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THE INFLUENCE OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE: THE MEDIATING ROLE OF EARNINGS MANAGEMENT

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Abstract: This study aims to examine the impact of corporate governance mechanisms towards the financial performance of companies in Indonesia, where earnings management is applied as an intervening variable. Corporate governance is a significant element in mitigating agency conflicts that may impact a firm's financial outcomes and lead to earnings manipulation. A quantitative approach was employed, using path analysis to test the proposed relationships. 312 observations of data were collected from 78 listed industrial companies in the Indonesia Stock Exchange during 2021-2024 through purposive sampling. The results show that the percentage of independent commissioners and institutional ownership considerably reduces the earnings management behavior. However, the size of the audit committee and managerial ownership do not appear to have a major impact. Furthermore, financial performance is strongly and favorably impacted by institutional ownership and independent commissioners. However, it has been discovered that earnings management significantly and negatively affects financial outcomes. Furthermore, the evidence points to earnings management as a partial mediating factor in the relationship between corporate governance elements and financial performance. This study contributes to the body of knowledge in accounting and corporate governance by empirically evaluating the mediating function of earnings management in the link between governance systems and business financial performance in the Indonesian context.

Keywords: *Earnings Management, Financial Performance, Corporate Governance*

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1. Introduction

Corporate governance has been a prominent subject in the corporate arena, particularly in and following a succession of high-profile corporate failures in the early 2000s, such as those of Enron, WorldCom, and Tyco. In the Indonesian context, cases involving companies like Bank Lippo and Kimia Farma highlight significant shortcomings in applying effective corporate governance principles. In addition to raising questions about the boards of directors' and external auditors' monitoring powers, these company failures eroded public confidence in the accuracy of financial reporting and accounting procedures (Hermawan et al., 2018). As a result, the significance of governance structures that oversee managerial conduct and protect shareholders' interests has come into sharper emphasis.

Earnings management refers to the deliberate intervention by corporate managers in the financial reporting process with the intention of altering reported earnings to meet particular goals or expectations. Rather than reflecting the company's actual financial condition, these adjustments often serve personal or strategic interests, such as meeting analyst forecasts, securing performance-based bonuses, or smoothing out income fluctuations over time. According to Healy & Wahlen (1999) such behavior falls under the umbrella of opportunism, where financial statements are crafted not purely to inform, but to influence perceptions. While these practices may offer short-term advantages, such as stabilizing earnings or maintaining investor confidence, they pose serious concerns regarding the credibility and transparency of financial information. When earnings are manipulated, the reliability of reported figures is compromised, which can mislead stakeholders and distort economic decision-making. Over time, this erosion in financial data integrity can damage the company's reputation, reduce investor trust, and ultimately hinder sustainable financial performance. In essence, although earnings management may create the illusion of stability or growth, it often masks underlying issues, potentially leading to more severe consequences in the future when true performance is revealed.

According to the OECD (2015), corporate governance is a collection of values and procedures designed to match management's goals with those of shareholders and other stakeholders. It is widely recognized that effective governance structures can mitigate agency problems by fostering transparency, accountability, and responsible decision-making. These mechanisms are also believed to suppress opportunistic behaviors such as earnings manipulation and, in turn, contribute positively to a firm's financial performance. In spite of this theoretical expectation, empirical research has produced conflicting findings about the direction and strength of the relationships between financial outcomes, earnings management, and corporate governance (Al-Matari et al., 2014; Zabri et al., 2016). This suggests that the interactions between these variables may be more intricate and context-specific.

Previous studies have mostly focused on examining the direct impact of governance mechanisms on either financial performance or earnings management behaviors (Duru et al., 2016; Latif & Abdullah, 2015). However, relatively few studies have investigated how earnings management may act as a mediating factor in the governance–performance nexus. This research gap is particularly noticeable in emerging economies, where corporate governance frameworks are still evolving and often differ substantially from those in more mature markets. The novelty of this study is that it places earnings management as a mediating variable that bridges the relationship between corporate governance and financial performance.

