

## EFFECT OF FOREIGN OWNERSHIP, AUDIT COMMITTEES, LEVERAGE, AND INFORMATION ASYMMETRY ON EARNINGS MANAGEMENT WITH ESG DISCLOSURES AS A MODERATING VARIABLE

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### Abstract

*This study explores the influence of foreign ownership, audit committee, leverage, and information asymmetry on earnings management, with Environmental, Social, and Governance (ESG) disclosure considered as a moderating variable and firm size treated as a control variable. The analysis utilized panel data regression, drawing from a sample of companies listed on the main board of the Indonesia Stock Exchange (IDX) between 2020 and 2023. A purposive sampling method was applied, and outlier cases were excluded, resulting in 115 valid observations. The results indicate that information asymmetry has a significant positive relationship with earnings management. However, this relationship is weakened when moderated by ESG disclosure. In contrast, foreign ownership, audit committee composition, leverage, and standalone ESG disclosure show no significant individual impact on earnings management. Moreover, ESG disclosure does not serve as a mediating factor between foreign ownership, audit committee, or leverage and earnings management. These findings highlight the critical role of ESG transparency in curbing earnings management practices that may be detrimental to stakeholder interests. The results suggest that policymakers should strengthen ESG disclosure requirements, while firms should prioritize transparent ESG reporting as a governance mechanism to mitigate information asymmetry and reduce earnings manipulation, particularly in emerging markets like Indonesia.*

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### Article Info

- **Received** : 15<sup>th</sup> June 2025
- **Revised** : 04<sup>th</sup> February 2026
- **Published** : 18<sup>th</sup> February 2026
- **Pages** : 47-70
- **DOI** : <http://dx.doi.org/10.33019/ijbe.v10i1.1261>
- **JEL** : M41, Q56, G32
- **Keywords** : audit committee, foreign ownership, earnings management, ESG disclosure, information asymmetry



## 1. Introduction

In the context of global advancements in the era of globalization, competition in financial markets has intensified, driving companies to adopt various strategies to maintain competitiveness and sustain their financial performance. One common strategy is earnings management. Rankin et al. (2018) define earnings management as efforts by managers to manipulate financial reports to appear better than they are, without stakeholders being directly aware. Indriani and Pujiono, (2021) explain that earnings management practices can undermine the credibility of financial reports because of management's intervention to manipulate information for personal gain. Earnings management plays a crucial role in shaping the perceptions of investors, creditors, and other parties regarding a company's performance, creating a more positive image of the company that can influence stock prices, company valuation, investor interest, tax liabilities, credit ratings, and investment decisions. According to the Indonesian Accounting Association Statement of Financial Accounting Standards (PSAK) No. 201 on the Presentation of Financial Statements (Ikatan Akuntan Indonesia, 2024), financial statements are a systematic representation of the financial position and performance of an entity, including companies. Kieso et al. (2018) state that financial statements serve as the primary tool for conveying financial information to external parties. Financial statements play a crucial role for external parties, particularly shareholders and creditors, in assessing a company's performance. They provide valuable information to users in decision-making processes, with company profits being one of the primary pieces of information frequently used.

Over time, accounting authorities and professional associations in Indonesia have issued various regulations, policies, and legal frameworks aimed at reducing earnings management practices, with the hope of minimizing their impact on business practices within the country. Despite the critical role financial statements play, earnings management remains prevalent among publicly listed companies and state-owned enterprises (BUMNs). The cases of financial statement manipulation by PT Wijaya Karya (Persero) Tbk. and PT Waskita Karya (Persero) Tbk. in 2023 exemplify how these practices can exceed legal boundaries, ultimately leading to legal violations. In both of these BUMNs—key pillars in Indonesia's infrastructure development—the internal oversight role of the audit committee must be called into question, especially as these companies experienced significant losses and a decline in market value on the stock exchange.

Another example is PT Indofarma Tbk., which demonstrated earnings management practices in 2024, resulting in inaccurate financial reporting. Once again, the oversight role of the audit committee needs to be strengthened. These examples clearly illustrate that earnings management can have significant consequences for both companies and stakeholders. It can obscure fair valuation for investors, reduce the quality of earnings information in financial statements, and lead to detrimental outcomes. Therefore, companies should curtail unlawful earnings management activities. Nevertheless, ethically conducted earnings management that complies with regulations can help companies achieve consistent profits and enhance the perceived value of the company among investors.

Various studies have explored the link between earnings management and factors such as foreign ownership, audit committees, leverage, information asymmetry, and Environmental, Social, and Governance (ESG) aspects. Understanding how these elements affect earnings



management can support companies in allocating resources more effectively to limit such practices. Despite extensive research on earnings management determinants, the existing literature presents three critical gaps that limit our understanding of how governance mechanisms and transparency tools interact to constrain earnings manipulation, particularly in emerging market contexts.

First, empirical inconsistency without theoretical reconciliation. Prior studies report contradictory findings across multiple governance variables, yet few attempts have been made to explain these inconsistencies systematically. For instance, foreign ownership has been found to reduce earnings management in some contexts (Tran et al., 2023; Al-Duais et al., 2021) but shows no significant effect or even positive associations in others (Hendratno & Mawardi, 2023). Similarly, audit committee effectiveness yields mixed results: some studies report significant negative effects on earnings management (Fitri & Siswantoro, 2021; Feronika et al., 2021), while others find no meaningful impact (Handayani & Ibrani, 2020). Leverage and information asymmetry exhibit similar patterns of conflicting evidence (Surjandari et al., 2021 vs. Laudza & Nindiasari, 2022; Feronika et al., 2021 vs. Tangngisalu & Jumady, 2020). These inconsistencies are not merely statistical artifacts; they signal the presence of unidentified moderation mechanisms that determine when and how governance factors influence earnings management. Agency theory predicts that monitoring mechanisms (foreign ownership, audit committees) and financial constraints (leverage) should systematically affect managerial opportunism, yet empirical evidence remains fragmented. This suggests that the effectiveness of governance mechanisms may be contingent on the broader information environment within which they operate a condition rarely tested in prior research.

