earnings manipulation. The p value of  $-0.013$  supports hypothesis 9 and highlights that industry-specific expertise enhances audit precision and reduces the opportunity for REM.

The overall model interpretation indicates that the contribution of exogenous variables to BTD remains limited. The  $R^2$  value of 0.030 for BTD shows that only 3% of its variability is explained by auditor reputation, audit tenure, and AFIS, suggesting that external factors beyond the model remain dominant. However, the combined effect on REM is considerably stronger. With an  $R^2$  of 0.550, the model explains 55% of the variation in real earnings management through both direct and indirect pathways. Auditor reputation and AFIS have significant direct negative effects on REM, while audit tenure does not exhibit a significant direct influence.

Taken together, these findings affirm that auditor quality and competency play a crucial role in reducing earnings management practices, both directly and through lowering BTD. BTD emerges as an important mediating channel, showing that real earnings manipulation is shaped not only by the auditor’s characteristics but also by how extensively firms exploit book–tax differences as a space for reporting discretion. These insights enrich theoretical understanding and offer practical implications for regulators, auditors, and companies in strengthening financial reporting governance.

The empirical results derived from 105 manufacturing firms listed on the Indonesia Stock Exchange from 2021–2023 offer a comprehensive understanding of how auditor characteristics and Book–Tax Differences (BTD) shape the dynamics of real earnings management (REM). First, the study reaffirms the critical role of **auditor reputation**, indicating a significant negative relationship with REM. Auditors affiliated with Big Four firms demonstrate stronger independence, superior audit quality, and more stringent enforcement of reporting standards, thus effectively constraining managerial discretion in manipulating real activities. This finding aligns with Signaling Theory, in which reputable auditors emit credible signals of financial statement reliability, thereby reinforcing market confidence.

The evidence further reveals that industry specialist auditors exert a strong and significant negative effect on REM. Their deep sectoral knowledge and enhanced ability to recognize atypical operational patterns



enable them to detect subtle forms of real activity manipulation more effectively. Consistent with institutional theory, industry specialization represents a professional adaptation to sectoral norms and complexities, strengthening the auditor's role as an external governance mechanism. Conversely, audit tenure presents a more nuanced outcome. While tenure shows a positive but insignificant influence on REM, suggesting a potential erosion of independence over time, the empirical direction supports concerns about familiarity threats and reduced objectivity in prolonged auditor–client relationships.

Turning to tax-related reporting outcomes, the study finds that auditor reputation and auditor industry specialization both exert significant negative effects on BTD. These results suggest that high-quality auditors are capable of reducing both accounting-based and tax-based distortions. Their ability to curb aggressive financial reporting and tax planning helps narrow the gap between book income and taxable income, thereby enhancing overall reporting integrity. In contrast, audit tenure demonstrates a negative and significant effect on BTD, suggesting that longer auditor–client relationships may improve the auditor's deep understanding of business processes and tax practices, ultimately reducing reporting misalignments. This supports agency theory perspectives that emphasize the benefits of auditor familiarity when independence is properly safeguarded.

The mediation analysis offers additional insight. BTD is shown to mediate the relationship between auditor reputation, industry specialization, audit tenure, and REM, highlighting its role as a transmission channel through which auditor attributes influence real earnings manipulation. High-quality auditors not only reduce REM directly but also indirectly through their impact on BTD, reinforcing the idea that BTD functions as a diagnostic indicator of earnings quality and reporting discipline. Yet, when analyzed in isolation, BTD exhibits a positive but statistically insignificant effect on REM, indicating that differences in book and taxable income alone do not reliably predict real activities manipulation within the manufacturing sector.

Collectively, these findings underscore the importance of strengthening audit quality attributes—particularly reputation and industry expertise—as part of broader governance mechanisms to enhance financial reporting credibility. They further emphasize the strategic role of BTD as a mediating construct, helping explain how auditing mechanisms suppress opportunistic managerial behavior in financial and tax reporting.

## **E. CONCLUSION AND SUGGESTION**

This study examines ten hypotheses concerning the role of audit quality—represented by auditor reputation, audit firm industry specialization, and audit tenure—in influencing Book–Tax Differences (BTD) and Real Earnings Management (REM) among manufacturing firms listed on the Indonesia Stock Exchange during the period 2021–2023. Using SEM-PLS and multiple linear regression, the study reveals a consistent pattern: higher audit quality functions as a governance mechanism that constrains managerial discretion in manipulating real activities.

Auditor reputation shows a significant negative effect on REM, indicating that high-reputation audit firms—particularly Big Four auditors—are more capable of limiting managers' ability to modify operational activities for earnings management purposes. A similar outcome is found for industry specialization; auditors with deep sector-specific knowledge are more effective at identifying irregularities in financial reporting. Meanwhile, audit tenure exhibits a positive but insignificant relationship with REM, suggesting that the length of the auditor–client relationship does not directly increase the risk of reduced independence or real earnings manipulation.

Regarding tax-financial reporting differences, auditor reputation and industry specialization significantly reduce BTD, implying that high-quality auditors are better at minimizing discrepancies between taxable income and accounting income. Audit tenure also shows a significant negative effect on BTD, suggesting that stronger auditor familiarity with the client leads to better alignment between tax and commercial reporting. BTD is subsequently tested as a mediating variable and is found to mediate the relationships between auditor reputation, industry specialization, and tenure with REM—although the mediating effect for tenure is relatively small. However, BTD as an independent variable does not significantly influence REM, indicating that it cannot serve as a reliable early indicator of real earnings manipulation.

Overall, the findings underscore that audit quality plays a crucial role in safeguarding the integrity of financial reporting, both by strengthening oversight mechanisms and by reducing tax–accounting discrepancies. These results reinforce theoretical perspectives from Agency Theory, Signaling Theory, and Positive Accounting Theory, which posit that auditors reduce information asymmetry and limit managerial

opportunism. Within this framework, BTD operates as a partial transmission channel through which audit quality affects REM.

The practical implications highlight the importance of appointing reputable auditors with industry-specific expertise to enhance audit quality and mitigate REM. Capital market regulators may use these findings to refine policies on auditor rotation, tenure monitoring, and industry-based audit risk assessment. From an academic standpoint, the study contributes to the literature on audit quality and earnings management by incorporating BTD as a mediating mechanism. Nevertheless, several limitations—such as the focus solely on manufacturing firms, the short observation period, and the absence of control variables or disaggregated BTD measures—leave room for more comprehensive future research.

Subsequent studies are encouraged to expand the industrial scope, extend the time horizon, include relevant control variables, and adopt disaggregated BTD measurements. Methodological improvements, including more extensive reporting of construct validity and the use of mixed methods, may further enrich understanding of REM dynamics. With these enhancements, future research will be better equipped to capture the complex interaction between audit quality, book-tax misalignments, and managerial reporting behavior.

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