

## Transfer Pricing Audit Policy Design Toward A Fair Tax System In Indonesia

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### ABSTRACT

The execution of transfer pricing (TP) audit policies, aimed at deterring tax evasion activities and ensuring adherence to the arm's length principle (ALP) among affiliated parties, is scrutinized in this investigation. This study adopts a qualitative research approach encompassing post-positivism and constructivism, employing data analysis methodologies like triangulation techniques and utilizing NVivo tools such as Coding. The research seeks to elucidate and scrutinize the enforcement of transfer pricing audit policies, pinpoint factors affecting their execution, and devise strategies for managing transfer pricing audits. Findings reveal that the enforcement of TP audit policies can be examined from the contextual policy aspect, encompassing influential interests, decision-making locus, and resource utilization, alongside considerations of policy content, including actor strategies and regulatory characteristics. External factors such as perceptions of the Indonesian tax system and internal factors such as human resource preparedness impact policy execution. Practical implications include the necessity to update operational guidelines, stay abreast of business model advancements, and enhance Customer Relationship Management (CRM) implementation to bolster TP audit efficacy.

**Keywords:** Policy Implementation, Audit, Transfer Pricing.

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### INTRODUCTION

The issue of transfer pricing for tax purposes has been a subject of ongoing debate, encompassing politics, economics, and public opinion, which often diverge (Cooper et al., 2017). The economic perspective highlights the strategy employed by multinational corporations to transfer money from their subsidiaries in high-tax countries to subsidiaries in low-tax countries, in order to decrease their total tax obligations (Nguyen et al., 2019). From a public interest standpoint, it is evident that this endeavor obstructs the government's ability to maximize tax collections, which serve as the principal means of generating state income (Lo & Wong, 2011).

Each of these sides elicits criticism of the relevant regulations and initiates debates regarding ideas for modifications concerning transfer pricing restrictions (Rogers & Oats, 2022).

The study of transfer pricing in the context of public policy is intended to serve as a crucial foundation for the development of comprehensive transfer pricing rules and procedures in Indonesia, with law enforcement playing a key role. Researchers have the ability to gather perspectives from policymakers, beneficiaries, and implementers (Alaerts, 2020). Transfer pricing debates can be conducted extensively, encompassing policy aims and implementation outcomes. In addition, scholars also endeavor to examine the variables that impact the execution of transfer pricing. In this instance, the researchers examined two important factors, specifically the substance of the policy and the surrounding conditions in which it was implemented (implementation context). The variables encompassed in this analysis consist of the degree to which the interests of the target group are incorporated into the policy's content, the nature of benefits bestowed upon the target group, the desired level of policy-induced change, the appropriateness of program location, the level of detail in mentioning policy implementers, and the availability of sufficient resources to support the program (Mubarok et al., 2020; Wicaksono, 2021). From a pragmatic standpoint, Indonesia exhibits a captivating phenomenon in the realm of transfer pricing. Where the taxpayer prevails in numerous tax issues between taxpayers and the government when taken to court. Many taxpayers have chosen to challenge their underpaid taxes in court, resulting in a need to pay both the underpayment and associated penalties. Nevertheless, the DJP's success rate in court was low as they were unable to substantiate the accuracy of the transfer pricing modifications, as per the DJP's perspective. The DJP stated that their success rate at the tax dispute resolution appeal level is approximately 40%, while their failure rate is around 60%.

Meanwhile, in legal proceedings, DJP has a success rate of about 80% in winning cases. Approximately 80% of tax litigation cases have a high likelihood of success due to the DGT's contention that tax collection must adhere to regulatory guidelines. If the actions taken by tax officials in the process of tax collection do not adhere to the regulations, it is possible to initiate a legal case (Silalahi, 2023). Nevertheless, in the event that the taxpayer is dissatisfied with the ruling on the objection, they have the option to initiate legal proceedings. According to the 2019 DJP Performance report, 6,763 Tax Court rulings were made regarding Appeals and Lawsuits. The number of decisions has shown an increase in comparison to 2018, reaching a total of 6,034 ([www.pajak.go.id](http://www.pajak.go.id)).

The implementation of distribution leads to the determination of appeal and lawsuit outcomes based on decisions issued by the DJP between 2017 and 2018, which can exemplify tax conflicts emerging from audit findings. In the Tax Court Decision of 2018, approximately 71% of

taxpayer requests were either partially or fully approved. This can serve as an example in the implementation of tax regulations, where numerous issues arise in the practical execution of tax administration.