Second, theoretical ambiguity regarding ESG's role in corporate governance. The literature presents two competing theoretical perspectives on ESG disclosure. The transparency view, grounded in agency theory and signaling theory, posits that ESG disclosure enhances monitoring effectiveness by reducing information asymmetry and increasing the detectability of earnings manipulation (Velte, 2019; Hong et al., 2022; Yangklan & Sincharoonsak, 2021). Conversely, the symbolic legitimacy view suggests ESG disclosure may serve as an impression management tool that does not substantively constrain managerial opportunism or may even facilitate it (Almubarak et al., 2023). Critically, existing studies treat ESG primarily as a direct predictor or control variable in earnings management models. This approach overlooks a fundamental theoretical question: Does ESG disclosure alter the effectiveness of traditional governance mechanisms? If ESG disclosure enhances transparency, it should amplify the monitoring capacity of foreign investors and audit committees while mitigating the opportunistic effects of leverage and information asymmetry. However, if ESG disclosure is merely symbolic, no such moderating effects should be observed. No prior study has systematically tested ESG disclosure as a moderating



variable that conditions the relationship between multiple governance factors and earnings management, leaving this theoretical debate unresolved.

Third, limited evidence from weak institutional environments with inadequate measurement approaches. The majority of earnings management research focuses on developed markets with strong legal enforcement, transparent information environments, and dispersed ownership structures (Leuz et al., 2003). These contexts differ fundamentally from emerging markets like Indonesia, which are characterized by concentrated family ownership, weak investor protection, limited analyst coverage, and relationship-based business practices (Claessens et al., 2000; Siregar & Utama, 2008). In such environments, the relative effectiveness of formal governance mechanisms (audit committees, foreign ownership) versus transparency tools (ESG disclosure) may differ substantially from developed market patterns. Moreover, prior research in the Indonesian context suffers from measurement limitations. Most studies employ accrual-based earnings management models (e.g., Modified Jones Model) that are vulnerable to specification errors and may fail to detect revenue manipulation—a particularly prevalent form of earnings management in emerging markets (Stubben, 2010). Similarly, ESG measurement often relies on self-reported CSR disclosures or binary indicators, which may not capture the quality and comprehensiveness of ESG information. The recent implementation of OJK Regulation No. 51/2017 on sustainable finance and ESG reporting creates a unique empirical setting to examine whether mandatory ESG disclosure frameworks in emerging markets can enhance governance effectiveness in constraining earnings management.

To the best of our knowledge, this study is the first to examine ESG disclosure as a moderating mechanism across multiple governance and financial determinants of earnings management in an emerging market setting. This study addresses these three gaps by examining ESG disclosure as a moderating variable that conditions the relationships between four key determinants (foreign ownership, audit committees, leverage, and information asymmetry) and earnings management in Indonesian listed firms. Our study offers three distinct contributions:

First, theoretical contribution: We reconcile contradictory findings in prior literature by testing a contingency framework in which the effectiveness of governance mechanisms depends on the transparency environment created by ESG disclosure. This approach shifts the research focus from "Does governance reduce earnings management?" to "Under what informational conditions do governance mechanisms effectively constrain earnings management?". By positioning ESG disclosure as a moderator rather than a direct predictor, we provide a theoretical mechanism that explains when and why governance factors influence earnings management.

Second, empirical contribution: We employ advanced measurement approaches that address limitations in prior research. Specifically, we use the Stubben (2010) Revenue Model to detect earnings management, which is more appropriate for capturing sales manipulation—a



common practice in emerging markets where managers exploit revenue recognition flexibility. Additionally, we use Bloomberg ESG scores rather than self-reported CSR disclosures, providing a more comprehensive and independently verified measure of ESG disclosure quality. This measurement innovation enhances the reliability and validity of our findings compared to prior studies relying on binary or self-reported ESG indicators.

Third, contextual contribution: We provide the first comprehensive examination of ESG disclosure's moderating role in a weak institutional environment following mandatory ESG reporting implementation. Indonesia's unique context—combining concentrated ownership, weak enforcement, and recent ESG regulation—offers an ideal setting to test whether transparency-enhancing mechanisms can substitute for or complement formal governance structures when institutional quality is low. Our findings have direct implications for policymakers in emerging markets considering ESG disclosure mandates as governance reform tools.

This study is expected to provide multiple contributions to various stakeholders. For regulators and policymakers, our findings offer evidence-based insights into whether ESG disclosure mandates effectively enhance corporate governance and financial reporting quality in weak institutional environments, informing the design of future regulatory reforms. For academics, the study enriches theoretical frameworks by demonstrating that governance effectiveness is contingent on the information environment, advancing understanding of boundary conditions under which agency theory predictions hold. The moderation framework we develop can be extended to examine other transparency mechanisms and governance contexts. For practitioners and investors, the study provides actionable insights on using ESG disclosure quality as a monitoring tool and red flag indicator for earnings management risk, supporting more informed investment and lending decisions. For researchers, this study establishes a methodological template for examining moderating effects in corporate governance research and demonstrates the value of advanced earnings management detection models in emerging market contexts.

## 2. Literature Review

### Agency Theory

Agency theory, as outlined by Jensen and Meckling (1976), is fundamentally a contract between the owner (principal) and the manager (agent) in which shareholders (principals) engage managers (agents) to transfer decision-making power to them, with conflicts arising because managers may not follow the actions or policies set by the principals. To address this, principals can offer incentives and apply monitoring costs to ensure managers adhere to the established policies. Jensen and Meckling (1976) also note conflicts of interest between owners and managers, where owners seek good returns on their investments, while managers benefit from bonuses and executive perks if the business performs well. Agency theory aims to separate the roles of management and shareholders to create an efficient and effective



working environment, but it often leads to conflicts and problems when disagreements arise. Management, hired by shareholders, has the duty to be accountable to them. However, these conflicts can lead to managers not disclosing all information, creating information asymmetry that can hinder a company's progress and provide opportunities for fraud (Nugroho et al., 2018). Although management is expected to provide accurate information to shareholders, sometimes the information is not accurate, leading to fraudulent reporting.