Indonesia serves as a compelling context for such investigation due to its distinct corporate landscape, which is characterized by concentrated ownership structures, significant control by founding families, and limited independence in board oversight (Utama et al., 2017). Furthermore, while regulatory frameworks promoting good governance have been introduced, their adoption in many firms appears to be driven more by the need to fulfill compliance requirements than by a genuine commitment to governance best practices (Prabowo & Simpson, 2011). These factors make Indonesia an ideal setting to examine whether governance structures can effectively reduce earnings management and thereby enhance financial performance, or whether such mechanisms remain symbolic in practice.

2. Literature Review and Hypothesis Development

2.1. Agency Theory and Corporate Governance

According to agency theory, there may be a conflict of interest in a contractual arrangement between managers and principals, or shareholders, which could cause the agent to act opportunistically (Jensen & Meckling, 1976). Information asymmetry results from managers acting as agents knowing more about the state of the business than shareholders do. Managers might exploit the imbalance of information to pursue actions that benefit themselves rather than the shareholders' interests (Eisenhardt, 1989).

Internal and external controls are the two broad categories into which corporate governance measures fall, according to Walsh & Seward (1990). Organizational structures and procedures that are intended to oversee and guide managerial behavior are known as internal governance mechanisms. These typically include the board of commissioners (or board of directors in some systems), audit committees, ownership structures, and executive compensation arrangements. On the other hand, external mechanisms operate outside the firm's organizational boundaries and include elements such as capital market pressures, regulatory oversight, and the executive labor market, all of which can influence corporate behavior and discipline management.

This study focuses specifically on internal corporate governance processes, as they directly and immediately impact managerial decision-making. The key elements being explored include the proportion of independent commissioners on the board, the effectiveness of the audit committee, the level of institutional ownership, and the degree of managerial ownership. These internal factors are chosen because they reflect the firm's internal commitment to oversight and accountability, which are critical in influencing both earnings management behavior and financial outcomes.

2.2. Earnings Management

Healy & Wahlen (1999) have explained earnings management as the positive involvement of managers in the process of financial reporting. They do this by making a contribution to the financial situation of the company through their accounting estimates judgment and structuring transactions. These strategies are typically utilized in order to mislead stakeholders regarding the firm's true financial performance or impact decisions based on accounting metrics, including executive compensation, debt arrangements, or investor judgments. This manipulation can occur within the bounds of accepted accounting standards, making it difficult to detect, yet it raises significant concerns about the transparency and integrity of financial reporting.

Trucco (2015) identified several motivations for managers to carry out earnings management, including: (1) bonus motivation, where managers try to maximize the bonuses received; (2) other contractual motivations, such as debt agreements; (3) political motivation, to reduce political costs and government oversight; (4) tax motivation, to minimize the tax burden; (5) CEO turnover, where CEOs who are about to retire or are threatened with dismissal tend to increase profits; and (6) initial public offerings (IPOs), to provide a positive signal to investors.

2.3. Financial performance

Financial performance reflects a company's capacity to achieve operational success, translating its financial outcome over a given period. Good financial performance usually signifies that the management has utilized the company's resources appropriately and efficiently to create value (Gitman & Zutter, 2015). Financial performance can be measured in several ways, like the use of financial ratios, market-based indicators, or both. To determine the financial performance in this research, Return on Assets (ROA) has been used. ROA is an accounting ratio measure. It is one of the most significant measures of operating efficiency that demonstrates the ability of the management of a company to convert its assets into profits.

