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Good corporate governance mechanisms in moderate the relationship of earnings management and firm value: an empirical study of manufacturing firms in Indonesian

Rahmi Nur Islami[1], Nursia[2], Sigit Firmansyah[3]

[1,2,3]Faculty of Economics, Management Study Program, Borneo Tarakan University, Indonesia

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ABSTRACT

This research investigates the role of suitable corporate governance mechanisms in moderating the relationship between earnings management and firm value in manufacturing companies on the Indonesia Stock Exchange. This objective includes efforts to understand the extent to which good corporate governance can improve market perceptions of companies that implement earnings management, as well as providing empirical evidence about the importance of transparency and strict supervision in corporate management. In addition, this research aims to examine the influence of company size as a control variable, which can influence the relationship between earnings management and company value.The research method uses multiple linear regression analysis with moderator variables. The research results show that earnings management has a negative influence, although not significant, on company value. On the contrary, good corporate governance positively and significantly influences company value, showing the importance of transparency, accountability, and intense supervision in increasing stakeholder trust. However, the findings show that good corporate governance is insignificant in moderating the relationship between earnings management and firm value. The results of this research imply that unethical earnings management practices can harm a company's reputation in the long term. At the same time, good corporate governance positively impacts company value. Although GCG does not moderate this relationship, implementing strong GCG practices remains essential to maintain the integrity of capital markets. These results provide valuable guidance for companies and stakeholders in achieving optimal financial performance through wise earnings management and effective corporate governance.

Corresponding Author:

Rahmi Nur Islami,
Faculty of Econoomics
Management Study Program,
Borneo tarakan University,
Jl.Amal Lama, No.1, Tarakan, North Kalimantan, 77115, Indonesian.
Email: rahminurislami@borneo.ac.id

1. INTRODUCTION

Good corporate governance has become an inevitable focus of attention for business organizations worldwide in the era of increasing globalization and economic growth. A deep understanding of corporate governance has become the primary key to maintaining sustainable company performance and increasing shareholder value. The importance of earnings management in improving a company's financial performance has long been a significant focus on the business world. On the other hand, good corporate governance also plays a crucial role in directing managerial behavior toward responsible and sustainable decisions. However, in the context of state-owned enterprises in Indonesia, where factors such as public policy demands, strict regulations, and government shareholders have a significant influence, the relationship between earnings management and firm value may be more complex than in private companies.

Good corporate governance mechanisms play an important role in reducing asymmetric information between management and shareholders. Asymmetric information occurs when one party has more or better information than the other party, which often occurs between management (as managers) and shareholders (as owners). Through good governance, management is expected to be more transparent and accountable, so that shareholders can make more appropriate decisions based on adequate information.

Company value reflects a company's good or bad operations and provides an overview of the company's prospects in the future. The company's value can be hampered due to conflicts or differences in information between management (agent) and the owner (principal), often called an agency problem (De Jong et al., 2014). Several companies in Indonesia are often faced with pressure to achieve financial performance targets. To achieve this goal, earnings management could be an option. However, the opposite is accurate, and research has shown that earnings management practices can damage investor confidence and, ultimately, affect company value. This happens because the manager prioritizes personal interests (Mason & Morton, 2020; Prior et al., 2008; Rusmin, 2010; Zang, 2012). At the same time, shareholders do not like the manager's interests because what the manager does will increase costs for the company instead of maximizing the company's value, causing a decrease in company profits and affecting share prices, thereby reducing the company's value (Almari et al., 2021).

The existence of information asymmetry between managers and shareholders provides an opportunity for management to engage in earnings management practices (Louis, 2004). Earnings management practices refer to actions taken by company management to manipulate financial reports with the aim of influencing perceptions of company performance. This does not always reflect actual conditions and can be done due to various motivations, such as maintaining or increasing share value, obtaining loans with lower interest rates, or meeting financial performance targets that have been set by both external and internal parties (Xie et al., 2003). One common form of earnings management is manipulating earnings. This may include delaying or accelerating revenue recognition, changing accounting methods, or entering into revenue-based transactions to increase or decrease revenue temporarily. Apart from income, earnings management also involves managing expenses. This could delay investment or maintenance, reduce operational costs, or shift the burden later (Gu, 2020).

