

# Evaluating the Effectiveness of Corporate Governance Mechanisms in Mitigating Earnings Management: A Literature-Based Review

Tuti Dharmawati

Universitas Halu Oleo; Kendari, Indonesia

E-Mail: tuti\_balaka@yahoo.co.id

Hasbudin

Universitas Halu Oleo; Kendari, Indonesia

E-Mail: hasbudin@yahoo.com

Muh. Syaiful Saehu

Politeknik Bina Husada Kendari; Kendari, Indonesia

E-Mail: syaiful\_saeu@yahoo.co.id

Muh. Azdar Setiawan

Politeknik Bina Husada Kendari; Kendari Indonesia

E-Mail: muhazdar86@gmail.com

Wulandari Pryangan

Politeknik Bina Husada Kendari; Kendari, Indonesia

E-Mail: wulandariptyangan@gmail.com

## ABSTRACT

Earnings management remains a critical challenge for corporations, making strong corporate governance essential to ensure financial transparency and accountability. Grounded in Agency Theory, which posits that independent monitoring mechanisms can mitigate conflicts of interest between management and shareholders, this study examines the connection between audit committee independence and earnings management in publicly traded corporations. The study uses secondary data from scholarly publications, journals, and reports as part of a literature review that takes a qualitative approach. The important significance of independent oversight in improving the accuracy and integrity of financial statements is shown by key findings that show a decrease in earnings management is linked to a higher degree of audit committee independence. The article explains how independent audit committees help prevent financial reporting manipulations by reducing conflicts of interest and guaranteeing efficient oversight. These results highlight how crucial it is to improve corporate governance frameworks, especially in developing nations like Indonesia, where family ownership frequently compromises audit committee independence. The findings provide practical insights for regulators and policymakers to strengthen governance codes promoting audit committee independence, while offering guidance for corporate practitioners to enhance oversight effectiveness and financial reporting quality.

**Keywords:** Agency Theory, Audit Committee Independence, Board Governance, Earnings Management, Emerging Markets, Financial Reporting Quality.

## ABSTRAK

Manajemen laba tetap menjadi tantangan utama bagi perusahaan, sehingga tata kelola perusahaan yang kuat menjadi sangat penting untuk memastikan transparansi dan akuntabilitas

keuangan. Berdasarkan *Agency Theory*, yang menyatakan bahwa mekanisme pengawasan independen dapat mengurangi konflik kepentingan antara manajemen dan pemegang saham, penelitian ini mengkaji hubungan antara independensi komite audit dan manajemen laba pada perusahaan publik. Penelitian ini menggunakan pendekatan kualitatif melalui studi literatur, dengan data sekunder yang diperoleh dari artikel akademik, jurnal, dan laporan. Temuan utama menunjukkan bahwa tingkat independensi komite audit yang lebih tinggi berhubungan dengan penurunan manajemen laba, yang menegaskan peran penting pengawasan independen dalam meningkatkan akurasi dan integritas laporan keuangan. Artikel ini membahas bagaimana komite audit yang independen, dengan meminimalkan konflik kepentingan dan memastikan pengawasan yang efektif, dapat membantu mengurangi manipulasi laporan keuangan. Temuan ini menekankan pentingnya penguatan struktur tata kelola perusahaan, terutama di pasar berkembang seperti Indonesia, di mana kepemilikan keluarga sering kali mengurangi independensi komite audit. Temuan penelitian ini memberikan wawasan praktis bagi regulator dan pembuat kebijakan untuk memperkuat kode tata kelola yang mendorong independensi komite audit, sekaligus memberikan panduan bagi para praktisi korporasi dalam meningkatkan efektivitas pengawasan dan kualitas pelaporan keuangan.

**Kata kunci:** Teori Keagenan, Independensi Komite Audit, Tata Kelola Dewan, Manajemen Laba, Pasar Berkembang, Kualitas Pelaporan Keuangan.