This problem of transfer pricing practice indicates that the current implementation of the transfer pricing fairness evaluation mechanism remains inadequate. The methods for testing the fairness of transfer pricing are outlined in the Circular Letter of the Director General of Taxes No.04/PJ.7/1993 dated 9 March 1993, as well as the Regulation of the Director General of Taxes Number PER-43/PJ/2010 dated 6 September 2010, which was later amended by Regulation of the Director General of Taxes Number PER-32/PJ/2011 dated 11 November 2011. These regulations pertain to the application of fairness and business customs principles in transactions between taxpayers and parties with special relationships (Devita et al., 2023; Sitanggang & Firmansyah, 2021).

This research aims to analyze the implementation of transfer pricing audit policies in Indonesia, identify the factors that influence their implementation, and formulate recommendations based on field findings for enhancing the effectiveness of policies for conducting transfer pricing audits.

## RESEARCH METHODS

The sampling technique utilized in research bears resemblance to the qualitative approach commonly employed, known as purposeful sampling (Muthiah et al., 2020). Purposeful sampling is designed to procure comprehensive data from sources abundant in information, thus making the sample size and type contingent upon the research objectives (Irsyadillah & Bayou, 2022). Researchers employ specific respondent criteria to ascertain the sample for their research. A sampling frame is defined as a depiction of the population encompassed within the sample to be acquired. Consequently, it is imperative to confine the criteria within the sampling frame to establish the sample intended for employment in the study (Pratama, 2020).

**Table 1. Informant**

Actor	Code	Informant	Reasons for Selection of Informants
Implementor	I-1	PRY	Policy implementers and transfer pricing audit decision-makers
	I-2	ED	Auditor/transfer pricing audit implementer and decision maker
	I-3	RST	Auditor/transfer pricing audit implementer and decision maker
	I-4	RH	Auditor/transfer pricing audit implementer and decision maker

	I-5	BYU	Auditor/transfer pricing audit implementer and decision maker
	I-6	SGY	Auditor/transfer pricing audit implementer and decision maker
	I-7	WHY	Auditor/transfer pricing audit implementer and decision maker
Taxpayer/ Proxy/ Affected	TP1	BLM	Tax consultant
	TP2	PH	Tax consultant
	TP3	KRM	Tax consultant
Academics	SC1	MSD	Tax Academic, Former Director General of Taxes
	SC2	DS	Tax Academic
	SC3	PBS	Tax Academic t
	SC4	FER	Tax Academic

This study primarily utilizes Grindle's (2019) research framework, which posits that challenges in policy implementation are shaped by two primary determinants: policy substance factors and policy implementation factors. This aligns with research findings indicating that the primary obstacle in executing transfer pricing audit policies resides in the substance of the policy, subsequently influencing its implementation (Cools & Rossing, 2021). Conversely, Grindle (2019) contends that the effectiveness of policy implementation predominantly hinges on the level of policy execution, comprising the Content of Policy and the Context of Policy. Grindle emphasizes that the policy implementation process necessitates an inception with clearly defined goals, objectives, programs, and activities, coupled with the allocation of resources to actualize these targets.

The process of data analysis commences with organizing the information derived from interviews, which can be articulated through verbal descriptions or written statements by categorizing and correlating pertinent elements. These data are then condensed to differentiate between essential research data and non-research data sourced from the interview outcomes. Subsequently, the data is presented and conclusions are drawn to address the research objectives.

## RESULTS AND DISCUSSION

### Implementation of the Transfer Pricing Audit Policy

At the policy implementation stage, the government carries out the enacted policy per legislative requirements or policy directives. Currently, implementation is formally the responsibility of the numerous government agencies and departments tasked with overseeing

their respective policy domains. Policy implementation occurs after a measure is signed into law (Ali, 2012).

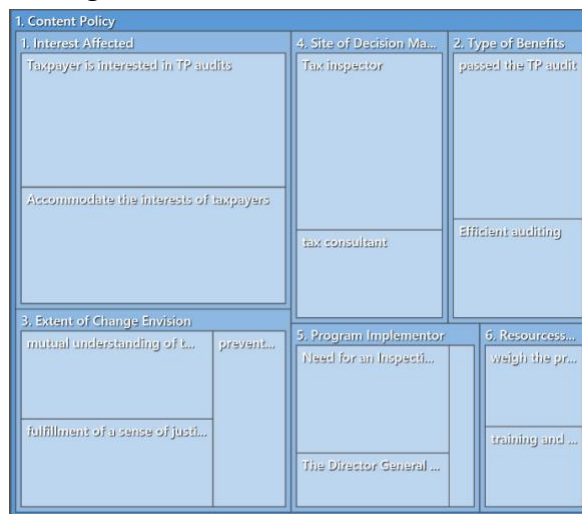
Political and administrative efforts are required to execute the transfer pricing audit policy. Through the policy content and implementation context, which in this instance is the transfer pricing audit, Grindle's (2019) theory demonstrates that the outcomes of policy implementation have a significant impact on groups, individuals, and society at large, as well as on behavior and the acceptance of change.

