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Do Financial Hardships Impact Good Corporate Governance? Case study of companies listed on the IDX

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ABSTRACT

The purpose of this research is to examine the impact of financial hardship, accessible cash flow, sales growth, and firm size on profit and income management, with efficient Corporate Governance (GCG) serving as a mediating element. A quantitative approach, using a targeted sampling technique, yielded a selection of 20 firms, resulting in 100 observations overall. The theory was tested using route modeling and panel data regression using the software EViews. The findings indicate that effective corporate governance (GCG), firm size, sales growth, and fiscal issues have no discernible effect on income revenue management, but that accessible cash flow does have a significant positive effect. In addition, an efficient corporate governance (GCG) cannot mediate the connection between the independent variable and income management. The significance of this study lies in its reinforcement of the empirical evidence that accessible cash flow is the primary driver of earnings management tactics in Indonesia, but that the successful implementation of Corporate Governance (GCG) has not yet been shown to be successful in curbing opportunistic managerial conduct. As a result of these findings, regulators and stakeholders are urged to improve the standards of efficient Corporate Governance (GCG) practices in order to safeguard the interests of stakeholders.

Keywords: financial distress, free cash flow, sales growth, firm size, good corporate Governance

JEL Classification: M0, M1, M41

INTRODUCTION

According to Ross et al (2016:208), Financial distress is a situation in which a company experiences great financial difficulties, which often affects the continuity of its operations. Management is often faced with pressure to create a true financial picture, which is beneficial for maintaining investor confidence and meeting the criteria of a credit

agreement. In cases like this, management often seeks solutions to help overcome the condition, including performing profit management actions.

Agency theory is a theory that describes the interaction between agents and principals and states that agency problems occur as a result of information imbalances between managers acting as agents and principals (Nainggolan & Karunia, 2022). Inadequate information causes management to prioritize personal gains over revenue. Companies that are under pressure sometimes have difficulty paying their short-term obligations, leading to bankruptcy or restructuring (Tsaqif & Agustiningsih, 2021). In the context of agency problems, the cause of financial distress generally stems from a decline in company performance. When a company is in a recession, the company's management may prioritize profit management methods. Accounting strategies to increase or decrease revenue may involve discretionary accrual actions based on the severity of financial distress. The management goal of managing profits to improve performance is contrary to the principal's wishes, resulting in an information imbalance and the emergence of agency problems. Based on the explanation of the theory, the following is the phenomenon of financial distress.

According to the Statement of Financial Accounting Concept (SFAC) No.1, profit information in financial statements is essential to assist users, both internal and external, in developing company policies. Good for decision-making related to capital increases, loan agreements, and executive remuneration, which are based on the company's profits contained in the annual report (Putri, 2024). Therefore, users of financial statements utilize profit information as the main basis for formulating company policies and making strategic decisions. Many companies manipulate the earnings information provided in these financial statements to meet management satisfaction standards in to achieve certain goals, which can be detrimental to stakeholders such as shareholders and investors. Moreover, when a company experiences a financial crisis, this activity of manipulating profits in financial statements is commonly done, this is commonly called profit management.

Profit management arises due to agency theory, which occurs due to a conflict of interest between the company's management (agent) and shareholders (principal). Management is motivated to maximize their interests by meeting economic needs such as obtaining investment contracts, loans, or compensation, while shareholders are motivated to sign contracts that will improve their well-being through increased profitability (Syaddyah et al., 2020).

According to Sulistyanto in Ernayani et al (2020:144), profit management is a method in which company management manipulates or manages financial statements in a way that does not always reflect the company's actual performance. The main goal of profit management is to form a stakeholder perspective (including investors, debtors, financial analysts, etc.) about a company's performance, in hopes of raising stock prices, getting better credit, or receiving other benefits. The following is the phenomenon of profit management in companies in the food and beverage sub-sector.

Sustainable finance can be defined as the process of making financial decisions that consider environmental, social, and governance factors, in addition to traditional factors. The goal is to allocate capital in a way that not only generates competitive financial returns but also supports the transition to a more sustainable, inclusive, and stable economy. It covers the entire spectrum of financial activities, from investment decisions to lending to insurance offerings. Masno (2025:387)

In this study, there is still a gap in previous research by Linda Apriliana, Lita Khoirun Nisa, and Rikke Prastika (2024), which states that financial distress does not have a significant effect on earnings management because it indicates that an increase in financial distress tends to reduce earnings management Practices. This may be due to increased scrutiny from creditors and authorities when companies are in financial crisis, thereby reducing management's ability to manipulate profits.