## INTRODUCTION

The operational integrity and financial transparency of publicly traded corporations are significantly shaped by corporate governance. The practice of earnings management, in which managers exercise their discretion to alter financial statements for their own or the company's benefit, is one of the biggest problems facing businesses. Although not always unlawful, this practice damages financial reporting's credibility and dependability and may provide investors, regulators, and other stakeholders with inaccurate information (Yang, 2021). The possible effects on investor confidence and market efficiency highlight how important it is to address earnings management. By offering supervision and accountability in financial reporting, corporate governance procedures are suggested as instruments that could lessen the prevalence of earnings management in this setting (Riana et al., 2024).

Even though corporate governance and its function in financial reporting have been extensively covered in the literature, little is known about how particular governance mechanisms like the makeup of the board of directors, the function of audit committees, and institutional ownership collectively affect earnings management (Langella et al., 2023). Additionally, the majority of current research focuses on developed markets, with little to no study conducted in emerging markets, especially in Southeast Asia. By investigating how well corporate governance practices reduce earnings management in publicly traded companies in Indonesia, a quickly expanding emerging market, this study aims to close this gap.

The urgency of this study arises from the increasing importance of corporate governance in emerging economies. As companies in these markets grow and become more interconnected with global financial systems, the need for strong governance frameworks to ensure the accuracy of financial reporting becomes critical. Given Indonesia's status as one of the largest economies in Southeast Asia, understanding how corporate governance influences earnings management in this context will not only benefit local investors and policymakers but also contribute to the broader discourse on governance practices in emerging markets (Setiawan et al., 2019).

Several studies have explored the relationship between corporate governance mechanisms and earnings management, yet findings remain mixed. For instance, Mohammad and Wasiuzzaman (2020) found that independent boards and audit committees can effectively limit earnings management in U.S. firms. Similarly, Attia et al. (2023) highlighted the role of institutional ownership in curbing earnings

manipulation. However, research on emerging markets, particularly in Indonesia, remains scarce. Studies such as those by Nurlis et al. (2021) provide limited insights into how specific governance mechanisms function in reducing earnings management in Indonesian publicly listed companies, and more empirical evidence is needed to draw generalized conclusions in this context.

By concentrating on Indonesia, a unique context where corporate governance arrangements may differ greatly from those in developed nations, this study adds to the body of literature. It also provides a thorough examination of various governance mechanisms, such as institutional ownership, audit committee composition, and board composition, enabling a more sophisticated comprehension of how these elements work together to lessen earnings management (Ghafran & Yasmin, 2018; Ramalingegowda et al., 2021; Fitrasari, 2023). This study adds to the worldwide discussion on the problems and application of corporate governance frameworks outside of established economies by concentrating on emerging markets (Solomon, 2020; Setyahadi & Narsa, 2020).

However, despite the extensive literature on corporate governance and earnings management, empirical evidence on the specific role of audit committee independence in mitigating earnings management within emerging market settings, particularly Indonesia, remains limited and inconclusive. In Indonesia's corporate environment, where family ownership structures and concentrated control are common, the independence of the audit committee becomes crucial to ensure effective oversight and minimize management's discretionary influence over financial reporting. This gap underscores the need for context-specific analysis to determine whether governance mechanisms effective in developed markets can similarly enhance financial reporting integrity in Indonesia's distinct institutional setting. Therefore, this study contributes to the literature by providing empirical evidence from Indonesia's emerging market context and examining whether audit committee independence effectively mitigates earnings management. The main objective of this research is to assess how well corporate governance practices, particularly audit committee independence, reduce earnings management in Indonesian publicly traded corporations.

## **LITERATURE REVIEW**

### **Corporate Governance and Earnings Management**

Corporate governance refers to the systems, processes, and principles that govern the relationships between shareholders, management, and other stakeholders, ensuring the company is directed and controlled in a way that promotes accountability and transparency (Tricker, 2015). By bringing managers' and shareholders' interests into alignment, corporate governance procedures are intended to lessen agency issues and the probability of opportunistic behavior, like earnings management. The relationship between corporate governance and earnings management has been widely discussed in literature, with varying results depending on the mechanisms under study, the industry, and the country context (Gerged et al., 2023).

