

Research Paper

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE DISCLOSURE IMPACTS ON EARNINGS MANAGEMENT IN INDONESIA

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ABSTRACT

Purpose - This study aims to analyze the impact of Environmental, Social, and Governance (ESG) disclosure on earnings management practices among companies listed on the Indonesia Stock Exchange (IDX). It explores how ESG transparency influences corporate financial reporting behavior.

Research Method - This study uses data from Thomson Reuters, covering 86 IDX-listed companies that disclosed ESG information during the 2019-2023 period.

Findings - It revealed that ESG disclosure in the environmental and social dimensions is found to reduce earnings management practices, while governance disclosure shows no significant effect. Companies with higher revenue levels are more effective in leveraging ESG disclosure to enhance transparency.

Implication - This study offers a novel contribution by examining the influence of ESG disclosure on earnings management in Indonesia, while also considering company revenue levels as a comparative factor. The findings hold important policy and practical implications, especially for regulators and corporate management, in understanding the broader impact of ESG practices on the integrity of financial reporting.

Keywords: Environmental, Social, and Governance (ESG) disclosure, Earnings Management

JEL code: M41, G34, Q56

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INTRODUCTION

ESG disclosure has become a crucial aspect of corporate transparency and sustainability (Pathak & Gupta, 2022). Companies increasingly face pressure from investors and other stakeholders to disclose their ESG risks, practices, and impacts (Mohammad & Wasiuzzaman, 2021) in order to validate their objectives and provide meaningful information to both internal and external stakeholders, sustainability reports must include financial, economic, and environmental data. The significance of ESG disclosure cannot be understated, as regulators around the world have mandated ESG reporting and related disclosures (Pathak & Gupta, 2022).

The effectiveness of ESG initiatives is a critical factor considered in companies' strategic decision-making processes. In line with this, companies have a responsibility to align their activities and operations with the prevailing goals and values of society an idea commonly referred to as Corporate Social Responsibility (CSR) (Yuan et al., 2022). CSR is built on three foundational pillars: environmental, social, and governance dimensions (Garel et al., 2022). These pillars not only serve as indicators of a company's CSR performance but also function as a framework for analyzing non-financial practices implemented by organizations (Pulino et al., 2022).

Globally, companies are shifting focus beyond profit maximization by engaging in social, environmental, and governance issues, reflecting growing attention to CSR and Sustainable Development (SD) (Pulino et al., 2022). Poor CSR performance can negatively affect investor perceptions of earnings disclosures, thereby impacting company valuation. Earnings management involves efforts to manipulate financial reports (Yopie & Robin, 2023).

Stakeholder-oriented strategies may create opportunities for self-interested insiders to exploit corporate resources through collusion with non-shareholder stakeholders, such as employees, to engage in opportunistic earnings manipulation (Ni, 2020). By considering ESG disclosure as consisting of three distinct dimensions, ESG, as recently proposed by (Gerged et al., 2023), this study aims to explore the relationship between ESG disclosure and earnings management.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency Theory

The agency theory introduced by (Jensen & Meckling, 1976) is a foundational concept in organizational and economic studies, examining the interaction between principals (owners) and agents (managers). Agency theory provides a comprehensive framework for understanding how information asymmetry between managers and stakeholders can lead to earnings manipulation. Managers may exploit this imbalance to pursue personal gain through financial statement manipulation (Ghorbani & Salehi, 2020). In Indonesia, such practices are common among publicly listed companies, influenced by factors such as managerial competence, corporate governance structures, and the implementation of International Financial Reporting Standards (IFRS) (Hakim et al., 2022).

Recent studies have highlighted the importance of ESG performance in curbing earnings management strategies. ESG disclosure has shown positive effects on a company's economic, environmental, and social performance (Alsayegh et al., 2020). Research by (Pathak & Gupta, 2022) indicates that firms with strong ESG strategies are less likely to engage in earnings manipulation. This relationship is particularly relevant in the Indonesian context, where ESG principles may serve as a deterrent against the pressures that often lead to profit manipulation. ESG practices can assist management in mitigating agency conflicts and enhancing stakeholder

relationships. For example, (Saleh et al., 2023) found that ESG disclosure reduces excess cash holdings, thereby decreasing stakeholder conflicts and increasing firm value.

However, ESG activities can also be strategically used to obscure earnings management. Companies may engage in ESG initiatives to divert attention from manipulative financial reporting, highlighting ESG's dual role in both enhancing and potentially concealing corporate governance practices (Almubarak et al., 2023).

