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| RESEARCH ARTICLE

Governance Mechanisms on Earnings Management: Does Audit Quality Moderate? Evidence from Indonesia

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| ABSTRACT
This study examines the determinants of earnings management in Indonesia's consumer non-cyclical sector, focusing on the roles of leverage, board gender diversity, managerial ownership, and institutional ownership, with audit quality as a moderating variable. Using 375 firm-year observations from 75 companies listed on the Indonesia Stock Exchange between 2020 and 2024, the study applies Moderated Regression Analysis (MRA). Earnings management is measured using discretionary accruals derived from the Modified Jones Model. The findings reveal that leverage exerts a significant positive effect on earnings management, whereas gender diversity, managerial ownership, and institutional ownership each exert a significant negative effect. Regarding moderation, audit quality significantly weakens the effect of leverage on earnings management while strengthening the suppressive effect of board gender diversity. Audit quality does not moderate the effects of either ownership variable. These results suggest that gender-diverse boards, managerial equity stakes, and institutional ownership represent effective governance mechanisms, whose efficacy is further reinforced when coupled with high-quality external auditing.

| KEYWORDS
Earnings Management, Leverage, Board Gender Diversity, Managerial Ownership, Institutional Ownership, Audit Quality

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1. Introduction
Financial reporting is the main way corporations inform investors, creditors, regulators, and other stakeholders of their economic performance. The usefulness of this communication depends fundamentally on one assumption: that the information presented reflects the underlying economic reality of the firm as faithfully as possible. When this assumption breaks down, when managers exercise the discretion available to them under accounting standards not to convey truth but to serve private interests, the entire informational architecture of capital markets is compromised. Because earnings management is so hard to remove, accounting scholars and regulators have focused on it. It operates within the law, exploits the flexibility deliberately built into accounting standards to accommodate economic complexity, and requires sophisticated detection mechanisms that many governance structures simply do not possess.

One of the most prominent definitions of earnings management is deliberate involvement in external financial reporting for private advantage by Schipper (1989). Healy & Wahlen (1999) add that earnings management occurs when managers use judgement in financial reporting and transaction structuring to alter financial reports to mislead stakeholders about the company's economic performance or to influence contractual outcomes that depend on accounting numbers. Both definitions agree that earnings management is intentional and driven by incentives that conflict with open and credible reporting.

These incentives are well-documented. Managers may manipulate earnings to meet analyst forecasts, avoid reporting losses, satisfy the conditions of debt covenants, maximise accounting-based performance bonus compensation, or signal favorable performance ahead of equity offerings. The diversity of these motivations explains why earnings management is observed across industries, ownership structures, and institutional environments, and why no single governance mechanism has proven sufficient to eliminate it entirely. Understanding earnings management therefore requires examining the complex interaction of multiple governance factors rather than any single determinant in isolation.

Indonesia provides a particularly relevant and challenging context for this inquiry. As the largest economy in Southeast Asia and one of the most dynamic emerging markets globally, Indonesia has experienced rapid capital market development alongside persistent governance weaknesses that create fertile conditions for earnings management. The country's legal and regulatory framework, while strengthened considerably in recent decades through the establishment of the Financial Services Authority (OJK) and successive corporate governance reform initiatives, still faces implementation gaps that leave room for managerial opportunism in financial reporting. Indonesian listed companies' concentrated ownership structures, where founding families, government entities, or affiliated institutional investors often hold dominant stakes, complicate governance by creating conflicts of interest between controlling and minority shareholders.

A prominent case from recent years illustrates the real-world consequences of earnings management in the Indonesian market. PT Tiga Pilar Sejahtera Food Tbk (AISA), a producer of consumer goods, became embroiled in one of the country's most significant financial reporting scandals following the discovery of irregularities in its 2017 financial statements. After an initial controversy involving one of its subsidiaries eroded investor confidence and depressed the company's share price, shareholders commissioned an investigative audit conducted by Ernst & Young Indonesia. The investigation revealed that former members of management had deliberately recorded six affiliated companies as third parties, producing an overstatement of approximately IDR 4 trillion in receivables, an overstatement of IDR 662 billion in sales, and an overstatement of IDR 329 billion in EBITDA within the food division. A substantial flow of funds to parties affiliated with the former management was also identified without adequate disclosure. The case demonstrated not only that earnings management could be executed at a large and visible public company through the manipulation of related-party transactions and accrual accounts, but also that such practices inflict lasting damage on investor trust and corporate reputation when the external monitoring architecture fails to detect them in a timely manner. This type of accrual-based manipulation, often invisible to investors who examine only bottom-line figures rather than the underlying relationships among revenue, receivables, and earnings, is precisely what makes earnings management so difficult to detect without systematic analytical tools.