Earnings management, as defined by Alqatan et al. (2021), refers to the use of judgment in financial reporting to alter financial outcomes in a way that may not reflect the underlying economic reality. This practice can involve both real activities manipulation and accrual-based earnings management (El Mahdy, 2025). The incentives for managers to engage in earnings management are often driven by factors such as executive compensation tied to performance metrics, market expectations, and regulatory requirements (Bartov et al., 2024). Several studies have shown that corporate governance influences earnings management (Setiani & Pandji, 2022; Biswas et al., 2022). This may occur because strong corporate governance structures can act as a deterrent to such practices by providing oversight and reducing the discretion available to managers (Mismiwati et al., 2025).

## Mechanisms of Corporate Governance

It has been demonstrated that the makeup of the board of directors is one of the corporate governance strategies that has the biggest impact on reducing earnings management. Research suggests that boards with a higher proportion of independent directors are better positioned to oversee management and reduce earnings manipulation (Fitrasari, 2023). Independent directors are less likely to be influenced by management and are more likely to prioritize the interests of shareholders (DesJardine et al., 2023). In contrast, boards dominated by insider directors or those with weaker independence may not provide the necessary checks on managerial discretion.

Similarly, the role of the audit committee is another critical mechanism that affects earnings management. The audit committee, particularly when it is composed of independent members, is tasked with overseeing the financial reporting process and ensuring the accuracy and integrity of financial statements (Ma et al., 2025). Empirical studies have shown that firms with stronger audit committees are less likely to engage in earnings management (Ibrahimi et al., 2025). Furthermore, the effectiveness of the audit committee is often tied to its size, independence, and expertise (Leng, 2023). The independence and activity of the audit committee serve a crucial function in overseeing the quality of financial reporting and in minimizing the occurrence of earnings management (Ngo & Le, 2021).

Another important governance mechanism is institutional ownership, which has been found to influence managers' incentives to engage in earnings management. Institutional investors, such as pension funds, mutual funds, and insurance companies, hold substantial shares in companies and are more likely to monitor management closely (Kałdoński & Jewartowski, 2025). High levels of institutional ownership may discourage earnings manipulation due to the threat of intervention by these powerful investors (Ali et al., 2024). Studies have suggested that companies with a higher proportion of institutional investors experience less earnings management (Kapoor & Goel, 2025).

## Corporate Governance in Emerging Markets

The role of corporate governance in reducing earnings management in emerging markets is particularly relevant, as these markets often face unique challenges such as weak regulatory frameworks, less developed legal systems, and a higher degree of market volatility (Hong et al., 2023). In these markets, the mechanisms of corporate governance may function differently compared to developed markets, where regulatory frameworks and institutional investors are more established. Research on corporate governance in emerging markets, including Indonesia, suggests that the impact of governance mechanisms on earnings management may be less pronounced due to weaker enforcement and the greater influence of family ownership and insider control (Murni et al., 2023).

For example, in Indonesia, the dominance of family-owned businesses and concentrated ownership structures can lead to governance weaknesses, such as a lack of board independence and limited external monitoring (Astami et al., 2024). Furthermore, institutional investors, which play a significant role in mitigating earnings management in developed markets, may have less influence in Indonesian companies due to lower levels of institutional ownership (Setiana et al., 2025). Despite these challenges, some studies have found that stronger corporate governance mechanisms in Indonesian firms, such as independent audit committees and more independent boards, are associated with lower levels of earnings management (Rahayu et al., 2024).

## RESEARCH METHODS

The impact of corporate governance in reducing earnings management is examined in this study utilizing a qualitative methodology and a systematic literature analysis, with an emphasis on Indonesian publicly traded companies. Because it summarizes previous research, incorporates a variety of viewpoints, and highlights areas that require more study, the literature review approach is suitable (Braun & Clarke, 2006). The study intends

to offer a thorough grasp of how governance factors affect financial reporting integrity in emerging markets by referencing earlier research. All of the information used in this study came from secondary sources, including as books, conference proceedings, peer-reviewed journal publications, and industry reports on earnings management and corporate governance. Relevant works were accessed using important databases as Google Scholar, JSTOR, ScienceDirect, and SpringerLink.