Policy implementation is the phase in which the government puts into effect the enacted policy in accordance with legal requirements or policy action. Various government agencies and departments tasked with the implementation of their respective policy areas are formally accountable at this juncture. The process of policy implementation commences once a measure is signed into law (Ali, 2012).

The transfer pricing audit policy is implemented through an administrative and political procedure. The impact of policy implementation outcomes on society, individuals, and groups, as well as the adoption and reception of change, is evident when considering the policy content and implementation context—specifically, the transfer pricing audit—in accordance with Grindle's (2019) theory.

**Content Policy**

In Grindle's theory, content policy or policy content comprises the following elements: influencing interests, benefit type, desired degree of change, decision-making location, program implementer, and resources involved. In contrast, the context of implementation comprises elements such as the influence, strategies, and interests of the involved actors, as well as institutional characteristics, compliance, and responsiveness. The NVIVO hierarchical map analysis consists of the following:



**Figure 1. Hierarchy Chart pada Node Content Policy**

The analysis of interviews with research informants concerning the substance of the transfer pricing audit policy is predominately governed by the interest-affected node, as indicated by the hierarchy chart. Sub-node concerning taxpayers interested in transfer pricing audits has the most substantial area of any node; accommodating taxpayers' interests follows suit. The second most prominent node in content policy concerns the intended scope of change. The majority of the statements provided by academic informants, WPs, and implementers concern the satisfaction of WPs' sense of justice and the establishment of a collective comprehension regarding the necessity of TP audits. Additionally, it seems that a sub-node serves to thwart tax evasion.

In general, research findings in terms of policy content of transfer pricing audit policies can be presented in the following table:

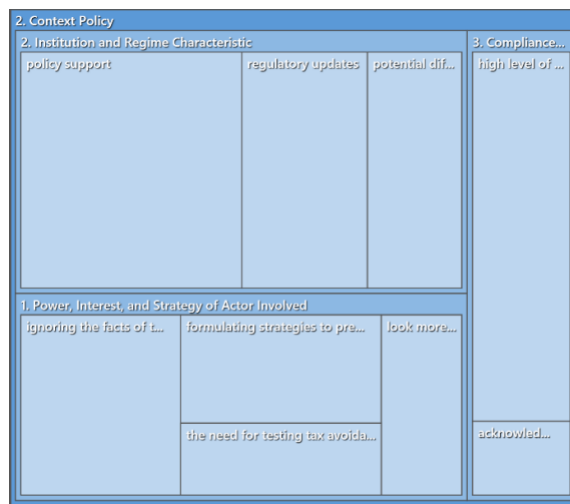
**Table 2. Summary of Research Findings on Content Policy**

<b>Node</b>	<b>Research Finding</b>
<b>I. Content Policy</b>	
<i>1. Interest Affected</i>	TP audits accommodate the interests of taxpayers and also taxpayers with an interest in TP audits. Ideally, a transfer pricing audit must accommodate taxpayers' interests. This means that the audit is carried out not only for the benefit of government income but also as a going concern for taxpayers. Business continuity (going concern) in a company is important for interested parties (stakeholders), especially investors
<i>2. Type of Benefits</i>	The types of benefits obtained from transfer pricing audits are efficient audits and taxpayers passing TP audits. An efficient audit will save the use of time and cost resources for both tax auditors and taxpayers. Meanwhile, the status of a taxpayer who has passed a TP audit is for a good company reputation
<i>3. Extent of Change Envision</i>	The degree of change to be achieved is preventing tax avoidance, a common understanding of the need for TP audits and the fulfillment of a sense of justice for taxpayers.
<i>4. Site of Decision Making</i>	WP feels that the transfer pricing audit does not fulfill a sense of justice because it focuses more on the interests of the state. However, there are also those who argue that transfer pricing audits fulfill a sense of justice in terms of not differentiating treatment between taxpayers.