The academic literature on earnings management determinants is extensive but fragmented. Dozens of potential predictors have been examined, yet results are frequently inconsistent across samples, sectors, and time periods, making it difficult to determine whether governance tools consistently regulate profits management in Indonesia. Leverage, board gender diversity, management ownership, and institutional ownership are four factors with solid theoretical underpinnings and ongoing empirical discussion in Indonesia. Audit quality moderates this research.

2. Literature Review

Agency theory (Meckling & Jensen, 1976) states that contemporary publicly listed corporations have a fundamental separation between owners and managers. Separation, the structural underpinning of efficient financial markets, causes stress. Principals, or owners, assign decision-making power to managers, or agents, with the hope that agents would act in their best interests. However, agents possess private information about firm operations, investment opportunities, and management quality that is not directly observable by principals. This information asymmetry creates conditions under which self-interested agents can take actions that benefit themselves at the expense of principals without being easily detected. Earnings management is one of the most direct manifestations of this agency problem: managers use the discretion available to them under accounting standards to report earnings that serve their interests rather than faithfully reflecting underlying economic performance.

Agency theory also explains why governance might decrease profits management. External shareholders, creditors, and auditors monitor management-outside party information gaps, raising the likelihood of self-serving reporting being found and punished. The effectiveness of these monitoring mechanisms depends on their quality, their independence from management, and their capacity to process and interpret financial information. This is precisely why audit quality, board composition, and ownership structure are theoretically expected to influence the degree of earnings management observed at any given firm.

Positive accounting theory by Watts & Zimmerman (1986) complements the agency framework by predicting when managers would pick accounting procedures that inflate or deflate reported profits. The theory assumes managers are rational economic players who deliberately pick accounting procedures to maximise predicted benefit. This assumption yields three standard hypotheses. According to the bonus plan hypothesis, managers whose remuneration is dependent on accounting-based performance metrics would choose income-increasing accounting methods to maximise bonuses. The debt covenant concept anticipates enterprises operating near loan agreement contractual limits, typically expressed as minimum financial ratios, will choose accounting policies that increase reported income to avoid technical default and the associated penalties. The political cost hypothesis predicts the reverse for large, politically visible firms: managers of such firms will select income-decreasing policies to reduce the scrutiny and potential regulatory intervention associated with the appearance of high profitability.

Both theoretical frameworks explain earnings management and what firm-level features make it more or less common. Their explanations also explain why governance factors and profits management are not necessarily linked. The direction and magnitude of any individual variable's effect depend on which theoretical mechanism dominates in a given context, a reality that accounts for much of the empirical inconsistency observed in the literature.

2.1 Hypothesis Development

Leverage on Earnings Management

A firm's debt-to-asset ratio, or leverage, indicates its dependence on external finance. Two theoretical channels predict its interaction with profits management differently. Watts & Zimmerman (1986)'s debt covenant theory predicts that highly leveraged enterprises would choose income-increasing accounting procedures to avoid loan agreement financial ratio thresholds, creating a positive leverage-earnings management connection. Consistent with this prediction, Agustia & Suryani (2018); Indracahya & Faisol (2017) document positive leverage effects in Indonesian manufacturing samples, while Al-Shattarat (2024) confirms the relationship using evidence from the United Kingdom.

The debt monitoring hypothesis, however, offers a competing prediction, creditors impose rigorous oversight on highly indebted borrowers through frequent reporting requirements and covenant compliance reviews, creating an external discipline that constrains managerial discretion over accruals. Evidence consistent with this monitoring channel has been documented by Fatikhah (2024); Gunawan & Bangun (2025); Kaifa et al. (2025) in recent Indonesian studies. Since Indonesian credit markets have been more vigilant after the epidemic, this unresolved contradiction prompts empirical reexamination in the consumer non-cyclical sector. Based on positive accounting theory's main prediction:

H1: Leverage has a positive effect on earnings management.