2.4. The Impact of Corporate Governance on Earnings Management

Effective corporate governance is expected to lead to less earnings management by managers. Independent boards of commissioners play a key role in ensuring high-quality financial reporting and overseeing management activities. According to Peasnell et al. (2005), a larger percentage of independent boards of commissioners is thought to improve supervisory efficacy and curtail earnings management methods. It will be responsible for overseeing the precision of the financial reporting process and overseeing the internal control structure. There is going to be less profits administration techniques as more members of an audit committee are going to carry out its duties effectively (Klein, 2002). Because institutional investors usually have the means and know-how to properly monitor management's actions, institutional ownership can be a potent weapon for corporate governance. By encouraging more careful monitoring, a greater degree of institutional ownership is expected to reduce profits management techniques (Mitra & Cready, 2005). Likewise, managerial ownership is essential for bringing managers' incentives into line with shareholders', which lowers the possibility that managers may manipulate earnings. Because these decisions immediately affect their personal financial well-being, managers who own stock in the company are more inclined to make choices that protect the company's long-term worth (Warfield et al., 1995). From these considerations, the first hypothesis in this study is:
H1a: The percentage of independent commissioners negatively affects earnings management.
H1b: The size of the audit committee negatively affects earnings management.
H1c: Institutional ownership negatively affects earnings management.
H1d: Managerial ownership negatively affects earnings management.

2.5. The Influence of Corporate Governance on Financial Performance

Effective corporate governance procedures are crucial for enhancing a business's financial performance because they lessen agency conflicts and boost operational effectiveness. According to Liu et al. (2015), an independent board of commissioners is more likely to provide impartial monitoring and protect the interests of minority owners, both of which can enhance the company's financial performance. Furthermore, an effective audit committee can improve internal controls and raise the caliber of financial reporting, both of which contribute to better financial performance (Aldamen et al., 2012). The size of the audit committee may also play a role, as a larger committee can bring together a diverse set of expertise and experiences, facilitating more effective monitoring of the company's activities. Institutional ownership offers strong incentives for institutional investors to closely monitor management and advocate for decisions that can enhance the company's value (Cornett et al., 2007). Institutional investors are well-endowed and seasoned enough to make a better evaluation of the performance of the firm and its future since they have a lot to support them. Similarly, managerial ownership induces managers to make value-enhancing choices since their interests will be identical with those of shareholders (Jensen & Meckling, 1976). When managers own shares in the company, they themselves turn into shareholders and hence are motivated to care about decisions that maximize long-term shareholder wealth. From these insights, the second hypothesis in this study is:

H2a : Financial performance is positively impacted by the percentage of independent commissioners.
H2b : The size of the audit committee has a positive effect on financial performance.
H2c : Institutional ownership has a positive effect on financial performance.
H2d : Managerial ownership has a positive effect on financial performance.

2.6. The Impact of Earnings Management on Financial Performance

Long-term financial performance can be impacted by earnings management. Earnings management can boost profits in the near term, but it can also hurt the company in the long run by lowering investor confidence and the quality of earnings (Dechow et al., 1995). In addition to raising investor concerns about the caliber of reported results, aggressive earnings management may result in the inability to meet future profit goals. Lower financial performance and a decline in the company's value may result from this (Graham et al., 2005). Earnings management techniques can also lead to operational inefficiencies and the diversion of managerial resources from worthwhile endeavors. The third hypothesis in this research, as supported by the aforementioned arguments, is:

H3: Earnings management negatively impacts a company's financial performance.

2.7. Earnings Management as a Intervening Variable

Strong company governance practices improve financial performance by mitigating earnings management occurrences. Corporate governance has an indirect effect on financial performance through earnings management. Agency theory offers an explanation framework for the relationship. Effective corporate governance procedures, according to agency theory, reduce agency problems and abate opportunistic managerial practices, like earnings manipulation. With diminished earnings management, firms can manage to increase their financial performance based on the increased confidence of investors and the quality of disclosed financial information. Earnings management has been shown to act as a mediator in the relationship between corporate governance and financial performance, based on prior researches (Leuz et al., 2003; Jiraporn et al., 2008). Such proof is still lacking, though, especially in developing nations like Indonesia where corporate governance standards may be different from those in more established ones. Taking these factors into account, the fourth hypothesis in this research is:

H4 : Earnings management mediates the relationship between corporate governance mechanisms and financial performance.