METHODS

This study uses a quantitative approach with a panel data regression design. The research population consists of all food and beverage sub-sector companies listed on the Indonesia Stock Exchange (IDX) during the period 2019-2023. The sample selection was conducted using purposive sampling based on the following criteria: (i) companies were listed before 2019 and were still active in 2023, (ii) published complete annual reports and financial reports during the observation period, and (iii) research variable data were available consistently. Based on these criteria, 20 companies were selected as samples, with a total of 100 observations. Data was obtained from the IDX official website (www.idx.co.id) and the annual reports of each

company.

OPERATIONALISATION OF VARIABLES

1. Earnings Management (EM) is measured by discretionary accruals (DA) using the Modified Jones (1995) model. The calculation is carried out in three stages: calculating total accruals, estimating non-discretionary accruals using an industry-year regression, and then obtaining DA as the difference between total accruals and non-discretionary accruals.

2. Financial Distress (FD) is calculated using the Altman Z-Score manufacturing model formula.

3. Free Cash Flow (FCF) is measured as the difference between operating cash flow and capital expenditure, divided by total assets from the previous year.

4. Sales Growth (SG) is calculated from annual sales growth.

5. Firm Size (SIZE) is proxied by the natural logarithm of total assets.

6. Good Corporate Governance (GCG) is proxied by the proportion of institutional ownership to total outstanding shares.

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ESTIMATION PROCEDURE

Data processing was performed using EViews 9 software. Chow, Lagrange Multiplier, and Hausman tests were used to determine the best panel model (common effect, fixed effect, or random effect). Diagnostic tests (multicollinearity, heteroscedasticity, autocorrelation) were then performed, and robust standard errors were used when necessary. Extreme data were handled by winsorising at the 1% level to maintain the stability of the estimates.

RESULT AND DISCUSSION

Descriptive Analysis

Descriptive statistical analysis describes in more detail the general characteristics of the sample used in the study, so that the minimum, maximum, mean, and standard deviation values of the variables used can be known. Based on the results of data processing using the Eviews 9 software, descriptive statistics can be seen in Table 4.1 below:

Table 4.1
Descriptive Analysis

	Y	C	X1	X2	X3	X4	Z
Mean	-0.053270	1.000000	3.494380	0.103310	0.071640	23892.42	0.752300
Median	-0.052500	1.000000	2.562000	0.122500	0.052000	26951.00	0.769000
Maximum	-0.008000	1.000000	14.69100	0.571000	2.473000	30735.00	0.998000
Minimum	-0.195000	1.000000	-1.407000	-3.591000	-0.855000	13620.00	0.133000
Std. Dev.	0.026480	0.000000	3.417833	0.432454	0.348579	5676.421	0.199613
Skewness	-1.539299	NA	1.042512	-6.698900	3.048863	-0.678597	-0.789379
Kurtosis	9.889726	NA	3.460954	55.96137	24.43244	1.854426	2.747909
Jarque-Bera	237.2754	NA	18.99919	12435.03	2068.882	13.14297	10.65011
Probability	0.000000	NA	0.000075	0.000000	0.000000	0.001400	0.004868
Sum Sum Sq.	-5.327000	100.0000	349.4380	10.33100	7.164000	2389242.	75.23000
Dev.	0.069418	0.000000	1156.477	18.51463	12.02919	3.19E+09	3.944681
Observations	100	100	100	100	100	100	100

Based on table 4.1, it is shown that the amount of data used in this study is as many as 100 observational data. The total sample data was taken from 20 food and beverage sub-sector companies listed on the Indonesia Stock Exchange (IDX) for 5 (five) years, with a date, namely from 2019 to 2023, accessed through the www.idx.co.id website. The following is a descriptive analysis obtained from Table 4.1:

a) The earnings management values in the sample are clustered around -0.05, with little variation between firms. This indicates that most companies do not engage in aggressive earnings manipulation

b) Financial Distress (X1) varies widely among companies, ranging from highly distressed to very healthy. The average Z-score indicates that most of the companies in the sample had healthy financial conditions during the observation period. c) Free Cash Flow (X2) values fluctuate considerably, with some companies recording negative cash flows. This spread reflects differences in investment and operational cash management across companies.