Board Gender Diversity on Earnings Management

Agency theory (Meckling & Jensen, 1976) views the board of directors as a fundamental internal monitoring mechanism that constrains management opportunism depending on its makeup. Diversity, including gender, affects the board's monitoring of management's financial reporting choices. Female directors consistently exhibit more ethical sensibility, lower risk tolerance, and more diligent monitoring engagement relative to their male counterparts (Adams & Ferreira, 2009; Post & Byron, 2015). These behavioral orientations strengthen the board's supervisory function and narrow the information gap between management and the board, raising the probability that opportunistic accrual choices are detected and challenged before they reach published financial statements.

Empirical evidence in Indonesia broadly supports this prediction. Iqbal et al. (2025) document a significant negative association between female board representation and discretionary accruals in non-financial Indonesian companies from 2020 to 2023. Setiany & Yahawi (2022) confirm consistent findings in an earlier sample period, while Yopie & Chandrawati (2023) establish that the effect operates through genuine oversight quality rather than symbolic board composition changes. Salsabilla & Diantimala (2024), The Indonesian banking sector shows no substantial influence, indicating that sector-specific regulatory conditions affect this connection. Given the theoretical prediction and supporting data, the following hypothesis is offered:

H2: Board gender diversity has a negative effect on earnings management.

Managerial Ownership on Earnings Management

Agency theory (Meckling & Jensen, 1976) predicts that managers with ownership shares in their organisations diminish the disparity between management and shareholder interests that encourages opportunism. The manager's personal wealth becomes sensitive to long-run firm value, making income manipulation personally costly upon discovery and shifting the incentive structure toward more transparent reporting. This alignment effect has received consistent empirical support in the Indonesian literature. Mahariana & Ramantha (2014) document a significant negative relationship in manufacturing sector companies, Purnama (2017) confirms the pattern across a multi-sector sample, and Ishmah & Permatasari (2025) demonstrate its persistence after controlling for leverage, firm size, and dividend policy. The robustness of this finding across different periods and specifications provides strong grounds for the following hypothesis:

H3: Managerial ownership has a negative effect on earnings management.

Institutional Ownership on Earnings Management

Agency theory (Meckling & Jensen, 1976) suggests institutional ownership can monitor manager-shareholder conflicts. Institutional investors hold substantial equity stakes, possess professional analytical capabilities, and maintain investment horizons that position them as effective monitors of managerial conduct (Roodposhti & Chashmi, 2011). Their capacity to scrutinize corporate performance reduces the information asymmetry that separates managers from owners and constrains the opportunity for opportunistic reporting. Annabella & Susanto (2022); Erawati & Lestari (2019) Indonesian samples show a negative relationship between institutional ownership and earnings management, supporting this monitoring function.

The strength of this monitoring effect is not uniform across contexts. Some institutional investors in emerging markets adopt more passive investment strategies oriented toward short-term returns, which may limit the time and resources available for intensive governance engagement with individual portfolio firms, and recent Indonesian evidence such as Gunawan & Bangun (2025); Modisa & Sriyani (2026); Sulaiman et al. (2025) reflects this variation in monitoring intensity. On balance, however, agency theory provides the dominant expectation that institutional investors, given their sizeable stakes and analytical resources, act as effective external monitors that discourage earnings manipulation. Based on this theoretical expectation and the supporting empirical evidence, the following hypothesis is proposed:

H4: Institutional ownership has a negative effect on earnings management.

