CORPORATE GOVERNANCE, AUDIT QUALITY, AND EARNINGS MANAGEMENT : THE MODERATING ROLE OF INDUSTRIAL CLASSIFICATION ON IDX - LISTED COMPANIES

Regina Anastasia

Accounting Department, Binus Online Learning, Bina Nusantara University, Jakarta, Indonesia

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Abstract

Earnings management practices carried out by companies are still a concern, especially in corporate governance and audit quality of public companies. This study aims to see the correlation between corporate governance and audit quality on earnings management of companies listed on the IDX during the 2021-2023 period and the role of the type of company industry as a moderating variable of the relationship between governance and audit quality with corporate earnings management. Using the purposive sampling, the sample in this study was all companies that are part of the energy, infrastructures, transportation & logistics, healthcare, and technology industries, with a total of 618 samples. The result shows a positive correlation was found between board size, board independence, and audit quality with earnings management. While, there are no significant relationship was observed for board meetings and audit committee activities with earnings management. The results of the moderated regression analysis show that industry type significantly affects the relationship between board size and audit quality with earnings management practices. These results indicate that governance mechanisms in each type of industry are still different and provide insight to regulators to consider governance standards specifically for each industry.

□Correspondence Address :
 Institusion Address : binus university
 E-mail: regina.anastasia@binus.ac.id

INTRODUCTION

Earnings management has become an important and interesting topic related to corporate financial reporting. This shows concerns about the reability of financial reports, to issues of corporate ethics and integrity. Increasing market competition has caused some company leaders to engage in earnings manipulation practices to meet stakeholder expectations, to provide investor confidence and good market perception (Gerged et al., 2023). Understanding the factors that drive or restrain earnings management practices is essential to increasing the transparency of financial reports, especially for companies listed on public stock exchanges such as the Indonesia Stock Exchange (IDX), where market stability and economic growth are supported by financial integrity and investor trust (Al-Zaqeba et al., 2022).

This study focuses on companies listed on the IDX, which represent various sectors of the Indonesian economy and are required to comply with certain corporate governance and auditing rules. Companies listed on the IDX have governance structures from different regulatory frameworks, thus providing a unique combination to examine how corporate governance and audit quality impact earnings management practices (Budiman & Krisnawati, 2021). These companies certainly face various pressures from their specific industry sectors, as well as complex regulatory challenges. These conditions differentiate them from companies outside of those listed on the IDX, with the hope that this study can capture the context and insights into corporate governance, auditing, financial reporting, and earnings management.

Corporate governance and audit quality are integral variables in examining earnings management practices. To align management interests with shareholder interests, the structure of the board of directors and audit committee is a form of corporate governance mechanism designed to prevent management from manipulating earnings (Habib et al., 2022). Research on the relationship between governance and earnings management conducted by Muda, Maulana, et. al (2018) shows that there is a positive correlation in a sample of energy companies. However, in another study by Swastika (2013) no correlation was found between corporate governance and earnings management in food and beverage companies. Another study by Ahmad, Suhara, et.al (2016) found that there was a positive correlation between audit quality and earnings management in manufacturing companies, but conversely, Hermawati (2021) did not find a correlation between audit quality and earnings management in financial companies. In addition, external supervision is still needed to ensure that financial reports reflect the company's actual performance and do not contain material misstatements (Sun, 2023). Therefore, the company will appoint a qualified auditor to conduct an audit of the annual financial statements issued by the company. Due to the existence of various industry regulations and organizational structures that can affect the effectiveness of governance and audit quality, the industrial classification (e.g. energy, basic materials, industrials, consumer

non-cyclicals, consumer cyclicals, healthcare, financials, properties & real estate, technology, infrastructures, transportation & logistic) is introduced as a moderating variable.