3. Research Method

3.1. Population and Sample

Manufacturing firms listed on the IDX between 2021 and 2024 make up the study's population. The decision to focus on the manufacturing sector stems from its prominence on the IDX and the relatively homogeneous nature of its operational characteristics, which allows for more meaningful and comparative analysis. Purposive selection was used to choose the research sample, which comprised businesses that satisfied the following requirements: (1) manufacturing firms listed on the IDX between 2021 and 2024, (2) businesses that released full audited financial statements during the study period, (3) companies that provided

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comprehensive data for all variables under investigation, and (4) companies that utilized the rupiah as their reporting currency. Following these criteria, 78 companies were selected for each year of observation, resulting in a total of 312 observations over the course of the study. This sample represents approximately 60% of the total manufacturing companies listed on the IDX, suggesting that it is a robust and representative subset of the population.

3.2. Operational Definition and Measurement of Variables

Independent Variable: Corporate Governance Mechanism

1. Proportion of Independent Commissioners (PDKI): Determined by dividing the total number of board members by the number of independent commissioners, this figure shows how many members of the board are impartial controllers who are unaffiliated with the day-to-day operations of the business.
2. Audit Committee Size (UKA): The number of people who make up the audit committee of the company is the variable's definition. A larger audit committee might result in a more reliable system to monitor internal control and financial reporting, which would raise the standard of corporate governance.
3. Institutional Ownership (KI): This refers to the percentage of the company's shares owned by institutional investors such as pension funds, mutual funds, or insurance firms in relation to the total number of shares outstanding within the company. Institutional ownership is generally a sign that the company is subject to more intense monitoring from more sophisticated investors that are more likely to invest in improved corporate governance policies.
4. Managerial Ownership (KM): This is derived by multiplying the total percentage owned by members of the executive team of the company, board of directors, and commissioners and dividing it by the total issue of shares of the company. Managerial ownership aligns management with the interest of shareholders, which may encourage executives to optimize company and shareholder value.

Intervening Variable: Earnings Management

The earnings manipulation is examined based on discretionary accruals (DA) calculated after the modified Jones model that emerged as part of Dechow et al. (1995) framework. This enables us to identify the proportion of accruals over which there is managerial discretion and serve as an indicator of the extent to which the earnings are managed or massaged through accounting options.

Dependent Variable: Financial Performance

A company's financial performance demonstrates its capacity to generate profits through efficient management of its equity, liabilities, and assets over a certain time period. This study measures financial performance using return on assets (ROA).

3.3. Data Analysis Techniques

This research employs path analysis to explore the influence of corporate governance practices on financial performance, with earnings management acting as an intermediary variable. Path analysis is a sophisticated statistical method that builds on multiple linear regression, allowing for the exploration of mediation relationships. It provides a deeper understanding of both direct and indirect effects among variables, making it especially valuable for analyzing complex models that involve mediating factors.

4. Results and Discussion

4.1. Results

Descriptive Statistics

An overview of the features of the data utilized in this investigation is given via descriptive statistics. Table 1 below provides a summary of each research variable's descriptive statistical values.

Table 1. Descriptive Statistics

Variables	Average	Minimum	Maximum
Proportion of Independent Board of Commissioners (PDKI)	0.398	0.200	0.600
Audit Committee Size (UKA)	3,241	3,000	5,000
Institutional Ownership (IP)	0.648	0.200	0.950
Managerial Ownership (KM)	0.057	0,000	0.300
Earnings Management (DA)	0.058	0.010	0.058
Return on Assets (ROA)	0.047	-0.010	0.250

Table 1 provides the descriptive statistics of the variables used in this study. The mean proportion of Independent Commissioners (PDKI) is 0.398, ranging from a minimum of 0.300 and a maximum of 0.600. This implies that, on average, approximately 39.8% of the company's board of commissioners are independent, which is equivalent to most of the companies meeting the minimum requirement of the Financial Services Authority (OJK) of having 30% independent commissioners. With regard to the number of members in the Audit Committee (UKA), the average is 3.241 members, ranging from 3 to 5 members. This indicates that most companies are complying with OJK's minimum size requirement for the audit committee.