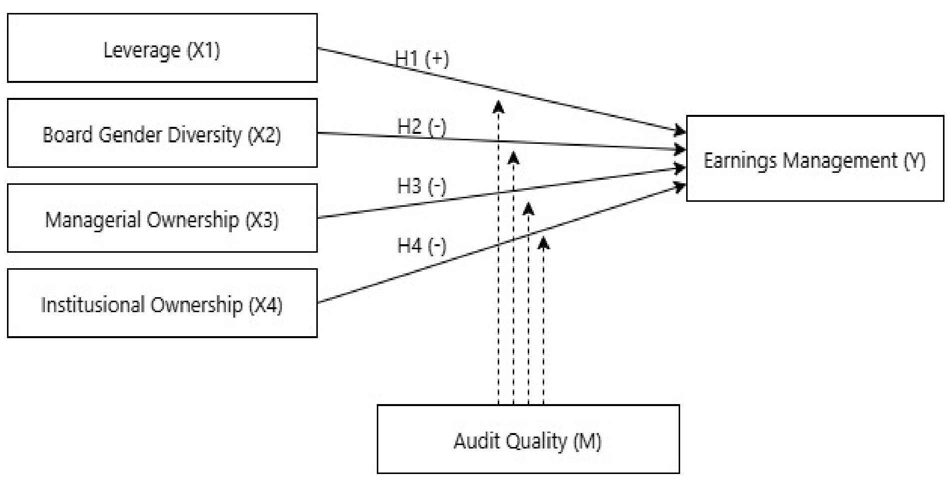
The Moderating Role of Audit Quality

This research claims that the four governance characteristics' impacts on profits management depend on the external audit environment. Quality, measured by Big Four membership, indicates the auditor's ability to find and report major misstatements (DeAngelo, 1981). High-quality auditors possess superior technical competence, stronger reputational incentives for independence, and more robust quality-control systems that constrain the range of accrual choices available to managers without auditor challenge.

Audit quality dampens earnings management and interacts with firm-level governance measures via two pathways. First, audit quality partly replaces another governance mechanism's monitoring role and reduces its impact. The second is complementarity, whereby audit quality reinforces an existing mechanism and produces synergistic outcomes that neither could achieve independently. In the case of leverage, the interaction is expected to operate through substitution. When a Big Four auditor provides rigorous independent verification of accrual estimates, creditors can partially rely on the auditor's assessment, relaxing some of the direct surveillance pressure they would otherwise impose on highly leveraged borrowers, so that audit quality weakens the positive effect of leverage on earnings management (Rosyidah & Rahayu, 2024; Yermiana et al., 2022). Complementarity is required for board gender diversity. Female directors' conservative reporting orientations are amplified when board deliberations are also subject to rigorous external verification, creating a dual governance environment in which each mechanism reinforces the other, so audit quality strengthens board gender diversity's suppressive effect on earnings management (Amara et al., 2025; Miladi & Chouaibi, 2021). For managerial ownership, audit quality is expected to reinforce the alignment already created by equity ownership, since rigorous external verification supports the transparency and accountability of reporting and thereby strengthens the capacity of managerial ownership to constrain earnings management (Suwarno et al., 2021). For institutional ownership, audit quality is likewise expected to reinforce the external monitoring exercised by institutional investors, strengthening their capacity to suppress opportunistic reporting when their oversight is supported by a credible external audit (Susbiyani et al., 2023). Based on these theoretical distinctions, the following hypotheses are proposed:

H5: Audit quality weakens the effect of leverage on earnings management.
H6: Audit quality strengthens the effect of board gender diversity on earnings management.
H7: Audit quality strengthens the effect of managerial ownership on earnings management.
H8: Audit quality strengthens the effect of institutional ownership on earnings management.

Figure 1. Research Framework



3. Methodology

Secondary data from Indonesia Stock Exchange (IDX) company annual reports and audited financial statements is used in this quantitative analysis. Given its goal of investigating causal and moderating links between governance characteristics and earnings management behaviour across a large cross-sectional sample, quantitative methodologies are acceptable. The analytical technique uses multiple linear regression and Moderated Regression Analysis (MRA) to assess direct and conditional impacts of audit quality.

All IDX-listed consumer non-cyclical manufacturing enterprises from 2020 to 2024 are the research population. This sector was selected for two reasons. First, companies in food and beverage, pharmaceutical, cosmetics, tobacco, and household product subsectors operate in capital-intensive environments with complex accrual estimation processes, including inventory valuation, asset depreciation, and trade receivable provisioning. These characteristics create broader opportunities for discretionary accrual management relative to operationally simpler industries. Second, the 2020 to 2024 period encompasses the economic disruption of the COVID-19 pandemic, the subsequent recovery phase, and the emerging pressures of global inflation and supply chain disruption, providing meaningful variation in the governance conditions under which earnings management decisions are made.

The sample was selected using a purposive sampling technique based on criteria. Table 1 shows the sample selection process, which involves excluding companies with missing or unavailable data.

