

## THE EFFECT OF AUDIT TENURE, TAX MINIMIZATION, AND DEBT COVENANT ON TRANSFER PRICING

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### Abstract

This study examines whether transfer pricing practices in industrial sector companies listed on the Indonesia Stock Exchange (IDX) during the 2021–2024 period are influenced by audit tenure, tax minimization, and debt covenants. A quantitative research method was implemented using secondary data obtained from companies' annual reports and financial statements. The purposive sampling technique was employed to select the sample, resulting in 18 companies with a total of 72 firm-year observations. The data were analyzed using panel data regression with the assistance of EViews 12. The Chow test, Hausman test, and Lagrange Multiplier test were conducted to select the most relevant model, which indicated that the Random Effect Model is the most appropriate estimation method. The findings indicate that transfer pricing is positively and significantly affected by audit tenure, suggesting that longer auditor–client relationships enhance auditors' ability to monitor and identify related-party transactions. In contrast, transfer pricing is negatively and significantly affected by tax minimization, proxied by the effective tax rate, and debt covenant, measured by the debt-to-equity ratio. Transfer pricing is simultaneously influenced by audit tenure, tax minimization, and debt covenants, although the adjusted R-squared value of 12.16% suggests that transfer pricing practices are largely explained by other factors outside the model. These findings provide insights for regulators and companies regarding the importance of auditor oversight in promoting transparency and compliance in related-party transactions.

Keywords: Audit Tenure, Tax Minimization, Debt Covenant, Transfer Pricing

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### 1. Introduction

The rapid development of the global economy and increasingly intense business competition have significantly influenced corporate business models and managerial behavior. Advances in technology, transportation, and communication have substantially contributed to the efficiency of international trade, resulting in increased flows of goods, services, labor, and investment across national borders. These developments have encouraged the transformation of domestic companies into multinational enterprises whose operations are no longer concentrated in a single country but extend across multiple jurisdictions (Azzuhriyyah & Kurnia, 2023).

Since the establishment of the World Trade Organization (WTO), international trade activities have expanded significantly, prompting governments to strengthen taxation regulations to protect state revenues. Corporations generally aim to maximize profits while minimizing tax burdens, making tax planning a crucial managerial strategy. One commonly employed tactic is transfer pricing, which determines the cost of goods, services, and tangible or intangible assets traded among affiliated companies within a

global corporation (Maulida & Wahyuddin, 2020; Aliino & Lane, 2015). Although transfer pricing is legally permitted, it becomes problematic when prices are used to shift profits to low-tax countries and deviate from the arm's length principle.

Transfer pricing practices pose a serious challenge to government tax revenues. Several prominent cases in Indonesia, such as Asian Agri, Adaro, Lanna Harita, Amoco Mitsui, and Toyota Motor Manufacturing Indonesia (TMMIN), illustrate how companies manipulate transaction prices to reduce taxable income (Kompasiana, n.d.). Efforts to combat such practices remain difficult due to weak regulatory enforcement, limited access to transaction data, and political intervention (Kompasiana, n.d.). In line with this issue, intra-group transactions have continued to increase, reaching IDR 6.248 trillion in 2021 and rising sharply to IDR 10.36 trillion in 2022. Consequently, tax audits related to transfer pricing have intensified and exceeded IDR 6 trillion (DDTC News, n.d.).

Data published by the Organisation for Economic Co-operation and Development (OECD) through the Mutual Agreement Procedure (MAP) Statistics indicate a significant upward trend in transfer pricing disputes from 2019 to 2023. In particular, the number of cases increased substantially in 2021, reflecting the growing complexity and global relevance of transfer pricing issues (OECD, 2023).

Several factors are believed to influence corporate transfer pricing decisions. One such factor is audit tenure, which refers to "the length of the professional relationship between an auditor and a client." The auditor's understanding of the client's business environment, internal controls, and risk profile can be enhanced by longer audit tenure, thereby improving audit quality and limiting aggressive transfer pricing practices. However, empirical findings regarding the effect of audit tenure on transfer pricing remain inconclusive. Some studies find that longer audit tenure reduces transfer pricing practices due to improved auditor oversight (Ardiyanti et al., 2025; Maharani et al., 2023).

