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Corporate Governance and Earnings Management: Insights from Jakarta Islamic Index Firms

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ABSTRACT

This study investigates the impact of corporate governance mechanisms, firm size, and market share on earnings management in companies listed on the Jakarta Islamic Index (JII) from 2014 to 2017. With a focus on the ethical framework of Islamic finance, the research aims to understand how governance structures mitigate opportunistic financial behaviors and promote transparency. The study employs a quantitative research design, using secondary data from audited financial reports of JII-listed firms. Multiple regression analysis was applied to assess the relationships between discretionary accruals, as a proxy for earnings management, and independent variables such as audit committee expertise, managerial and institutional ownership, board independence, firm size, and market share. The findings reveal that robust governance mechanisms, including well-composed audit committees, higher managerial and institutional ownership, and independent boards, significantly reduce earnings management. Larger firms and those subjected to high-quality audits also exhibit lower levels of financial manipulation. However, market share does not show a significant impact on earnings management, suggesting the dominance of governance and external scrutiny over competitive positioning in shaping reporting behaviors. These results underscore the interplay between governance practices and ethical financial reporting within the JII context. This research contributes to the broader literature on corporate governance and earnings management by offering insights specific to Islamic financial principles. The findings have practical implications for policymakers and practitioners, emphasizing the importance of strengthening governance frameworks to enhance corporate accountability and stakeholder trust. Further research could explore governance dynamics across diverse financial systems to build a comprehensive understanding of their global implications.

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INTRODUCTION

The dynamic global economic landscape has been significantly influenced by the ongoing digitization trend, characterized by volatility, uncertainty, complexity, and ambiguity—commonly referred to as the VUCA era (Heinonen et al., 2017; Kaivo-oja & Lauraeus, 2018; Zhang-Zhang et al., 2022). Within this context, corporate entities face unprecedented challenges requiring adaptive transformation strategies to ensure sustainability and competitiveness. These challenges, which vary across industries, often mandate corporate transformation initiatives involving management restructuring, technological upgrades, financial recalibration, and workforce optimization. For instance, Indonesia's state-owned electricity provider, PT Perusahaan Listrik Negara, has undertaken asset reevaluation (Aprilia et al., 2022; Dharma, 2016) and other measures to enhance its borrowing capacity amid increasing energy demands and infrastructural pressures. Similarly, the banking sector exemplifies transformation in response to shifting customer demographics and policy-driven housing initiatives, such as BTN's strategic response (Hidayanti et al., 2020; Meilawati et al., 2021; Wihasto, 2020) to accommodate a rapidly growing middle-class customer base and government housing programs.

Despite these transformative strides, ethical governance and adherence to Good Corporate Governance (GCG) principles remain contentious. Cases such as PT Karina Utama's financial mismanagement prior to its IPO demonstrate how lapses in GCG can lead to corporate scandals and financial instability. Manipulations such as inflated asset values and fictitious revenue streams highlight the importance of strong internal controls, audit committees, and independent oversight (Fadli et al., 2021; Jaya & Narsa, 2020). Globally, the collapse of entities like Enron and their auditors, Arthur Andersen, underscore the devastating impact of governance failures and unethical financial practices on stakeholder trust and corporate viability. These examples collectively point to a critical need for strengthened corporate governance frameworks to mitigate financial misreporting and ensure organizational integrity.

At the heart of these governance challenges lies the phenomenon of earnings management, where financial reporting is deliberately manipulated to project favorable but misleading corporate performance metrics. Earnings management, while sometimes legally permissible within accounting standards, often distorts true economic performance and undermines stakeholder trust. Factors influencing earnings management include managerial and institutional ownership structures, the independence and expertise of board members, company size, and market share. For instance, the Efficiency Market Hypothesis (EMH) posits that financial information, particularly profitability metrics, significantly impacts market behavior and investment decisions. However, when such information is manipulated, it skews investor perceptions and financial market dynamics (Bigelow et al., 2014; Clarke et al., 2021; Martin, 2019; Miller & Skinner, 2015).

Existing literature has explored various dimensions of governance and their impact on earnings management, yielding mixed findings. For instance, some studies argue that the presence of independent board members effectively reduces earnings manipulation (Hsu et al., 2024; Lam, 2022; Musa et al., 2023), while others contend that the educational background of audit committee members may not significantly influence governance outcomes (Erzurumlu & Avci, 2020; Sukma & Bernawati, 2020). Similarly, institutional ownership is often posited as a deterrent to earnings management due to enhanced monitoring capabilities, though its efficacy remains debated (Cornett et al., 2007). Managerial ownership, on the other hand, is believed to align management and shareholder interests, reducing the propensity for financial misreporting, though evidence on this remains inconsistent (Rahiim & Wulandari, 2016). These studies collectively underscore the complexity of governance mechanisms and their varied implications for corporate transparency.

Within this broader discourse, the role of company size and market share also warrants attention. Larger firms, often subject to greater public scrutiny, may demonstrate more conservative financial practices to safeguard reputational capital (Dumitrascu et al., 2013; Walter, 2013). However, evidence suggests that size does not always deter earnings management, as resource-rich companies may exploit their influence for opportunistic reporting (Asthana, 2009; Bartels, 2013; DeCoster et al., 2015). Similarly, the relationship between market share and earnings management remains ambiguous, with some research indicating that dominant market players might manipulate financial outcomes to maintain competitive advantage (Mesly, 2014; Vickers, 2005).

Despite extensive scholarly attention, significant gaps persist in understanding how these governance variables interact within the context of Islamic financial principles. Studies focusing on firms listed on the Jakarta Islamic Index (JII) offer a unique perspective, given the stringent ethical and transparency standards imposed by Islamic financial tenets. Unlike conventional indices, JII-listed firms are subject to additional scrutiny regarding their adherence to Sharia principles, making them an ideal setting for exploring the interplay between governance mechanisms and earnings management. Previous research has demonstrated that companies within JII often display distinctive governance behaviors compared to their conventional counterparts, yet comprehensive analyses of these patterns remain limited.

This study addresses these gaps by examining the influence of GCG, company size, and market share on earnings management among JII-listed firms during the 2014-2017 period. By focusing on audit committee characteristics, ownership structures, board independence, and other governance variables, the research provides empirical insights into how Islamic financial principles shape corporate governance and financial reporting practices. This approach not only highlights the unique governance dynamics within JII-listed firms but also contributes to broader discussions on ethical financial practices in emerging markets.