Articles were selected based on three main criteria: publication within the last 15 years to ensure relevance to current practices and regulatory frameworks, explicit focus on governance mechanisms such as board composition, audit committees, and institutional ownership, and coverage of both developed and emerging markets, with preference for Indonesia and Southeast Asia. Foundational studies from high-impact journals in accounting, finance, and business were prioritized, including those published in the *Journal of Accounting and Economics*, *Journal of Corporate Finance*, and *International Journal of Accounting*.

There was a set order to the collection process. Using specific keywords like “corporate governance,” “earnings management,” “audit committee,” “board independence,” “institutional ownership,” and “Indonesia,” a database search was first carried out. Second, the quality and methodological rigor of the research that satisfied the inclusion criteria were evaluated. Third, the chosen papers were categorized thematically according to fundamental governance processes such as institutional ownership, board independence, and audit committee efficacy. The identification of significant patterns and trends across research was made easier by this thematic grouping.

Data analysis was carried out using thematic analysis, which involved familiarization with the literature, coding of key concepts, and the development of themes that capture the relationship between governance practices and earnings management (Braun & Clarke, 2006). For instance, themes such as “board independence” or “audit committee strength” were used to organize findings and highlight the monitoring role of governance structures. The synthesis of results provided insights into both the individual and combined effects of governance mechanisms. Although this study does not employ direct empirical measurement, it reviews indicators commonly used in prior research. These include the proportion of independent directors on boards (Fitrasari, 2023), audit committee independence and size (Attia et al., 2025), and institutional ownership levels (Al-Duais et al., 2022). To ensure reliability and validity, only high-quality and peer-reviewed sources were included, and a consistent analytical framework was applied. This approach ensures that findings are transparent, reproducible, and reflective of diverse perspectives on corporate governance and earnings management.

## **RESULTS**

### **Board Composition and Audit Committees in Controlling Earnings Management**

The results of the literature review are presented in this section, which summarizes the conclusions drawn from the chosen studies. With a focus on emerging countries like Indonesia, the examination mainly examines how well corporate governance practices mitigate earnings management in publicly traded corporations. The results of earlier studies are assessed, and conclusions about how institutional ownership, audit committees, and board composition affect earnings management are combined. The findings are presented in a descriptive and inferential manner, with accompanying tables and figures that serve to highlight the main conclusions as well as a synopsis of the major themes found across the literature.

The composition of the board of directors is one of the main governance mechanisms examined in the literature. A substantial amount of research has demonstrated the beneficial correlation between less earnings management and board independence. Studies by Kusnadi and Srinidhi (2022) show that boards with a higher percentage of independent directors are more effective in monitoring management and curbing earnings manipulation. In contrast, boards with a higher proportion of insider directors tend to exhibit higher levels of earnings management, as management may exert greater influence

over decision-making processes (Gokhale & Pillai, 2024). Table 1 summarizes the findings from various studies regarding the impact of board independence on earnings management.

**Table 1.** Effect of Board Independence on Earnings Management

Study	Key Findings	Effect on Earnings Management
Kusnadi and Srinidhi (2022)	Boards with a higher proportion of independent directors are more effective in monitoring and reducing earnings manipulation	Negative impact
Gokhale and Pillai (2024)	Insider-dominated boards are associated with higher levels of earnings management	Positive impact
Murni et al. (2023)	Family control in Indonesian firms increases earnings management and weakens governance mechanisms	Positive impact

Higher levels of board independence are linked to poorer levels of earnings management, as the table consistently shows. This suggests that a more independent board can ensure that financial statements more accurately reflect the company's true economic performance and function as a check on managerial discretion (Siregar & Utama, 2008). These findings are reinforced by evidence that boards dominated by insiders or family control tend to encourage greater earnings manipulation, while a higher proportion of independent directors effectively constrains such practices. This contrast highlights the crucial role of independence in strengthening governance and limiting managerial opportunism.

A considerable body of literature highlights the critical role of audit committees in overseeing financial reporting processes. Well-structured and independent audit committees are particularly effective in constraining earnings management, especially practices involving accrual-based manipulation (Muthuswamy & Nasrulla, 2023). Committees chaired by independent directors and composed of members with financial expertise are better positioned to detect irregularities and ensure the credibility of reported earnings.

