



How Temporary Book Tax Differences Influence Earning Quality? An Integrated Analysis with Investment Opportunity Set and Human Capital

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Abstract

We examined three variables, including the differences of temporary book tax, investment opportunity sets, and human capital to recognize if any of these variables have different impact on earnings quality. The population use of this research is manufacturing companies listed on the Indonesia Stock Exchange in 2017-2021. Based on the purposive sampling technique, a total of 338 data were obtained. By using ordinary least square technique of analysis, the test results reveal that the differences of temporary book tax have a negative impact on quality of earnings and the investment opportunity set has a positive impact on quality of earnings. Meanwhile, human capital has no impact on quality of earnings. Our study provides insight that the differences of temporary book tax and investment opportunity sets are important information that must be considered by investors in analyzing the quality of company earnings, so that investment provides optimal returns.

Keywords: earnings quality; book tax differences; investment opportunity sets; human capital

INTRODUCTION

Earnings is one of the important information presented in the financial statements. Accounting earnings provides important information that goes beyond cash

flow and is used as a key performance measure by various users (Dechow, 1994; Khajavi et al., 2016), such as investors, regulators, and accounting researchers (Ismail et al., 2021). Earnings is said to be qualified if the

earnings can be used by investors to predict abnormal earnings in the incoming (Feltham & Ohlson, 1995). Earnings is considered to have high quality if the earnings is able to function as a tool to predict sustainable earnings. Therefore, earnings will be considered of poor quality if they result from a financial reporting process that does not consider sustainable earnings. In other words, quality earnings describe the company's real ability to survive in the future. Of the many company decisions based on profit information, it shows quality earnings (Dechow & Dichev, 2002; Krismiaji & Sururi, 2021).

Currently, the quality of company financial information, especially earnings, is still the most important financial problem in capital markets of developing countries, including Indonesia. Accounting profit provides important information about company performance and is the main indicator for users as a basis for decision making (Khajavi et al., 2016; Salehi & Sehat, 2019). Quality profits will have an impact on the quality and accuracy of decision making (Lin et al., 2016). In other words, earnings quality can provide a real picture of the company at this time and an overview of the company's ability to survive in the future. Quality profits

can be proven by the many company decisions made based on profit information (Dechow & Dichev, 2002; Krismiaji & Sururi, 2021).

On the other hand, investors' concerns about earnings quality have increased in recent years, as many international companies announce non-actual earnings and report provisional information as part of company interim reports. This causes investors to be more careful in evaluating net income and using this information to determine company value (Hamdan, 2020; Khajavi et al., 2016; Krismiaji & Sururi, 2021). This condition is understandable given the many cases of fraudulent financial reporting by companies. Fraud in financial reporting can occur because an employee intentionally commits a material misstatement, even omissions of information in the organization's financial reports, for example, an employee submits a false expense report claiming non-existent personal travel or meals (ACFE, 2022).

The Association of Certified Fraud Examiners (ACFE, 2022) in their Report to the Nations: global study on occupational fraud and abuse reports that there are three primary categories of occupational fraud. One of the three main categories is financial statement fraud by 10% but contributed the largest

loss of \$ 954,000. The phenomenon of fraud in financial statement also occurs in Indonesia. Based on the 2019 Indonesia Fraud Survey report, financial statement fraud in Indonesia reached 22 cases out of 50 cases of misappropriation of state & company assets or wealth. The amounts of losses incurred was 242,260,000,000 out of a total loss of 873,430,000,000 or around 9.2%.

The phenomenon of fraudulent financial reporting indicates a failure in financial reporting, which is the main source of information for stakeholders in making decisions. Fraudulent financial statements have attracted the attention of researchers to examine various factors that affect earnings quality. These factors include book tax differences (Abdullaev & Park, 2019; Ashma' & Rahmawati, 2019; Widiatmoko & Indarti, 2019), investment opportunity set (Andriani et al., 2021; Narita & Taqwa, 2020; Widiatmoko & Indarti, 2018) and human capital (Handi et al., 2022; Kalalo & Sofian, 2022; Khajavi et al., 2016; Sowaity, 2022).