Another important determinant is tax minimization. Multinational corporations are motivated to shift earnings through transfer pricing mechanisms due to variations in tax rates across jurisdictions. Several studies find that transfer pricing decisions are significantly and positively influenced by tax minimization (Septiyani et al., 2018; Refgia et al., 2017; Yulianti & Rachmawati, 2019; Hartati et al., 2015). Conversely, other studies document a negative relationship between tax burden and transfer pricing intensity (Merle et al., 2019; Susanti & Firmansyah, 2018), while some report no significant effect (Mispyanti, 2015). These inconsistent findings indicate the need for further empirical investigation.

In addition, transfer pricing behavior may also be influenced by debt covenant considerations. The Debt Covenant Hypothesis within Positive Accounting Theory states that "Companies at risk of violating debt covenants typically use accounting techniques to increase reported earnings in the current quarter to avoid breaching agreements with creditors" (Fauzizah & Poerwati, 2023; Anggah & Yuliati, 2024). Transfer pricing may serve as one mechanism to manage reported profits and maintain compliance with debt agreements, especially in highly leveraged firms (Syah & Poerwati, 2023; Junaidi & Yuniarti, 2020).

Given the mixed findings of prior studies and the increasing importance of transfer pricing practices in Indonesia, this study aims to examine whether transfer pricing in industrial sector companies listed on the Indonesia Stock Exchange is affected by audit tenure, tax minimization, and debt covenants. This research seeks to provide empirical evidence within an emerging market context and offer insights for regulators and

companies in strengthening transparency, auditor supervision, and compliance with taxation and debt regulations.

## 2. Theoretical Background

Agency Theory explains conflicts that arise due to differences in objectives and information asymmetry between principals (shareholders) and agents (management) (Jensen & Meckling, 1976). Management, acting as the agent, may engage in opportunistic behavior to maximize personal benefits, including implementing tax planning strategies that conflict with government interests, as tax authorities seek to maximize public revenue (Yulia et al., 2019; Septiyani et al., 2018). In this context, transfer pricing becomes a strategic tool used by multinational firms to shift profits across affiliated entities in different jurisdictions to minimize tax burdens (Aliino & Lane, 2015). Such practices intensify agency conflicts, particularly between companies and tax regulators.

Attribution Theory further explains how auditors interpret management behavior and financial reporting outcomes by attributing causes to internal or external factors (Heider, 1958). Longer audit tenure enhances auditors' understanding of firm-specific conditions, internal controls, and risk profiles, thereby improving professional judgment and reducing the likelihood of aggressive accounting and transfer pricing practices (Utomo, 2024; Ardiyanti et al., 2025). However, excessively long audit tenure may also threaten auditor independence, making its effect on transfer pricing empirically ambiguous.

Positive Accounting Theory posits that managers act rationally to maximize their own utility by selecting accounting policies that minimize contractual and political costs (Watts & Zimmerman, 1986). The Debt Covenant Hypothesis states that "companies dealing with debt covenant violations typically use income-increasing techniques, such as transfer pricing, to improve reported financial performance and avoid technical default" (Fauzizah & Poerwati, 2023; Junaidi & Yuniarti, 2020). Additionally, the Political Cost Hypothesis suggests that "reported profits, especially in an international context, can be reduced by tax minimization techniques such as transfer pricing employed by companies with significant tax liabilities" (Hartati et al., 2015; Merle et al., 2019).

Transfer pricing, as a concept used to calculate transaction prices between companies with specific relationships within a business group, becomes problematic when prices deviate from the arm's length principle, allowing profit shifting and tax avoidance (Prasetio & Mashuri, 2021; Aliino & Lane, 2015). In empirical research, transfer pricing is commonly proxied by related-party transactions, such as the ratio of related-party receivables to total receivables, which reflects the intensity of intra-group transactions and the potential for profit shifting (Nuradila & Wibowo, 2018).

Based on these theoretical perspectives, audit tenure, tax minimization, and debt covenant are expected to influence transfer pricing decisions. Audit tenure affects the effectiveness of auditor oversight, tax minimization reflects firms' incentives to reduce tax liabilities, and debt covenant pressures motivate managers to manage earnings to maintain compliance with contractual obligations. However, prior empirical findings remain inconsistent, indicating the need for further investigation, particularly in emerging market contexts such as Indonesia.

## 3. Methods

This study implements a quantitative research method using secondary data. All industrial sector companies listed on the Indonesia Stock Exchange (IDX) during the 2021–2024 period was used as the population. Secondary data were collected through

documentation from audited annual reports and financial statements obtained from the official IDX website ([www.idx.co.id](http://www.idx.co.id)) and corresponding company websites. Data processing and statistical analysis were conducted using EViews version 12.