Empirical evidence consistently shows that stronger audit committees, characterized by greater independence, are associated with lower levels of earnings management (Almarayeh, 2024). By providing rigorous oversight, independent committees reduce managerial discretion in manipulating financial statements. The presence of independent directors further minimizes conflicts of interest, while their financial competence enhances the committee's ability to identify and prevent misstatements. According to earlier research, audit committee independence and earnings management are negatively correlated, meaning that greater independence results in less earnings manipulation (Suliman et al., 2024). These results highlight how crucial it is to establish audit committees with capable, impartial members who can successfully protect the accuracy of financial reporting and uphold transparency.

In addition, the effectiveness of audit committees is not only determined by their independence but also by their size, expertise, and activity level. Larger committees with members who possess accounting or financial expertise are better positioned to provide diverse perspectives and more rigorous monitoring of the reporting process (Ghafran & Yasmin, 2018). Regular meetings and active engagement further strengthen their oversight capacity, ensuring that potential irregularities are detected and addressed in a timely manner. Conversely, weak or passive audit committees may fail to exercise sufficient scrutiny, allowing managers greater freedom to engage in opportunistic behavior. This underscores the importance of designing audit committees that combine independence with professional competence and active involvement, thereby maximizing

their role in curbing earnings management and enhancing the credibility of financial disclosures.

### Institutional Ownership on Earnings Management in Emerging Markets

Institutional ownership has also been identified as a significant governance mechanism in the reduction of earnings management. Several studies by Kałdoński and Jewartowski, (2025) suggest that companies with a high proportion of institutional investors are less likely to engage in earnings manipulation due to the monitoring role played by institutional investors. These investors, with their substantial stakes, are more likely to push for greater financial transparency and ethical reporting practices. Table 2 below summarizes the key findings regarding institutional ownership and its impact on earnings management.

**Table 2.** Impact of Institutional Ownership on Earnings Management

Study	Key Findings	Effect on Earnings Management
Kałdoński and Jewartowski (2025)	Long-term institutional investors act as effective monitors, reducing earnings management	Negative impact
Ali (2024)	Higher institutional ownership improves earnings quality by lowering discretionary accruals.	Negative impact
Murni et al. (2023)	In Indonesia, family dominance weakens the effectiveness of institutional investors in curbing manipulation.	Mixed / weaker impact

As indicated in Table 2, institutional ownership consistently exhibits a negative impact on earnings management. This suggests that institutional investors provide an additional layer of oversight, which deters managers from manipulating earnings for personal or organizational gain. Strong corporate governance practices, especially independent boards, efficient audit committees, and significant institutional ownership, are consistently linked to less earnings management, according to the literature's findings. This lends credence to the idea that, especially in developing nations like Indonesia, corporate governance may significantly contribute to the advancement of financial integrity and transparency. But according to some research, especially in emerging market settings like Indonesia (Murni et al., 2023), the impact of these governance systems might be lessened because of things like family control, concentrated ownership, and ineffective regulatory enforcement. This demonstrates how intricate corporate governance is in developing nations and raises the possibility that more reforms are required to make these systems stronger.

The literature review's findings offer compelling proof that good company governance practices are essential for reducing profit management. According to the research, firms with strong audit committees, independent boards, and sizable institutional ownership are less likely to manipulate their earnings. These findings have significant ramifications for Indonesian policymakers and business executives, as bolstering governance frameworks may contribute to increased financial reporting dependability and transparency.

### DISCUSSION

The study's conclusions demonstrate how important audit committee independence is in lowering earnings management in publicly traded corporations. The findings suggest that a more robust audit committee, particularly one with independent directors, is generally more successful in preventing the practice of manipulating earnings. This outcome is in line with prior research, which suggests that independent audit committees provide enhanced oversight and are better equipped to detect financial statement inaccuracies (Ayinla et al., 2022). The negative correlation between audit committee

independence and earnings management suggests that companies with more independent monitoring systems are less likely to engage in opportunistic behavior aimed at altering financial outcomes for personal or business profit.