Related to earnings, there is a phenomenon of book tax differences, which is the difference between accounting earnings and fiscal income (Chi et al., 2014). Previous studies have shown that tax information in a company's financial statements

provides information about earnings quality (Blaylock et al., 2012) and investors use book tax differentials as a means of assessing earnings quality.

Until now, more research on book tax differences and their effect on earnings quality has been carried out by researchers in developed countries (Fadilah & Wijayanti, 2017; Widiatmoko & Indarti, 2019). It cannot be denied that developing countries like Indonesia have differences from developed countries, both in terms of economy and society (Waluyo, 2016). Some of the characteristics of developing countries are weak capital markets, low law enforcement and concentrated corporate ownership. In addition, there are fundamental differences in accounting standards and regulations between developing and developed countries. This condition can lead to information asymmetry, making it difficult for investors to assess company performance and make rational investment decisions (Ismail et al., 2013). Different laws and regulations in each country also allow for different research results (Fadilah & Wijayanti, 2017). Therefore, understanding the relationship between book tax differences and changes in future earnings in the Indonesian context is very important. This understanding will assist users of

financial statements in accurately predicting the effects of various book tax differences. For researchers, this understanding will also assist them in interpreting the literature and results of previous studies (Jackson, 2015).

Book tax differences are the difference in magnitude between commercial income and fiscal income. Temporary book tax differences occur due to differences in revenue and expense recognition periods based on accounting standards and tax regulations. The risk arising from the greater the difference between accounting earnings and fiscal income is the lower the quality of earnings (Noga & Schnader, 2013).

A transaction can be recognized based on accounting standards, but not recognized based on tax regulations (Sonnier et al., 2012). This difference is only temporary because it will be identified in the next period. In the end, accounting standards and tax regulations will recognize all transactions, it's just that there is a difference in recognition time between the two. Differences in recognition occur in transactions that include the calculation of compensation for losses, inventory valuation, amortization, depreciation, and accrual and realization.

With this difference in recognition, the company has the

flexibility to use profitable methods to increase its revenue (Abdullaev & Park, 2019). This condition provides an opportunity for management to carry out earnings management as a corporate planning strategy. This action will be responded negatively by the market, so that the value of the earnings response coefficient as a proxy for earnings quality will decrease. Some researchers report the higher the differences of temporary book tax the lower the quality of earnings (Ashma' & Rahmawati, 2019; Widiatmoko & Indarti, 2019). Companies that have higher differences of temporary book tax experience a decrease in the level of quality of earnings. Abdullaev & Park (2019) who tested companies in Korea reported that companies with larger differences in temporary book tax had lower persistence. In contrast, the results of Huang and Wang's (2013) study prove the higher the differences of book tax the higher the quality of earnings.

Investment Opportunity Set (IOS) is an action that may occur on investment occasions in the future that may have an impact on the development of company assets or projects that have a positive net present value. IOS has an important role for companies because IOS is an investment decision in the form of a

combination of assets owned (assets in place) and alternative future investments (Murwaningsari & Rachmawati, 2017; S. C. Myers, 1977). Companies with high investment opportunities sets have high growth occasion, so they can obtain high returns (profits). The market will respond positively to this, thereby increasing the earnings response coefficient which is a proxy for earnings quality (Andriani et al., 2021; Yasa et al., 2019). Several studies have proven that investment opportunity set owned by a company have positive effect on earnings quality (Andriani et al., 2021; Handi et al., 2022). In contrast, Widiatmoko & Indarti (Widiatmoko & Indarti, 2018) reported that the investment opportunity set has a negative impact on earnings quality. Whereas Indarti et al. (2021), Ashma & Rahmawati (2019) and Yunita & Suprasto (2018) prove that the investment opportunity set has no impact on the quality of earnings.