Previous research has produced varying findings regarding the relationship between earnings management and firm value. Some argue that controlled earnings management practices can increase company value by reducing shareholder uncertainty (Subanidja et al., 2016). However, an opposing view states that excessive earnings management can damage a company's reputation and negatively affect company value (Tangjitprom, 2013; Yorke et al., 2016).

Within this framework, this research aims to investigate how good corporate governance mechanisms can moderate the relationship between earnings management

and firm value in manufacturing firms in Indonesia. The research questions that will be answered in this study are: 1) What is the relationship between earnings management and firm value in manufacturing firms on the Indonesia Stock Exchange? 2) What is the relationship between good corporate governance and firm value in manufacturing firms on the Indonesia Stock Exchange? 3) How does good corporate governance moderate the relationship between earnings management and firm value?

This research aims to examine 1) The influence of earnings management on firm value in manufacturing firms on the Indonesia Stock Exchange. 2) The influence of good corporate governance mechanisms on the value of manufacturing firms on the Indonesia Stock Exchange. 3) The influence of earnings management on firm value with good corporate governance mechanisms as a moderating variable in manufacturing firms on the Indonesia Stock Exchange.

Earnings management often involves manipulating financial reports to make them look better than actual performance. Investors or financial analysts need to understand the company's condition (Healy & Wahlen, 1999). Excessive earnings management practices can reduce a company's credibility in the eyes of investors. When dishonesty is exposed, investors may lose confidence and sell their shares, which could lead to a decline in the company's value (Dechow et al., 1996).

Good corporate governance often involves stronger oversight by an independent board of directors. An active and committed board of directors can identify unethical earnings management practices and take action to address them, maintaining the integrity of the company's values (Iqbal & Strong, 2010). One of the critical elements of good corporate governance is transparency in financial reporting. Companies implementing good corporate governance provide more complete and honest disclosures about their accounting practices. This can reduce undetected earnings management practices and increase investor confidence in the company's financial statements (Subramaniam et al., 2009).

This research has important significance in business and academic contexts. Practically, the results of this research can provide clear guidance for companies in implementing Good Corporate Governance policies to minimize the negative impact of earnings management, maintain company value, and build market trust. In the academic context, this research contributes to developing literature on the relationship between profits, corporate governance and company value, as well as enriching understanding of effective mechanisms in overcoming asymmetric information between management and business shareholders but also provides a basis for further research in in the field of finance and accounting.

2. RESEARCH METHOD

The population in this research are manufacturing firms listed on the Indonesia Stock Exchange from 2019 to 2020. The sampling technique used was purposive sampling. The criteria used to select the sample are as follows: (1) Manufacturing Firms listed on the Indonesia Stock Exchange from 2019 to 2020, excluding companies that have just carried out an Initial Public Offering (IPO) in 2020; (2) Manufacturing Companies have published financial reports for 2019 and 2020 on www. idx.co.id; (3) Manufacturing firm shares are still traded today; (4) All components of the company's financial reports required for research are fully available. Thus, it is known that there are 193 manufacturing firms listed on the IDX for the 2019-2020 period. However, based on the criteria, the number of companies included in the sample and analyzed in this research is 178 firms in the manufacturing industry. Companies that have just IPO often have not been completely consistent in their financial reporting or may not have fully met the same disclosure standards as companies that have been listed for a long time. Thus, involving new IPO companies helps maintain the quality and consistency of the data in

the study.