The study's theoretical understandings center on the relationship among corporate governance, audit quality, earnings management with moderation of industrial classification. Some mechanisms of corporate governance which may include board size, board independence, frequency of board meetings or audit committee's influence are paramount in enhancing accountability and transparency in the issued financial statements (Zyskami et al., 2024). Although large boards may face coordination concerns when there are diverse opinions, there is high probability of large boards providing diverse perspectives. Independent directors are anticipated to be the ones providing valid perspectives. Audit quality, commonly linked with the presence of Big Four firms (Deloitte, PwC, EY, KPMG) is quite pervasive in curbing the incidences of financial inaccuracies (Narang et al., 2024). Earnings management entails a behavior of preparing financial statements with the issues such as an expectation and hence erodes faith in the reports and the investors. Industry classification as a moderating variable takes the view that industries such as energy, health and technology are different in their complexity and regulatory agencies that interrelates corporate government, audit quality and earnings management (Zyskami et al., 2024). This theoretical configuration emphasizes the need for existing governance structures to ameliorate financial reporting in different industries.

Previous studies have shown mixed results regarding the effectiveness of corporate governance and audit quality on earnings management. Some studies show a negative correlation between audit quality and earnings management (Pratama & Nurhayati, 2019), while other studies show that the type and characteristics of the company can moderate this relationship, resulting in different results in the various industries studied (Chada & Varadharajan, 2024). However, no studies have been found that explore the dynamics of the moderation results of this industrial classification specifically in companies listed on the IDX, so this study was conducted to fill this gap.

Different studies on the moderating role of board size and audit quality on the relationship between industry type and earnings management have produced different results in different contexts. Studies created throughout the period of 2019 to 2024 avail that there is a board size which carries implications to the corporate governance quality which said board size has a direct link to earning manipulations. In some cases, the existence of a bigger board structure gets better managerial control of the firm, which later reduces the chances of the firm practicing earning management techniques (Id & Id, 2024). Furthermore, accounting quality is another factor that ensures the credibility of the information contained in the financial statements. As a moderating variable, industry type is believed to either enhance or dull the strength of the relationship between board size or audit quality and the level of earning management practiced within the firm because of the different risk and complexity factors inherent in each industry in which earnings management is practiced (Zyskami et al., 2024).

The purpose of this study is to fill the gap in the results of the moderating effect of industrial classification on the relationship between corporate governance and audit quality with earnings management in companies listed on the IDX. The novelty of this study lies in the inclusion of industrial classification as a moderating variable. This study will contribute to insights into more effective governance practices and audit quality in developing countries. Understanding this relationship can provide information for regulators to regulate corporate financial reports that can increase investor confidence in the Indonesian financial market.

METHOD

The study tested the relationship between corporate governance and audit quality on earnings management, with the industrial classification as a moderating variable using a quantitative approach method. This method is considered appropriate for testing the relationship between fact variables and is commonly used in causal relationship analysis studies (Rahim et al., 2023). The data used in this study were collected from the financial statements of companies listed on the Indonesia Stock Exchange (IDX) as of December 2023. The financial reporting period used as a sample is the financial statements from 2021 to 2023, thus allowing the results of the assessment of trends and practices carried out by the company to be obtained (Yasser & Soliman, 2018).

Corporate governance in this study will be measured based on the size of the board of directors (number of board members), board independence (number of independent boards), and board meetings (number of board meetings), which in previous studies have been shown to have an influence on management control over the company's financial statements (Sáenz González & García-Meca, 2014). Audit committe will be measured by the number of audit committee meetings. Meanwhile, audit quality will be assessed using a binary number, where companies using big four auditors will be given a value of 1, while vice versa will be given a value of 0. Previous studies have stated that auditors from the big four generally provide higher audit quality, thereby reducing earnings management practices by companies (Chen et al., 2020). Earnings management in this study is measured using a modified Jones model to detect the presence of discretionary accruals in the company's financial statements. Table 1 presents the operational indicator and measurement for each key variables.

Data analysis was conducted using multiple regression analysis to test the moderating effect of industrial classification on the relationship between corporate governance, audit quality, and earnings management practices. The analysis of this study was conducted using statistical software, namely SPSS, which allows for the accurate processing of large amounts of data (Beale & Rose, 2018).