On the other hand, intellectual capital is the main factor in creating long-term performance and a company's competitive advantage. Human capital as the main component of intellectual capital, is a combination of the skills, abilities, experience, and expertise of employees obtained through their training and

experience (Ahangar, 2011; Smriti & Das, 2018). Well-managed human capital will create a company's competitive advantage which will influence improving company achievement, so that the market will respond positively. The increase in the earnings response coefficient as a proxy for quality of earnings indicates that the company's earnings quality is getting better. Several studies have proven that intellectual capital which contains human capital has a positive impact on quality of earnings (Kalalo & Sofian, 2022; Khajavi et al., 2016; Sowaity, 2022). However, Handi et al. (2022) reported that intellectual capital has no impact on quality of earnings.

Previous research findings show mixed results regarding the impact of the differences of temporary book tax, investment opportunity sets and human capital on quality of earnings. In addition, more research related to earnings quality has been carried out in developed countries and little has been done in emerging countries (Namazi & Rezaei, 2016). This opens opportunities to further investigate similar issues using a different earnings quality measure, namely the earnings response coefficient. High quality earnings are characterized by several characteristics, namely (1)

sustainable, (2) free from errors and manipulation, (3) informative, (4) an accurate measure of value creation or (5) conservative. The informativeness of high-quality earnings can be measured based on market reactions which are reflected in stock returns on announced earnings information, which is called the earnings response coefficient (Melgarejo, 2019; Nissim, 2021; Widiatmoko & Indarti, 2018). Earnings response coefficient shows the responsiveness of investors to profits announced by companies and is a direct proxy for earnings quality (Bilal et al., 2018; Elsiddig Ahmed, 2020). This study uses data from a long observation period of five years, which is expected to enrich the literature on earnings quality. If the company makes accounting choices that can reduce the accruals reflected in the temporary book tax differences, then the market response will be better. The same thing happens if management has higher investment opportunities and has increasingly superior resources which are reflected in human capital, then the market will respond positively, which means the quality of earnings will be higher. In addition to these three main variables, this research uses two control variables including leverage and profitability. The goal is to improve the research model.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Earnings Quality in Agency Theory Perspective

Public companies have high agency costs due to greater dispersion of ownership, separation between owner-managers, and less managerial ownership (Gao et al., 2013; Nissim, 2021; Shen et al., 2019). Managers of public companies are also targeted to capital market pressure to fulfill investors' expected returns and often have sets of equity-based compensation, inducing management to engineer reported earnings. These increased costs and stimuluses can result in greater engineering earnings (Givoly et al., 2010). On the other hand, public company management will be motivated to create strong governance due to the presence of high agency costs. In addition, ownership and regulation are dispersed, public companies have limited ability to communicate privately with stakeholders. Therefore, management used high-quality reporting as a surrogate for insider access (Hope et al., 2013).

Temporary Book-Tax Differences and Quality of Earnings

The concept of agency views that agency frictions occur because managers have the flexibility to

determine accounting policy methods that can maximize the interests of managers without thinking about responsibility to shareholders, resulting in agency costs. Temporary differences can furnish information to shareholders about management's flexibility in the accrual process, due to the limited freedom of accounting policy methods allowed in measuring fiscal profit which has an effect on lowering net income (Widiatmoko & Indarti, 2019). As the gap between income based on accounting standards and income according to taxation is greater, there will be an escalated risk of deteriorating quality of earnings (Noga & Schnader, 2013). This is based on the opportunistic nature of humans in agency theory where management has more flexibility in choosing accounting policy which is reflected in temporary differences, including taking advantage of opportunities in the results of differences in Financial Accounting Standards (SAK) and tax regulations, resulting in distortions in the book tax gap (Putri & Sujana, 2018). The logic of thought above is aligned with the inventions of several researchers in Indonesia (Ashma' & Rahmawati, 2019; Waluyo, 2016; Widiatmoko & Indarti, 2019), who reported that differences of temporary book tax have a negative impact on

quality of earnings. Abdullaev & Park's (2019) research on Korean KOPSI companies and Huang & Wang (2013) on banking companies in Taiwan also showed the same results. The higher the differences of the temporary book tax, the lower the quality of earnings. According to the logical think above, the hypothesis is formulated as follow:

H₁: The higher the temporary book tax differential, the lower the quality of earnings.