Table 1. Sample Selection

No	Description	Total
1	Population of companies in the consumer non-cyclicals sector listed on the Indonesia Stock Exchange (IDX) during the period 2020–2024.	129
2	Companies that do not have complete data for all variables used in the study.	(54)
3	Consumer non-cyclicals sector companies that do not present complete annual reports during the period 2020–2024.	(0)
Companies used as the sample		75
Total observations (75 companies × 5 years)		375

Source: Research data

3.1 Variables and Measurement

Earnings Management

Dechow et al. (1996) use Modified Jones Model discretionary accruals to assess earnings management. The concept separates discretionary accruals, which are due to management judgement rather than commercial activity. First, net income less operational cash flows equals total accruals:

$$TA_{it} = NI_t - CFFOt$$

Discretionary accruals are then obtained by scaling the change in total accruals by lagged total assets:

$$DA_{it} = (TA_{it} - TA_{it-1}) / A_{it-1}$$

Description:

TA_{it} : Total accruals of company i in year t
Ni_t : Net income after tax in year t
$CFFO_t$: Cash flows from operating activities in year t
DA_t : Discretionary accruals of company i in year t
TA_{it-1} : Total accruals of company i in year t-1
A_{it-1} : Total assets of company i in year t-1

A higher absolute value of discretionary accruals indicates a greater degree of managerial intervention in the financial reporting process, whether income-increasing or income-decreasing.

Leverage

Leverage is measured as the ratio of total debt to total assets, capturing the extent to which a firm relies on external debt financing relative to its total asset base:

$$LEV = \text{Total Debt} / \text{Total Assets}$$

A higher leverage value indicates greater dependence on borrowed funds and stronger exposure to creditor monitoring and debt covenant constraints (Naftalia & Marsono, 2013).

Board Gender Diversity

Board gender diversity is operationalized as the proportion of female members on the board of directors relative to total board size:

$$GD = \text{Number of Female Directors} / \text{Total Directors}$$

This statistic shows how much female input is given to board strategic and oversight decisions (Adams & Ferreira, 2009).

Managerial Ownership

Managerial ownership is measured as the percentage of total outstanding shares held by the company's directors and executives:

$$MO = \text{Shares Held by Management} / \text{Total Outstanding Shares} \times 100\%$$

Higher managerial ownership reflects stronger alignment between managerial and shareholder interests through the wealth-at-risk mechanism (Meckling & Jensen, 1976).

Institutional Ownership

Institutional investors pension funds, insurance companies, mutual funds, and other financial institutions—own a proportion of outstanding shares:

$$IO = \text{Shares Held by Institutions} / \text{Total Outstanding Shares} \times 100\%$$

A higher value indicates greater potential for institutional monitoring of managerial conduct (Roodposhti & Chashmi, 2011).

Audit Quality
Audit quality is 1 if the company's external auditor is from one of the Big Four public accounting firms (Deloitte, PricewaterhouseCoopers, Ernst & Young, and KPMG) and 0 otherwise. The literature uses Big Four membership as a proxy for audit quality because to their better technical skill, reputational incentives, and quality-control infrastructure (DeAngelo, 1981).

3.2 Data Analysis Technique

This research uses a number of data analytic approaches to assure statistical model validity and hypothesis testing reliability. Before inferential analysis, descriptive statistics are produced for all study variables to summarise the sample's core trends and distributional features.

To ensure regression model statistical integrity, conventional assumption diagnostics are performed before hypothesis testing. This research uses the central limit theorem to determine normality, which states that as the sample size increases, the sampling distribution of the estimators approaches normality regardless of the data distribution. Since the analysis uses 375 firm-year observations, far more than the conventional threshold of 30 observations at which the theorem takes effect, the residuals can be treated as approximately normally distributed to satisfy the normality assumption. For multicollinearity, Variance Inflation Factor (VIF) values below 10 suggest acceptable correlation among independent variables. The Glejser test detects heteroscedasticity, with significance values over 0.05 indicating consistent residual variance across predictor values. Values between the upper limit dU and 4-dU show no first-order serial correlation in the Durbin-Watson statistic. If autocorrelation is found, Cochrane-Orcutt correction is done before hypothesis testing.

IBM SPSS estimates Moderated Regression Analysis (MRA) for hypothesis testing. MRA is ideal for this research because it permits simultaneous analysis of the governance factors' direct impacts on earnings management and audit quality's conditional effects. Model is as follows:

$$Y = \alpha + \beta 1\ X1 + \beta 2\ X2 + \beta 3\ X3 + \beta 4\ X4 + \beta 5\ M + \beta 6\ X1.M + \beta 7\ X2.M + \beta 8\ X3.M + \beta 9\ X4.M + \varepsilon$$

Y is earnings management measured by discretionary accruals, X1 is leverage, X2 is board gender diversity, X3 is managerial ownership, X4 is institutional ownership, M is audit quality, and X1M through X4M are the governance variable-audit quality interaction terms. The F-statistic and Adjusted R^2 coefficient of determination evaluate model fit. At 5% significance, hypotheses with p-values below 0.05 are considered significant. A substantial interaction term shows that audit quality moderates the governance variable-earnings management link.