In addition, the average level of Institutional Ownership (KI) is 0.648, with values ranging from 0.200 to 0.950. This suggests that approximately 64.8% of the companies' shares are held by institutional investors, indicating a relatively concentrated ownership structure commonly found in Indonesian firms. On the other hand, Managerial Ownership (KM) is significantly lower, with an average of just 0.057, and a range from 0.000 to 0.300. This implies that, on average, only 5.7% of shares are owned by internal parties such as directors and commissioners.

Earnings management, as indicated by the absolute value of discretionary accruals (|DA|), averages 0.058, ranging from a low of 0.010 to a high of 0.200. This suggests a moderate level of earnings manipulation across the observed firms. Conversely, financial performance, in the form of Return on Assets (ROA), stands at an average of 0.047, which signifies that, on average, firms are able to earn a profit of 4.7% from their assets. ROA varies extensively, with a low of -0.100 to a high of 0.250, indicating variations in the profitability of the firms in the sampled population.

Path Analysis Results

The study path analysis's findings, which include the impact of corporate governance practices on financial performance and earnings management as well as the mediating function of earnings management, are shown in the following tables. A mediation test (Sobel test) and a linear regression model were used in this investigation.

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Table 2. Impact of Corporate Governance Mechanisms on Earnings Management

Independent Variables	Coefficient (β)	Significance	Information
Proportion of Independent Board of Commissioners (PDKI)	-0.142	$p < 0.05$	Significant, supports H1a
Audit Committee Size (UKA)	-0.029	$p > 0.10$	Not significant, H1b is not supported
Institutional Ownership (IP)	-0.176	$p < 0.01$	Significant, supports H1c
Managerial Ownership (KM)	-0.045	$p > 0.10$	Not significant, H1d not supported

Source: Processed data.

Table 2 reveals that among the four corporate governance mechanisms examined, only two significantly influence earnings management. The Proportion of Independent Commissioners (PDKI) negatively affects earnings management ($\beta = -0.142$; $p < 0.05$), indicating that a higher presence of independent commissioners helps reduce earnings manipulation. Likewise, Institutional Ownership (KI) has a significant negative impact ($\beta = -0.176$; $p < 0.01$), suggesting that institutional investors play an effective monitoring role. However, Audit Committee Size (UKA) and Managerial Ownership (KM) do not show significant effects ($p > 0.10$), meaning hypotheses H1b and H1d are not supported. This implies that these governance mechanisms may still lack strength or proper implementation in the Indonesian corporate context.

Table 3. Regression Results on Financial Performance

Independent Variables	Coefficient (β)	Significance	Information
PDKI	0.167	$p < 0.05$	Significant, supports H2a
UKA	0.038	$p > 0.10$	Not significant, H2b is not supported
KI	0.183	$p < 0.01$	Significant, supports H2c
KM	0.052	$p > 0.10$	Not significant, H2d not supported
Earnings Management (|DA|)	-0.197	$p < 0.01$	Significant, supports H3

Source: Processed data.

The regression results show that three variables significantly affect financial performance (ROA): proportion of independent commissioners (positive, $p<0.05$), institutional ownership (positive, $p<0.01$), and earnings management (negative, $p<0.01$). On the other hand, the size of the audit committee and the risk management committee do not have a significant impact, suggesting that their functions have not yet been effective in improving financial performance.

Table 4. Results of Earnings Management Mediation Analysis

Mediation Path	Indirect Effects	Immediate Effects	Z Sobel	Significance	Mediation Types	Information
PDKI → |DA| → ROA	0.028	0.167	2.24	$p < 0.05$	Partial	Significant mediation, supporting H4

KI → |DA| → ROA	0.035	0.183	2.82	p < 0.01	Partial	Significant mediation, supporting H4
UKA → |DA| → ROA	-	-	-	p > 0.10	No mediation	UKA is not significant → no mediation
KM → |DA| → ROA	-	-	-	p > 0.10	No mediation	KM is not significant → no mediation

Source: Processed data.

