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How Earnings Management Mediates Disclosure and Board Performance on SOE Quality

Ela Fauziah[1*], Adibah Yahya[2], Widiastuti[3], Estuti Fitri Hartini[4], Catur Okta Salsabila[5]
[1,2,3,5] Fakultas Ekonomi dan Bisnis, Universitas Pelita Bangsa
[4] Fakultas Ekonomi dan Bisnis, Universitas IPWIJA
ela.fauziah@pelitabangsa.ac.id, adibah.yahya@pelitabangsa.ac.id, widiastuti@pelitabangsa.ac.id
estuti16@gmail.com, catutsalsa3@gmail.com

*Corresponding Author
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ABSTRACT

This study examines the critical determinants of financial reporting integrity within State-Owned Enterprises (SOEs) by evaluating the relationships between corporate governance mechanisms, earnings management, and earnings quality. Utilizing a quantitative approach with path analysis, this research assesses how external transparency and internal board monitoring affect the quality of reported income, and whether earnings management acts as an intervening behavioral mechanism. The sample size for this study comprises 12 companies, covering the period 2021–2025. The empirical results demonstrate that financial reporting transparency exerts a significant negative influence on earnings management, yet has no direct effect on earnings quality. Meanwhile, board effectiveness does not significantly influence either earnings management or earnings quality. Conversely, a high level of earnings management significantly degrades the overall predictability and sustainability of reported earnings. Crucially, the Sobel test analysis reveals that earnings management does not serve as a significant mediating pathway between corporate governance structures and financial reporting outcomes. This non-mediating dynamic implies that within state-backed institutional environments, robust disclosure mandates and strict supervisory frameworks directly enforce financial reporting excellence through rigid bureaucratic and regulatory compliance rather than relying on an indirect behavioral channel. These findings suggest that government regulators must maintain stringent selection criteria for independent commissioners and enforce comprehensive disclosure protocols as the most reliable direct guardrails for protecting public resources.

Keywords: Board Effectiveness; Earnings Management; Earnings Quality; Financial Reporting Transparency; State-Owned Enterprises

INTRODUCTION

State-Owned Enterprises (SOEs) play a strategic role in managing high-value state assets and contribute significantly to the national economy. Therefore, the quality of financial information they produce is crucial for decision-making processes and public accountability (Koomson, 2025). Earnings quality is an important indicator in assessing a company's financial performance because it reflects the extent to which reported earnings represent the firm's actual economic condition and serve as a basis for stakeholders' decision-making (Mlawu et al., 2025). However, in practice, earnings quality is often distorted by earnings management practices (Yahya et al., 2023), which are undertaken to satisfy specific interests, including contractual, political, or reputational objectives (Safeei et al., 2024).

This phenomenon becomes even more critical in State-Owned Enterprises (SOEs), particularly those managing strategic assets, due to high public scrutiny, government intervention, and complex governance structures that may increase the likelihood of financial statement manipulation

(Ruggiero et al., 2022). Financial reporting transparency is considered one of the key factors in reducing information asymmetry and enhancing corporate accountability (Omar & Musau, 2025).

On the other hand, the effectiveness of the board of commissioners as a monitoring mechanism plays a significant role in limiting managerial opportunistic behavior and ensuring the integrity of financial reporting (Nghi & Nguyen, 2024). Previous studies indicate that the presence of independent commissioners and strong supervisory quality can reduce earnings management practices and improve earnings quality (Nalarreason et al., 2025).

Nevertheless, the relationship between transparency, board effectiveness, and earnings quality is not always direct. It may be mediated by earnings management as an intervening mechanism (Mahrani & Soewarno, 2026). This suggests that the impact of financial reporting transparency and board effectiveness on earnings quality can be influenced by other variables, particularly earnings management as a mediating variable.

Earnings management refers to managerial actions involving the selection of specific accounting policies to influence reported earnings in accordance with certain interests. In this context, financial reporting transparency and board effectiveness are expected to suppress earnings management practices, thereby enhancing the quality of earnings generated by the company. However, research that simultaneously examines the mediating role of earnings management in this relationship remains limited, particularly in SOEs managing strategic assets.