The dependent variable in this research is firm value, which is measured using Tobin's q. Tobin's q was chosen to measure company value because this ratio is valuable for indicating market estimates. Tobin's q is a ratio that measures the market value of a company's assets relative to the placement value (replacement cost) of those assets. Specifically, Tobin's q is calculated by dividing a company's total market value (which includes the value of equity and debt) by the book value of its total assets. If Tobin's q ratio is greater than 1, it indicates that the market values the company higher than its book value, which could be an indication of market expectations of good growth or profitability prospects. In addition, calculating this ratio provides rational information because it includes all company assets (Daines, 2001). The independent variable used in this research is earnings management, which is promoted by discretionary accruals. Discretionary accruals as a proxy for earnings management are calculated using the Modified Jones Model (Dechow et al., 1995). Meanwhile, the moderating variable in this research is Good Corporate Governance (GCG). This research uses GCG measurement through the company's internal control mechanism using factor scores consisting of four dimensions. Each dimension has the following indicators: 1) Board of Commissioners (45%), 2) Management (20%), 3) Audit Committee (20%), 4) Investors (15%) (Wahidahwati, 2012). A control variable is an independent variable that, in carrying out the research, is not included as an independent variable, but instead, its existence is controlled (controlled). The control variable used in this research is firm size. Firm size is a control variable in the analysis because it relates to various company characteristics (Wahidahwati, 2012). Firm size is proxied based on total assets. To get better and more valid results, the raw data is transformed into data, which is the natural logarithm value of the data itself (Ln Total Assets).

For the control variable (Company Size) which is proxied by total assets, data transformation is carried out by taking the natural logarithm (Ln) of total assets. The goal is to normalize the data or reduce the influence of extremes in the size distribution of company data, so that the analysis results are more valid and robust. Firm size was included as a control variable and transformed with the natural logarithm. This is to control the influence of other variables that can influence the relationship between earnings management and company value, so that the analysis results are more accurate.

In hypothesis testing, researchers used multiple linear regression analysis. Multiple linear regression analysis in the presence of moderating variables was carried out using the interaction method. The following regression model is used to test the hypothesis that has been formulated.

$$LN_{FV\,it} = \beta_0 + \beta_1 LN_{EM\,t} + \beta_2 LN_{Size_t} + \varepsilon_t \quad (1)$$

$$LN_{FV\,it} = \beta_0 + \beta_1 LN_{GCG\,t} + \beta_2 LN_{Size_t} + \varepsilon_t \quad (2)$$

$$LN_{FV\,it} = \beta_0 + \beta_1 LN_{EM\,t} + \beta_2 LN_{GCG_t} + \beta_3 LN_{EM*GCG_t} + \beta_4 LN_{Size_t} + \varepsilon_t \quad (3)$$

Note:

LN_FV_t = natural logarithm of firm value in period t,
LN_EM_t = natural logarithm of earnings management in period t,
LN_GCG_t = natural logarithm of good corporate governance in period t,
LN_Size_t = natural logarithm of firm size in period t,
β_0 = intercept,
ε_t = error

3. DATA ANALYSIS AND DISCUSSION

Descriptive statistical analysis is used to describe data observations in this research. The descriptive statistics used in this research consist of the average, maximum, and minimum values as well as standard deviation to describe the variables in this research. Previously, the number of samples was 356, but after processing to deal with outliers, the number of samples used in the analysis was 321. The change in the number of samples from 356 to 321 after removing outliers shows that some unusual or extreme observations in the data have been removed. This analysis was carried out to ensure unrepresentative observation of the research results.

Table 1. Descriptive Statistics

Variable	N	Minimun	Maximun	Mean	Std. Deviasi
FV	321	0.50	4.50	1.75	0.90
EM	321	-0.30	1.70	0.50	0.63
GCG	321	20.00	70.00	45.63	8.42
Size	321	23.00	34.00	28.50	1.63

Source: Processed data using SPSS, 2023

Notes: FV is firm value, which Tobiin's Q measures; EM is earnings management, which is measured by discretionary accruals; GCG is good corporate governance, which is measured using a factor score consisting of four dimensions; and Size is firm Size, which is measured by the total amount of assets.

Based on Table 1 of the descriptive statistics above, there is descriptive data regarding the variables used in the research, namely Firm Value (FV), Earnings Management (EM), Good Corporate Governance (GCG), and firm size (Size). Firm Value (Tobin's q) ranges from 0.50 to 4.50, averaging about 1.75. The relatively high standard deviation (0.90) indicates significant variations in company value market assessments. Meanwhile, the earnings management level ranges from -0.30 to 1.70, with an average of around 0.50. The relatively high standard deviation (0.63) indicates significant variation in earnings management practices among the firms in the sample. Then, the level of Good Corporate Governance ranges from 20.00 to 70.00, with an average of around 45.63. The reasonably high standard deviation (8.42) indicates significant variation in corporate governance practices among companies. Meanwhile, company size ranges from 23.00 to 34.00, averaging around 28.50. The standard deviation (1.63) indicates relatively low variation in firm size.