Based on Table 4, the mediation analysis results show that earnings management (|DA|) partially mediates the relationship between two corporate governance mechanisms—Proportion of Independent Commissioners (PDKI) and Institutional Ownership (KI)—and financial performance (ROA). The PDKI → |DA| → ROA path has an indirect effect of 0.028 (Sobel Z = 2.24, p < 0.05), while the KI → |DA| → ROA path shows an indirect effect of 0.035 (Sobel Z = 2.82, p < 0.01), supporting hypothesis H4 in both cases. This suggests that part of the positive impact of PDKI and KI on ROA operates through their ability to reduce earnings management. Conversely, no mediation effect is found for Audit Committee Size (UKA) and Risk Management Committee (KM), as their relationships with earnings management and ROA are not statistically significant.

4.2. Discussion

Independent commissioners has a negative effect on earnings management, which, in turn, positively influences financial performance. This supports the idea that independent commissioners provide more objective oversight of management and protect the interests of minority shareholders (Liu et al. 2015). Because independent commissioners are not closely affiliated with the company, they are better positioned to scrutinize management's decisions impartially, thus preventing earnings manipulation. The negative relationship between independent commissioners and earnings management suggests that their oversight reduces the potential for financial reporting manipulation, ultimately benefiting the company's financial performance. By ensuring that shareholders' interests are safeguarded and management decisions are properly monitored, independent commissioners play a key role in promoting transparency and improving corporate governance. In contrast, the study found that other mechanisms, such as audit committee size and managerial ownership, did not significantly impact earnings management or financial performance. This may suggest that while these elements are important in corporate governance, their effects on financial reporting practices might not be as immediate or evident in the context of the companies analyzed.

Institutional ownership was found to have a negative effect on earnings management, while also positively influencing financial performance. This supports the idea that institutional investors are both highly motivated and well-equipped to monitor management activities closely (Mitra & Cready, 2005). Institutional investors typically possess greater financial expertise and have access to a wider range of information, which equips them to identify instances of earnings manipulation. Moreover, their influence encourages management to prioritize sustainable, long-term performance over short-term financial gains, leading to more transparent and accurate financial reporting. As significant shareholders, institutional investors have the resources and power to hold management accountable, advocating for decisions that align with the long-term interests of the company. Their participation can guide the business toward more ethical financial procedures and discourage opportunistic conduct like earnings manipulation. Institutional investors are essential in ensuring that management's activities are in line with the interests of shareholders by encouraging greater levels of supervision, which in turn leads to better financial performance.

However, the size of the audit committee and managerial ownership do not seem to significantly affect earnings management or financial performance. This could be due to the specific context of Indonesia, where the implementation of these two corporate governance mechanisms is not yet fully optimized. In Indonesia, the size of the audit committee generally only meets the minimum regulatory standards, resulting in limited variation that may not be enough to create a significant impact on corporate practices. Similarly, managerial ownership in Indonesia is relatively low, averaging just 5.7%. This modest level of ownership may not be sufficient to effectively align the interests of managers with those of shareholders, thus limiting the potential for managerial ownership to significantly enhance financial performance or reduce earnings management practices. The limited effectiveness of these mechanisms could be attributed to the fact that the audit committees, while meeting basic legal requirements, may not possess the necessary expertise or independence to provide meaningful oversight of management decisions. Likewise, the relatively low stakes held by managers may diminish their personal incentives to prioritize the long-term interests of shareholders. As such, both the audit committee size and managerial ownership may not yet be robust enough in the Indonesian corporate governance environment to significantly influence financial outcomes or curtail earnings manipulation.