In doing so, this research advances existing literature by offering a nuanced understanding of governance mechanisms within an Islamic financial context. It underscores the importance of ethical oversight, transparency, and stakeholder accountability in mitigating earnings manipulation. Furthermore, the study's findings aim to inform policymakers and practitioners, emphasizing the need for tailored governance frameworks that align with both conventional and Islamic financial principles. Through its focus on JII-listed firms, this research not only bridges critical knowledge gaps but also reinforces the role of GCG in fostering sustainable and transparent corporate ecosystems.

LITERATURE REVIEW

Influence of Audit Committees' Educational Background on Earnings Management

The impact of audit committees' educational background on earnings management is a key consideration in corporate governance. Research suggests that audit committee members with strong financial and accounting expertise are more effective in overseeing financial reporting and mitigating earnings manipulation. Suprianto et al. (2019) argue that the presence of accounting experts on audit committees reduces managerial opportunistic behavior, thereby strengthening corporate governance. This finding aligns with agency theory, which suggests that well-qualified audit committee members can better monitor management and minimize conflicts of interest. Similarly, Siagian & Siregar (2018) found that financial expertise among audit committee members correlates with lower levels of earnings management, highlighting the importance of relevant educational qualifications in ensuring transparency and accountability.

Furthermore, the effectiveness of audit committees is not solely dependent on their educational background but also on their active participation in financial oversight. Istanti et al. (2023) emphasize that frequent and in-depth audit committee meetings help reduce real earnings management practices, suggesting that both expertise and engagement are necessary for effective oversight. Olabisi et al. (2022) further support this by demonstrating that audit committee size, independence, and financial knowledge significantly influence earnings management practices. In Indonesia, Lubis & Adhariani (2019) found that audit committees with members from financial or accounting backgrounds play a crucial role in reducing earnings manipulation. Additionally, Aulia (2021) highlights that the quality of external audits, when combined with well-qualified audit committees, further strengthens financial oversight and limits earnings management. These findings suggest that while educational qualifications are fundamental, they must be complemented by strong governance structures and active participation to maximize their effectiveness in ensuring financial integrity.

Influence of Proportion of Independent Boards of Commissioners on Earnings Management

The relationship between the proportion of independent board commissioners and earnings management is a crucial topic in corporate governance. Research presents mixed findings on the effectiveness of independent commissioners in reducing earnings manipulation. Lubis & Adhariani (2019) found that firms with a higher proportion of independent commissioners tend to exhibit lower earnings management, suggesting that independent oversight enhances financial transparency. This aligns with Beasley's perspective that independent boards serve as a critical governance mechanism in curbing opportunistic financial reporting (Ningrum, 2021). However, some studies challenge this assumption. For example, Istianingsih (2021) found no significant impact of independent commissioners on earnings quality, implying that factors such as institutional ownership and audit committee effectiveness may play a more decisive role in ensuring financial integrity.

Moreover, the effectiveness of independent commissioners is influenced by board size and the interaction with other governance mechanisms. Gunawan et al. (2021) found that a larger board with a higher proportion of independent members is more effective in mitigating earnings management. Similarly, Trisanti & Sari (2020) highlighted that independent commissioners, when combined with competent audit committees, significantly improve financial oversight. However, Rucita & Sanjaya (2021) argue that independent boards may sometimes serve as a mere formality without actively engaging in effective monitoring. These findings suggest that while independent commissioners have the potential to curb earnings management, their effectiveness depends on the broader governance framework, including audit committees and external monitoring mechanisms.

Influence of Managerial Ownership on Earnings Management

The impact of managerial ownership on earnings management remains a complex and debated issue within corporate governance. Research suggests that managerial ownership can reduce earnings management by aligning the interests of managers with those of shareholders. Piosik & Genge (2019) found a negative correlation between managerial ownership and earnings manipulation, indicating that when managers hold a significant stake in the company, they are less likely to engage in opportunistic financial reporting. This aligns with agency theory, which posits that increased managerial ownership mitigates agency conflicts, reducing the incentive for earnings manipulation (Hakim, 2022). Similarly, Rizani et al. (2019) argue that managerial ownership fosters greater accountability, thereby discouraging earnings management. However, other studies, such as that of Nengsih et al. (2021), challenge this notion, indicating that managerial ownership does not always prevent earnings management, as managers may still manipulate earnings to meet performance targets.

Furthermore, some researchers highlight the potential downside of managerial ownership, particularly in cases where it leads to entrenchment. Andriani et al. (2022) suggest that excessive managerial ownership can reduce external oversight, allowing managers to engage in earnings manipulation without sufficient accountability. This is further supported by Rahmawati & Fajri (2021), who argue that firm size and leverage can moderate the effects of managerial ownership on earnings management. Additionally, Sih (2021) emphasizes the role of governance structures in mitigating the risks associated with managerial ownership, suggesting that strong corporate governance mechanisms, such as independent boards and effective audit committees, are necessary to ensure transparency and prevent managerial opportunism. These findings indicate that while managerial ownership can align managerial and shareholder interests, its effectiveness in curbing earnings management depends on external governance factors and firm-specific conditions.

Influence of Firm Size on Earnings Management

The relationship between firm size and earnings management remains a debated topic in corporate finance. Many studies suggest that larger firms engage in less earnings management due to stronger internal controls, greater regulatory scrutiny, and heightened public and investor oversight. Tran & Dang (2021) found an inverse correlation between firm size and earnings manipulation, indicating that larger firms tend to exhibit lower levels of earnings management. This finding aligns with the argument that larger companies face significant reputational risks and greater regulatory monitoring, which discourages opportunistic financial reporting (Sun & Al Farooque, 2018). Moreover, firms with substantial market capitalization often have more resources to invest in high-quality audits and corporate governance structures, further reducing the likelihood of earnings manipulation (Ruwanti et al., 2019).

Conversely, other research suggests that larger firms may have more opportunities for earnings management due to their complexity and broader discretion in financial reporting. Fitri & Hakim (2021) argue that increased agency costs in larger firms may incentivize managers to manipulate earnings to meet performance targets or manage investor expectations. Similarly, Nasir et al. (2018) highlight that larger firms may utilize both accrual-based and real earnings management techniques due to their extensive financial resources and diversified operations. Additionally, the impact of firm size on earnings management is often moderated by corporate governance mechanisms, ownership structures, and financial leverage (Rahmawati & Fajri, 2021). This suggests that while firm size plays a role in influencing earnings management, other external and internal factors must also be considered to understand its full effect.