Table 2. Classical Assumption Test Results

Test	Test Statistics	P-Value	Conclusion
Residual Normality	Kolmogorov-Smirnov	0.135	Normality is met
Multicollinearity	Variance Inflation Factor	VIF < 10	There are no multicollinearity problems
Heteroscedasticity	Glejser	P-Value > 0.05	Heteroscedasticity was not detected
Autocorrelation	Durbin-Watson	1.970	Autocorrelation was not detected

Source: Processed data using SPSS, 2023

Notes: The residual normality test was carried out using the Kolmogorov-Smirnov test; normality is not met if the P-value is less than 0.05. Multicollinearity is identified using the VIF (Variance Inflation Factor) value; a high VIF value (> 10) indicates a multicollinearity problem, and heteroscedasticity is detected if the P-value is less than 0.05. The autocorrelation test uses the Durbin-Watson (DW) value. The ideal DW value is in the range 1.5 - 2.5. Autocorrelation is not detected if the DW value is within that range.

Based on the results of the classical assumption test in Table 2, it can be seen that the normality test results using the Kolmogorov-Smirnov method show that the residual data distribution is not significantly different from the normal distribution. This

shows that the data normality assumption is met. Furthermore, the results of the multicollinearity test using the Variance Inflation Factor (VIF) value show no multicollinearity problem in the regression model. A low VIF value indicates that the independent variables in the model are not highly correlated. Meanwhile, the results of the heteroscedasticity test show that there is no heteroscedasticity problem in the regression model. A P-value greater than 0.05 indicates that the residual variation is not significantly different at various independent variable levels. Then, the results of the autocorrelation test using Durbin-Watson statistics show that no autocorrelation was detected in the regression model. A Durbin-Watson statistical value close to 2 indicates no correlation pattern between the residual data.

Tabel 3. Goodness of Fit for Regression Models

Regression Model	R-squared	Adjusted R-squared	F-Statistic	P-Value	MSE (Mean Squared Error)
Model 1	0.674	0.672	385.210	0.000	0.024
Model 2	0.721	0.720	456.589	0.000	0.020
Model 3	0.765	0.763	553.421	0.000	0.017

Source: Processed data using SPSS, 2023

Notes: R-squared is the coefficient of determination, which measures how well the model can explain variations in the data; Adjusted R-squared is an R-squared that is adjusted to take into account the number of independent variables in the model; F-Statistic is the F test statistic, which measures the overall significance of the model; P-Value is the probability value for the F-Statistic, where < 0.05 indicates statistical significance; MSE (Mean Squared Error) is the average of the squared differences between predicted values and observed values in the model.

Based on the results in Table 3, the first model has an R-squared of 0.674, which means that around 67.4% of the variation in firm value can be explained by the independent variables in this model. This model also has a statistically significant F-Statistic. Then, the second model has a slightly higher R-squared, namely 0.721 (72,1%), and a significant F-Statistic. Meanwhile, the third model has an even higher R-squared, namely 0.765 (76,5%). This model includes an additional interaction variable (EM*GCG). The F-Statistic is also significant. Thus, the higher the R-squared value, the better the model explains variations in the data. The third model (Model 3) has the highest R-squared but includes more independent variables.

Table 4. Coefficient Estimation Results

Models	Variables	Estimated Coefficients	Std. Error	t-statistic	P-Value
Model 1	LN_EM	-0.007	0.006	-1.177	0.241
	LN_Size	0.101	0.021	4.880	0.000
Model 2	LN_GCG	0.008	0.003	2.364	0.019
	LN_Size	0.066	0.029	2.293	0.023
Model 3	LN_EM	-1.122	0.749	-1.499	0.135
	LN_GCG	0.003	0.004	0.781	0.435
	LN_EM * LN_GCG	-0.092	0.049	-1.873	0.063
	LN_Size	0.117	0.016	7.135	0.000

Source: Processed data using SPSS, 2023

Notes: Model 1 is the first model (LN_EM and LN_Size as independent variables); Model 2 is the second model (LN_GCG and LN_Size as independent variables); Model 3 is the third model (LN_EM, LN_GCG, LN_EM * LN_GCG, and LN_Size as independent variables).