Earnings management has been found to negatively affect financial performance, as seen in its impact on ROA. This aligns with the view that although earnings management might provide short-term benefits, it can be detrimental in the long term (Dechow et al., 1996). Manipulating earnings can compromise the quality of reported earnings and diminish investor confidence, ultimately lowering the company's value. Manipulated results no longer fairly represent the company's financial status, which can result in bad investment choices and a deterioration in market confidence. This could therefore make it more difficult for the business to draw in investment and maintain long-term growth. Earnings management refers to a deliberate effort by corporate management to adjust financial reports in a way that presents the company's performance as more consistent, favorable, or aligned with market expectations. This adjustment is often carried out through strategies such as accelerating revenue recognition, deferring expense acknowledgment, or applying flexible accounting policies that remain within the bounds of accepted accounting standards. Although these actions may appear legitimate on the surface, they can have substantial implications for a company's financial health. One of the most notable effects of earnings management is its ability to shape and in some cases distort, the perceptions of investors and creditors. When a company consistently reports rising or stable profits, external stakeholders may assume the business is financially sound. However, this appearance of stability may be the result of artificial earnings inflation, achieved by postponing expense recognition or relying on overly optimistic assumptions in reporting. This practice also undermines the integrity of financial information. Once financial statements are manipulated to serve specific interests, they lose their reliability as a tool for sound decision-making. Consequently, users of the financial reports, whether they are internal managers, investors, or regulatory bodies, may be led to make misguided decisions based on figures that do not accurately reflect the company's actual condition. Over time, the continued use of earnings management can backfire. In the short run, it may create an illusion of success. But if these manipulations accumulate, they can conceal real operational weaknesses. Eventually, when the truth surfaces, the fallout may include eroded investor trust, volatility in stock prices, and significant damage to the reputation of the management team.

The findings of the mediation analysis show that the relationship between corporate governance mechanisms more especially, the percentage of independent commissioners and institutional ownership and corporate financial performance is significantly influenced by earnings management as an intermediary variable. This result supports the idea that corporate governance has an indirect effect on performance by preventing earnings manipulation, in addition to its direct impact. The presence of effective independent commissioners, along with the involvement of institutional investors as major shareholders, contributes to a more rigorous supervisory environment over managerial behavior. In such a context, earnings management practices, which are often employed to smooth profit fluctuations or meet specific targets, become more restrained. This contributes to the enhancement of financial report quality, making the presented information more reliable for stakeholders. As a result, economic decisions are likely to be more rational, grounded in data that accurately reflects the firm's actual performance. A number of studies have confirmed this relationship. For instance, research by Ulfa & Syam (2022) reveals that both the proportion of independent commissioners and the level of institutional ownership are negatively correlated with earnings management, while showing a positive correlation with financial performance.

The theoretical implication of this study is that agency theory should be broadened to incorporate the role of earnings management as a form of agency conflict that directly impacts financial performance. This expansion of the theory highlights that earnings management, as a managerial practice, can worsen the agency problem and impact a company's financial results. Furthermore, the findings indicate that the effectiveness of corporate governance mechanisms in reducing agency conflicts is not consistent; it can differ based on the institutional context and the unique characteristics of each firm. This suggests that in order to fully align the interests of managers and shareholders, corporate governance procedures may need to be customized to the particular circumstances of various contexts and businesses.

The practical implication of this study is that companies need to pay attention to the quality, not just the quantity, of the implementation of corporate governance mechanisms. For example, increasing the proportion of independent commissioners who are truly independent and have relevant expertise may be more important than simply meeting the minimum requirements. Similarly, encouraging institutional ownership by investors who are active in corporate governance may be more effective than passive investors.

For regulators, the study highlights the necessity of enforcing stricter oversight of earnings management, particularly in firms with inadequate corporate governance structures. Moreover, it suggests that regulatory bodies should consider enhancing governance standards for instance, by raising the minimum proportion of independent commissioners or tightening the qualifications required for audit committee members.

5. Conclusion

This study looks at how corporate governance practices affect financial performance in Indonesian manufacturing companies from 2021 to 2024, using earnings management as an intervening variable. The results imply that not every corporate governance tool can effectively curtail profits management techniques. Specifically, the proportion of independent commissioners and institutional ownership have a greater impact on earnings management than audit committee size and management ownership. Furthermore, corporate governance procedures don't necessarily result in better financial success. The percentage of independent commissioners and institutional ownership have a considerable impact on financial performance, whereas audit committee size and managerial ownership do not. Financial performance is significantly impacted negatively by earnings management, suggesting that these techniques could be harmful in the long run. Furthermore, the relationship between financial performance and institutional ownership and independent commissioners is somewhat mediated by earnings management. This demonstrates that by lowering earnings management techniques, both processes can directly and indirectly enhance financial performance.

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