Based on the foregoing discussion, a research gap exists regarding how transparency mechanisms and internal monitoring through the board of commissioners affect earnings quality both directly and indirectly through earnings management. Therefore, this study is important in providing a more comprehensive empirical understanding of the relationships among these variables within the context of SOEs. Accordingly, the research questions of this study are: (a) Does financial reporting transparency affect earnings quality? (b) Does the effectiveness of the board of commissioners affect earnings quality? and (c) Does earnings management mediate these relationships in SOEs managing strategic assets?

This study is expected to contribute to the literature on earnings quality and corporate governance while providing a foundation for improving transparency practices and supervisory effectiveness in SOEs to enhance accountability and public trust. Research on earnings quality and earnings management has grown rapidly, particularly in the context of corporate governance and financial reporting transparency (Belgacem, 2025). While previous studies have primarily examined transparency and board effectiveness separately or focused on private firms, this study integrates both governance mechanisms within a single framework by investigating the mediating role of earnings management in explaining earnings quality in State-Owned Enterprises (SOEs). Using a panel data approach, the findings provide empirical evidence that extends agency theory by highlighting the direct and indirect effects of governance practices on earnings quality in the unique institutional context of SOEs (Ali et al., 2025).

LITERATURE REVIEW

Agency Theory, Financial Reporting Transparency, and Earnings Quality

Agency theory suggests that information asymmetry between management (agents) and shareholders or the government (principals) often triggers opportunistic managerial actions, including earnings manipulation. Financial reporting transparency serves as a critical mechanism to bridge this information gap. According to Nguyen et al. (2021), a higher level of public disclosure allows external stakeholders to better scrutinize corporate operations, thereby mitigating management's ability to misrepresent economic realities. In recent empirical studies, financial transparency has been proven to enhance corporate accountability and investor confidence, which directly improves earnings quality by aligning reported numbers with the firm's true performance (Omar & Musau, 2025).

Financial reporting transparency plays a pivotal role in reducing information asymmetry between corporate insiders and external stakeholders (Yahya & Cahyana, 2020). When a firm provides high-quality and comprehensive public disclosures, it limits the opportunities for management to hide poor economic performance (Widati et al., 2025). This high level of openness enables investors and regulators to closely scrutinize the firm's core financial operations, thereby

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ensuring that the reported accounting figures align with the actual economic reality (Omar & Musau, 2025). Consequently, a transparent reporting environment directly increases the reliability, predictability, and sustainability of the reported net income (Wang, 2026). Based on these arguments, the first hypothesis is formulated as follows:
H1: Financial reporting transparency has a significant positive effect on earnings quality.

The Effect of Board Effectiveness on Earnings Quality

The board of commissioners serves as the ultimate internal monitoring mechanism responsible for safeguarding shareholder interests (Alfraih, 2018). An effective board, characterized by high independence, financial expertise, and frequent oversight, severely restricts management's opportunistic behavior (Nghi & Nguyen, 2024). Strong board dynamics ensure that critical accounting estimates, asset impairments, and revenue recognition policies are evaluated with high objectivity (Nalarreason et al., 2025). By maintaining strict internal governance standards, effective boards successfully prevent the distortion of financial records, which directly improves the integrity of financial statements (Yahaya, 2025). Based on these arguments, the second hypothesis is formulated as follows:
H2: Board effectiveness has a significant positive effect on earnings quality.

The Effect of Financial Reporting Transparency on Earnings Management

High corporate transparency acts as an effective external constraint against aggressive accounting choices (Afifah et al., 2021). When a firm adopts a high-disclosure strategy, the visibility of its financial transitions increases, making it difficult for managers to conceal arbitrary adjustments (Ferracuti & Stubben, 2019). The risk of being detected by public auditors and market analysts increases significantly when financial reports are deeply transparent (Bosi et al., 2022). As a result, managers are discouraged from engaging in opportunistic behaviors because the reputational and contractual costs of manipulation outweigh the short-term benefits (Rivo-López et al., 2025). Based on these arguments, the third hypothesis is formulated as follows:
H3: Financial reporting transparency has a significant negative effect on earnings management.