d) Sales Growth (X3) showed mixed results, with some companies experiencing sharp declines while others recorded rapid growth. On average, growth rates were quite low, indicating limited expansion in this subsector.

e) Firm size (X4), proxied by total assets, also shows wide variation, from relatively small to very large companies. This spread reflects the diverse scale of operations in the food and beverage subsector.

f) Good Corporate Governance (Z), as measured by institutional ownership, tends to be high on average. However, the variation indicates that some companies are still dominated by non-institutional investors, which could potentially affect the effectiveness of governance

This test was conducted to determine the partial effects of financial distress, free cash flow, sales growth, and firm size on earnings management. The test was conducted as follows.

Table 4.2 t-test for the First Earning Management Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.065482	0.030354	-2.157303	0.0335
X1	0.001220	0.000927	1.316509	0.1912
X2	-0.015642	0.004239	-3.689998	0.0004
X3	-0.003431	0.004838	-0.709279	0.4799
X4	1.65E-07	1.01E-06	0.162720	0.8711
Z	0.007801	0.016387	0.476084	0.6351

Source: data processed by EViews, 2025

Based on Figure 4.2 above, it is known that the t-table value is 1.6140, seen at a significance level of α = 5% with df (n-k-1) or 100-6-1 = 93, (0.05) (93).

a) Based on the calculation results table, it can be seen that the t-statistic value is 1.316509 when compared to the t-table at a significance level of α = 5% with df (n-k-1) or 100-6-1 = 93, (0.05) (93), which is 1.6140, then the t-table > t-statistic, namely 1.6140 > 1.316509, which means that financial distress does not affect earning management. Meanwhile, the probability value of the financial distress variable (X1) is 0.1912 > 0.05, so the financial distress variable does not have a significant effect on earnings management at a significance level of 5%.

b) Based on the calculation results table, it can be seen that the t-statistic value is -3.689998 when compared to the t-table at a significance level of α = 5% with df (n-k-1) or 100-6-1 = 93, (0.05) (93), which

is 1.6140, then the t-table > t-statistic, i.e., 1.6140 > -3.689998, which means that free cash flow affects earnings management. Meanwhile, the probability value of the free cash flow variable (X2) is 0.0004 < 0.05, so the free cash flow variable has a significant effect on earnings management at a significance level of 5%.

c) Based on the calculation results table, it can be seen that the t-statistic value is -0.709279 when compared to the t-table at a significance level of α = 5% with d f (n-k-1) or 100-6-1 = 93, (0.05) (93), which is 1.6140, the t-table > t-statistic, namely 1.6140 > -0.709279, which means that sales growth does not affect earnings management. Meanwhile, the probability value of the sales growth variable (X3) is 0.4779 > 0.05, so the sales growth variable does not have a significant effect on earnings management at a significance level of 5%.

d) Based on the calculation results table, it can be seen that the t-statistic value is 0.162720 when compared to the t-table at a significance level of α = 5% with df (n-k-1) or 100-6-1 = 93, (0.05) (93), which is 1.6140, the t-table > t-statistic, namely 1.6140 > 0.162720, which means that firm size does not affect earnings management. Meanwhile, the probability value of the firm size variable (X4) is 0.8711 > 0.05, so the firm size variable does not have a significant effect on earnings management at a significance level of 5%.

Based on the calculation results table, it can be seen that the t-statistic value is 0.476084 when compared to the t-table at a significance level of α = 5% with df (n-k-1) or 100-6-1 = 93, (0.05) (93), which is 1.6140, the t-table > t-statistic, namely 1.6140 > 0.476084, which means that good corporate governance does not affect earnings management. Meanwhile, the probability value of the firm size variable (X4) is 0.6351 > 0.05, so the good corporate governance variable does not have a significant effect on earnings management at a significance level of 5%.