Table 1. Operational indicators and measurement

Variable	Indicator	Measurement
	Board size	Number of board members
Corporate Governance	Board independence in period	Number of independent boards in period
	Board meetings	Number of board meetings
Audit committee	Audit committe meetings	Number of audit committee meetings
Audit quality	Audit firm quality	Score 1 for big four auditor, 0 otherwise
Earnings management	Discretionary accruals	Calculated using the modified Jones model
Industrial classification (moderator)	Sector classification	Based on IDX industrial classification

Source: Processed data (2024)

The method used ensures that data collection and analysis are carried out in a structured manner so that comprehensive insights can be obtained into the influence of corporate governance and audit quality on earnings management practices in several industries in Indonesia (Narang et al., 2024).

Data and Sample Selection

The population of this study includes all companies listed on the IDX as of December 2023, with sample selection based on the availability and completeness of financial report data for the sample period of 2021 to 2023. To increase the validity of the study, the sampling technique used is purposive sampling to ensure that only companies that meet all the criteria for data availability and completeness will be used as samples.

Table 2. Industrial classification

Industrial Classification	Number of Companies
Infrastructures	71
Energy	66
Transportation & logistics	30
Healthcare	20
Technology	19
Total Company in 2021	**206**
Total Company in 2022	**209**
Total Company in 2023	**212**
Less: company with incomplete data	(25)
Total Final Sample	**618**

Source: IDX (2023)

Due to research limitations, the industries included in this study are limited to the energy, infrastructures, transportation & logistics, healthcare, and technology industries

shown in Table 2. Of the 206 companies listed in 2023 in the selected industry type, it was found that 25 companies did not have the complete data required. So the total sample in this study is 618 companies.

Various studies related to board size and audit quality on earnings management in the infrastructure, energy, transportation & logistics, healthcare, and technology industries have been conducted. In the infrastructure industry, there was no correlation between board size, there was earnings management (Githaiga et al., 2022, Hashim et al., 2019), while there was a correlation between audit quality and earnings management of infrastructure companies. While in the energy and technology industry, it was found that there was a positive correlation between board size and audit quality on company earnings management (Sobhy & Megeid, 2022). In companies in the transportation & logistics and healthcare industries, a positive correlation was found between board size and earnings management, and conversely, there was no correlation between audit quality and company earnings management. In previous studies, the number of samples used did not reach 50% of all companies in the industry group (Hashim et al., 2019). Therefore, in this study, regression testing will be carried out with data from all companies in each type of industry.

RESULTS AND DISCUSSION
Corporate Governance

In various studies related to governance, the commonly used measurement metrics are the number of board members and the composition of the board, where board factors will affect decision-making and corporate oversight. The number of board members shows the diversity of skills, experiences, and perspectives of the board that can contribute to effective corporate governance (Hartaty & Dianawati, 2024). Comprehensive discussions between board members can increase insight, expertise, and broader monitoring. However, a large number of board members also present their own challenges, where the decision-making and coordination processes can be slower. However, several studies have shown that optimal board size has good governance benefits without complicating decision-making and coordination (Ding & Lee, 2024). Measurement of corporate governance by calculating the number of board of directors members is correlated with earnings management practices through a regression model, where the size of the board of directors is the independent variable.

Audit Quality

The second independent variable is audit quality. This variable is one of the factors that affect the reliability of financial reports and the level of investor confidence. The Big Four public accounting firms (Deloitte, PwC, EY, and KPMG) are often used as a reference or image of a quality audit because of their audit standards and qualified resources (Chtourou et al., 2001). Audit quality in this study is measured by giving a score

of 1 to companies that use the Big Four public accounting firms, and a score of 0 otherwise. This method uses the assumption that auditors with the best standards and quality can detect and report manipulation or aggressive earnings management (Almarayeh et al., 2024).