A purposive sampling method was implemented to select the sample based on specific criteria relevant to the research variables. From an initial population of 70 industrial sector companies, several firms were excluded due to delisting during the observation period, incomplete financial and annual reports, reported losses, and the absence of related-party receivables. After applying these criteria, 18 companies were selected as the final sample. With a four-year observation period, the total number of firm-year observations used in this study is 72.

**Table 1.** Population and Sample Selection

No	Criteria	Number of Companies
1	Industrial sector companies listed on IDX (2021–2024)	70
2	Companies delisted during the observation period	(13)
3	Companies without complete financial statements and annual reports	(9)
4	Companies reporting losses during 2021–2024	(21)
5	Companies without related-party receivables	(9)
	Final sample companies	18
	Observation period (years)	4
	Total firm-year observations	72

Source: Processed secondary data (2025)

The dependent variable in this study is transfer pricing, proxied by Related Party Transactions (RPT), measured as the ratio of related-party receivables to total receivables. Audit tenure is measured by the number of consecutive years the same auditor audits a firm. Tax minimization is proxied by the Effective Tax Rate (ETR), calculated as total income tax expense divided by profit before tax. Debt covenant is measured using the Debt to Equity Ratio (DER).

Panel data regression techniques were implemented to analyze the data. Three estimation models were evaluated: the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). The model was selected using Chow, Hausman, and Lagrange Multiplier tests. According to the findings, the Random Effect Model (REM) is the best model for determining the relationship between audit tenure, tax minimization, debt covenant, and transfer pricing. Hypothesis testing employed T-tests for partial effects, F-tests for simultaneous effects, and the adjusted R-squared to assess the explanatory power of the model.

## 4. Results and Discussion

### 4.1 Regression Results and Hypothesis Testing

The results of the Random Effect Model regression are presented in Table 2. The table summarizes the coefficients, statistical significance, and overall model fit.

**Table 2.** Panel Data Regression Results (Random Effect Model)

Variable	Coefficient	t-Statistic	Probability	Significance ( $\alpha=0.05$ )
Constant	0.057214	0.679322	0.4993	Not Significant
Audit Tenure (AT)	0.034272	3.506140	0.0008	Significant (+)

Variable	Coefficient	t-Statistic	Probability	Significance ( $\alpha=0.05$ )
Tax Minimization (ETR)	0.168864	0.804609	0.4238	Not Significant
Debt Covenant (DER)	0.008081	0.890354	0.3764	Not Significant
Model Statistics	Value			
F-Statistic	4.276054			
Prob (F-Statistic)	0.0078			
Adjusted R-Squared	0.121593			
Number of Observations	72			
Number of Firms	18			
Estimation Model	Random Effect Model			
Dependent Variable: Transfer Pricing (proxied by Related Party Receivables Ratio).				

Based on Table 2, the following conclusions can be drawn regarding the hypothesis tests:

- 1) Effect of Audit Tenure (H1): Audit tenure has a positive and statistically significant effect on transfer pricing (coefficient = 0.034, t-stat = 3.506, p = 0.0008). Since the probability value is below the 0.05 significance level, H1 is supported.
- 2) Effect of Tax Minimization (H2): Tax minimization, proxied by the effective tax rate (ETR), does not have a statistically significant effect on transfer pricing (p = 0.4238 > 0.05). Therefore, H2 is not supported.
- 3) Effect of Debt Covenant (H3): Similarly, debt covenant, measured by the debt-to-equity ratio (DER), does not significantly influence transfer pricing (p = 0.3764 > 0.05). Thus, H3 is not supported.
- 4) The F-statistic of 4.276 (p = 0.0078) indicates that the independent variables jointly have a statistically significant effect on transfer pricing. However, the model's explanatory power is limited, as indicated by the adjusted R-squared value of 0.1216 (12.16%). This suggests that approximately 87.84% of the variation in transfer pricing practices is explained by other factors outside this model.

## 4.2 Discussion

### 4.2.1 The Significant Effect of Audit Tenure

The finding that audit tenure positively and significantly affects transfer pricing is notable. The regression shows that each additional year of auditor-client engagement is associated with an increase in transfer pricing intensity. This suggests that auditors with longer tenure possess deeper institutional knowledge of a firm's specific operations and intra-group transaction structures. This expertise likely enables them to more accurately identify, classify, and report related-party transactions, leading to a higher measured ratio of related-party receivables in the financial statements.