RESEARCH DISCUSSION

The Effect of Financial Distress on Earning Management

Based on the table of t-test calculations, it can be seen that the t-statistic value is 1.316509 when compared to the t-table at the significance level of α = 5% with df (n-k-1) or 100-6-1 = 93, (0.05) (93) which is 1.6140, then the t-table > t-calculation is 1.6140 > 1.316509 this means that financial distress does not affect earning management. While the probability value of the financial distress variable (X1) is 0.1912 > 0.05, the financial distress variable does not have a significant effect on earning management at a significance level of 5%.

This research is in line with research conducted by Putri Kristyaningsih (2021), Alif Difa Miftakhunnimah & Ahmad Juanda (2020), Adi Nurdiansyah (2021), and Sally Irawan & Prima Apriwenni (2021), which stated that financial distress does not have a significant effect on earnings management. It is said that it does not have a significant effect because companies that experience financial distress do not always encourage the implementation of profit management measures. Companies that experience financial distress believe that profit management actions can cause greater losses for the company in the future, so they will prefer to report the actual profit as a good sign to outsiders who will be able to reduce asymmetric information rather than doing profit management. If a company is proven to be doing profit management, then the company will lose the trust of its stakeholders, including shareholders. Of course, investors will trust a company with a good reputation, not only because of its profitability, but also because of its track record, including never being accused of submitting false financial statements.

Conceptually, agency theory assumes that financial pressure encourages managers to engage in opportunistic behavior in the form of profit

manipulation to cover up declining performance. However, the results of this study show the opposite, namely that financial distress does not have a significant effect on profit management practices. This finding indicates a shift in managerial orientation from short-term interests to a long-term orientation that emphasizes transparency, credibility, and corporate sustainability, while highlighting the importance of non-financial factors such as corporate reputation, investor confidence, and organizational legitimacy as determinants in decision-making. Companies facing financial difficulties tend to avoid earnings manipulation because they realize that such practices can damage the company's image and incur higher agency costs in the future. Thus, this study not only supports previous findings but also broadens understanding by establishing that non-financial dimensions play a significant role in explaining earnings management behavior amid financial pressure.

THE EFFECT OF FREE CASH FLOW ON EARNINGS MANAGEMENT

Based on the results of the t-test calculation, a t-statistic of -3.689998 was obtained, which is greater in absolute terms than the t-table value of 1.6140 at a significance level of 5% (df = 93). In addition, the probability value of the free cash flow variable (X2) is 0.0004 < 0.05, so it can be concluded that free cash flow has a significant effect on earnings management. This means that the greater the free cash flow a company has, the higher the tendency for management to engage in earnings management practices.

The results of this study are in line with the findings of Oktavia & Kananto (2020), Setiawati et al. (2019), Irawan & Apriwenni (2021), and Sitanggang et al. (2020), which show a significant effect of free cash flow on profit management practices. This relationship can be explained through agency theory, in which a conflict of interest between managers (agents) and shareholders (principals) arises in the management of free cash flow. Shareholders tend to want free cash flow to be distributed in the form of dividends, while management prefers to use it for reinvestment, even though this does not always generate optimal profits. This condition encourages managers to engage in earnings management to cover potential losses or present better financial performance to investors.

The significance of these findings shows that the existence of free cash flow is an important factor that influences managers' opportunistic behavior in managing earnings. Thus, the results of this study reinforce empirical evidence that the greater the flexibility of funds a company has, the greater the opportunity for earnings management practices. However, these findings also contradict the research by Hakim et al. (2023) and Jelanti (2020), which reported that free cash flow does not have a significant effect on earnings management. This difference in results indicates the possibility of contextual factors such as industry characteristics, corporate governance, or the research period moderating the relationship between free cash flow and earnings management.

THE EFFECT OF SALES GROWTH ON EARNING MANAGEMENT

Based on the t-test results, a t-statistic of -0.709279 was obtained, which is smaller than the t-table value of 1.6140 at a significance level of 5% (df = 93). The probability value of the sales growth variable (X3) is also 0.4779 > 0.05. Thus, it can be concluded that sales growth does not have a significant effect on profit management. This shows that an increase in sales does not always encourage management to engage in profit manipulation practices.

The results of this study are consistent with studies conducted by Sadewa & Sopian (2024), Yeldi et al.