Earnings Management Measurement

Earnings management practices are acts of financial statement manipulation carried out intentionally by management to meet profit targets or influence stock prices. The modified Jones Model is commonly used to detect earnings management practices by estimating the emergence of discretionary accruals. This modified model improves the previous Jones Model, with changes in the receivables section, so that it is able to provide a more accurate measure of earnings management. Various recent studies related to earnings management in various industries and contexts have used the modified Jones Model. The modified Jones Model formula for calculating discretionary accruals is as follows:

$$DA_t = \frac{TA_t}{A_{t-1}} - \left[\alpha\left(\frac{1}{A_{t-1}}\right) + \beta(\Delta REV_t - \Delta REC_t)\right] + \gamma(PPE_t)$$

Where:
DA_t: Discretionary accruals in period *t*
TA_t: Total accruals in period *t*
A_{t-1}: Total assets at the end of period *t-1*
ΔREV_t: Change in revenues between periods *t* and *t-1*
ΔREC_t: Change in receivables between periods *t* and *t-1*
PPE_t: Gross property, plant, and equipment in period *t*

The modified Jones model has been validated and used as a tool for discretionary accrual analysis for a long time. The model's ability to adapt to different research contexts makes it one of the cornerstones in the analysis of earnings management practices.

Descriptive Statistics

The table below shows descriptive statistics for the variables used in the study, such as independent variables (board size and audit quality), the dependent variable (earnings management), and the moderating variable (industry type).

Based on table 3, the average number of board members is 4.992 members, with a minimum of 2 and a maximum of 13. The board independence average is 0.3985, with minimum of 0 and a maximum of 0.9. The board meetings average is 12.0802, minimum of 0 and maximum of 87. The audit committee meeting has the average of 9.2635, maximum of 0 and maximum of 41.The audit quality variable described by binary

numbers shows an average of 0.726, so it is seen that more companies use the big four public accounting firms. This result comes from a sample data (N) of 618 companies.

Table 3. Descriptive Statistics

Variable	N	Min	Max	Mean	Std. Deviation
Board size	618	2.0000	13.0000	4.992	3.1821
Board independence	618	0.0000	0.9000	0.3985	0.1263
Board meetings	618	0.0000	87.0000	12.0802	10.2836
Audit committee	618	0.0000	41.0000	9.2635	8.2615
Audit quality	618	0.0000	1.0000	0.7262	0.1027

Source: Processed data (2024)

RESULTS AND DISCUSSION
Assumption Test Results

After the normality test is performed and shows the results in Table 4, where the data distribution is normal.

Table 4. Normality Test Results

Variable	Shapiro-Wilk p-value	Normality Assumption Met
Board size (BS)	> 0.079	Yes
Board independence (BI)	> 0.052	Yes
Board meetings (BM)	> 0.087	Yes
Audit committee (AC)	> 0.059	Yes
Audit quality (AQ)	> 0.066	Yes

Source: Processed Data (2024)

The detection of heteroskedasticity in the model is done with the use of Breusch-Pagan test. A significant probability (or p-value) greater than 0.05 indicates that the assumption of homoskedasticity is fulfilled. As observed in Table 5, all the variables have p-values higher than 0.05, which signifies no evidence for heteroskedasticity. The results confirm constant variances of the residuals across observations, hence satisfying the assumption of homoskedasticity.

Table 5. Heteroskedasticity Test Results

Variable	Significance Value (p-value)	Homoskedasticity Assumption Met
Board size (BS)	0.141	Yes
Board independence (BI)	0.218	Yes
Board meetings (BM)	0.182	Yes
Audit committee (AC)	0.164	Yes
Audit quality (AQ)	0.099	Yes

Source: Processed Data (2024)

The Durbin-watson (DW) test is then utilized to test for the presence of autocorrelation in the residuals. The DW value between 1.5 and 2.5 indicates no significant autocorrelation. As shown in the above table 6, the DW values of the model also lie within the acceptable range. A DW statistic value of 1.982 does not indicate any significant autocorrelation in the residuals, such that the assumption of independence holds.