Influence of Audit Quality on Earnings Management

The relationship between audit quality and earnings management is a crucial aspect of corporate governance and financial reporting. High-quality audits serve as a safeguard against opportunistic financial practices by ensuring that financial statements accurately reflect a firm's true economic position. Studies consistently suggest that firms with higher audit quality are less likely to engage in earnings manipulation. Alhadab & Clacher (2018) found that high-quality audits significantly reduce both real and accrual earnings management, particularly in high-stakes environments like IPOs. Similarly, Komariyah et al. (2021) noted that audits conducted by Big Four firms are more effective in curbing real earnings management, as these firms possess the expertise and resources to implement stringent audit procedures. Furthermore, Muttakin et al. (2017) emphasized the role of audit quality in assessing the risk of earnings manipulation, particularly in firms with complex ownership structures. These findings highlight the critical role of high-quality audits in maintaining the integrity of financial reporting.

However, while audit quality is generally associated with lower earnings management, its effectiveness can depend on regulatory environments and corporate governance mechanisms. Prayogo & Sitardja (2021) argue that stringent audit regulations reinforce audit quality, further reducing the likelihood of earnings manipulation. Lestari & Aeni (2019) also found that audit quality is negatively correlated with earnings management, particularly when discretionary accruals are used as a proxy for manipulation. Additionally, the interaction between audit quality and other governance structures is significant. Sih (2021) noted that combining high audit quality with strong ownership structures enhances financial transparency, while Sitanggang et al. (2022) found that audit committees play a crucial role in strengthening the impact of high-quality audits. These findings suggest that while audit quality is essential, its effectiveness is amplified when complemented by regulatory oversight and strong governance frameworks.

Influence of Institutional Ownership on Earnings Management

The impact of institutional ownership on earnings management is a complex issue that depends on various factors, including the level of ownership concentration and the characteristics of institutional investors. Institutional ownership generally enhances corporate governance by increasing oversight, which can reduce opportunistic earnings management practices (Kabacinski et al., 2022; Rizani et al., 2019). This aligns with agency theory, suggesting that institutional investors act as a counterbalance to managerial discretion, thereby improving financial reporting quality (Rizani et al., 2019). Additionally, firms with higher institutional ownership tend to have stronger corporate governance mechanisms, which further discourage earnings manipulation (Christina & Alexander, 2019). However, the effectiveness of institutional ownership in curbing earnings management can vary depending on investor incentives. For example, foreign institutional investors, particularly those from jurisdictions with strong regulatory oversight, exert a more significant influence on earnings quality than domestic investors (Beuselinck et al., 2017).

On the other hand, some studies indicate that institutional ownership can, in certain cases, contribute to earnings management. When institutional investors prioritize short-term financial performance, managers may feel pressured to manipulate earnings to meet their expectations (Sawitri et al., 2023). Furthermore, the concentration of institutional ownership plays a crucial role—firms with a more concentrated institutional presence experience stronger monitoring, while those with dispersed institutional investors may lack sufficient oversight, leading to increased earnings management risks (Rafique et al., 2018). The interaction between institutional ownership and other governance mechanisms, such as audit quality and managerial ownership, also influences earnings management outcomes. For instance, a strong audit committee can enhance the positive effects of institutional ownership, while high managerial ownership may create conflicts of interest that lead to earnings manipulation (Aryanti et al., 2017; Susanto, 2018). Additionally, the regulatory environment significantly shapes the effectiveness of institutional ownership in mitigating earnings management, with firms in emerging markets often experiencing weaker oversight compared to those in developed economies (Bao & Lewellyn, 2017). These findings underscore the importance of considering institutional investor characteristics, ownership concentration, and corporate governance mechanisms when evaluating the role of institutional ownership in earnings management.

Addressing Research Gaps and Moving Forward

The literature underscores the multifaceted nature of earnings management and its interplay with governance mechanisms, firm characteristics, and external oversight. While audit committees, managerial ownership, board independence, firm size, audit quality, and institutional ownership all contribute to earnings management to varying extents, their effects are context-dependent. The divergence in findings across studies points to potential moderating factors, such as industry characteristics, regulatory environments, and cultural influences, that warrant further exploration. This study contributes to the ongoing discourse by examining these relationships within the context of Jakarta Islamic Index-listed firms, where Islamic financial principles impose unique governance standards. By bridging these research gaps, the study aims to enhance our understanding of how governance mechanisms operate within a distinct ethical framework, providing insights that are both academically significant and practically relevant.

METHOD

Research Design

This study employs a quantitative research design to examine the impact of corporate governance (CG), firm size, and market share on earnings management practices. The research focuses on companies listed in the Jakarta Islamic Index (JII) from 2014 to 2017. The JII provides a distinct context due to its compliance with Islamic financial principles, making it an ideal setting for exploring governance dynamics. By employing multiple regression analysis, the study quantifies the relationships between dependent and independent variables, offering empirical insights into governance practices within the Islamic financial framework.

Population and Sampling

The study population includes all non-financial companies listed on the JII during the research period. JII-listed companies were chosen for their adherence to Islamic principles, which emphasize transparency and ethical financial practices. A purposive sampling technique was utilized to select a representative sample that meets specific inclusion criteria. These criteria include:

1. Companies that remained listed on the JII from 2014 to 2017.

2. Availability of complete and audited financial reports during the study period.
3. Financial reports expressed in Indonesian Rupiah for consistency in data analysis.
4. Inclusion of relevant data points such as institutional and managerial ownership, audit committee characteristics, and firm size.

Based on these criteria, the sample consisted of 18 firms, resulting in a total of 72 firm-year observations across the four-year period. This sample provides a robust dataset for evaluating the interplay of governance mechanisms and earnings management practices.

Variables and Operational Definitions

The research framework includes both dependent and independent variables. Each variable is operationally defined to ensure empirical measurability and alignment with the research objectives.

Dependent Variable:

- Earnings Management (EM): Earnings management is represented by discretionary accruals, a commonly used proxy. Discretionary accruals are calculated using the modified Jones model, which isolates discretionary components from total accruals to measure management's influence on reported earnings.