5. <i>Program Implementor</i>	The location for TP audit decision making is with taxpayers and tax auditors. Taxpayers can follow directions from the tax officer but can also direct them to question the basis of the tax examiner's assumptions and then bring these differences to court. Meanwhile, tax auditors have the authority to interpret tax regulations and decide whether there are violations in transfer pricing transactions carried out by the company
6. <i>Resourcess Committed</i>	In the implementation of the TP audit, it was found that the DJP was pursuing targets, the inspectors were less firm and, therefore still needed a more detailed inspection guide. Even though there is a Regulation of the Director General of Taxes Number PER-22/PJ/2013 and a Circular Letter of the Director General of Taxes Number SE - 50/PJ/2013, tax auditors still need further and more detailed guidance regarding the list of documents that must be provided and checked by taxpayers. as well as the inspection steps

**Context Policy**

The context is a multifaceted setting that shapes the policy-making process through concurrent engagements among different stakeholders. Interviews reveal a prevalent high level of taxpayers' adherence to tax payment. Nevertheless, a challenge arises from taxpayers' resistance to the SKP imposed by tax inspectors, which is deemed unjustifiable. The hierarchical map analysis generated by NVIVO is presented as follows.



**Figure 2. Hierarchy Chart of Context Policy Node**

According to the hierarchical chart, the examination of interviews conducted with research informants concerning the framework of transfer pricing audit policies is predominantly influenced by node institutions and regime characteristics (Munsanje, 2021). The primary focus lies on the policy support sub-node, which holds the most substantial significance, followed by policy revisions and potential disparities in interpretation.

The second most prominent node within the policy context pertains to the Power, Interest, and Strategy of Engaged Stakeholders (Hein et al., 2017). The majority of insights provided by scholarly informants, taxpayers, and implementers revolve around disregarding company circumstances and formulating strategies to combat tax evasion. Furthermore, a sub-node has emerged emphasizing the necessity to assess indicators of tax evasion and adopt a more comprehensive approach (Prabhakar et al., 2023).

In general, the results of research pertaining to the policy framework of transfer pricing audit procedures can be effectively showcased in a tabular format.

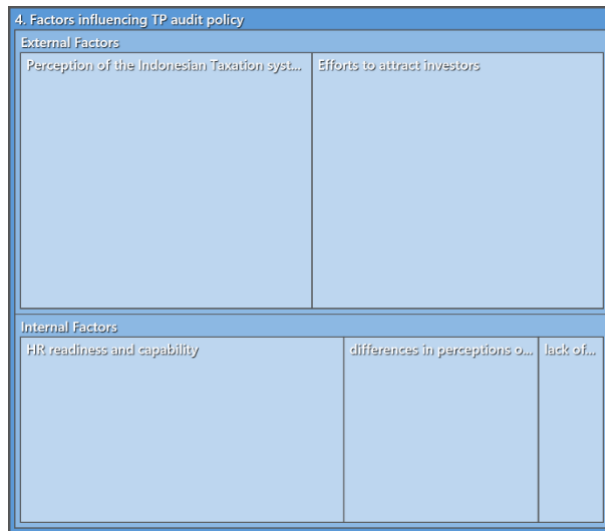
**Table 3. Summary of Research Findings in Policy Context**

Node	Research Finding
<b>II. Context Policy</b>	
1. <i>Power, Interest, and Strategy of Actor Involved</i>	In implementing the transfer pricing audit policy, tax auditors should look more broadly, not ignore the facts of the company's condition, formulate strategies to prevent tax avoidance, and test tax avoidance indicators. Tax auditors must look at the broader figure. This means that the TP audit process does not only consider obtaining state income in the form of tax payments, but must also consider that the WP audited are investors who have worked hard to find the desire to invest in Indonesia.
2. <i>Institution and Regime Characteristic</i>	Characteristics of institutions and regimes in power in the form of policy support, regulatory updates, potential differences in interpretation. The potential for differences in interpretation of Indonesian tax regulations between taxpayers and tax inspectors, especially regarding transfer pricing practices, is very large. This is because one of the principles of a TP transaction that leads to tax avoidance is the fairness

	of the transaction. However, the fairness of transactions is very relative in nature and the range is very long, so it can give rise to large differences in interpretation.
3. <i>Compliance and responsiveness</i>	The level of compliance expected from the TP audit policy is recognition of all facts and a high level of compliance. In general, taxpayers' compliance with paying taxes is high. However, the problem is the objection to the SKP imposed by tax inspectors on taxpayers, which is considered unreasonable.