(2023), and Aulia & Hidayat (2023), which also found that sales growth does not have a significant effect on profit management practices. These findings can be explained by the argument that even though companies experience sales growth, this condition does not necessarily trigger profit manipulation because management is more focused on maintaining stable and sustainable sales trends. Companies with strong financial conditions also tend to avoid profit manipulation practices in order to maintain their reputation and investor confidence.

However, the results of this study differ from those of Harni et al. (2022), who reported that sales growth has a significant effect on earnings management. This difference in results indicates the existence of contextual factors, such as industry characteristics, competition intensity, and corporate governance, which can moderate the relationship between sales growth and earnings management practices.

THE EFFECT OF FIRM SIZE ON EARNINGS MANAGEMENT

Based on the table of t-test calculation results, it can be seen that the t-statistic value is 0.162720 when compared to the t-table at the significance level of α = 5% with df (n-k-1) or 100-6-1 = 93, (0.05) (93) which is 1.6140, then the t-table > t-calculation is 1.6140 > 0.162720 this means that the firm size does not affect earning management. While the probability value of the firm size variable (X4) is 0.8711 > 0.05, the firm size variable has no significant effect on earnings management at a significance level of 5%. Thus, it is evident that firm size does not have a significant effect on earnings management practices. This means that the size of a company is not a determining factor in encouraging management to manipulate earnings.

These results are in line with the research of Rahmawati et al. (2024), Apriliani & Rakhmanita (2024), Agustia & Suryani (2018), Aurelia & Jenni (2022), Meilani & Widyastuti (2022), Sitanggang et al. (2019), and Supatminingsih & Wicaksono (2020), who all found that company size does not have a significant effect on earnings management. The consistency of these findings shows that even though large companies have more assets and resources, this does not necessarily reduce the likelihood of earnings management practices. In fact, the complexity of asset management in large companies can increase the risk of inaccuracy in financial reporting and disclosure, so that company size cannot be considered the main determinant of profit manipulation practices.

The significance of these results is that structural factors such as company size are not strong enough to explain variations in profit management behavior. This establishes the importance of considering other factors, such as corporate governance mechanisms, audit quality, and external pressure from investors and regulators, which play a greater role in influencing managers' tendency to engage in earnings manipulation. Thus, this study not only reinforces previous findings but also provides an understanding that company size is not a dominant variable in explaining earnings management practices amid the dynamics of modern business.

THE INFLUENCE OF GOOD CORPORATE GOVERNANCE ON EARNINGS MANAGEMENT

Based on the table of t-test calculation results, it can be seen that the t-statistic value is 0.476084 when compared to the t-table at the significance level of α = 5% with df (n-k-1) or 100-6-1 = 93, (0.05) (93) which is 1.6140, then the t-table > t-calculation is 1.6140 > 0.476084 this means that good corporate governance earning management. While the probability value of the firm size variable (X4) is 0.6351 > 0.05, the good corporate governance variable does not have a significant effect on earnings management at a significance level of 5%.

This research is in line with research conducted by

Hadi Sucipto & Umi Zulfa (2021), Dewi Ayu Mellenia & Khomsiyah (2023), Hustianto Sudarwadi, et al (2021), Orina Margareth Tambun (2021), Rico Nur Ilham, et al (2022), Sri Supatminingsih & Monot Wicaksono (2020), which stated that good corporate governance does not have a significant effect on earnings management. It is said to have no significant effect because institutional ownership refers to the ownership of shares by institutional investors. Institutional owners are considered to be more thorough with financial information. In addition, monitoring activities conducted by companies and institutional investors may limit managers' behavior. Thus, the presence of institutional investors may motivate managers to pay attention to the company's performance, and institutional investors are seen as an effective monitoring tool in all managerial decisions. Thus, it can be concluded that the greater the proportion of shares owned by institutional shareholders, the less likely it is for managers to perform profit management by manipulating real-world activities.

The significance of these results is that structural factors such as company size are not strong enough to explain variations in earnings management behavior. This establishes the importance of considering other factors, such as corporate governance mechanisms, audit quality, and external pressure from investors and regulators, which play a greater role in influencing managers' tendency to manipulate earnings. Thus, this study not only reinforces previous findings but also provides an understanding that company size is not a dominant variable in explaining earnings management practices amid the dynamics of modern business.