Independent Variables:

1. Audit Committees' Educational Background (EB): The educational background of audit committee members, particularly their expertise in accounting or finance, is measured as a dummy variable. A value of 1 indicates that at least one committee member has relevant educational qualifications; otherwise, the value is 0.
2. Independent Board of Commissioners (IBC): The proportion of independent commissioners is calculated as the ratio of independent board members to the total number of commissioners. This variable reflects the board's capacity to provide unbiased oversight.
3. Managerial Ownership (MO): Measured as the percentage of shares held by managers and affiliated entities, managerial ownership represents the alignment of management and shareholder interests.
4. Institutional Ownership (IO): This variable represents the proportion of shares owned by institutional investors, such as banks, insurance companies, and investment firms. Higher institutional ownership implies increased monitoring capabilities.

5. Firm Size (FS): Firm size is proxied by the natural logarithm of total assets, as larger firms are presumed to face greater external scrutiny and have more resources to enforce governance mechanisms.
6. Market Share (MS): This is calculated as the firm's revenue relative to the total revenue of its industry peers. Market share reflects the firm’s competitive position and its influence on market dynamics.

Data Collection

The study relies on secondary data obtained from audited financial reports of JII-listed companies for the period 2014 to 2017. These reports were sourced from the Indonesia Stock Exchange (IDX) website, ensuring the reliability and credibility of the data. Financial statements were analyzed to extract relevant information for each variable, including ownership structures, board composition, audit committee attributes, and discretionary accruals.

Analytical Framework

A multiple regression model was developed to test the study’s hypotheses, examining the relationships between the dependent variable (earnings management) and the independent variables. The regression model is specified as follows:

$$DA=\beta_0 + \beta_1 EB + \beta_2 IBC + \beta_3 MO + \beta_4 IO + \beta_5 FS + \beta_6 MS + \epsilon$$

Where:

DA: Discretionary accruals (proxy for earnings management).

β_0: Intercept term.

β_1 to β_6: Coefficients for independent variables.

EB: Audit committee educational background.

IBC: Proportion of independent board commissioners.

MO: Managerial ownership.

IO: Institutional ownership.

FS: Firm size.

MS: Market share.

ϵ: Error term.

The use of discretionary accruals as a dependent variable allows for the assessment of earnings management behaviors, while the inclusion of independent variables tests the influence of governance mechanisms and company attributes. The regression analysis was performed using statistical software to evaluate the significance and strength of the relationships between variables. Key steps in the analysis include descriptive statistics, classical assumption, regression analysis, and hypothesis testing.

RESULTS

Descriptive Statistics

The descriptive statistical analysis provides an overview of the research data, offering insights into key variables such as earnings management (EM), independent board of commissioners (IBC), institutional ownership (IO), managerial ownership (MO), firm size (FS), and market share (MS). The study focuses on 18 companies listed in the Jakarta Islamic Index from 2014 to 2017, resulting in 72 observations. Descriptive statistics summarize the data through measures such as minimum, maximum, mean, and standard deviation. For instance, the earnings management variable (EM), measured using discretionary accruals, exhibits a mean value of -2,586,454,249,530.74, with a minimum of -28,180,000,000,000 and a maximum of 5,121,398,000,000, indicating substantial variations in financial reporting practices among sampled firms.

Table 1

Descriptive Statistics of Variables

Variable	N	Minimum	Maximum	Mean	Std. Deviation
EB	72	0	1	0.583	0.4965
IBC	72	0.2857	0.8000	0.4474	0.1407
IO	72	0.2313	0.9986	0.6159	0.1615
MO	72	0.0000	8.7917	0.2973	1.3941
FS	72	3.3971	33.1988	24.6702	11.9082
MS	72	0.0702	55.5389	1.1666	6.5057
EM	72	-28,180,000	5,121,398	-2,586,454	6,521,634
Valid N (listwise)	72				

Source: Primary data. Authors' estimation. EM in IDR Million.

The independent board of commissioners (IBC) variable has a mean value of 0.447, with a minimum of 0.285 and a maximum of 0.800, showing that on average, independent commissioners constitute about 44.7% of the board. Institutional ownership (IO) presents an average of 0.615, suggesting that institutional investors hold approximately 61.5% of the shares in the sampled firms. The minimum institutional ownership is 0.231, while the maximum reaches 0.998, with a standard deviation of 0.161, indicating moderate variation across companies. Managerial ownership (MO), on the other hand, has a mean of 0.297, with values ranging from 0 to 8.79 and a standard deviation of 1.39, highlighting differences in managerial shareholding levels across firms.

Firm size (FS), measured as the natural logarithm of total assets, shows an average value of 24.67, with a minimum of 3.39 and a maximum of 33.19. The standard deviation of 11.90 suggests significant differences in firm sizes within the sample. Meanwhile, market share (MS) has a mean of 1.16, with a minimum of 0.070 and a maximum of

55.53, indicating substantial dispersion in market presence among the sampled firms. These findings emphasize the importance of considering firm-specific characteristics when analyzing corporate governance and financial performance.

The analysis also examines the educational background of audit committee chairs (EB). Among the 72 observations, 42 firms (58.3%) have audit committee chairs with accounting or finance backgrounds, while 30 firms (41.7%) do not. This distribution suggests that most firms recognize the importance of appointing audit committee chairs with relevant expertise to enhance financial oversight and reporting quality. However, the presence of firms without such qualifications raises concerns about the effectiveness of audit committees in mitigating earnings management.

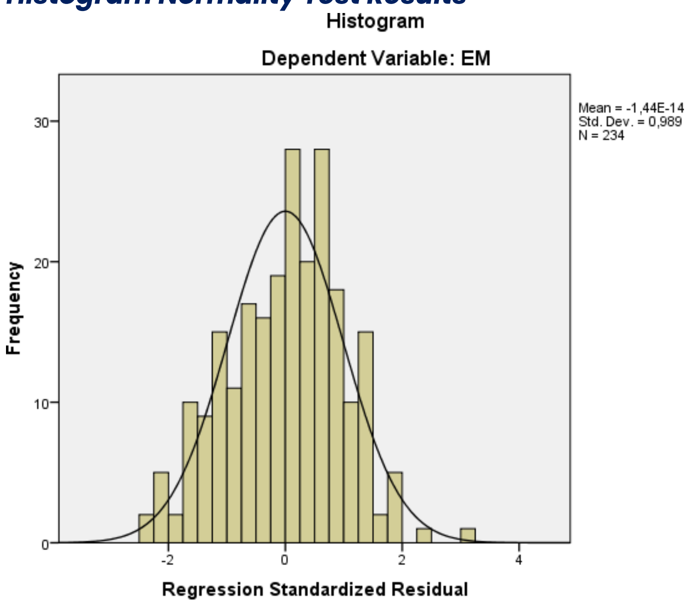
Classical Assumption Tests

Normality Test

The normality test is conducted to determine whether the residuals in the regression model follow a normal distribution. This assessment is essential to ensure the validity of the regression analysis and is performed using a histogram (Figure 1), a normal probability plot (P-P plot) (Figure 2), and the Kolmogorov-Smirnov (K-S) test. The histogram visually compares the observed data distribution with an approximated normal distribution, while the normal probability plot checks whether the residuals align with a diagonal reference line, indicating normality. If the residuals follow the diagonal line, it suggests that they are normally distributed, fulfilling one of the key assumptions of regression analysis.