**Factors Influencing Transfer Pricing Audit Policy**

Research results reveal that factors influencing transfer pricing audit policies can be categorized into two main groups: internal factors stemming from the tax authority (DJP) and the government and external factors originating from taxpayers and investors. The hierarchical map analysis conducted using NVIVO is presented as follows.



**Figure 3. Hierarchy Chart Node Context Policy**

The hierarchy chart reveals that the examination of interviews conducted with research participants on the determinants impacting transfer pricing audits is predominantly influenced by external factors (Sebele-Mpofu et al., 2021). The sub-node focusing on endeavors to allure investors and viewpoints on the Indonesian tax structure emerges as the most prominent area within this analysis.

The subsequent substantial node pertains to internal factors, with a majority of insights stemming from academic informants, WP, and implementers highlighting variations in perceptions of transfer pricing practices (Mogos et al., 2022). This is succeeded by issues such as inadequate examination time and the readiness and capacity of human resources.

In general, research findings in terms of factors influencing TP audit policies can be presented in the following table:

**Table 4. Summary of Research Findings on Factors that Influence the Implementation of Transfer Pricing Audit Policy**

<b>Node</b>	<b>Research Finding</b>
<b>1. External Factor</b>	
a. Perception of the Indonesian Taxation system	If the transfer pricing audit policy imposed on investors who have invested their capital in Indonesia is considered to be a heavy burden, then they can move to another country that is more profitable in terms of tax rates.
b. Efforts to attract investors	If foreign investors think that our tax policies, one of which is the transfer pricing audit, can be burdensome for them, investors will think again about investing capital in Indonesia. On the other hand, if the transfer pricing audit policy carried out by tax auditors is less firm, the potential for lost state revenue from aggressive tax avoidance practices will also be large
<b>2. Internal Factors</b>	
a. HR readiness and capability	Qualified human resources from tax authorities are needed to better understand aspects of economics, business and taxation as one unit in analyzing company affiliate transaction schemes in accordance with the principles of fairness and business practices.
b. lack of inspection time	When conducting transfer pricing audits, tax auditors often lack the time to carry out quality audits

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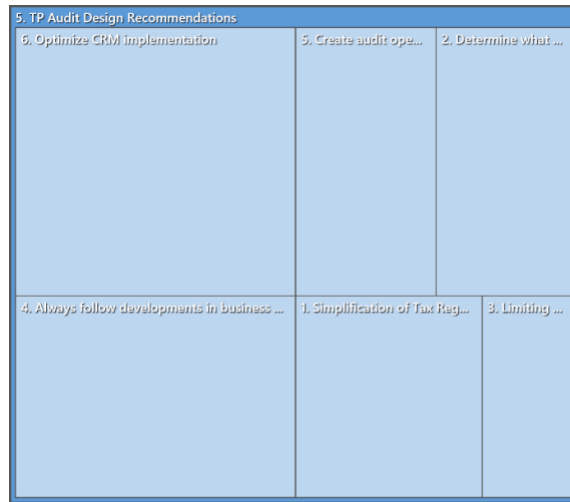
c. differences in perceptions of TP practices	The practice of transfer pricing is more subjective with different angles between taxpayers and tax inspectors. The greater the difference in perception between taxpayers and tax auditors regarding TP provisions, the greater the potential for disputes so that effective audits cannot be achieved.
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### **Transfer Pricing Audit Policy Design**

Transfer pricing audits typically consume a significant amount of time and resources. The revenue boost resulting from such audits may pertain to the collection of revenue over a one to two-year period. The arduous efforts involved in conducting a transfer pricing audit can lead to substantial revenue adjustments that may prove advantageous for developing nations (Amidu et al., 2019). Nonetheless, these outcomes are not swift or effortless. Adequate resilience is necessary due to the intricate and uncertain nature of transfer pricing issues. Transfer pricing departments in both tax authorities and the private sector often face scrutiny, as the return on investment in enhancing transfer pricing capabilities is usually not swiftly realized and may not be easily discernible.