Investment Opportunity Set and Quality of Earnings

Investment opportunity set (IOS) is an investment opportunity owned by a company in the form of a combination of assets and becomes an investment option in the future (Indarti et al., 2021; Murwaningsari & Rachmawati, 2017; Myers, 1977). According to the perspective of agency theory, investment opportunity sets can be a means to minimize problems that arise in the agency relationship between management and principals through investment decisions by management. Companies that have high investment occasions will have high growth in the future, which affects escalated company profits. This condition will be valued positively by the market because companies with high growth occasions will

furnish high returns in the future (Al-Gamrh et al., 2020; Handi et al., 2022; Rusdi et al., 2021; Yasa et al., 2019). Several studies have proven that companies with higher investment opportunity sets will also have higher earnings response coefficients, which means that companies have better quality of earnings (Andriani et al., 2021; Handi et al., 2022). According to the explanation above, the following hypothesis is formulated.

H₂: Investment opportunity set positively influence on earnings quality.

Human Capital and Earnings Quality

Information asymmetry is a problem that arises in the agency relationship between management and principals (Namazi & Rezaei, 2016). These problems can be minimized through the disclosure of information by companies, including intellectual capital information. Intellectual capital is a non-financial asset that has no physical form but has value to create excellence in the future. Conceptually intellectual capital includes multidimensional, which is a combination of human capital, structural capital and relational capital owned by a company (Mention & Bontis, 2013).

Human capital is a combination of the skills, abilities, experience, and expertise of employees obtained through their training and experience (Ahangar, 2011) and is the main component of intellectual capital which is the key to the success of a company. Human capital that is owned and managed properly by the company is the company's main capital to achieve competitive advantage which will have an impact on improving company performance (Bayraktaroglu et al., 2019). Superior quality resources and good company performance will be encouraged by management to disclose it in the annual report, so that investors understand the process of creating company value. Companies with quality resources will also tend to reduce the level of earnings manipulation, which means that earnings quality increases (Mangena et al., 2010). This good performance will be responded positively by the market, so that the earnings response coefficient, which is a proxy for earnings quality, will increase. Investors will have more confidence in companies with good quality human capital because they can reduce investment risks and achieve returns as expected. Several empirical findings prove that the more quality human capital one has, the higher the quality

of reported earnings (Kalalo & Sofian, 2022; Khajavi et al., 2016; Sarea & Alansari, 2016; Sowaity, 2022). Based on the logic of thought and the support of the research results, the following hypothesis is formulated.

H₃: Human capital positively affects quality of earnings.

METHOD

Manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2017-2021 are the population of this study. The selection of the sample used a purposive sampling method with the following criteria: 1) announced audited financial reports, 2) experienced no loss before or after tax, and 3) had the required data. Based on these criteria, 537 data were obtained. This study uses one dependent variable, namely earnings quality as proxied by earnings response coefficient (ERC), three independent variables, including temporary book tax differences (TBTD), investment opportunity set as measured by the ratio of market value to book value of assets (MVBVA) and human capital as measured by value added human capital (VAHU), as well as two control variables, namely profitability as measured by the ratio of return on assets (ROA) and leverage which is measured by the ratio of debt to total assets (DTA). Operational

definitions and variable measurements are presented in Table 1.

The hypotheses in this study were tested using ordinary least squares (OLS) regression with the following equation:

$$EQ = \alpha + \beta_1 TBTD + \beta_2 IOS + \beta_3 HC + \beta_4 LEV + \beta_5 ROA + \epsilon$$

Where:

EQ	: Earnings quality
TBTD	: Temporary book-tax differences
IOS	: Investment opportunity set
HC	: Human capital
LEV	: Leverage
ROA	: Return on assets.
α	: Constant
β	: Regression coefficient
ϵ	: Standard Error

RESULTS AND DISCUSSION

Descriptive statistics

Descriptive statistics related to all variables used in this study are presented in Table 2. The earnings response coefficient (ERC) as a proxy for earnings quality has an average value of 0.0156 with a standard deviation of 0.0651. This value expresses that the market response to the company's unexpected profit is positive. The temporary book-tax difference has a minimum value of -0.5103 and a maximum value of 0.5175. This value indicates that the level of accounting earnings is greater than taxable earnings, or vice versa.