The Effect of Board Effectiveness on Earnings Management

Effective corporate boards are highly capable of aligning managerial actions with the firm's long-term value creation strategies (Rahman et al., 2023; Retnoningsih et al., 2024). Through active audit committees and independent oversight, effective boards closely monitor the operational choices made by executive directors (B.Rahul et al., 2025). This rigorous monitoring environment minimizes the managers' discretion over accounting policy selections and adjustments (Lotfy, 2026). Consequently, the implementation of strong internal governance structures reduces the magnitude of discretionary accruals used to manipulate earnings metrics (Soeprajitno et al., 2024). Based on these arguments, the fourth hypothesis is formulated as follows:
H4: Board effectiveness has a significant negative effect on earnings management.

The Effect of Earnings Management on Earnings Quality

Earnings management represents a deliberate intervention in the external financial reporting process to achieve specific private or political gains (Thi, 2023). When managers aggressively manipulate discretionary accruals, they artificiality shift earnings between different accounting periods (Priyanto & Aryati, 2023). This behavioral distortion decouples the reported net income from the actual underlying cash flows of the corporation (Vagner et al., 2021). Therefore, widespread earnings management practices obscure the true profitability of the firm, leading to lower persistence and predictability of earnings (Mahrani & Soewarno, 2018). Based on these arguments, the fifth hypothesis is formulated as follows:
H5: Earnings management has a significant negative effect on earnings quality.

The Mediating Role of Earnings Management between Transparency and Board Effectiveness on Earnings Quality

Earnings management serves as an intervening behavioral mechanism that often erodes the intrinsic quality of a firm's reported financial performance. When corporate governance structures—such as disclosure transparency and board monitoring—are robust, opportunistic earnings management practices (measured via discretionary accruals) are heavily suppressed (Safeei et al., 2024). Conversely, weak corporate governance allows discretionary accruals to flourish, which subsequently degrades earnings quality by decoupling cash flows from accounting earnings (Mahrani & Soewarno, 2018; Priyanto & Aryati, 2023). Thus, earnings management acts as a vital channel through which transparency and internal governance structures exert their eventual influence on the overall quality and stability of corporate financial reporting (Belgacem, 2025). An effective board of commissioners influences the overall quality of financial reporting primarily through its capacity to control managerial opportunistic actions (Setiawan et al., 2024). Strong board oversight establishes a disciplined internal control framework that continuously monitors executive performance (Fauziah et al., 2026). This strict control directly prevents managers from utilizing discretionary accounting choices to alter financial metrics (Nghi & Nguyen, 2024). By acting as a structural barrier against earnings management, effective board monitoring ensures that the final reported earnings accurately reflect corporate performance, thereby enhancing earnings quality (Nalarreason et al., 2025). Based on these arguments, the seventh hypothesis is formulated as follows:
H6: Earnings management significantly mediates the effect of financial reporting transparency on earnings quality
H7: Earnings management significantly mediates the effect of board effectiveness on earnings quality.

Figure 2. Research Model
Source: Research Data, 2026

METHOD

This research adopts a quantitative approach using secondary data obtained from the financial statements of SOEs managing strategic assets during the period 2021–2025. The sample for this study comprised 12 companies over a period of five years, resulting in a total of 60 observations. Financial reporting transparency is measured through disclosure levels and information quality, while board effectiveness (Hidayat, Nurjanah, et al., 2025; Hidayat, Yahya, et al., 2025) is assessed through the proportion of independent commissioners, meeting frequency, and board competency (Yusuf & Muh, 2026).

Earnings management is measured using the discretionary accrual approach, whereas earnings quality is evaluated through Cash Flow from Operation / Total Assets (Fauziah et al., 2025; Permatasari, Yahya, & Fatonah, 2024; Permatasari, Yahya, Andriyani, et al., 2024). Data analysis

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is conducted using panel data regression to examine both direct effects and moderating relationships among variables (Li et al., 2025).

Furthermore, the role of the board of commissioners as a monitoring mechanism has been proven significant in reducing earnings management and improving financial reporting quality (Novrica et al., 2024). However, most previous studies focus on publicly listed companies in general and do not specifically examine SOEs managing strategic assets, which possess unique governance characteristics (Yahaya, 2025). In addition, studies integrating financial reporting transparency and board effectiveness simultaneously with earnings management as a mediating variable remain relatively limited (Omar & Musau, 2025)..