### **Stakeholder Theory**

Stakeholder theory, as described by Freeman (1994), emphasizes that one of the primary challenges for companies is addressing the interests of diverse stakeholder groups, particularly amid issues like information asymmetry and potential conflicts of interest. In contrast to agency theory—which concentrates on relationships between firms and financial stakeholders such as investors and creditors (Ross, 1973; Jensen & Meckling, 1976)—stakeholder theory broadens the scope by highlighting corporate accountability to non-financial stakeholders as well. Fostering strong stakeholder relationships is seen as an effective way to deter unethical practices in governance and to limit earnings manipulation. This theory highlights the value of collaboration in enhancing both financial outcomes and corporate social responsibility (CSR), with an emphasis on transparency in disclosure to suppress earnings management behavior.

### **Positive Accounting Theory**

Positive Accounting Theory (PAT), developed by Watts and Zimmerman (1986), aims to interpret and forecast corporate decisions regarding accounting practices. According to PAT, management tends to adopt accounting methods that serve their own interests, enhance reported earnings, and provide advantages to investors. The theory includes three central hypotheses: the bonus plan hypothesis, the debt covenant hypothesis, and the political cost hypothesis. The bonus plan hypothesis asserts that managers tend to increase reported earnings in order to qualify for compensation tied to financial performance. The debt covenant hypothesis proposes that earnings are manipulated by managers to prevent violations of debt agreements. Meanwhile, the political cost hypothesis suggests that large firms may postpone profit recognition to avoid attracting political scrutiny or regulatory pressure. PAT thus offers a theoretical lens through which earnings management behavior and its influence on financial reporting can be interpreted.

### **Earnings Management**

As stated by Rankin et al. (2018), earnings management involves managerial efforts to manipulate financial reports without being identified by the users of those reports. One of the key metrics in evaluating a company's success is its market or intrinsic value, which reflects profitability for shareholders, making management professionalism crucial. Indriani and Pujiono (2021) emphasize that earnings management practices can undermine the reliability and credibility of financial reports, where management manipulates reports for personal gain. Due to divergent interests and unequal access to information between company owners and management, managers may be tempted to distort financial reports to present favorable performance results. Although it can increase a company's value in the short term, this



practice harms the company in the long run. Financial statements become a target for earnings management as they reflect a company's performance.

### **Foreign Ownership**

Foreign ownership refers to investments made by foreign individuals or organizations that hold shares in a business in another country, benefiting from those investments (OECD, LOCA, 1997). According to agency theory, increased foreign ownership strengthens regulations on managers, limits earnings management, and reflects the company's true financial situation (Jensen, Meckling, 1976). Foreign investors, especially from developed countries, have high standards for financial information quality and provide management solutions that control business situations. Their independence and objectivity align the interests of managers and owners, reducing earnings management activities. Studies by Nguyen et al. (2020) indicate that foreign investment plays a role in limiting earnings management by minimizing inefficiencies and preventing overinvestment. Similarly, Al-Duais et al. (2021) found that firms with substantial foreign ownership are generally more capable of reducing real earnings management activities.

### **Audit Committee**

According to Liyanto and Anam (2019), the audit committee is a body established by the board of commissioners to strengthen the oversight of internal and external control systems as well as financial reporting processes. Its main function is to serve as an intermediary between the board of commissioners and internal and external auditors, so the audit committee must maintain independence and moral integrity. The role of the audit committee is vital in maintaining the integrity of financial reports and aligning them with required standards, with members meeting regularly to evaluate reports and discuss important issues. While the competence of audit committee members in various industries is not specifically regulated by Indonesian law, they are expected to have sufficient understanding of the company's business processes. The Financial Services Authority Regulation, POJK No. 02/POJK.05/2014, stresses that the presence of financial expertise among audit committee members is critical for enhancing the reliability of financial statements and curbing earnings management practices. In contrast, POJK 55/POJK.04/2015 merely requires audit committees to convene at least four times annually, without emphasizing the need for industry-specific competence. This absence of sectoral knowledge among committee members may create opportunities for management—who often have deeper industry insights—to engage in earnings manipulation.

**Leverage** Leverage refers to a company's capacity to use equity funds to pay off its debts, which relates to the proportion of debt to a company's equity (Santoso, Junaeni, 2022). According to Kusumawati (2019), agency theory suggests that leverage can motivate management to adjust profit reporting in order to avoid breaching debt agreements. This supports the debt covenant hypothesis, which posits that managers are incentivized to engage in earnings management to maintain compliance with lending terms. Mismanagement in financial strategy can increase debt ratios, so companies must be careful in managing profits to gain credit support and maintain shareholder confidence. High debt levels encourage companies to take earnings management actions to maintain access to credit, illustrating how



leverage utilizes debt to achieve economic benefits and evaluate the company's capital structure.

### **Information Asymmetry**

Information asymmetry arises when managers possess greater access to internal data and future business prospects than shareholders or external stakeholders (Budi, Anggraeni, 2023), enabling them to potentially manipulate financial reports for self-interest. As financial reports serve as the primary tool for stakeholders to assess a company's health and operational results, such imbalances can lead to intentional distortions. A common proxy for measuring information asymmetry is the bid-ask spread, which reflects market liquidity and captures the informational gap between company management and shareholders, as described by (Nathasa, Intan, 2018) in (Budi, Anggraeni, 2023).

### **Environment, Social, and Governance (ESG)**

Proponents of ESG believe that ESG enhances profit quality (Donaldson, Preston, 1995); (Freeman, 1994). Companies that are socially and ethically responsible build good relationships with stakeholders, promoting sustainable performance and reducing profit manipulation. In contrast, agency theory as proposed by Jensen and Meckling (1976) argues that managers may leverage ESG initiatives as a tool to obscure unfavorable behavior while improving their personal or corporate image. This strategic use of ESG can potentially result in a positive association between ESG practices and earnings manipulation. In this study, the Environment, Social, and Governance (ESG) variable is represented by the ESG Score obtained from the Bloomberg Terminal. The score is independently compiled by Bloomberg and reflects the company's overall ESG performance in a comprehensive manner. It serves as Bloomberg's objective evaluation of how a firm performs in relation to ESG criteria, particularly in areas that have material implications for financial outcomes.