From an Agency Theory perspective, this result underscores the auditor's role as an effective monitoring mechanism that reduces information asymmetry between management and shareholders. Longer tenure allows auditors to accumulate firm-specific knowledge, enhancing their ability to detect and scrutinize complex transfer pricing arrangements. Furthermore, Attribution Theory helps explain this outcome; experienced auditors are more adept at attributing unusual transaction patterns to internal managerial decisions rather than external market factors. Although prolonged audit tenure is often associated with independence concerns, the statistically strong finding (p < 0.01) suggests

that, within the Indonesian industrial sector context, the benefits of auditor competence and accumulated expertise outweigh potential familiarity threats.

#### 4.2.2 The Non-Significant Effects of Tax Minimization and Debt Covenant

Contrary to expectations based on prior literature, tax minimization was not a significant driver of transfer pricing in this sample. This implies that firms with lower effective tax rates were not necessarily more inclined to intensify related-party transactions. A plausible explanation is the heightened regulatory scrutiny and enforcement of transfer pricing regulations in Indonesia. The increased compliance costs and potential penalties associated with aggressive tax planning through transfer pricing may discourage its use as a primary tax minimization tool, leading firms to rely on other, less detectable strategies.

Similarly, the lack of a significant relationship between debt covenant pressure and transfer pricing suggests that leverage-related contractual constraints do not motivate firms to manipulate related-party transactions to manage reported financial performance. While Positive Accounting Theory's Debt Covenant Hypothesis posits that managers facing covenant violations may use income-increasing techniques, the empirical evidence from this study indicates that transfer pricing is not the preferred mechanism. This could be due to regulatory limits on leverage ratios and increased monitoring by creditors, which reduce managerial flexibility in using transfer pricing to alter accounting outcomes.

#### 4.2.3 Overall Model Implications and Limitations

While the model is statistically significant overall, its limited explanatory power (Adjusted  $R^2 = 12.16\%$ ) highlights the complexity of transfer pricing determinants. A substantial portion of the variance remains unexplained by audit tenure, tax minimization, and debt covenants. Other critical factors likely include firm profitability, size, ownership structure, the degree of multinational complexity, managerial bonus schemes, and other corporate governance attributes. This opens avenues for future research to incorporate a more comprehensive set of variables.

In conclusion, this study finds that in the Indonesian industrial sector, audit tenure is the most influential variable among those tested for explaining transfer pricing behavior. This reinforces the critical importance of auditor oversight and professional expertise in enhancing transparency and accountability in related-party transactions within emerging markets. For regulators, this underscores the value of auditor experience while also necessitating vigilance regarding auditor independence. For companies, it highlights that robust external audit processes are a key component of credible financial reporting in the complex area of intra-group transactions.

## 5. Conclusion

This study examines the effects of audit tenure, tax minimization, and debt covenant on transfer pricing practices in industrial sector companies listed on the Indonesia Stock Exchange during the 2021–2024 period. The findings of panel data regression using the Random Effect Model indicate that transfer pricing is significantly and positively affected by audit tenure, while tax minimization and debt covenant do not have significant effects.

The significant influence of audit tenure suggests that a longer auditor-client relationship can enhance the auditor's understanding of a company's specific operations and related-party transactions, thereby improving the detection and monitoring of transfer pricing practices. This finding highlights the role of audit oversight as an effective

governance mechanism in reducing information asymmetry and enhancing transparency in related-party transactions.

In contrast, the absence of a significant effect of tax minimization indicates that transfer pricing is not solely driven by firms' efforts to reduce tax burdens. Increased regulatory supervision, tax compliance requirements, and potential enforcement risks may limit the use of transfer pricing as a tax planning strategy. Similarly, the insignificance of debt covenant effects implies that firms do not primarily use transfer pricing to manage leverage-related contractual constraints, possibly due to regulatory restrictions and creditor monitoring.

Simultaneously, audit tenure, tax minimization, and debt covenant jointly influence transfer pricing, although the explanatory power of the model remains relatively low, as reflected by an adjusted R-squared of 12.16%. This finding indicates that transfer pricing decisions are influenced by other factors beyond the scope of this study, such as corporate governance structures, firm size, profitability, and multinational complexity. Overall, the findings provide empirical evidence that auditor characteristics play a more dominant role than tax and debt-related incentives in explaining transfer pricing practices within the Indonesian industrial sector. These findings offer practical implications for regulators, auditors, and corporate management in strengthening audit supervision and promoting compliance in related-party transactions. Future research should incorporate additional variables to develop a more comprehensive model of transfer pricing determinants in emerging market contexts.

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