Figure 1

Histogram Normality Test Results

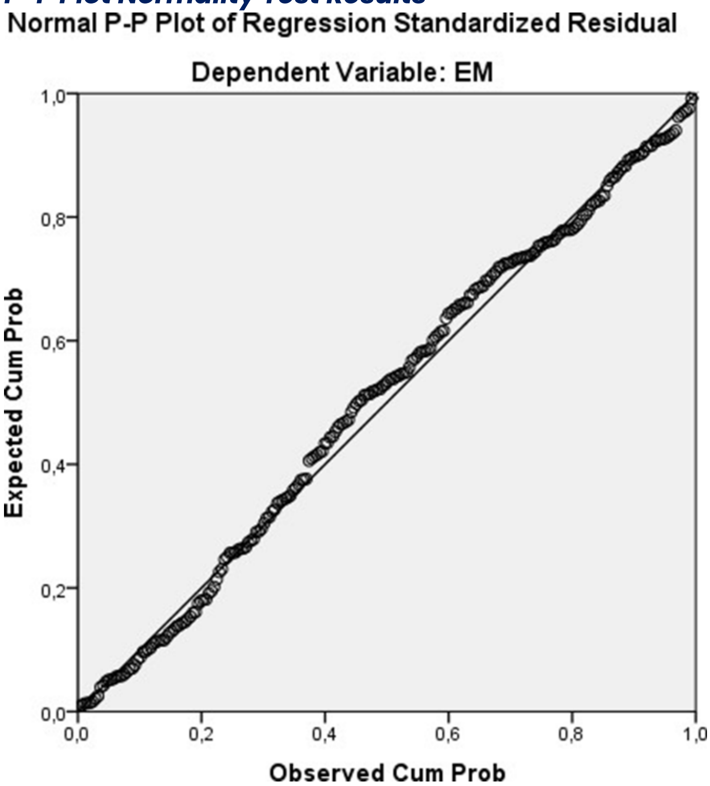


Source: Primary data. Authors' estimation.

Based on the results, the histogram does not exhibit any skewness, suggesting a symmetric and normal distribution of residuals. The normal probability plot further confirms this, as the data points are closely aligned with the diagonal line. Additionally, the Kolmogorov-Smirnov (K-S) test produces a test statistic of 0.057 with a significance level (p-value) of 0.065, which is greater than the 0.05 threshold. Since $p > 0.05$, the null hypothesis of normality is not rejected, indicating that the residuals are normally distributed. These findings confirm that the regression model meets the assumption of normality, ensuring the reliability of subsequent hypothesis testing and statistical inferences.

Figure 2

P-P Plot Normality Test Results



Source: Primary data. Authors' estimation.

Multicollinearity Test

The multicollinearity test aims to determine whether there is a correlation between independent variables in the regression model. Multicollinearity occurs when independent variables exhibit a high degree of correlation, which can distort regression estimates and affect the reliability of statistical inferences. In this study, the multicollinearity test was conducted by evaluating the tolerance values and Variance Inflation Factor (VIF) for each independent variable, including audit committee chair educational background (EB), independent board of commissioners (IBC), institutional ownership (IO), managerial ownership (MO), firm size (FS), and market share (MS). The results, as presented in Table 2, indicate that all tolerance values exceed 0.10 and all VIF values are below the threshold of 10, suggesting that no multicollinearity is present among the independent variables.

Table 2

Multicollinearity Test Results

Variable	Tolerance	Conclusion	VIF	Conclusion
EB	0.901	No Multicollinearity	1.110	No Multicollinearity
IBC	0.960	No Multicollinearity	1.042	No Multicollinearity
IO	0.916	No Multicollinearity	1.091	No Multicollinearity
MO	0.959	No Multicollinearity	1.043	No Multicollinearity
FS	0.967	No Multicollinearity	1.034	No Multicollinearity
MS	0.968	No Multicollinearity	1.033	No Multicollinearity

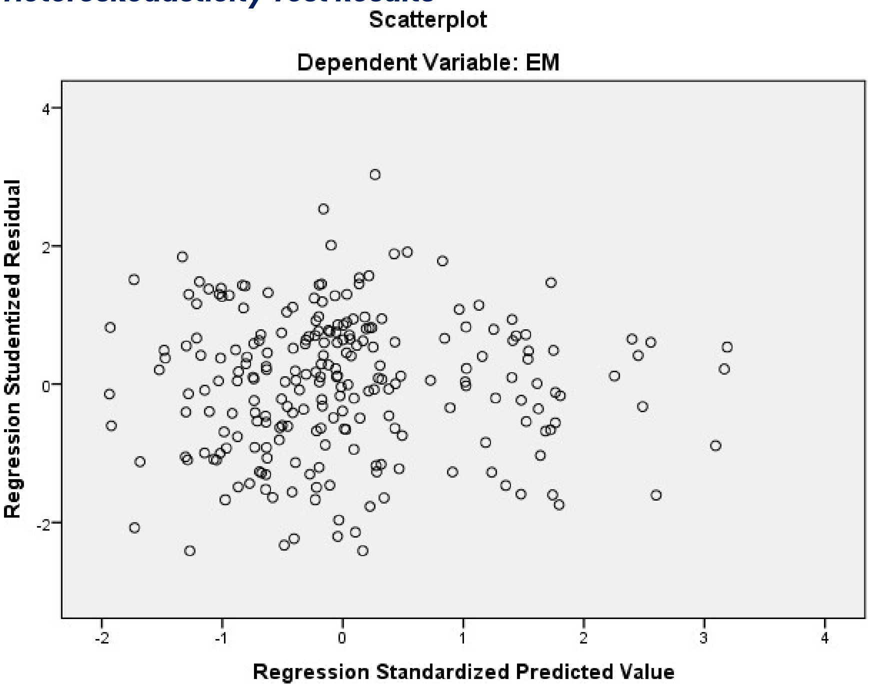
Source: Primary data. Authors' estimation.