### **Hypothesis Development**

Foreign ownership, where a portion of a company's shares is owned by foreign parties, is associated with more reliable financial reporting (Hutauruk et al., 2022). Stronger oversight and foreign expertise in governance and accounting (Agustin, Widiatmoko, 2022) can minimize earnings management practices. Agency theory, Jensen and Meckling (1976) suggests that foreign ownership enhances oversight of managerial actions, thereby promoting more transparent and reliable financial reporting. Foreign investors, particularly those originating from countries with stringent financial disclosure standards, are believed to foster improved governance and managerial discipline (Al-Duais et al., 2021). While some research, including that of (Agustin, Widiatmoko, 2022), presents contrasting evidence, foreign ownership is generally perceived as a factor that contributes to reducing the likelihood of earnings manipulation.

#### **H1: Foreign ownership negatively affects earnings management.**

Where both their size and the frequency of their meetings significantly contribute to limiting such practices. Functioning as a representative body of the company's owners (principals), the audit committee plays a key role in addressing agency problems, as outlined in agency



theory, by reinforcing oversight and governance mechanisms. An audit committee with more members can divide audit tasks more thoroughly, while a high meeting frequency facilitates faster detection and intensifies the monitoring of earnings management practices. Additionally, the expertise and educational background of audit committee members enhance their understanding of audit processes and accounting procedures, reducing the likelihood of earnings management practices by those meeting held by the audit committee. Fitri and Siswantoro (2021) found that a larger audit committee size significantly reduces the practice of earnings management, a conclusion that is consistent with the findings of Feronika et al. (2021) and Wahyuni et al. (2023). However, a contrasting result was reported by Handayani and Ibrani (2020), who observed that the presence of an audit committee does not significantly affect earnings management. These differing outcomes underscore the need for further empirical investigation to better understand the audit committee's actual role in limiting earnings manipulation.

## **H2: Audit committee activity is negatively associated with earnings management.**

The tendency for firms with higher leverage to engage in earnings management aligns with the debt covenant hypothesis under Positive Accounting Theory, as formulated by Watts and Zimmerman (1986). Debt contracts often stipulate that borrowers maintain specific debt-to-equity ratios, prompting managers of highly leveraged firms to adopt accounting practices that produce more conservative earnings figures. These adjustments are made to ensure compliance with covenant terms, effectively reducing reported leverage. As a result, leverage acts as a motivating factor behind earnings management aimed at staying within contractual debt limits. Empirical evidence from (Surjandari et al., 2021) confirms that leverage significantly influences earnings management, with similar conclusions drawn by other studies such as (Priharta et al., 2018); (Afiffah et al., 2018); (Fatimah, 2019); and (Kusumawati, 2019). However, other studies (Laudza, Nindiasari, 2022); (Pradana, 2021) found no significant influence, highlighting the need for further investigation.

## **H3: Leverage has a positive relationship with earnings management.**

When managers possess superior access to internal financial data, it can lead to opportunistic behavior, such as manipulating financial statements for personal benefit. Dai et al. (2013) emphasize that firms experiencing high information asymmetry are more prone to engage in earnings manipulation, which may result in heightened tensions between management and investors, reflecting agency conflicts as described in agency theory. Supporting this view, Feronika et al. (2021) also reported a significant and positive relationship between information asymmetry and earnings management. However, divergent findings have been presented by Tangngisalu and Jumady (2020), Budi and Anggraeni (2023), Ridwan and Suryani (2021), as well as Rizki (2021), suggesting that further investigation is necessary to clarify these inconsistencies.

## **H4: Information asymmetry has a positive influence on earnings management.**

Stakeholder theory suggests that firms committed to ESG principles prioritize long-term value creation and ethical conduct, reducing incentives for opportunistic earnings manipulation. Empirical evidence largely supports this view, as strong ESG performance and disclosure have been shown to limit managerial discretion over accruals (Velte, 2019; Hong



et al., 2022; Yangklan & Sincharoonsak, 2021). Although some studies document a positive association between ESG disclosure and earnings management, these findings are often attributed to contextual or institutional factors. Adopting a transparency-based perspective, this study posits that ESG disclosure primarily constrains earnings management.

**H5: ESG disclosure is generally found to have a negative relationship with earnings management.**

Foreign ownership, defined as the participation of foreign investors in a firm's equity structure, is commonly associated with higher financial reporting quality due to superior accounting expertise, stronger governance practices, and stricter monitoring of managerial behavior. Prior studies document that foreign investors tend to demand higher transparency and are more effective in constraining opportunistic earnings management (Hutauruk et al., 2022; Agustin & Widiatmoko, 2022). From an agency theory perspective, Jensen and Meckling (1976) argue that increased ownership by informed and sophisticated investors strengthens oversight over managerial actions, thereby reducing information advantages that enable earnings manipulation. Consistent with this view, Al-Duais et al. (2021) find that foreign ownership is negatively associated with earnings management, highlighting its monitoring role in mitigating agency conflicts. ESG disclosure further enhances this monitoring mechanism by improving the firm's information environment and increasing the transparency of corporate activities. Strict ESG management has been shown to limit managerial discretion over accruals and reduce opportunities for earnings manipulation (Hong et al., 2022). By reducing information asymmetry and strengthening external scrutiny, ESG disclosure enables foreign investors to more effectively exercise their monitoring function. Accordingly, ESG disclosure is expected to complement and reinforce the governance role of foreign ownership in constraining earnings management.