The effectiveness of an audit heavily relies on meticulous case selection. Thus, it is crucial to allocate sufficient time and resources to risk evaluation and subsequent case selection, while also ensuring appropriate resources are allocated for the actual audit process. Various indicators can be utilized to identify a transaction as high risk, and these will be elaborated upon later (Siddiqi, 2012). Materiality alone is generally an unreliable criterion for risk assessment, as transactions frequently involve valuation errors due to transfer pricing inaccuracies. Consequently, if materiality is the primary factor for case selection, undervalued transactions may be disregarded despite their significance. This could be a direct consequence of the entity setting unjustifiable prices. The hierarchical map analysis from NVIVO is presented below:



**Figure 4. Hierarchy Chart Node Recommendations for increasing the effectiveness of TP Audits**

Based on the hierarchical chart, it is evident that the examination of interviews with research participants concerning suggestions for enhancing the efficiency of transfer pricing audits is predominantly influenced by the CRM implementation optimization node, which is indicated by the most substantial area. Subsequently, the subsequent node consistently focuses on the advancement of the business model, followed by the node that determines the priority of testing subjects and individuals, establishing operational directives for transfer pricing audits, simplifying tax regulations, and ultimately restricting the discretionary powers of the tax authority.

In general, the research outcomes related to recommendations for enhancing the effectiveness of transfer pricing audit procedures can be outlined in the subsequent table:

**Table 5. Summary of Research Findings Recommendations for increasing the effectiveness of the TP Audit Policy**

<b>Node</b>	<b>Research Finding</b>
(1) simplification of tax regulations	TP audit regulations must be designed to be simpler so that there will be no conflicting regulations. Apart from that, it will also be easier for taxpayers to comply with existing regulations and avoid aggressive tax avoidance practices.

(2) determine in advance what is ready and what will be audited	The need for careful planning before conducting a TP audit. This planning involves determining what and who will be tested first. This is to be able to optimize the use of both WP and DJP resources to create effective TP audits.
(3) limiting the tax authority's discretion	The discretion given to the examiner in following up on the results of the examination is a bounded discretion where the law stipulates several alternative decisions and the examiner is free to choose one of the alternative decisions provided by statutory regulations, however, discretion as a free authority requires limitations and procedures for its use. discretion so that the use of discretion can be accounted for.
(4) always follow developments in business models	Indonesia's transfer pricing audit policy is considered not up to date so it is feared that it cannot be used as a regulatory reference for transactions from new business models and in the end the government cannot do anything about the status of these transactions.
(5) create operational guidelines for TP audits and	The existing transfer pricing regulations are only general in nature and do not provide detailed guidance on TP audit steps and what documents need to be prepared by taxpayers.
(6) Optimizing CRM implementation	One of the results of CRM is an extensification function compliance map, namely a map that illustrates taxpayer compliance risks. The higher the level of possible Taxpayer non-compliance and the higher the possible contribution to revenue is the main priority as an extensification target.

## CONCLUSION

This study's conclusion, derived from the analysis and discussion outcomes, is that the TP Audit Policy Content implementation of the transfer pricing audit policy is intended to accommodate the interests of both taxpayers and taxpayers with an interest in TP audits. Efficient audits and taxpayers passing transfer pricing audits are the outcomes of such audits. The

objectives are to achieve a degree of change that satisfies taxpayers' sense of justice, a consensus regarding the necessity of TP audits, and the prevention of tax evasion. An audit of DJP's implementation by TP revealed that the organization was pursuing objectives. With regard to the policy context, tax auditors implementing the transfer pricing audit policy ought to adopt a more comprehensive approach, refrain from disregarding factual information regarding the company's state, devise strategies to thwart tax avoidance and examine indicators of tax avoidance. Achieving a high level of compliance and acknowledging all facts are the TP audit policy's anticipated standards of compliance.

External and internal factors influence the implementation of audit policies pertaining to transfer pricing. Efforts to attract investors and perceptions of the Indonesian tax system as a result of transfer pricing audit policies are examples of external factors. HR readiness and capability, insufficient inspection time during transfer pricing audits, and divergent perceptions of TP practices are internal factors.

The policy for managing transfer pricing audits is formulated through the simplification of tax regulations, pre-determination of auditable and non-auditable items, restriction of the tax authority's discretion, and continuous monitoring of business model advancements. This is in light of the fact that Indonesia's transfer pricing audit policy is deemed obsolete and cannot serve as a regulatory benchmark. The government ultimately lacks the ability to intervene in the status of a transaction originating from a novel business model, establish operational guidelines for TP audits, or optimize CRM implementation.

One drawback and suggestion of this study is that it exclusively conducts a qualitative analysis of the execution of transfer pricing audit policies. Future researchers are advised to begin their investigations with a quantitative approach, wherein they develop models to assess the efficacy of transfer pricing audit policies and the various determinants that impact them. By employing Grindle's policy implementation theory in this investigation, it becomes feasible to conduct problem analysis employing diverse theoretical frameworks, yielding varying outcomes.

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