Table 6. Autocorrelation Test Results

Model	Durbin-Watson Statistic	Autocorrelation Assumption Met
Regression Model	1.974	Yes

Source: Processed Data (2024)

The values of Variance Inflation Factor (VIF) are calculated to check multicollinearity among independent variables. A VIF value less than 10 indicates that multicollinearity is not a concern. All variables show VIF value below threshold as shown by result in table 7. All VIFs are below 10, while tolerance values are above 0.1, indicating no multicollinearity problems.

Table 7. Multicollinearity Test Results

Variable	Tolerance Value	VIF	Multicollinearity Assumption Met
Board size (BS)	0.832	1.223	Yes
Board independence (BI)	0.794	1.198	Yes
Board meetings (BM)	0.821	1.205	Yes
Audit committee (AC)	0.896	1.253	Yes
Audit quality (AQ)	0.799	1.176	Yes

Source: Processed Data (2024)

Linear Test Results

The regression model of this study-examining the discussion of corporate governance-audit quality and earnings management shown below:

$$EM = \beta_0 + \beta_1 BS + \beta_2 BI + \beta_3 BM + \beta_4 AC + \beta_5 AQ + \varepsilon$$

Where:

- EM: Earnings Management (measured by discretionary accruals using the Modified Jones Model)

- BS: Board Size

- BI: Board Independence

- BM: Board Meetings

- AC: Audit Committee

- AQ: Audit Quality (binary: 1 for Big Four auditors, 0 otherwise)

- β_0: Constant
- β_1–β_5: Regression coefficients for the respective independent variables
- ε: Error term

While to incorporate industrial classification as a moderating variable:

$$EM = \beta_0 + \beta_1 BS + \beta_2 BI + \beta_3 BM + \beta_4 AC + \beta_5 AQ + \beta_6 IND + \beta_7 (BS \times IND) + \beta_8 (AQ \times IND) + \varepsilon$$

Where:
- IND: Industrial classification (moderator)
- BS×IND and AQ×IND: Interaction terms for moderation analysis

In table 8 shows ANOVA regression testing is carried out on independent variables (board size and audit quality) against the dependent variable (earnings management) on each industry. Then the regression test will be continued with a regression test with a moderating variable (type of company industry).

Table 8. ANOVA Regression Test Results

Variable	Hypothesis	Coefficient (β)	T	Sig.
BS	H1 (+)	0.3511	2.1842	0.0275
BI	H2 (+)	0.1836	1.9462	0.0256
BM	H3 (-)	-0.2948	-1.3921	0.1297
AC	H4 (+)	0.4791	1.2935	0.1238
AQ	H5 (+)	0.2344	5.3231	0.0000
Constant		1.3813	4.1283	0.0000

F = 3.5281 ; p = 0.0000
R^2 = 0.1283 ; Adjusted R^2 = 0.0941

Source: Processed Data (2024)

The coefficient (β) of board size equals 0.3511, t-value 2.1842 and level of significance equal to 0.0275. This is again lower than the general cut off of 0.05. Here also, this establishes a hypothesis rather than a null, as it was intended in case of bivariate plot, stating a positive correlation between board size and earnings management. A bigger board size could provide more diverse perspectives, but could also at the same time impair the monitoring efficiency thereby expanding the scope of earnings management activities.

In case for the board independence, the coefficient obtained is equal to 0.1836, t-value 1.9462 and level of significance equal to 0.0256.Since the significance level is below 0.05, this result supports H2 implying that board independence and management of earnings are again positively related. If once board independence is energetic enough to be able to at least reduce earnings management, the result does not really come up to expectation as far as independent member of the board is concerned: for in this case it

seems that the current independent members are not ecplicitly active in supervision of management practices.

As for the board meetings, the coefficient is -0.2948 with a t-value equal to -1.3921 and the significance level is 0.1297. Because the p-value is more than 0.05, it can be concluded that there is no relationship between the frequency of board meetings and the practice of earnings management. Hence, H3 is not valid. This result infers that there isn't a substantial relationship between the frequency of board meetings and how earnings management is practiced, most likely as a result of the superficiality of the conversations held in the first place, or because the monitoring has not been taken as seriously as it should.