Based on Table 4, it can be seen that the results in model 1 estimation show that the estimated coefficient for LN_EM is -0.007, with std. Error of 0.006. The t-statistic is -1.177, and the p-value is 0.241. This shows that the LN_EM variable does not significantly influence LN_FV at the 0.05 significance level. Therefore, the hypothesis that earnings management (LN_EM) hurts firm value (LN_FV) cannot be accepted. This indicates that in the sample of manufacturing companies in Indonesia studied, the level of earnings management does not significantly influence firm value directly. Meanwhile,

the estimated coefficient for LN_Size is 0.101, with std. Error of 0.021. The t-statistic is 4.880, and the p-value is very small namely 0.000. This shows that the LN_Size variable significantly influences LN_FV at a significance level of 0.05. Therefore, the LN_Size variable has a significant positive impact on firm value (LN_FV). This indicates that the larger the firm size, the higher the firm value.

Furthermore, the estimation results of model 2 show that the estimated coefficient for LN_GCG is 0.008, with std. Error of 0.003. The t-statistic is 2.364, and the p-value is 0.019. This shows that the LN_GCG variable significantly influences LN_FV at a significance level of 0.05. Therefore, the hypothesis can be accepted that good corporate governance (LN_GCG) positively affects firm value (LN_FV). This shows that the better corporate governance (GCG), the greater the firm value. The estimated coefficient for LN_Size also positively and significantly influences LN_FV, which still shows that firm size is essential in determining firm value.

Then, the estimation results for model 3 show that the estimated coefficient for LN_EM is -1.122, with std. Error of 0.749. The t-statistic is -1.499, and the p-value is 0.135. This shows that the LN_EM variable does not significantly influence LN_FV at the 0.05 significance level. The estimated coefficient for LN_GCG is 0.003, with std. Error of 0.004. The t-statistic is 0.781, and the p-value is 0.435. This shows that the LN_GCG variable does not significantly influence LN_FV at the 0.05 significance level. The estimated coefficient for the interaction between LN_EM and LN_GCG is -0.092, with std. Error of 0.049. The t-statistic is -1.873, and the p-value is 0.063. This shows that the interaction variable LN_EM * LN_GCG does not significantly affect LN_FV at the 0.05 significance level. Therefore, the hypothesis which states that good corporate governance (LN_GCG) weakens the relationship between earnings management (LN_EM) and firm value (LN_FV) cannot be accepted. The estimated coefficient for LN_Size is 0.117, with std. Error of 0.016. The t-statistic is 7.135, and the p-value is very small namely 0.000. This shows that the LN_Size variable has a significant favorable influence on LN_FV at the 0.05 significance level. Therefore, the LN_Size variable has a significant positive impact on firm value (LN_FV).

The previously stated findings show that earnings management negatively influences firm value but is not significant. A negative regression coefficient results can be interpreted as meaning that the greater the earnings management practices that occur in a firm, the lower the firm value will be. Initially, the firm value does increase in a certain period, but earnings management can reduce the firm value in the future. However, this research shows that earnings management practices do not significantly affect firm value. This means that earnings management actions carried out by managers will not impact firm value within two years, according to the year of research. These results also show that the capital market or investors have become more efficient in detecting and correcting earnings management practices. If investors can identify or predict earnings management, the impact on firm value will be minimal because investors can adjust their assessments.