4. Results and Discussion

4.1 Descriptive Statistics

This analysis uses 375 firm-year data from 75 Indonesia Stock Exchange-listed consumer non-cyclical firms from 2020 to 2024. Mean leverage, measured by debt-to-assets ratio, is 0.526 with a standard deviation of 0.303, indicating a moderate reliance on debt financing across the sample. Board gender diversity averages 0.132, confirming that female representation on boards remains limited and that decision-making bodies are still predominantly male. Managerial ownership averages 0.074, reflecting the relatively small equity stakes held by management, whereas institutional ownership averages 0.718, indicating that the majority of shares are held by institutions and that external monitoring is structurally strong within this sector. The mean of earnings management, proxied by discretionary accruals, is 0.005 with a standard deviation of 0.136, indicating that enterprises exhibit both income-increasing and income-decreasing behaviour.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Leverage (X1)	375	0,09	2,64	0,5259	0,30260
Gender Diversity (X2)	375	0,00	0,75	0,1318	0,17995
Managerial Ownership (X3)	375	0,00	1,00	0,0743	0,18474
Institutional Ownership (X4)	375	0,00	1,00	0,7185	0,26588
Earnings Management (Y)	375	-0,58	1,28	0,0053	0,13578
Audit Quality (M)	375	0,00	1,00		0,49525

Source : Processed Data, 2026

4.2 *Classical Assumption Diagnostics*

The regression model satisfies the classical assumptions required for reliable estimation. The central limit theorem establishes normality since the sample of 375 observations considerably surpasses the traditional threshold at which the estimators' sampling distribution approaches normality, making the residuals nearly normally distributed. Every independent variable's variance inflation factor is below 10, ranging from 1.048 to 1.138, preventing multicollinearity. Heteroscedasticity is absent because the residual variance is consistent across predictor values, according to the Glejser test. The acceptable Durbin-Watson value of 1.590 indicates no first-order serial correlation. These diagnostics show that the model is statistically sound and suitable for hypothesis testing.

4.3 *Model Fit and Hypothesis Testing*

Moderated Regression Analysis produces a significant model. The F-statistic of 42.058 with a significance value of 0.001 shows that governance factors and audit quality predict earnings management, proving the model's fitness. The adjusted coefficient of determination is 0.328, showing that model variables explain 32.8 percent of earnings management variance and outside factors 67.2 percent. As per the study's aims, the discussion below begins with direct consequences, covering each of the four governance factors before moving to audit quality's moderating function.

Table 2. Results of Hypothesis Testing (Moderated Regression Analysis)

Model	N	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
(Constant)		-3,020	0,020		-154,77	0,001
Leverage (X1)	375	0,243	0,023	0,573	10,414	0,001
Gender Diversity (X2)	375	-0,259	0,092	-0,201	-2,806	0,005
Managerial Ownership (X3)	375	-0,178	0,058	-0,142	-3,086	0,002
Institusional Ownership (X4)	375	-0,043	0,014	-0,175	-3,034	0,003
X1*M (X5)	375	-0,035	0,080	-0,014	-2,342	0,038
X2*M (X6)	375	-0,199	0,109	-0,141	-3,833	0,007
X3*M (X7)	375	-0,025	0,212	-0,006	-0,120	0,904
X4*M (X8)	375	-0,070	0,023	-0,174	-1,053	0,243

Source : Processed Data, 2026

The Effect of Leverage on Earnings Management

Leverage improves earnings management with a coefficient of 0.243 and a significance value of 0.001. According to the debt covenant concept in positive accounting theory, corporations with greater debt control profits more intensively. When a large portion of a firm's assets are funded by debt, management must continuously meet loan agreement criteria, including financial ratios and minimum profits standards. As firms approach the limits set by these covenants, the cost of breaching them, which may include accelerated repayment, higher interest charges, or the loss of access to future financing, becomes increasingly severe. Under such pressure, managers have a strong incentive to exercise the discretion available to them under accounting standards in order to present reported earnings that keep the firm within its contractual boundaries. In the consumer non-cyclical sector, where firms rely heavily on stable cash flows to service ongoing obligations, this pressure is particularly relevant. Managers of highly leveraged firms are motivated not only to avoid covenant violations but also to sustain the confidence of creditors and to strengthen the firm's bargaining position in future debt negotiations. Earnings that appear stable and healthy reduce the perceived risk of default and support more favorable lending terms, which reinforces the tendency to manage reported figures upward. This finding aligns with prior Indonesian evidence, including Indracahya & Faisol (2017), Agustia & Suryani (2018), Setiowati et al. (2023), which similarly documents a positive association between leverage and earnings management. This also shows that leverage improves earnings management. These researches demonstrate that increased indebtedness increases the motivation to control profits and emphasises the fundamental role of debt-related pressure in developing market enterprises' financial reporting behaviour.