**H6: ESG disclosure strengthens the negative effect of foreign ownership on earnings management.**

Because external investors do not have direct access to a firm's internal financial information, they rely on internal governance mechanisms—particularly the audit committee—to assess the credibility of reported earnings. The audit committee supports the board of commissioners in overseeing the financial reporting process and mitigating agency conflicts by monitoring managerial behavior and ensuring the reliability of financial statements. Prior empirical studies indicate that higher audit committee activity, commonly proxied by meeting frequency, is associated with lower levels of earnings management (Fitri & Siswantoro, 2021; Feronika et al., 2021; Wahyuni et al., 2023). From a transparency-based perspective, ESG disclosure enhances the information environment in which governance mechanisms operate. Strict ESG management has been shown to limit managerial discretion over accruals and reduce opportunities for earnings manipulation by increasing disclosure quality and external scrutiny (Hong et al., 2022). Similarly, Yangklan and Sincharoonsak (2021) find that CSR reporting—an integral component of ESG disclosure—negatively affects earnings management. By reducing information asymmetry and improving the



availability of non-financial information, ESG disclosure enables audit committees to perform their monitoring function more effectively. Accordingly, ESG disclosure is expected to complement and strengthen the role of audit committee activity in constraining earnings management.

**H7: ESG disclosure strengthens the negative relationship between audit committee activity and earnings management.**

According to the debt covenant hypothesis within Positive Accounting Theory (Watts & Zimmerman, 1986), lending agreements commonly impose financial constraints that motivate managers of highly leveraged firms to engage in earnings management in order to comply with contractual requirements. To avoid covenant violations, managers may adopt accounting methods that accelerate earnings recognition, thereby reducing reported leverage ratios. Consistent with this argument, prior empirical studies document a positive relationship between leverage and earnings management (Surjandari et al., 2021; Priharta et al., 2018; Afiffah et al., 2018; Fatimah, 2019; Kusumawati, 2019). From a transparency-based perspective, ESG disclosure constrains such opportunistic behavior by enhancing the corporate information environment and increasing external scrutiny. Hong et al. (2022) demonstrate that strict ESG management limits managerial discretion over accruals, while Yangklan and Sincharoonsak (2021) find that ESG-related CSR reporting significantly reduces earnings manipulation. By improving disclosure quality and reducing information asymmetry, ESG disclosure is expected to restrict managers' ability to exploit leverage-related incentives for earnings management. Accordingly, ESG disclosure is anticipated to weaken the positive association between leverage and earnings management.

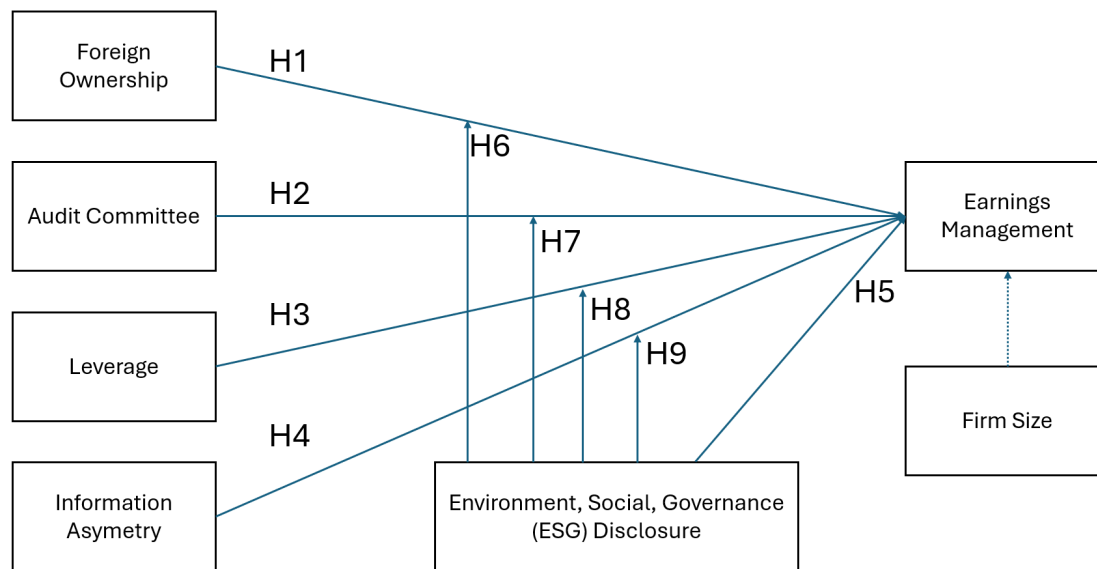
**H8: ESG disclosure weakens the positive relationship between leverage and earnings management.**

Information asymmetry creates opportunities for managers, who possess superior firm-specific information, to engage in earnings management for personal benefit (Dai et al., 2013). Empirical evidence generally supports a positive relationship between information asymmetry and earnings management, although findings remain mixed across institutional settings (Feronika et al., 2021; Tangngisalu & Jumady, 2020). Recent studies suggest that ESG-related practices can mitigate opportunistic financial reporting by enhancing transparency and external monitoring. Hong et al. (2022) document that stringent ESG management constrains managerial discretion in accrual-based earnings management, while Yangklan and Sincharoonsak (2021) find that CSR reporting—an integral component of ESG disclosure—significantly reduces earnings manipulation. From a transparency-based perspective, ESG disclosure improves the corporate information environment, thereby reducing information asymmetry between managers and external stakeholders. As a result, ESG disclosure is expected to weaken the ability of managers to exploit information advantages for earnings management purposes. Accordingly, this study hypothesizes that



ESG disclosure attenuates the positive relationship between information asymmetry and earnings management.

**H9: ESG disclosure weakens the positive effect of information asymmetry on earnings management.**



**Figure 1.** Research Framework

### 3. Research Methods

#### Sample and Data

This research focuses on companies listed on the main board of the Indonesia Stock Exchange (IDX) during the period 2020 to 2023 as the target population. A purposive sampling technique was applied to select the sample, using specific criteria designed to align with the objectives of the study. The selection criteria are outlined as follows:

1. Entities recorded as main board issuers on the IDX between 2020 and 2023.
2. Main board companies with Bloomberg ESG Scores for the period 2020 to 2023.
3. Non-bank main board companies with Bloomberg ESG Scores for the period 2020 to 2023.