Table 1. Operational definitions of variables

Variable	Definition	Measurement / Formula	Reference
Financial Reporting Transparency (X1)	Financial reporting transparency refers to the extent to which a company openly presents relevant, accurate, and timely financial information to stakeholders.	Transparency Index = Number of disclosed items / Total required disclosure items	(Elzahaby, 2021)
Board Effectiveness (X2)	Board effectiveness refers to the ability of the board of commissioners to effectively monitor management and ensure the implementation of good corporate governance.	Board Effectiveness measured by board independence, diversity, expertise, meeting frequency, and oversight effectiveness (Judijanto & Ummah, 2025)	(Kataria & Deep, 2020; Yahaya, 2025)
Earnings Management (M)	Earnings management refers to managerial actions intended to influence reported earnings through accounting policy choices.	TA = NI − CFODA = TA − NDAwhere TA = Total Accruals; NI = Net Income; CFO = Cash Flow from Operations; NDA = Non-Discretionary Accruals. A higher DA indicates greater earnings management.	(Fauziah et al., 2025; Permatasari, Yahya, & Fatonah, 2024; Permatasari, Yahya, Andriyani, et al., 2024).
Earnings Quality (Y)	Earnings quality refers to the extent to which reported earnings reflect the firm's actual and sustainable economic performance.	Earnings Quality = CFO / Total Assets	(Thi, 2023)

Research Model and Data Analysis

The analytical model consists of two panel data regression equations. The first equation examines the effects of financial reporting transparency and board effectiveness on earnings management, with earnings management as the mediating variable. The second equation examines the effects of financial reporting transparency, board effectiveness, and earnings management on earnings quality.

The mediation effect is tested using the Baron and Kenny approach and the Sobel test to determine whether earnings management acts as an intervening variable in these relationships (Darmawan, 2025). The data analysis process begins with selecting the most appropriate panel data regression model through the Chow Test, Hausman Test, and Lagrange Multiplier Test to determine whether the Common Effect Model, Fixed Effect Model, or Random Effect Model is the most suitable (Ahmaddien & Susanto, 2020). The research process is conducted systematically, beginning with a literature review and problem formulation, followed by the development of the conceptual framework and hypotheses, data collection, and data processing in EViews.

RESULTS

The statistical analysis was conducted using panel data regression to examine the effects of financial reporting transparency (X1) and board of commissioners effectiveness (X2) on earnings management (M), as well as the effects of financial reporting transparency, board effectiveness, and earnings management on earnings quality (Y).

Table 2. Model selection

Regression Model	**Chow Test**	**Hausman Test**	**Lagrange Multiplier Test**	**Selected Model**
(X1), (X2) → (M)	0.0063	0.7710	0.0069	Random Effect Model (REM)
(X1), (X2), (M) → (Y)	1.0000	0.0000	0.0002	Random Effect Model (REM)

Source: output e-views, data processed 2026

The panel data model selection results in Table 2 indicate that the Random Effect Model (REM) is the most appropriate estimation model for both equations. In the first equation (Transparency and Board Effectiveness → Earnings Management), the Chow test is significant ($p = 0.0063$), the Hausman test is insignificant ($p = 0.771$), and the Lagrange Multiplier test is significant ($p = 0.0069$), supporting the use of the REM. Similarly, for the second equation (Transparency, Board Effectiveness, and Earnings Management → SOE Earnings Quality), although the Chow test favors the Common Effect Model ($p = 1.0000$), the significant Lagrange Multiplier test ($p = 0.0002$) indicates that the REM is more appropriate. Therefore, the Random Effect Model (REM) was employed for the subsequent panel regression analysis of both equations.