Table 1. Operational Definition and Variable Measurement

Variables	Operational definition	Measurement	Reference
Earnings Quality (EQ)	Response Coefficient can be interpreted as a measure of market response (cumulative abnormal return/CAR) to unexpected earnings (EU) through regression results	$R_{it} = \frac{P_{it} - P_{it-1}}{P_{it-1}}$ $R_{mt} = \frac{IHSG_{it} - IHSG_{it-1}}{IHSG_{it-1}}$ $AR_{it} = R_{it} - R_{mt}$ $CAR_{t+3,t-3} = \sum_{t-3}^{t+3} AR_{it}$ $UE = \frac{E_{it} - E_{it-1}}{E_{it-1}}$ $CAR_{it} = \alpha + \beta_1 UE + \varepsilon$	Widiatmoko dan Indarti (2018b) Yasa et al. (2019)
Temporary Book-Tax Differences (TBSD)	The difference between taxable income and net income	$TBSD = \frac{\text{Total Beda Temporer}}{\text{Rata - Rata Total Aset}}$	Widiatmoko dan Indarti (2019)
Investment Opportunity Set (IOS)	Ratio between market value and book value of assets	$MVBVA = \frac{\text{Tot Asset} - \text{Tot Ekuitas} + (J. Saham Beredar \times \text{closing price})}{\text{Tot Asset}}$	Yasa et al. (2019)
Human Capital	The comparison of value added (difference in income/output and all expenses except employee/input expenses) with human capital (employee expenses)	$VAHU = \frac{VA}{HC}$ $VA = OUTPUT - INPUT$	Bayraktaroglu (2019)
Leverage (LEV)	Ratio between the total value of debt and the value of total assets as a percentage of funds by creditors to the company	$LEV = \frac{\text{Total Hutang}}{\text{Total Aset}}$	Widiatmoko dan Indarti (2019)
Profitabilitas (ROA)	The ratio between net income and total assets	$ROA = \frac{\text{Net Income}}{\text{Total Aset}}$	Widiatmoko et al. (2020)

Table 2. Descriptive statistics

Variables	N	Minimum	Maximum	Average	Std. Deviation
EQ	338	-0.1341	0.2363	0.0156	0.0651
TBSD	338	-0.5103	0.5175	-0.0050	0.0541
IOS	338	0.3580	18.3979	1.5939	1.7739
HC	338	0.2365	10.9727	2.2539	1.5882
LEV	338	0.0651	4.9011	0.4875	0.3498
ROA	338	0.0003	0.9210	0.0658	0.0959

Note: EQ = earnings quality; TBSD = temporary book tax differences; IOS = investment opportunity set; HC = human capital; LEV = leverage; ROA = return on assets

The average value of -0.0050 demonstrates that the sample firms have higher accounting earnings than

their taxable income. Investment opportunity set has the lowest value 0.3580, the highest value is 18.3979

and the average value is 1.5939. The average value of 1.5939 indicates that on average the sample companies have high investment opportunities. Human capital has the highest value of 10.9727 and the lowest value of 0.2365. The average value of 2.2539 indicates that the resulting value added is 2.2539 times the salary expense issued. Leverage has a maximum value of 4.9011, a minimum value of 0.0651, and an average of 0.4875 with a standard deviation of 0.0651. The average value of the sample companies has a debt of 48.75% of the total assets owned. The minimum return on assets of the sample companies is 0.0003 indicating that the lowest profit for the sample companies is 0.03% of the total assets owned. The average sample company generates a net profit of 6.58% of its total assets.

Regression Testing Results

Before testing the hypothesis with ordinary least squares regression, tests for the fulfillment of normality and classical assumptions are first performed. The normality testing result in the first stage with a total of 537 data showed a z skewness value of 17.5616 above 1.96 so that the residual errors were not normally distributed. Therefore, it is necessary to transform the data by eliminating

the extreme data (outliers), so that the number of data becomes 338. The Z skewness value of the test after data transformation shows a figure of 1.1875, lower than 1.96 which means the residual error is normally distributed.