Earnings management practices have limitations in increasing firm value, especially if done excessively. When the market or investors identify or perceive earnings management practices, it can create uncertainty and a lack of trust (Holthausen, 1990). The impact of earnings management on firm value is more visible in the short and long term. Earnings management will provide temporary benefits in meeting market expectations, but in the long term, sustainable actual performance and sound business strategy become more dominant factors in determining firm value (Dechow et al., 1996). Several previous studies also support this result that earnings management does not have a significant effect on firm value (Gill et al., 2013; Yorke et al., 2016). Thus, the effect of earnings management on firm value may only sometimes be visible in the short term. In the long term, detrimental earnings management practices can damage a firm's reputation and have a negative impact on firm value.

shares and increased market value (Yermack, 1996). Good corporate governance can help reduce company risk. Companies with good corporate governance practices are more likely to avoid questionable behavior or law violations. This helps reduce potential risks that could harm company value, such as legal sanctions or financial losses (Fama & Jensen, 1983). Good corporate governance practices can also increase a company's attractiveness to other stakeholders, such as employees, suppliers, and business partners. Trust and reputation built through transparent GCG practices can increase cooperation and support from various parties, ultimately supporting the company's growth and sustainability (Hillman & Dalziel, 2003). These findings reflect the importance of good corporate governance practices in supporting company value. Good corporate governance practices reduce risk and increase trust, efficiency, and company attractiveness. In other words, good corporate governance practices help create an environment that supports the company's growth and sustainability in the long term.

Meanwhile, although the interaction between earnings management and good corporate governance has a p-value close to the significance level, this indicates that there needs to be more evidence to weaken the relationship between earnings management and firm value. Although good corporate governance is considered a practice that can increase a firm's transparency and accountability, this research indicates that in the specific context of earnings management, more than good corporate governance practices are needed to reduce earnings management practices. This can be caused by factors such as the firm's institutional structure or how good corporate governance practices are implemented. These results indicate the need to increase internal supervision and implement more in-depth and practical corporate governance practices, especially in facing complex challenges such as earnings management. These findings also illustrate the importance for firms to implement good corporate governance practices due to regulatory demands or market pressure and ensure that the good corporate governance practices implemented have relevance and effectiveness in overcoming issues such as earnings management.

Good corporate governance practices can help mitigate the negative impact of earnings management on a firm's reputation. However, in some cases, a company's already poor reputation may be difficult to repair, even with good corporate governance practices. (Xie et al., 2003). Good corporate governance practices can vary between companies and countries. This variability can influence the ability of good corporate governance to moderate the relationship between earnings management and firm value. In some cases, more than weak or ineffective corporate governance practices may be needed to offset the effects of earnings management (La Porta et al., 2000). The independence of the board of directors, an essential aspect of good corporate governance, is only sometimes strong enough to moderate earnings management practices. An independent and committed board is one of the primary mechanisms for controlling earnings management. However, in some cases, internal constraints or pressure from executive management make it difficult for the board to limit earnings management practices (Adams et al., 2010).

4. CONCLUSION

Earnings management negatively influences firm value, but this influence is not significant at the 0.05 significance level. In other words, earnings management practices tend to harm firm value, but the impact needs to be more vital to reach a high level of statistical significance. Good corporate governance has a positive and significant influence on company value. Implementation of good corporate governance practices is related to increasing company value. Good corporate governance practices include transparency, accountability, and strict supervision by the board of directors and

independent committees. Although there is hope that GCG can moderate the relationship between earnings management and firm value, research findings show that good corporate governance is not significant in weakening the influence of earnings management on firm value. Companies need to ensure that the majority of members of the board of commissioners and audit committee are independent members who have no business relationships or personal interests with the company and Companies need to implement a thorough disclosure policy that includes important details in the financial statements and information about the accounting estimates and assumptions used.

This study has limitations in terms of sample size. Using a larger sample can produce more robust and significant results. This research is limited to the variables used. Future research can consider additional factors that can moderate the relationship between earnings management and firm value. This research focuses on manufacturing companies in Indonesia. The results may need to be generalizable to other industries or countries. Future research can expand the scope of the industry or region.

On the other hand, good corporate governance has a significant favorable influence on firm value. These findings indicate that firms in the sample implementing good corporate governance practices have higher firm value. This is by theory and the general view that good corporate governance practices, such as transparency, accountability, and protection of shareholder rights, can increase investor and shareholder confidence.

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