The Effect of Board Gender Diversity on Earnings Management

Having more female directors on the board reduces earnings manipulation, with a coefficient of -0.259 and a significance value of 0.005. According to agency theory, the board of directors is a crucial internal monitoring mechanism whose efficacy relies on its makeup and diversity. Female directors widen the breadth of opinions on financial reporting decisions, and more inclusive debate generates a more thorough accounting option appraisal, restricting the room for opportunistic behaviour. A board that closely monitors management's decisions may spot and oppose accounting procedures that might manipulate financial statements before they appear in the financial statements. Female directors tend to be more prudent, ethical, and compliant with reporting criteria. These traits increase management discretion monitoring and reduce aggressive accounting practices, improving profits reporting dependability. In the context of Indonesian consumer non-cyclical firms, where board structures have historically been male-dominated, the growing presence of women on boards contributes to a more balanced and rigorous governance process that constrains the manipulation of earnings. This result is consistent with Iqbal et al. (2025), Setiany & Yahawi (2022), and Yopie & Chandrawati (2023), who find that gender-diverse boards reduce earnings management through improved oversight and greater caution in financial reporting, reinforcing the view that diversity in board composition strengthens the integrity of financial disclosure.

The Effect of Managerial Ownership on Earnings Management

Managerial ownership negatively impacts earnings management with a coefficient of -0.178 and a significance value of 0.002. This supports agency theory's central claim that the separation of ownership and control creates conflicts of interest, which may be resolved by managers owning shares in the organization. Managers become partial principals who are economically responsible for their judgements when they possess shares. Thus, management and shareholders' interests align, decreasing the incentive imbalance that drives opportunistic reporting. Managers with an ownership stake are less likely to manipulate results and more likely to enhance operational performance since any decline in earnings lowers their share value. Equity ownership therefore operates as a self-enforcing governance mechanism, encouraging managers to monitor internal activities and to safeguard the credibility of the financial statements rather than to distort them for short-term gain. This internal alignment is especially valuable in firms where external monitoring may be incomplete, since it embeds the incentive to report faithfully within the management structure itself. The finding confirms the agency theory proposition and is consistent with Mahariana & Ramantha (2014), Purnama (2017), and Ishmah & Permatasari (2025), reinforcing the view that managerial ownership functions as an effective internal governance mechanism for curbing earnings management.

The Effect of Institutional Ownership on Earnings Management

Higher institutional shareholding is connected with lesser earnings manipulation, with a coefficient of -0.043 and a significance value of 0.003. Banks, insurance companies, and investment organisations have large stakes and the resources, experience, and analytical ability to oversee management actions better than dispersed shareholders. Their sustained scrutiny of corporate performance reduces the information asymmetry that separates managers from owners, limiting the opportunities available to management to obscure the true economic condition of the firm through accrual adjustments. The presence of large institutional shareholders also alters managerial behavior through the awareness of being monitored. Knowing that sophisticated investors are actively reviewing financial disclosures, management is encouraged to prepare earnings figures with greater care and to avoid practices that might attract adverse attention or provoke intervention. In the consumer non-cyclical sector, where institutional ownership is structurally high, this external oversight constitutes a significant check on opportunistic reporting. This study supports Erawati & Lestari (2019), Kusumawardana & Haryanto (2019), and Ishmah & Permatasari (2025) that institutional ownership complements internal controls to reduce earnings management.