Classical assumption testing includes heteroscedasticity, multicollinearity, and autocorrelation. The output of the heteroscedasticity test using Glejser is presented in Table 3. Based on the information in Table 3, it can be detected that the significance value of all predictor and control variables is above 0.05. The results of the multicollinearity test offered in Table 4 show that all independent variables have a variance inflation factor (VIF) value under 10. Table 4 also provides a Durbin Watson score of 2.041, which is between the du value (1.846) and 4-du (2.154). Therefore, the regression model can be used in this study because there are no heteroscedasticity, multicollinearity, and autocorrelation problems.

Table 4 presents the results of the ordinary least squares regression test. Based on the information in Table 4, the adjusted R² value is 0.111. This figure shows that the book tax differences, investment opportunity set, human capital and leverage as well as return on assets

Table 3. Heteroscedasticity Test Results

Model	Unstandardized Coefficients		Standardized	t	Sig.
	β	Std. Error	β		
TBTD	-0.01	0.041	-0.024	-0.430	0.667
IOS	0.00	0.001	0.085	1.291	0.198
HC	-0.00	0.002	-0.039	-0.572	0.568
LEV	-0.00	0.007	-0.050	-0.873	0.383
ROA	-0.00	0.029	-0.005	-0.076	0.939

Note: Dependent variable: ABSRESID

EQ = earnings quality; TBTD = temporary book tax differences; IOS = investment opportunity set; HC = human capital; LEV = leverage; ROA = return on assets

as control variables can explain the variation in earnings quality by 11.10%. The resting 88.90% is elucidated by else variables not admitted in the research model. The calculated F value of 9,396 is significant at the 5% level indicating that the research model is feasible to use.

Table 4 provides information that the temporary book-tax difference has a negative and significant effect on earnings quality,

so the first hypothesis is accepted. The investment opportunity set variable shows a positive influence on earnings quality, so the second hypothesis is accepted.

Meanwhile, human capital shows no positive effect on quality, so the third hypothesis is rejected. The test results on the control variable show that leverage has no influence on quality of earnings. Meanwhile, profitability is proven to be able to improve the quality of company

Table 4. The Results of Regression Test

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	VIF
	β	Std. Error	β			
Constant	0.011	0.008		1.368	0.172	
TBTD	-0.167	0.063	-0.139	-2.662	0.008	1.033
IOS	0.013	0.002	0.366	5.897	0.000	1.462
HC	-0.005	0.003	-0.114	-1.795	0.074	1.534
LEV	-0.015	0.010	-0.080	-1.488	0.138	1.083
ROA	0.005	0.045	0.007	0.109	0.913	1.663
DW						2.041
R ²						0.124
Adjusted R ²						0.111
F _{count}						9.396
Sig. F						0.000

Note: EQ = earnings quality; TBTD = temporary book tax differences; IOS = investment opportunity set; HC = human capital; LEV = leverage; ROA = return on assets

earnings as measured by the earnings response coefficient.

Temporary Book-Tax Differences and Quality of Earnings

The test results show that the higher the temporary book tax differences, the lower the earnings quality. The findings of this study support agency theory which views that one agency conflict occurs because management uses the freedom to choose accounting methods to maximize their interests, without thinking about responsibility to shareholders (Widiatmoko & Indarti, 2019). Temporary book tax differences can provide information to shareholders about management's authority in the accrual process, which has an impact on reducing the quality of earnings. The results of this study indicate that regulators and investors can use the temporary book tax difference as a signal for management actions in managing earnings. The higher book tax differences also indicate that companies are managing earnings (Huang & Wang, 2013). This management action will be responded negatively by investors, so that the earnings response coefficient which is a proxy for earnings quality will decrease. This fact supports the results of previous studies which

show that temporary book-tax differences will reduce earnings quality (Narita & Taqwa, 2020; Putri & Sujana, 2018; Widiatmoko & Indarti, 2019). Abdualeva & Park (2019) who conducted research on KOSPI companies in Korea also proved that companies with high book tax differences have high discretionary accruals values and low persistence.