GOOD CORPORATE GOVERNANCE MEDIATES FINANCIAL DISTRESS ON EARNINGS MANAGEMENT

Based on the calculation of the path analyst and the Sobel test above, it can be seen that the indirect effect value is smaller than the direct effect (0.0000258135 < 0.001220) in the path analyst then the p-value in the Sobel test is strengthened by 0.70793878 > 0.05, with the test value of the statistical Sobel test of 0.3746258, These findings confirm that good corporate governance (GCG) does not act as a mediating variable between financial distress and earnings management. In other words, the existence of GCG is not strong enough to suppress earnings management practices arising from corporate financial pressures. This is understandable because the implementation of GCG in some companies is often merely a formality, only to meet regulatory requirements, rather than an effective managerial control system.

The results of this study are aligned with the findings of Dewi Ayu Mellenia & Khomsiyah (2023) and Hadi Sucipto & Umi Zulfa (2021), which show that the application of GCG is unable to reduce the impact of financial distress on earnings management. This condition illustrates that although corporate governance mechanisms are theoretically expected to provide oversight, in reality, their effectiveness is highly dependent on the quality of implementation and management commitment. If governance is only procedural, then companies remain vulnerable to profit management when facing financial pressure. This finding also reinforces the argument that the quality of GCG implementation is more important than the mere existence of a formal governance structure in maintaining the integrity of a company's financial reporting.

GOOD CORPORATE GOVERNANCE MEDIATES FREE CASH FLOW AGAINST EARNINGS MANAGEMENT

Based on the results of path analysis and Sobel's test, it is known that the indirect effect of free cash flow on earnings management through Good Corporate

Governance (GCG) is 0.00000133712, which is greater than the direct effect of –0.0001220. However, the Sobel test results show a z value of 0.3176 with p = 0.7508 (> 0.05), so that the mediating effect is not statistically significant.

The difference between the magnitude of the direct and indirect effects also has no practical significance because both values are very small, so it can be concluded that GCG is unable to mediate the relationship between free cash flow and earnings management. This condition shows that when a company has large free cash, the opportunity for managers to engage in earnings management practices remains high, due to the incentive to use the flexibility of cash flow for personal gain or to maintain the company's performance appearance. Although GCG is theoretically designed to improve transparency and accountability, its effectiveness is often weak in the face of managers' opportunistic motivations. This may be due to weak management commitment to implementing governance principles, or GCG implementation that is merely formal without adequate oversight mechanisms.

These findings are consistent with the research by Erma Setiawati et al. (2019) and Fitri Kurnia Shandy and Wisnu Panggah Setiyono (2022), which states that GCG does not function as a mediator in the relationship between free cash flow and earnings management. Thus, it can be asserted that efforts to control profit management practices in companies with high free cash flow levels cannot rely solely on the existence of GCG mechanisms, but must be complemented by stronger external oversight, including the role of independent auditors and strict capital market regulations, so that managers' opportunistic incentives can be minimized.

GOOD CORPORATE GOVERNANCE MEDIATES SALES GROWTH AGAINST EARNINGS MANAGEMENT

The path analysis and Sobel test results show that the indirect effect of sales growth on earnings management through Good Corporate Governance (GCG) has a value of 0.000008066234, which is greater than the direct effect of –0.003431. However, the Sobel test produced a statistical value of –0.035 with p = 0.972 (> 0.05), which means that the mediating effect is not statistically significant. The proportion of the mediated effect is also very small in practical terms, so it can be concluded that GCG is unable to mediate the relationship between sales growth and earnings management. This condition indicates that high sales growth pressure is more dominant in driving earnings management practices than the effectiveness of GCG implementation.

Companies with rapid sales growth are usually under pressure to maintain a positive image in the eyes of investors and other stakeholders, so managers have a strong incentive to manipulate earnings in order to maintain market expectations. In this context, GCG is not effective enough as a control mechanism because its implementation is often inconsistent, or management's commitment to good governance principles is still low. In addition, the weakness of GCG in mediating can also be explained by agency problems, where managers have an incentive to maximize personal interests, even at the expense of the quality of financial reports.