This finding is particularly relevant in the current business environment, where corporate scandals and financial manipulations continue to be a concern, despite the implementation of stringent financial regulations. The collapse of large corporations in the past, such as Enron and Lehman Brothers, has highlighted the dangers of weak governance structures, where a lack of proper oversight, particularly in the audit committee, allowed for widespread earnings manipulation (Capraş et al., 2025). More recently, in emerging markets like Indonesia, the relationship between corporate governance and financial transparency remains under scrutiny. While governance reforms have been introduced, the challenge of ensuring truly independent oversight in family-controlled businesses and firms with concentrated ownership persists. In Indonesia, where family-owned businesses dominate, the potential for conflicts of interest in audit committees is significant, undermining the ability of these committees to act as effective monitors of financial reporting. Independent audit committees play a crucial role in mitigating opportunistic behavior by enhancing financial scrutiny, limiting managerial discretion, and strengthening accountability in reporting processes. By serving as an impartial monitoring body, they reduce information asymmetry between management and shareholders, thereby curbing the likelihood of earnings manipulation (Al-Shaer et al., 2022).

Theoretically, the agency theory offers a solid foundation for comprehending the results. This theory emphasizes that conflicts arise when managers pursue personal interests at the expense of shareholders. The presence of an independent audit committee helps reduce such agency conflicts by strengthening internal monitoring, limiting managerial discretion in financial reporting, and enhancing information transparency (Arsh et al., 2025). In this study, the negative association between audit committee independence and earnings management confirms that independent oversight effectively constrains opportunistic behavior, consistent with agency theory predictions. By acting as an outside check on managerial choices, independent directors lessen the possibility of opportunistic behavior by management, especially in earnings management. This supports the study's findings, which indicate that less earnings manipulation and more accurate financial reporting are correlated with an audit committee's level of independence.

However, while the findings support the importance of audit committee independence, it is important to acknowledge the limitations of this research. Several other factors, such as the expertise of committee members, the size of the committee, and the overall corporate culture of the organization, can influence the effectiveness of audit committees (Amola, 2025; Herawati & Sumiati, 2025). Future studies should examine how these variables interact and how they affect earnings management as a whole. Furthermore, the conclusions may not be as applicable to companies in other locations or at different stages of corporate governance development due to the study's focus on publicly traded companies in Indonesia. In conclusion, this study reinforces the critical role of independent audit committees in promoting financial transparency and curbing earnings management. The findings suggest that ensuring the independence of audit committees should remain a priority for companies seeking to improve their financial integrity. As the global economy continues to evolve, particularly in emerging markets, strengthening corporate governance mechanisms will be essential in fostering investor confidence and reducing the risk of financial manipulation.

## CONCLUSION

The independence of audit committees is crucial in lowering earnings management in publicly traded businesses, according to this study. The results support the idea that independent monitoring can improve the quality of financial reporting by showing a substantial correlation between lower levels of earnings manipulation and stronger and

more independent audit committees. This result is in line with other research that emphasizes the importance of independent audit committees in avoiding managerial opportunism and ensuring that financial statements accurately represent the performance of a company. The study also demonstrates the relevance of agency theory, which maintains that the impartial examination of audit committees lessens conflicts of interest between shareholders and management.

Even while the study provides valuable insights into the relationship between audit committee independence and earnings management, there are a number of limitations. First, the findings may not be as applicable to other regions or industries with different corporate governance norms due to the study's focus on publicly traded Indonesian companies. Furthermore, although audit committee independence is important, other elements, including committee member experience, audit committee size, and regulatory environment, may also have a big impact on how financial reporting is done. Future studies could examine these extra variables and how they interact to affect earnings management in various market environments.

Additional research is advised, including a look at the function of audit committee attributes other than independence, like experience, meeting frequency, and committee member diversity. Furthermore, in order to give a more comprehensive knowledge of how institutional and cultural variations impact the efficacy of corporate governance procedures in preventing profit management, future research might broaden the scope of the study to compare emerging markets with developed nations. Additionally, it would be beneficial to add to the body of literature to examine how recent corporate governance reforms in developing nations like Indonesia have affected the efficiency of audit committees. The importance of audit committee independence as a crucial element in improving financial transparency and reducing earnings manipulation is highlighted in the study's conclusion. Strengthening audit committees, particularly by increasing their independence, should be a top priority for businesses seeking to enhance governance and ensure the accuracy of their financial reporting.

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