Investment Opportunity Set and Quality of Earnings

The positive impact of the investment opportunity set on earnings quality indicates that the higher the growth opportunity, the higher the company's quality of earnings. Based on the perspective of agency theory, investment opportunity sets can be a means of minimizing problems that arise in the agency relationship between management and principals through investment decisions by management. Companies with high investment opportunities will have high growth in the future, so that the future earnings will also increase. Expectations for a high rate of return will cause the market to respond positively to unexpected earnings (Handi et al., 2022; Yasa et al., 2019).

The findings of this research are in line with the previous research which prove that companies with

higher investment opportunity sets will also have higher earnings response coefficients, which means that companies have better earnings quality (Andriani et al., 2021; Handi et al., 2022). However, the results of this study contradict the results of the research by Widiatmoko & Indarti (2018), which reports that investment opportunities have a negative effect on earnings quality. Investors are more concerned about announced earnings than investment opportunities. Companies that are growing need more funds to finance their investments, affecting dividends distributed tend to be low.

Human Capital and Earnings Quality

As the main resource for companies, human capital should be a key factor in creating competitive advantage and competitiveness which will have an impact on improving performance (Mutuc, 2021). This condition will cause a positive market reaction, so that the earnings response coefficient increases, which means the quality of ABA also increases. However, the findings of this study show different facts, human capital does not have an impact on improving earnings quality. This condition indicates that the human resources owned by the

company have not been managed optimally. This is evidenced by 232 or 67% of the data from the research sample having a human capital added value (VAHU) below the average of 2.2539, while only 106 (33%) of the data has a value above the average.

This finding of this study contradicts the results of previous research which reported that well-managed intellectual capital, especially human capital, will encourage companies to have a competitive advantage and improve sustainability performance (Herlina et al., 2023; Khajavi et al., 2016; Mutuc, 2021; Sowaity, 2022). The impact of intellectual capital and human capital on profit quality is caused by an increase in the company's financial performance (Mutuc, 2021).

The findings of this study also conflict with agency theory. Good resource ownership and management should encourage management to disclose it in annual reports and the market will respond positively, so that the earnings response coefficient, which is a proxy for earnings quality, will also increase. The findings of this study are in line with the results of research by Handi et al. (2022), who reported that human capital has no effect on earnings quality.

CONCLUSION, IMPLICATION AND LIMITATION

This research investigated the impact of temporary book tax differences, investment opportunity sets as well as human capital on earnings quality as well as leverage and return on assets as control variables. In accordance with the hypothesis, temporary book tax differences have a negative influence on earnings quality. The higher the book value of tax differences, the lower the earnings quality. The findings of this study support the agency theory which states that the separation of functions between management and principal will lead to a conflict of interest between the two parties. The freedom of management in using accounting recognition methods according to their interests without considering the interests of shareholders, resulting in agency costs. Temporary differences can be a source of information for principals to assess management in the accrual process because the choice of accounting recognition method for measuring taxable income is limited, which results in a decrease in net income.

This research proves that the higher the investment opportunity owned by the company, the higher the quality of its earnings. The investment

opportunity set describes the company's future growth potential which will impact the quality of reported earnings. When the firm's investment opportunity set is high, the value of the firm will increase because more and more investors are interested in investing in the hope of obtaining a greater return in the future. This condition may lead to the possibility of earnings management practices due to maintaining the stability of the company's growth.

Despite the contributions made, this research has limitations. This research uses human capital which is a part of intellectual capital as a predictor of earnings quality. The results of the study were unable to prove the positive effect of human capital on earnings quality. Therefore, future researchers should explore the intellectual capital and its elements as predictors of earnings quality, so that the results will be more comprehensive. Future researchers also need to consider other measures of earnings quality, such as the level of accruals (earnings management) and accounting conservatism. This research is still limited to the manufacturing industry on the Indonesia Stock Exchange. Future researchers may consider testing companies listed on capital markets in developing countries so that the

results better describe the quality of earnings for these companies.

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