Audit Quality as a Moderating Variable

Audit quality considerably reduces leverage's earnings management benefit. The interaction variable has a coefficient of -0.035 and a significance value of 0.038, showing that enterprises audited by credible public accounting firms have less motivation to manage high leverage profits. Superior auditors, usually Big Four member, possess the expertise, resources, and reputational stake necessary to detect indications of manipulation and to resist management's attempts to present overly favorable financial results. Their involvement raises the likelihood that aggressive accounting choices will be identified and corrected, so that the pressure implied by the debt covenant hypothesis is offset by more rigorous external oversight. The tendency of highly leveraged firms to manage earnings is therefore attenuated when a credible auditor stands between management and the users of the financial statements. Yermiana et al. (2022) find that audit quality reduces leverage's favourable effect on earnings management via stricter supervision.

Audit quality exacerbates board gender diversity's profits management impact. The interaction term is significant and negative, with a coefficient of -0.199 and a significance value of 0.007, showing that earnings management declines further in firms that combine gender-diverse boards with high-quality external auditing. The internal monitoring exercised by female directors and the external verification provided by reputable auditors operate as complementary mechanisms that reinforce one another. When a board inclined toward prudence and thorough scrutiny is paired with an auditor capable of independently validating the resulting disclosures, the combined effect produces a more robust system of control than either mechanism could achieve alone. The two layers of oversight, one internal and one external, jointly narrow the opportunities for opportunistic reporting. This finding echoes Miladi & Chouaibi (2021), who report that audit quality reinforces the suppressive effect of female representation on earnings management.

However, audit quality does not decrease managerial ownership's profits management impact. The management ownership control mechanism is independent of external audit quality, since the interaction term has a coefficient of -0.025 and a significance value of 0.904. Management ownership strongly connects managers and shareholders via stock holdings' economic motivations, the suppression of opportunistic behavior originates from within the firm rather than from external verification. The motivation to report faithfully is already internalized by managers who stand to lose from any decline in reporting quality, so the addition of high-quality auditing does not produce a meaningful incremental effect. The two mechanisms address the agency problem through different channels, one through internal incentive alignment and the other through external assurance, and they do not appear to reinforce one another. This result is consistent with Suwarno et al. (2021), who likewise find that audit quality is not significant as a moderator of the managerial ownership relationship.

Audit quality does not attenuate institutional ownership's profits management impact. Coefficient of -0.070 and significance value of 0.243 indicate that the interaction term is not statistically significant, suggesting that the monitoring function exercised by institutional investors already operates independently and with substantial capacity. Institutional investors with dominant shareholdings possess their own resources and mechanisms for overseeing management, and this monitoring capacity is sufficiently strong that it does not require reinforcement from external auditing. When two external monitoring mechanisms act in the same direction, their effects tend to overlap rather than compound, so the presence of high-quality auditing adds little pressure beyond the oversight already provided by large institutional owners. The redundancy between these two external controls explains the absence of a significant moderating effect. This finding aligns with Susbiyani et al. (2023), who observe that the pressure exerted by institutional ownership on earnings management varies with context and is not consistently reinforced by audit quality.

5. Conclusion

The evidence shows that leverage exerts a positive effect on earnings management, whereas board gender diversity, managerial ownership, and institutional ownership each exert a negative effect. These findings indicate that higher indebtedness intensifies the incentive to manage earnings, consistent with the debt covenant hypothesis, while gender-diverse boards and concentrated managerial and institutional ownership function as effective governance mechanisms that constrain opportunistic reporting, consistent with agency theory.

Results show a varied pattern for audit quality's moderating influence. Audit quality reduces the favourable impact of leverage on earnings management and amplifies the suppressive effect of board gender diversity, showing that high-quality external auditing and internal governance improve financial reporting dependability. However, audit quality does not moderate management or institutional ownership, suggesting that these systems already monitor independently and gain little from external auditing. The study's main finding is that audit quality's governance complementarity relies on the mechanism it interacts with, reinforcing mechanisms that operate through monitoring while adding little to those that operate through direct interest alignment or already-strong ownership oversight.

The significance of these findings lies in their implications for corporate governance practice and policy in emerging markets. For companies, the results underscore the value of increasing female representation on boards and of prudent debt management as instruments for enhancing the credibility of financial statements. For investors and analysts, leverage and the reputation of the external auditor emerge as meaningful signals when assessing the likelihood of earnings manipulation. For regulators, the evidence supports policies that promote board diversity and strengthen audit quality as complementary pillars of financial reporting integrity.

This study has limitations that suggest additional investigation. The study covers one industry over five years, which may restrict its applicability to other businesses or institutions. Further study should incorporate governance factors or examine actual earnings management alongside accrual-based indicators to further understand how governance processes affect financial reporting quality.

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