These results are in line with the research by Muraudin Hasmaru Rizky and Wiwi Idawati (2024), which found that GCG does not function as a mediator in the relationship between sales growth and earnings management. Thus, it can be asserted that efforts to minimize earnings management practices in companies with high sales growth are not sufficient by relying solely on the implementation of GCG, but also require stricter external oversight and increased transparency in financial reporting.

GOOD CORPORATE GOVERNANCE MEDIATES FIRM SIZE TOWARDS EARNINGS MANAGEMENT

Based on the results of path analysis and Sobel's test, it was found that the indirect effect of firm size on earnings management through Good Corporate Governance (GCG) was only 0.01287, much smaller than the direct effect of 1.65000. The Sobel test shows a z value of –0.469 with a significance of p = 0.639 (> 0.05), so that the mediating effect is not statistically significant. A comparison between the direct and indirect effects also shows that the proportion of the effect mediated by GCG is very small, only about 0.77% of the total effect.

These findings indicate that almost all of the relationship between firm size and earnings management occurs through a direct channel without being mediated by GCG mechanisms. This can be explained by the characteristics of large companies, which tend to have complex organizational structures and greater influence over regulators and other stakeholders, so that governance mechanisms often do not function optimally as controllers of profit management practices. Thus, the effectiveness of GCG in this study appears weak, mainly because the quality of governance implementation is highly dependent on the integrity and competence of the parties involved. This finding is in line with the research by Moh. Rifqi Hidayatullah and Abubakar Arif (2023), which states that GCG is unable to mediate the influence of firm size on earnings management. Therefore, to strengthen earnings management control in large companies, there needs to be an emphasis on stricter external oversight mechanisms and improvements in the quality of GCG implementation that is not merely formalistic but truly functional in practice.

CONCLUSION AND SUGGESTION

Based on the test results, it is known that financial difficulties do not have a significant effect on earnings management (p-value = 0.1912 > 0.05), while free cash flow has a significant effect on earnings management (p-value = 0.0004 < 0.05). The variables of sales growth (p-value = 0.4779 > 0.05), company size (p-value = 0.8711 > 0.05), and GCG (p-value = 0.6351 > 0.05) did not show a significant effect on earnings management. In addition, good corporate governance was also proven to be unable to mediate the influence of financial difficulties, free cash flow, sales growth, and company size on earnings management. These findings indicate that corporate governance mechanisms are not yet strong enough to suppress earnings management practices when companies face financial pressures.

This study has several limitations that need to be considered. First, the measurement of good corporate governance was conducted in aggregate, thus possibly obscuring the different effects of each component, such as the board of commissioners, audit committee, or institutional ownership. Second, the use of a cross-sectional design limits our understanding of the dynamics of the relationship between variables in the long term. Third, the mediation test method used, namely the Sobel test, has limitations because it is sensitive to the assumption of normality and a sample size that is not too large. Therefore, further research is recommended to use the bootstrap or panel data method, as well as to test the components of good corporate governance separately in order to obtain a more comprehensive picture.

In conclusion, this study confirms that only free cash flow has a significant effect on earnings management, while other variables, including good corporate governance, do not show a significant effect either directly or as a mediator. This indicates that the scope for earnings management practices arises more from the flexibility of free cash flow than from other factors. Thus, the quality of corporate governance implementation needs to be substantively strengthened in order to function effectively in preventing profit management practices, especially

when companies are under financial pressure.

LIMITATION

Research Limitations certainly have limitations, which can be corrected in future research. The study only used financial difficulties, free cash flow, sales growth, and company size on revenue profit management, with GCG as a mediating variable. A quantitative approach was used using purposive sampling techniques, resulting in a sample of 20 companies (100 observations). Hypothesis testing was carried out through panel data regression and path analysis using The results showed that financial difficulties, sales growth, company size, and GCG did not have a significant impact on the management of income profit, while free cash flow had a positive and influential impact. In addition, GCG cannot mediate the relationship between independent variables and revenue management. The contribution of this study lies in strengthening the empirical evidence that free cash flow is the main driver of profit management practices in Indonesia, while the implementation of GCG has not been effective in curbing managerial opportunistic behavior.

These findings differ from some previous studies on GCG and profit management in Indonesia, as they emphasize the dominance of free cash flows over governance mechanisms. These practical implications encourage regulators and investors to improve the quality of GCG implementation to protect the interests of stakeholders.

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