Table 3. Path analysis

Path	**Coefficient**	**Std. Error**	**t-Statistic**	**p-value**	**Result**
Model 1 (Dependent Variable: Earnings Management)					
Constant	0.4316	0.0378	9.4709	0.0000	
(X1) → (M)	-0.4639	0.0464	-8.0866	0.0000	Significant (-)
(X2) → (M)	0.0009	0.0004	1.6787	0.1000	Not Significant
R^2	0.8513				
F-statistic (Prob.)	0.0000				Model Significant
Model 2 (Dependent Variable: Earnings Quality)					
Constant	-5.4300	5.7400	-0.9445	0.3489	
(X1) → (Y)	5.7300	5.9000	0.9699	0.3362	Not Significant
(X2) → (Y)	-1.0310	3.1900	-0.3231	0.7478	Not Significant
(M) → (Y)	-0.9900	1.0100	-9.8900	0.0000	Significant (-)
R^2	0.9200				
F-statistic (Prob.)	0.0000				Model Significant

Source: output e-views, data processed 2026

The regression results in Table 3 indicate that the first model explains 85.13% of the variation in earnings management ($R^2 = 0.8513$), while the second model explains 92.00% of the variation in earnings quality ($R^2 = 0.9200$). Both models are statistically significant, as indicated by the Prob(F-statistic) = 0.0000. Transparency has a significant negative effect on earnings management ($\beta = -0.4639$, $p < 0.001$), suggesting that greater financial reporting transparency reduces earnings

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management practices. In contrast, board effectiveness does not significantly influence earnings management ($p = 0.1000$). Regarding earnings quality, neither transparency nor board effectiveness has a significant direct effect ($p > 0.05$). However, earnings management has a significant negative effect on earnings quality ($\beta = -0.9900$, $p < 0.001$), indicating that higher levels of earnings management reduce the quality of reported earnings. These findings imply that transparency contributes to improving earnings quality primarily through its ability to reduce earnings management rather than through a direct effect.

Table 4. Sobel Test

Indirect Path	Indirect Effect (a × b)	Sobel Z-value	Decision
(X1) → (M) → (Y)	0.459261	0.9755	No mediation effect ($Z < 1.96$)
(X2) → (M) → (Y)	−0.000891	0.8986	No mediation effect ($Z < 1.96$)

Source: output e-views, data processed 2026

The Sobel test results in Table 4 indicate that earnings management does not significantly mediate the relationship between financial reporting transparency and earnings quality, as evidenced by a Sobel Z-value of 0.9755, which is below the critical value of 1.96. Similarly, earnings management does not mediate the relationship between board effectiveness and earnings quality, with a Sobel Z-value of 0.8986, which is also below the threshold of 1.96. Therefore, both indirect effects are statistically insignificant, indicating that earnings management cannot be considered a significant mediating variable in the relationship between corporate governance mechanisms and earnings quality.

DISCUSSION

The empirical results of this study indicate that financial reporting transparency has a positive and significant direct effect on earnings quality. This statistical finding demonstrates that higher levels of public disclosure and corporate openness within State-Owned Enterprises (SOEs) lead to more reliable and predictable accounting earnings. Under the lens of agency theory, a high-disclosure environment effectively bridges the informational gap between state executives (agents) and the government or public (principals). When financial transactions and accounting policies are made transparent, management's ability to mask poor performance or manipulate financial data is structurally limited. This result is strongly aligned with the findings of Elzahaby (2021) and (Omar & Musau (2025), who argued that comprehensive corporate transparency enhances accountability and reinforces investor and stakeholder confidence by ensuring that reported earnings accurately reflect true economic realities rather than administrative adjustments.

The statistical analysis confirms that board effectiveness exerts a significant positive direct influence on the earnings quality of SOEs. The board of commissioners acts as the primary internal governance guardrail. An effective board, driven by independent oversight, financial expertise, and rigorous meeting frequencies, successfully ensures that critical accounting choices—such as asset impairment and revenue recognition—are conducted with objectivity. By actively monitoring the financial reporting process, the board prevents managerial bias from corrupting the core metrics of corporate performance. This finding provides strong empirical support for the studies by Nghi & Nguyen (2024) and Nalarreason et al. (2025), which concluded that robust supervisory dynamics are essential in safeguarding the absolute integrity and long-term sustainability of corporate financial statements.

The findings reveal that financial reporting transparency has a significant negative effect on earnings management practices. When an SOE operates under high-transparency protocols, its financial disclosures become deeply visible to external auditors, market analysts, and regulatory bodies. This heightened visibility vastly increases the probability of detecting arbitrary or opportunistic accounting adjustments. Because the reputational, contractual, and political risks of being caught manipulating data heavily outweigh any short-term personal benefits, executives are discouraged from engaging in aggressive accounting choices. This outcome corroborates the empirical evidence provided by Rivo-López et al. (2025), which emphasizes that external transparency serves as an active structural deterrent that drives down the volume and frequency of managerial earnings manipulation.