Heteroskedasticity Test

The heteroscedasticity test aims to determine whether there is an unequal variance of residuals from one observation to another in the regression model. This test is conducted using a scatterplot graph. The scatterplot results in Figure 3 indicate that the data points are randomly dispersed both above and below zero on the Y-axis, suggesting that there is no heteroscedasticity in the regression model. Thus, it can be concluded that the model meets the assumption of homoscedasticity, ensuring the reliability of the regression estimates.

Figure 3

Heteroskedasticity Test Results



Source: Primary data. Authors' estimation.

Autocorrelation Test

The autocorrelation test is conducted to determine whether there is a correlation between the error terms in period *t* and those in the previous period in a linear regression model. To detect the presence of autocorrelation, the Durbin-Watson (DW) test is applied. The results indicate a DW value of 2.134 at a 0.05 significance level, with a sample size of 72 and five independent variables (k = 5). This value falls between *dU* (1.81945) and *4-dU* (2.18055), suggesting that the regression model is free from autocorrelation. Therefore, it can be concluded that there is no correlation between the error terms across different time periods, ensuring the validity of the regression estimates.

Regression Analysis Results

The *t*-test results, as shown in Table 3, indicate that board size, independent commissioners, and the audit committee do not significantly impact earnings management. The significance value for board size is 0.592, while independent commissioners have a significance value of 0.354, both of which are above the 0.05 threshold. Similarly, the audit committee variable has a significance value of 0.084, also exceeding 0.05. These results suggest that corporate governance mechanisms such as board composition and audit oversight may not be sufficient on their own to influence earnings management practices.

Conversely, firm size is found to have a significant impact on earnings management, with a significance value of 0.000, which is well below 0.05. This finding suggests that larger firms are more likely to engage in earnings management practices, possibly due to greater financial complexity and pressure to meet market expectations. In contrast, leverage does not significantly affect earnings management, as indicated by its significance value of 0.105, which exceeds 0.05. This implies that a company's debt levels do not necessarily drive earnings manipulation within the sample observed.

The negative coefficient for the audit committee (-0.519) suggests that a stronger audit committee presence reduces earnings management, although its statistical significance is limited. Meanwhile, the positive coefficient for firm size (1.819) indicates that as firms grow larger, they are more likely to engage in earnings management. Additionally, leverage has a positive coefficient (0.512), suggesting a potential relationship between debt levels and earnings manipulation, even though the statistical significance is weak.

Table 3

Regression Test Results

Model	Unstandardized Coefficients	Standardized Coefficients	t	Sig.
	B	Std. Error	Beta	
1 (Constant)	-5564350283000.000	3926556019000.000		-1.417
EB	2827022356000.000	1547633214000.000	0.215	1.827
IBC	-496595241900.000	5291683417000.000	-0.011	-0.094
IO	2526172015000.000	4718590437000.000	0.063	0.535
MO	-1536203267000.000	534291305600.000	-0.328	-2.875
FS	161850384200.000	62263467850.000	0.030	0.260
MS	45101155050.000	113906239000.000	0.045	0.396
F	103.917 (0.000)			
R^2	.695			
Adjusted R^2	.688			

Source: Primary data. Authors' estimation.

The F-test results, as shown in Table 3, confirm that all independent variables collectively have a significant impact on earnings management. The F-statistic value of 103.917, with a significance level of 0.000, indicates that board size, independent commissioners, the audit committee, firm size, and leverage, when considered together, significantly influence earnings management. This suggests that while individual variables may not always show strong effects, their combined influence on financial reporting practices is substantial.

The coefficient of determination (R^2), as seen in Table 5, shows a value of 0.688, meaning that 68.8% of the variation in earnings management can be explained by the independent variables. This indicates that the model has a strong explanatory power, with firm size, leverage, and corporate governance factors playing a major role in determining earnings management practices. However, the remaining 31.2% of variation is attributed to other factors not included in this study, such as profitability and auditor independence.

Hypothesis Testing

The study tests six hypotheses, each addressing a specific governance or firm characteristic. The results of the regression analysis are summarized below.

1. Educational Background of Audit Committee (H1): The educational background of audit committee members significantly influences earnings management. Companies with audit committees that include members with financial expertise report lower levels of discretionary accruals. This finding aligns with prior research (Wu et al., 2012; Xie et al., 2003) suggesting that financial

expertise enhances the committee's ability to oversee financial reporting and mitigate earnings manipulation. These results underscore the importance of qualified audit committees in ensuring governance effectiveness, particularly in JII-listed firms where compliance with Islamic principles necessitates high levels of transparency.

2. Managerial Ownership (H2): The analysis reveals a negative relationship between managerial ownership and earnings management, supporting the hypothesis that greater managerial ownership reduces the propensity for earnings manipulation. This finding aligns with agency theory, which posits that aligning management's interests with those of shareholders discourages opportunistic behavior (Rahiim & Wulandari, 2016). However, the effect size is modest, suggesting that other factors may mediate this relationship. For example, corporate culture and the regulatory environment may influence the extent to which managerial ownership impacts earnings management.
3. Independent Board of Commissioners (H3): The proportion of independent board members significantly impacts earnings management. Companies with a higher proportion of independent commissioners report lower levels of discretionary accruals, consistent with previous findings (Cornett et al., 2007; Mardjono & Chen, 2020; Sampurno et al., 2023). Independent boards enhance oversight and ensure adherence to governance principles, reducing opportunities for financial manipulation. However, the effectiveness of independent boards may depend on their ability to exert influence within the broader governance framework, as highlighted by mixed findings in previous studies (García-Meca & Sánchez-Ballesta, 2006; Jiraporn et al., 2018; Mihail & Micu, 2021).
4. Firm Size (H4): Firm size demonstrates a significant negative relationship with earnings management. Larger firms, subject to greater public scrutiny and regulatory oversight, are less likely to engage in opportunistic financial practices. This finding supports the argument that larger firms face higher accountability, which incentivizes transparent reporting (Barsan, 2017; Comello et al., 2023; Stiglingh et al., 2017). Nonetheless, the relationship between firm size and earnings management is not uniform, as some larger firms may exploit their resources to mask financial manipulation, as suggested in previous studies (Anning & Adusei, 2022; Dewi & Ulupui, 2014; Jakaša, 2017; Nia et al., 2022).
5. Audit Quality (H5): Audit quality, as indicated by the rigor and independence of external auditors, significantly reduces earnings management. Companies with high-quality audits report lower discretionary accruals, supporting the hypothesis that stringent auditing practices enhance the reliability of financial statements (Xie et al., 2003). This finding reinforces the critical role of external

audits in maintaining governance integrity and preventing earnings manipulation, particularly in contexts where internal governance mechanisms may be less robust.