The main board is a listing board provided to list shares of large companies and those with quite long operational experience.

#### Variables and Measurements

##### Independent Variables

##### Foreign Ownership (FO)

In this research, foreign ownership is measured as the percentage of a company's shares held by non-domestic investors. This is calculated by dividing the number of shares held by foreign shareholders by the total outstanding shares. The measurement is represented by the following formula:



Foreign Ownership (FO) = Total Outstanding Shares/  $\Sigma$  Number of Foreign Ownership Shares

#### Audit Committee (AC)

The audit committee is represented by the frequency of its meetings within a year. This proxy follows the approach of Fitri and Siswanto (2021), who indicated that an increased frequency of audit committee meetings contributes to lowering earnings management practices.

Audit Committee (AC) =  $\Sigma$  Frequency of Audit Committee Meetings Held Annually

#### Leverage (LEV)

Leverage reflects how much debt the company uses to finance its activities. According to Purnama and Taufiq (2021), this ratio reflects the proportion of funding through debt. High debt levels can result in extreme leverage, where the company faces difficulties in repaying its debt. Leverage in this study is measured using the Debt to Asset Ratio (DAR), calculated by dividing a firm's total liabilities by its total assets. The ratio is determined using the following formula:

Leverage (LEV) = Total Assets/ Total Liabilities

#### Information Asymmetry (SPRD)

Managers having superior insight into internal operations relative to shareholders gives rise to information asymmetry. It is measured by the relative bid-ask spread:

$$Spread = \frac{Ask_{it} - Bid_{it}}{(Ask_{it} + Bid_{it})/2}$$

#### Dependent Variable

Earnings management (EM) is calculated using (Stubben, 2010) Revenue Model:

$$\Delta A/R_{it} = \alpha + \beta_1 \Delta R1\_3it + \beta_2 \Delta R4it + \epsilon_{it}$$

Where:

- $\Delta A/R_{it}$  is the change in accounts receivable for company  $i$  in period  $t$ .
- $\alpha$  is the intercept or constant in the regression equation.
- $\beta_1$  is the regression coefficient that measures the relationship between revenue changes in quarters 1 to 3 ( $\Delta R1-3it$ ) and changes in accounts receivable.
- $\beta_2$  is the regression coefficient that measures the relationship between revenue changes in quarter 4 ( $\Delta R4it$ ) and changes in accounts receivable.
- $\Delta R1\_3it$  refers to the variation in revenue over 1 to 3 quarter for company  $i$  in period  $t$ .
- $\Delta R4it$  refers to the variation in revenue over 4 quarter for company  $i$  in period  $t$ .
- $\epsilon_{it}$  is the residual or error term from the equation, considered an indicator of earnings management (discretionary revenues).



### Moderating Variable

ESG Disclosure will be proxied by the ESG Score from Bloomberg Terminal. As an independent metric, this score is developed by Bloomberg to assess the overall ESG standing of a company, taking into account significant financial performance related to ESG factors. The ESG Score is rated on a scale of 1 to 10.

### Control Variable

Firm size is measured using the natural logarithm of total assets. This variable functions as a control to capture the consistent impact of company size on earnings management behavior.  
Firm Size = log of Total Assets

### Hypothesis Testing and Research Model

Panel data regression can be estimated through three approaches: the common effect model (CEM), fixed effect model (FEM), and random effect model (REM) (Ekananda, 2016). To determine the most appropriate model, this study applies the Chow Test, Hausman Test, and Lagrange Multiplier Test. Classical assumption testing involves verifying the absence of autocorrelation, multicollinearity, heteroscedasticity, and confirming that the data distribution follows normality. This study uses moderation, which functions as both a dependent variable on its own and interacts with other dependent variables.

The following equation represents the regression model applied in this research:

$$EM = \alpha + \beta_1 FO + \beta_2 AC + \beta_3 LEV + \beta_4 SPRD + \beta_5 ESG + \beta_6 FO * ESG + \beta_7 AC * ESG + \beta_8 LEV * ESG + \beta_9 SPRD * ESG + \varepsilon$$

Where:

EM is Earnings Management;  $\alpha$  is Constant;  $\beta$  is Regression Coefficient;  $\varepsilon$  is Error Coefficient; FO is Foreign Ownership; AC is Audit Committee; LEV is Leverage; SPRD is Information Asymmetry (Bid-Ask Spread); ESG is Environment, Social, and Governance Disclosure

An outlier test is a statistical technique used to identify data that is different or unusual in a sample. According to Ghazali (2018), an outlier is data with unique characteristics that deviate significantly from other observations, appearing as extreme values for one or a combination of variables. Causes of outliers, according to Ghazali (2018), include data entry errors, missing value specification failures, data not from the sample population, or a non-normal distribution of variables in the population. Outlier tests can be performed by adding, transforming, or reducing extreme data. The results of this test may reduce the number of data samples used in the research.

This study employs regression analysis to evaluate the model's Goodness-of-Fit, which reflects how well the regression function predicts actual outcomes. The model's predictive accuracy is assessed through statistical indicators such as the coefficient of determination, F-statistic, and t-statistic. According to Ghazali (2018), these statistics are considered



significant when their values lie within the rejection region of the null hypothesis (Ho), and considered not significant when the values fall within the acceptance region.