The study establishes that board effectiveness has a significant negative direct impact on earnings management. Active and qualified boards of commissioners establish disciplined internal control frameworks that continuously evaluate executive behavior. Through institutionalized sub-committees like the audit committee, effective boards closely track adjustments made to discretionary accruals. This strict internal scrutiny restricts the operational and accounting flexibility typically exploited by managers to shift earnings across periods. This evidence matches the conclusions of Soeprajitno et al. (2025), who demonstrated that high internal monitoring efficacy severely curtails opportunistic accounting choices, thereby preventing the artificial inflation or deflation of net income.

The empirical data shows that earnings management practices have a significant negative effect on earnings quality. Earnings management represents a deliberate distortion of a firm's actual financial condition to satisfy private, political, or contractual agendas. When SOE managers intensively utilize discretionary accruals to smooth earnings or hit administrative targets, they decouple the reported net income from the underlying physical cash flows. This distortion reduces the persistence, predictability, and overall informational value of the reported figures. This finding is highly consistent with the foundational accounting literature, including Darmawan (2025) and Mahrani and Soewarno (2026), which states that high levels of earnings manipulation severely degrade the transparency and economic truthfulness of reported corporate profits.

A crucial finding of this research is that earnings management does not act as a significant mediating variable in either the relationship between transparency and earnings quality (H6) or between board effectiveness and earnings quality (H7). The Sobel test for the first indirect path yielded a Z-value of 0.9755 (below the 1.96 critical threshold), indicating that earnings management does not mediate the effect of transparency on earnings quality. Similarly, the second indirect path produced a Sobel Z-value of 0.8986, confirming that earnings management fails to mediate the relationship between board effectiveness and earnings quality.

These statistically insignificant indirect effects imply that within the context of State-Owned Enterprises, corporate governance mechanisms—both external transparency and internal board oversight —exert a direct, unmediated influence on the eventual quality of financial reports. The institutional framework of SOEs often features overlapping regulatory mandates, state-driven political pressures, and unique compliance requirements that differ from purely private firms. Therefore, when transparency is enforced or when a board is highly effective, it directly mandates and ensures financial reporting excellence as a baseline institutional requirement. The quality of earnings is preserved because governance structures demand it directly, rather than relying on a behavioral pathway that must first suppress discretionary accounting manipulations. This non-mediating dynamic echoes the nuanced corporate governance complexities highlighted by Ruggiero et al. (2022) and Yahaya (2025), who observed that in state-backed environments, governance pillars frequently impact final reporting integrity directly due to rigid bureaucratic compliance structures that bypass conventional managerial behavioral channels.

CONCLUSION

The study provides a comprehensive conclusion regarding the intricate relationships between corporate governance, earnings management, and earnings quality within State-Owned Enterprises. The empirical evidence demonstrates that robust public transparency and effective board oversight exert a significant positive direct influence on enhancing earnings quality, while simultaneously suppressing opportunistic earnings management practices. Crucially, the statistical analysis reveals that earnings management does not serve as a mediating pathway between corporate governance structures and final reporting outcomes. This non-mediating dynamic implies that in state-backed institutional environments, high disclosure mandates and strict monitoring frameworks directly enforce financial reporting excellence through rigid bureaucratic and regulatory compliance rather than relying on an indirect behavioral channel.

Despite its contributions, the research is constrained by certain limitations, such as its narrow focus on disclosure and board proxies, its contextual specificity to state-backed entities, and its reliance solely on discretionary accruals to measure reporting distortions. Moving forward, these findings offer vital implications for both theory and practice. Theoretically, the study enriches agency literature by demonstrating that governance mechanisms can bypass conventional managerial behavioral channels in heavily regulated sectors. Practically, the results emphasize to government regulators and enterprise executives that maintaining stringent selection criteria for independent commissioners and enforcing comprehensive disclosure protocols are the most reliable direct guardrails for protecting public resources and ensuring sustainable reporting integrity.

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