As for the audit committee, the coefficient is 0.4791 with a t-value equal to 1.2935 and the significance level is 0.1238. Logic dictates that because this level of significance is above 0.05, H4 is not valid. This implies that neither the existence nor functional activities of the audit committee make useful contributions to earnings management. It may denote also that the audit com

The coefficient for the variable audit quality has a value of 0.2344 and is associated with a t-value of 5.3231 and a level of significance of 0.0000. It is clear that since the level of significance is lower than 0.05, there is a high positive relationship between audit quality and earnings management, thus providing support for H5. It may be that there is an inverse relation between the two and therefore higher audit quality is related to better detection of earnings management practices which border on paradoxical since quality of audits is assumed to curtail the practice of earnings management.

Hypothesis H6 is confirmed by the findings related to Table 9 in the simple moderated regression analysis results and relates to board size and audit quality with the family earnings management practices of organizations. The model has an R^2 of 0.2377 and an Adjusted R^2 of 0.1152 suggesting that Suffice it to say that approximately 23.77% of the variations in the model have been forever altered by Becker and Yan, somewhat moderating the variance to 11.52% after the number of controls has been taken into account. An overall F-test was significant with F-statistics being equal to 4.3826, p value = 0.0000 proving the null hypothesis statistically which also means that the model can be trusted in making predictions about the dependent variable.

In regard to plugging in the independent variables, it was seen that – Board Size (BS) is significant with p value of 0.0482 which again becomes highly significant when moderation is introduced (p = 0.0097**). This supports the assertion that industry type does affect the relationship between Board Size and Earnings Management Practices. Furthermore, Board Meetings (BM) and Audit Committee (AC) are seen to be closely marginalized with p values of 0. 0233 and 0.0349 respectively, giving some thirst for industry type as a possible moderating variable on their relations with earnings management practices. Nevertheless, it was found that Board Independence (BI) and Audit Quality (AQ) were unable to moderate the relationships under study as reflected by

their high p-values (0.1283 and 0.1190, respectively) which exceed the generally accepted level of 0.05.

Table 9. Moderated Regression Analysis

Variable	β	Std. Error	t-value	p-value	Sig.
BS	0.4618	0.0361	2.0192	0.0482	0.0097**
BI	0.0372	0.0173	0.3028	0.1283	0.1826
BM	0.0639	0.1272	1.9735	0.0927	0.0233*
AC	0.5192	0.0986	1.2832	0.0822	0.0349
AQ	0.3492	0.1381	1.3888	0.1190	0.2011
F = 4.3826 ; p = 0.0000					
R^2 = 0.2377 ; Adjusted R^2 = 0.1152					

Source: Processed Data (2024)

CONCLUSION AND SUGGESTIONS

The results indicate that board size, board independence, and audit quality have significant positive correlations with earnings management, partially supporting the hypotheses. However, board meetings and audit committee do not show significant correlations with earnings management. These findings suggest that certain governance factors are associated with corporate earnings management, although not always in the expected direction, pointing to potential contextual factors that influence these relationships. While the moderated regression result shows that the type of industry in IDX influences the relationship between some characteristics of the board for example board size and an earnings management practice but not others such as board independence and audit quality. It is demonstrated that the industry context; however, has significant effects on particular facets of corporate governance and their use by earnings management practices in firms.

In future studies, it is advisable to conduct a comparative analysis of all the industries that are represented on the Indonesia Stock Exchange (IDX). This is to enable deeper understanding on the differences in corporate governance characteristics and earnings management practices in relation to the different industries. Future studies incorporate a larger range of industries in order to investigate whether some industries require different types of governance structures or have different practices with regards to earnings management. In this way, researchers will be able to appreciate the importance of context, particularly industry, in explaining the effects of board composition and audit quality on the practice of earnings management in corporations, thereby increasing the validity and relevance of the outcomes across industries.

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