## 4. Results

The following table outlines the sample selection criteria:

**Table 1. Research Sample Criteria**

No.	Sample Criteria	Year			
		2020	2021	2022	2023
1.	IDX main board companies	345	345	345	345
2.	IDX main board companies without complete Bloomberg ESG Scores for 2020-2023	(286)	(286)	(286)	(286)
3.	IDX main board companies with complete Bloomberg ESG Scores for 2020-2023	59	59	59	59
4.	IDX main board bank companies with Bloomberg ESG Scores for 2020-2023	(12)	(12)	(12)	(12)
5.	IDX main board non-bank companies with Bloomberg ESG Scores for 2020-2023	47	47	47	47
6.	Outlier data reduction	(18)	(16)	(16)	(23)
7.	Total companies	29	31	31	24
8.	Total Sample				115

Source: IDX, processed (2024)

The results of descriptive statistical testing of the research variables are shown in Table 2 below:

**Table 2. Descriptive Statistics of Research Data**

Variabel	n	Mean	Std. Dev	Minimum	Maximum
EM	115	0,0081178	0,0054224	0,001224	0,025364
FO	115	0,4198031	0,2392871	0,035317	0,934271
AC	115	8,843478	6,384729	3	29
LEV	115	0,2440265	0,1840228	0,000029	0,713743
SPRD	115	0,0060577	0,0048958	0,00061	0,031153
ESG	115	3,029043	1,147492	0,81	5,23
TA	115	13,61488	0,3901818	12,7057	14,4579

Source: Processed Secondary Data, 2024 (STATA 17)

### Model Selection Testing



**Table 3. Model Selection Results**

No.	Testing	Hypothesis	Result	Decision
1.	Chow Test	Ho: CEM Ha: FEM If Prob <0,05 then Ho is rejected	Prob > F = 0.0413	Ha accepted, FEM model
2.	Hausman Test	Ho: REM Ha: FEM If Prob <0,05 then Ho is rejected	Prob > chi2 = 0.0506	Ho accepted, REM model

Source: Processed Secondary Data, 2024 (STATA 17)

Based on the model testing above, it can be concluded that the REM (Random Effect Model) was chosen for this study. For the panel data model testing, the REM using the Generalized Least Square (GLS) estimation method will be applied. To address potential violations of classical assumptions, all estimations are conducted using cluster-robust standard errors at the firm level, following Wooldridge (2010).

**Table 4. Classic Assumption Test**

No.	Testing	Result	Decision
1.	Normality Test (Shapiro-Wilk)	Prob > z = 0.00627	Ho rejected (not normally distributed)
2.	Autocorrelation Test (Woolridge Test)	Prob > F = 0.3697	Ho accepted (no autocorrelation)
3.	Heteroscedasticity Test (Breusch-Pagan/ Cook-Weisberg)	Prob > chi2 = 0.0324	Ho rejected (heteroscedasticity detected)

Source: Processed Secondary Data, 2024 (STATA 17)

**Table 5. Classic Assumption Test (Multicollinearity Test)**

Variable	VIF	Decision
FO	22.83	Multicollinearity detected
AC	25.08	Multicollinearity detected
LEV	11.55	Multicollinearity detected
SPRD	6.04	No Multicollinearity detected
ESG	13.32	Multicollinearity detected
FO_ESG	22.83	Multicollinearity detected
AC_ESG	36.01	Multicollinearity detected
LEV_ESG	11.85	Multicollinearity detected
SPRD_ESG	6.22	No Multicollinearity detected

Source: Processed Secondary Data, 2024 (STATA 17)

Several diagnostic issues were identified during preliminary testing. First, the Shapiro–Wilk test indicates non-normal residuals; however, normality is not a strict requirement for the consistency of GLS estimators, particularly in moderate to large samples. Second, heteroskedasticity is detected, which is mitigated by the use of firm-level clustered robust standard errors that provide heteroskedasticity-consistent inference. Third, no evidence of serial autocorrelation is found, supporting the suitability of the Random Effects specification.



Finally, multicollinearity is observed among interaction terms involving ESG disclosure, as indicated by elevated VIF values. This condition is expected in moderation models and does not bias coefficient estimates, although it may increase standard errors. Therefore, the model remains valid for hypothesis testing.

As a robustness check, the main regression is re-estimated using cluster-robust variance estimators to ensure the stability of statistical inference under heteroskedasticity and within-panel correlation. The results remain qualitatively consistent with the baseline findings, indicating that the conclusions are robust to alternative variance specifications.

While classical assumption tests are traditionally associated with pooled OLS models, this study follows contemporary panel data econometric practice by prioritizing robust inference through clustered standard errors rather than strict assumption compliance, thereby ensuring consistent and reliable estimation results.

### Hypothesis Testing Results

**Table 6. Summary of Results**

Variable	Direction Prediction	Coefficient ( $\beta$ )	Sig	Decision
(Constant)		0,06590	0,004	
FO	-	-0,00617	0,533	H1 rejected
AC	-	0,00068	0,096	H2 rejected
LEV	+	0,00683	0,485	H3 rejected
SPRD	+	0,46230	0,066	H4 accepted
ESG	-	0,00266	0,111	H5 rejected
FO_ESG	+	0,00047	0,871	H6 rejected
AC_ESG	+	-0,00017	0,103	H7 rejected
LEV_ESG	-	-0,00139	0,644	H8 rejected
SPRD_ESG	-	-0,17078	0,063	H9 accepted
TA		-0,00479	0,003	
Adjusted R <sup>2</sup>		0,1854		
F sig		0,0378		

Source: Processed Secondary Data, 2024 (STATA 17)

**The research model is as follows:**

$$EM = 0,06590 - 0,00617 * FO + 0,00068 * AC + 0,00683 * LEV + 0,46230 * SPRD + 0,00266 * ESG + 0,00047 * FO_{ESG} - 0,00017 * AC_{ESG} - 0,00139 * LEV_{ESG} - 0,17078 * SPRD_{ESG} - \epsilon$$

**Where:**

EM is Earnings Management;  $\alpha$  is Constant;  $\beta$  is Regression Coefficient;  $\epsilon$  is Error Coefficient; FO is Foreign Ownership; AC is Audit Committee; LEV is Leverage; SPRD is Information Asymmetry (Bid-Ask Spread); ESG is Environment, Social, and Governance Disclosure



### Adjusted R-Square and F-Test

The F-test results indicate a Prob>chi2 value of 0.0378, which is below the 0.05 threshold. This suggests that the independent variables collectively have a significant effect on earnings management. Consequently, the model is deemed appropriate for subsequent analyses, including partial testing through the t-test. The adjusted R-squared value is 0.1854, meaning that 18.54% of the variation in the dependent variable can be explained by the independent variables in the model, while the remaining 81.46% is attributed to other influencing factors not accounted for in this study.