6. Institutional Ownership (H6): Institutional ownership negatively correlates with earnings management, indicating that institutional investors play a vital role in monitoring management practices. Companies with higher institutional ownership report lower levels of discretionary accruals, consistent with previous findings (Cornett et al., 2007; Koh, 2003; Shah & Shah, 2014; Shaikh & Shah, 2012). Institutional investors' ability to influence governance decisions enhances transparency and reduces opportunities for financial manipulation. However, the effectiveness of institutional ownership may vary based on the quality of institutional monitoring and the regulatory environment.

DISCUSSION

This study investigates the impact of corporate governance (CG), firm size, and market share on earnings management among companies listed on the Jakarta Islamic Index (JII). The results reveal significant relationships between governance mechanisms and discretionary accruals, a proxy for earnings management. These findings highlight the effectiveness of corporate governance structures in mitigating opportunistic financial practices within the context of Islamic finance, where transparency and accountability are prioritized.

Audit Committees and Earnings Management

The findings affirm that audit committees with members who have financial expertise significantly reduce earnings management, consistent with the conclusions of previous studies (Wu et al., 2012; Xie et al., 2003). These results highlight the critical role of knowledgeable audit committees in detecting and addressing discrepancies in financial reporting. Audit committees serve as a bridge between management and external auditors, ensuring that financial statements are prepared in compliance with established standards. Their effectiveness is particularly relevant in the JII context, where Islamic financial principles demand heightened transparency and ethical accountability.

However, the findings also underscore that the mere existence of an audit committee is insufficient. The effectiveness of these committees hinges on their composition, particularly the inclusion of members with expertise in accounting and finance. This insight aligns with prior studies suggesting that the educational background of committee members influences their capacity to monitor financial reporting effectively (Abernathy et al., 2014; Cohen et al., 2014; Zalata et al., 2018).

Managerial Ownership and Earnings Management

Managerial ownership demonstrates a negative relationship with earnings management, supporting the hypothesis that aligning managerial and shareholder interests discourages financial manipulation. This finding is consistent with agency theory, which posits that when managers have a financial stake in the company, they are more likely to prioritize long-term value creation over short-term opportunism (Rahiim & Wulandari, 2016). By reducing the divergence of interests between managers and shareholders, managerial ownership mitigates the risk of earnings manipulation.

Nevertheless, the modest effect size suggests that managerial ownership alone may not be sufficient to eliminate earnings management. Other contextual factors, such as corporate culture, governance norms, and regulatory frameworks, likely interact with managerial ownership to influence financial behavior (Elghuweel et al., 2017; Filatotchev & Nakajima, 2014; Li et al., 2013; Sáenz González & García-Meca, 2014). Future research could explore these moderating factors to provide a more nuanced understanding of the relationship between managerial ownership and earnings management.

Independent Boards and Earnings Management

The study confirms that the proportion of independent board members negatively correlates with earnings management, reinforcing the findings of Cornett et al. (2007). Independent boards enhance governance by providing unbiased oversight of managerial practices, ensuring that financial reporting aligns with stakeholder expectations. This relationship is particularly salient in the JII context, where independent boards are expected to uphold ethical standards consistent with Islamic principles.

However, the effectiveness of independent boards may depend on their ability to exercise authority within the governance structure. Previous studies highlight that board independence does not always translate into reduced earnings management (Bansal, 2022; Musa et al., 2023), suggesting that other factors, such as board size, tenure, and expertise, may influence their effectiveness. Future research could investigate these additional dimensions to provide a more comprehensive understanding of board dynamics.

Firm Size and Earnings Management

Firm size exhibits a significant negative relationship with earnings management, indicating that larger firms are less likely to engage in financial manipulation. This finding aligns with prior research (Barsan, 2017; Comello et al., 2023; Stiglingh et al., 2017) suggests that larger firms face greater public scrutiny and regulatory oversight, incentivizing transparent reporting. The results highlight the role of external pressures in complementing internal governance mechanisms to reduce earnings management.

However, the relationship between firm size and earnings management is not uniform across studies. For example, Dewi & Ulupui (2014) report a positive correlation, suggesting that some large firms leverage their resources to engage in sophisticated forms of financial manipulation. These discrepancies underscore the need for further research to identify the conditions under which firm size influences earnings management. Factors such as industry characteristics, market conditions, and the strength of regulatory oversight may mediate this relationship.

Audit Quality and Earnings Management

High-quality audits significantly reduce earnings management, underscoring the importance of external oversight in ensuring reliable financial reporting. This finding supports the conclusions of Xie et al. (2003), which emphasize that rigorous auditing practices enhance the credibility of financial statements. By providing an independent assessment of a company's financial health, high-quality audits deter opportunistic financial behavior and reinforce stakeholder trust.

The results also highlight the complementary relationship between internal governance mechanisms and external audits. While governance structures such as audit committees and independent boards address internal accountability, external audits provide an additional layer of oversight, ensuring that financial practices align with established standards. This dual approach is particularly relevant in the JII context, where compliance with Islamic financial principles necessitates robust internal and external governance mechanisms.

Institutional Ownership and Earnings Management

Institutional ownership negatively correlates with earnings management, demonstrating the critical role of institutional investors in enhancing governance. By leveraging their financial stakes and monitoring capabilities, institutional investors encourage transparency and accountability, reducing opportunities for earnings manipulation. This finding aligns with studies suggesting that institutional ownership strengthens governance by increasing managerial accountability (Cornett et al., 2007; García-Sánchez et al., 2022; Lin & Fu, 2017; Ntim & Soobaroyen, 2013).

However, the effectiveness of institutional ownership may vary depending on the quality of monitoring provided by institutional investors. For example, Agustina (2013) found no significant relationship between institutional ownership and earnings management, highlighting that not all institutional investors exercise their monitoring roles effectively. Future research could explore the characteristics of institutional investors, such as their investment horizons, governance expertise, and regulatory environments, to better understand their impact on financial reporting behavior.

The JII Context and Islamic Finance

The unique context of JII-listed firms provides valuable insights into the interplay between corporate governance and earnings management within an Islamic financial framework. Islamic principles emphasize transparency, ethical accountability, and stakeholder equity, imposing additional governance requirements on JII-listed firms. The findings suggest that these principles enhance governance effectiveness by reinforcing the ethical dimensions of financial reporting.

However, the study also highlights the challenges associated with implementing governance mechanisms in the JII context. For example, while governance structures such as audit committees and independent boards are effective in reducing earnings management, their impact may be limited by contextual factors such as cultural norms, regulatory environments, and resource constraints. Addressing these challenges requires a holistic approach that integrates Islamic principles with practical governance strategies to ensure sustainable and ethical financial practices.

Implications for Policy and Practice

The findings have significant implications for policymakers, practitioners, and researchers. Policymakers should prioritize regulatory frameworks that mandate robust governance mechanisms, such as qualified audit committees, independent boards, and high-quality audits. These frameworks should also consider the unique requirements of Islamic finance, ensuring that governance practices align with ethical and religious principles.

For practitioners, the results underscore the importance of investing in governance structures that enhance transparency and accountability. Companies should prioritize the recruitment of qualified audit committee members, the inclusion of independent board members, and the adoption of rigorous auditing practices to reduce earnings management and build stakeholder trust.

For researchers, the study highlights the value of exploring governance dynamics within diverse contexts, offering opportunities for comparative analyses across conventional and Islamic financial frameworks. Future research could examine the interaction between governance mechanisms and cultural, regulatory, and industry-specific factors to provide a more comprehensive understanding of financial reporting behavior.

CONCLUSION

This study examines the influence of corporate governance mechanisms, firm size, and market share on earnings management in companies listed on the Jakarta Islamic Index (JII) from 2014 to 2017. The findings demonstrate that governance factors, such as audit committee expertise, managerial and institutional ownership, and independent boards, significantly reduce earnings management by enhancing oversight and accountability. Larger firms and those subject to high-quality audits are less likely to engage in earnings manipulation, reflecting the importance of external scrutiny and robust audit practices. However, market share does not exhibit a significant relationship with earnings management, suggesting that other factors may play a stronger role in shaping reporting behaviors.

The implications of this research are twofold. First, it underscores the importance of corporate governance in mitigating unethical financial practices, particularly within the context of Islamic finance, which prioritizes transparency and ethical accountability. Second, it provides actionable insights for policymakers and practitioners to strengthen governance frameworks, enhancing stakeholder trust and corporate integrity.

By focusing on JII-listed firms, this study contributes to the broader literature on governance and earnings management by offering insights into how Islamic financial principles shape corporate behavior. The findings highlight the need for further exploration of governance dynamics across diverse financial and regulatory contexts to develop a comprehensive understanding of their impacts on financial reporting practices.

Limitations of the Study

Despite its contributions, this study has several limitations. The primary limitation lies in its focus on companies listed on the Jakarta Islamic Index (JII), which restricts the generalizability of the findings to other market contexts, such as conventional financial systems or non-Islamic indices. While JII-listed firms provide a unique perspective on governance within an Islamic financial framework, the results may not fully reflect the complexities of governance dynamics in broader contexts.

Another limitation is the reliance on secondary data, which may not capture qualitative aspects of governance practices, such as board interactions, organizational culture, or decision-making processes. These factors, while critical to understanding governance effectiveness, are challenging to quantify and thus are not included in this analysis. Additionally, the study uses discretionary accruals as the sole proxy for earnings management, which may not encompass all dimensions of financial manipulation.

Lastly, the study covers a limited time frame (2014–2017), potentially overlooking longer-term trends in governance and financial reporting. Future studies could extend this time frame to provide a more comprehensive analysis of governance dynamics.

Recommendations for Future Research

Future research could address the limitations of this study by exploring governance dynamics in a broader range of market contexts, including conventional financial systems and non-Islamic indices. Comparative analyses between Islamic and conventional markets could provide valuable insights into the unique impacts of Islamic financial principles on corporate governance and financial reporting practices.

Incorporating qualitative methodologies, such as interviews or case studies, could offer a deeper understanding of the internal dynamics of governance mechanisms, such as board interactions, audit committee processes, and decision-making frameworks. Such approaches would complement quantitative findings and provide a richer perspective on governance effectiveness.

Expanding the scope of research to include alternative proxies for earnings management, such as real earnings manipulation or cash flow-based measures, could yield a more nuanced understanding of financial reporting behaviors. Furthermore, longitudinal studies that examine governance practices over extended periods could capture long-term trends and provide insights into the evolving nature of governance and earnings management.

Finally, future research could explore the moderating effects of industry characteristics, cultural norms, and regulatory environments on the relationships between governance mechanisms and earnings management, providing a more holistic understanding of governance dynamics.

Author Contributions

Conceptualization: P.W. & Y.A.; Data curation: P.W.; Formal analysis: P.W., Y.A., & A.H.; Funding acquisition: P.W. & Y.A.; Investigation: P.W. & Y.A.; Methodology: P.W. & Y.A.; Project administration: P.W.; Resources: Y.A.; Software: P.W. & Y.A.; Supervision: Y.A.; Validation: P.W., Y.A., & A.H.; Visualization: P.W. & Y.A.; Writing – original draft: P.W. Y.A., & A.H.; Writing – review & editing: P.W., Y.A., & A.H. All the authors have read and agreed to the published version of the manuscript.

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Institutional Review Board Statement

This study was approved by the Program Studi Ekonomi Islam (S1), Universitas Islam Indonesia, Yogyakarta, Indonesia.

Informed Consent Statement

Informed consent was not required for this study.

Data Availability Statement

The data presented in this study are available upon request from the corresponding author. The data are not publicly available because of the institution's policies.

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Conflicts of Interest

The authors declare that they have no conflicts of interest.

Declaration of Generative AI and AI-Assisted Technologies in the Writing Process

During the preparation of this work, the authors used ChatGPT, DeepL, Grammarly, and PaperPal to translate from Bahasa Indonesia into American English and improve the clarity of the language and readability of the article. After using these tools, the authors reviewed and edited the content as needed and took full responsibility for the content of the published article.

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