### T-Test

#### Foreign ownership does not negatively affect earnings management

This study concludes that foreign ownership does not significantly affect earnings management, indicating that foreign shareholders' oversight is insufficient to reduce earnings management practices as suggested by agency theory (Jensen, Meckling, 1976). This could be due to sector variations in the sample and is consistent with prior research by (Agustin, Widiatmoko, 2022). Thus, the hypothesis stating that foreign ownership negatively affects earnings management is rejected.

#### Audit committee does not negatively affect earnings management

This study concludes that the audit committee does not significantly affect earnings management, despite the t-test showing significance, as the coefficient direction does not align with the hypothesis. The increased frequency of audit committee meetings may strengthen earnings management due to several factors. First, the higher frequency of meetings does not necessarily correlate with the quality of the audit committee's oversight, as meetings may focus on non-substantive issues unrelated to the supervision of management activities. Second, a higher frequency of meetings may indicate more internal problems within the company, potentially caused by earnings management practices. Third, the frequent meetings may be due to the lack of expertise within the audit committee and poor communication between the audit committee and management. This result aligns with the study by Katmon and Farooque (2017), which also identified a positive association between audit committee meeting frequency and earnings management. As a result, the hypothesis proposing that the audit committee has a negative impact on earnings management is not supported.

#### Leverage does not positively affect earnings management

The study concludes that leverage does not affect earnings management, likely because the sample companies' leverage remains within safe limits (<50%). This differs from the positive accounting theory's restrictive covenant hypothesis (Watts, Zimmerman, 1986), which suggests that high leverage might drive earnings management. The findings are consistent with research by Laudza and Nindiasari (2022) and Pradana (2021), leading to the rejection of the hypothesis that leverage positively affects earnings management.



#### Information asymmetry positively affects earnings management

This study concludes that information asymmetry positively affects earnings management, consistent with the theory that imbalanced information between management and shareholders can lead to earnings manipulation, as noted by (Dai et al., 2013). It is evident that information asymmetry can lead to speculative earnings management because managers with greater access to company profits can alter financial disclosures for personal gain or the benefit of a minority. The mismatch in information received by investors creates conflict between investors and managers, potentially leading to agency conflicts, as described by agency theory. A high level of information asymmetry between company management and shareholders increases the likelihood of earnings manipulation. This result is in line with the findings of Feronika et al. (2021), who reported a significant and positive effect of information asymmetry on earnings management. Thus, the hypothesis suggesting that information asymmetry positively influences earnings management is accepted.

#### ESG Disclosure does not negatively affect earnings management

The study concludes that ESG Disclosure does not significantly affect earnings management, possibly because management's awareness of ESG importance is still low. This is consistent with Citrajaya and Gozali (2020), who also found no significant effect of corporate social responsibility (CSR) on earnings management. Therefore, the hypothesis that ESG Disclosure negatively affects earnings management is rejected.

#### ESG Disclosure does not strengthen the effect of foreign ownership on earnings management

In contrast to prior research by Hong et al. (2022), which found that rigorous ESG practices constrain earnings manipulation, this study finds that ESG Disclosure does not enhance the influence of foreign ownership on earnings management. Consequently, the proposed hypothesis is not supported.

#### ESG Disclosure does not strengthen the effect of the audit committee on earnings management

Although there is statistical significance in hypothesis 7 with a P-value  $< 0.10$ , the results are inconsistent with hypothesis 2. Other studies, such as Hong et al. (2022), suggest that strict ESG management can limit earnings manipulation, but this does not hold in this context. Therefore, the hypothesis is rejected.

#### ESG Disclosure does not weaken the effect of leverage on earnings management

The results of this study indicate that ESG Disclosure does not diminish the impact of leverage on earnings management. This outcome contradicts earlier studies, including those by Priharta et al. (2018) and Hong et al. (2022), which suggest that strong ESG governance can help curb earnings manipulation. As a result, the hypothesis is not accepted.

#### ESG Disclosure weakens the effect of information asymmetry on earnings management

The results of the t-test indicate that ESG Disclosure significantly weakens the effect of information asymmetry on earnings management. Through improved transparency, ESG Disclosure contributes to reducing information asymmetry, thus limiting the potential for financial report manipulation. This outcome aligns with the findings of Hong et al. (2022),



reinforcing the hypothesis that ESG Disclosure can diminish the influence of information asymmetry on earnings management practices.

## **5. Conclusion and Suggestion**

### **5.1. Conclusion**

Our findings indicate that ESG disclosure primarily influences earnings management through the information environment channel rather than formal governance mechanisms. ESG disclosure reduces information asymmetry by providing complementary non-financial information that enhances the transparency and detectability of earnings manipulation (Dhaliwal et al., 2011). In contrast, foreign ownership and audit committees function as monitoring mechanisms that depend on information availability but do not directly generate disclosure, which may explain the absence of a strong moderating effect. This pattern is consistent with the institutional characteristics of emerging markets such as Indonesia, where formal governance mechanisms often face limitations due to weak legal enforcement and relationship-based practices (Leuz et al., 2003). Consequently, ESG disclosure may serve as a more effective transparency signal than traditional monitoring structures. Overall, these results align more closely with signaling and information asymmetry theories than with a purely agency-based monitoring perspective.

### **5.2. Suggestions**

Future research could improve by using content analysis of sustainability reports for ESG Disclosure, expanding the sample to other countries, using additional audit committee variables such as financial expertise, and including more independent variables such as profitability, company size, and tax avoidance to better understand the factors influencing earnings management.

## **Discussion**

This study has several limitations that should be considered when interpreting the results. First, ESG disclosure is measured using Bloomberg's aggregate ESG score, which provides standardized and externally verified information but does not capture firm-specific disclosure depth or individual ESG dimensions; future studies may employ content analysis or disaggregated ESG measures. Second, the use of a Random Effects Model, while appropriate for the data structure, limits the treatment of potential endogeneity, suggesting that future research could apply alternative panel techniques such as fixed effects or dynamic models to strengthen causal inference.



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