Hypothesis Development

The Effect of Environmental Disclosure on Earnings Management

Environmental disclosure is associated with higher earnings quality, which indirectly improves the readability and credibility of management discussion and analysis reports (Yan, 2024). This implies that transparent environmental reporting can enhance the overall quality of financial reporting. Environmental disclosure serves as a tool to reduce agency costs by providing greater transparency and aligning managerial and shareholder interests with the broader expectations of stakeholders (Fan et al., 2024). Effective environmental reporting can also improve company performance and investor trust, thereby supporting sustainable business practices (Zheng, 2023).

A study by (Almubarak et al., 2023) on Saudi Arabian companies found that ESG disclosure had a positive and substantial impact on earnings management, particularly among financially distressed firms. This suggests that companies may use ESG reports to conceal deceptive financial activities. In contrast, (Ardhaoui et al., 2024) found that higher levels of environmental disclosure were associated with improved earnings quality. This implies that companies with more comprehensive environmental disclosure tend to report more persistent and reliable earnings, reflecting lower levels of earnings management.

The relationship between environmental disclosure and earnings management is complex and context-dependent. Some studies found no significant relationship (Sun et al., 2024) or mixed results (Parvin et al., 2020), while others reported a positive relationship, indicating that environmental disclosure can be opportunistically used to obscure earnings manipulation (Festus et al., 2023).

H₁: Environmental disclosure has a positive and significant effect on earnings management.

The Effect of Social Disclosure on Earnings Management

Social disclosure involves companies reporting on their social activities and impacts, including employee welfare, community engagement, and broader social responsibilities. The extent of social disclosure is influenced by factors such as company size, industry, and financial performance (Czaja-Cieszyńska & Kordela, 2023). Social disclosure can help mitigate principal-agent problems by increasing transparency and reducing information asymmetry between shareholders and management, thereby better aligning their interests (Arif et al., 2024). Enhanced transparency through social reporting may deter managerial opportunism, such as earnings management.

The relationship between social disclosure and earnings management is shaped by various factors, including company size, visibility, and financial distress. Larger and more visible firms are more likely to use CSR disclosure to manage earnings (Li et al., 2023). Furthermore, companies facing financial difficulties may increase ESG disclosures to obscure earnings manipulation (Almubarak et al., 2023).

Social disclosure can serve as a governance mechanism, pressuring management to adhere to higher ethical standards and reducing the likelihood of earnings management. According to agency theory, managers acting in their own self-interest may engage in earnings manipulation to achieve personal goals. By being transparent about their social responsibilities

and impacts, companies can gain legitimacy among stakeholders and demonstrate their commitment to ethical business practices (Itan et al., 2023).

H₂: Social disclosure has a positive and significant effect on earnings management.

The Effect of Governance Disclosure on Earnings Management

High-quality governance disclosure is associated with reduced earnings management practices, as transparent and comprehensive disclosure provides stakeholders with greater opportunities to monitor and deter managers from engaging in manipulative accounting practices (Yeh et al., 2014). A study by (Putri, 2024) on manufacturing firms in Indonesia found that good corporate governance and high disclosure quality significantly reduced earnings manipulation.

Effective corporate governance can play a critical role in limiting earnings management. Due to information asymmetry and divergent interests, agency theory highlights internal conflicts between management and shareholders. By enhancing transparency and aligning managerial and shareholder interests, governance disclosure mechanisms are essential for mitigating these conflicts (Tahir et al., 2023).

Further studies show that active governance by minority shareholders in state-owned enterprises in China can reduce earnings management costs, enhance disclosure transparency, and limit knowledge hoarding by top management (Guo et al., 2023).

H₃: Governance disclosure has a positive and significant effect on earnings management.

The Effect of Independent ESG Disclosure on Earnings Management

ESG disclosure can reduce earnings management practices. Companies with higher ESG scores tend to exhibit lower levels of income manipulation, as ESG performance enhances transparency and reduces information asymmetry between managers and stakeholders (Menla Ali et al., 2024). Specifically, higher-quality ESG reporting is associated with a decrease in opportunistic earnings management behavior, indicating that firms with strong ESG practices are less likely to engage in manipulative financial reporting (Pathak & Gupta, 2022).

However, high ESG scores may also lead to increased real earnings management, revealing the potential for greenwashing, where companies use ESG disclosure to portray a favorable image while simultaneously engaging in income manipulation (Mohapatra et al., 2025). In contrast, other studies have shown that firms with stronger ESG performance are less likely to engage in earnings manipulation through abnormal loan loss provisions (Kolsi et al., 2022).

Research has demonstrated that ESG disclosure plays a vital role in improving transparency and reducing earnings management, which is often driven by agency conflicts (Yuan et al., 2022). Moreover, ESG disclosure is associated with higher earnings quality, as it reduces managerial manipulation and unethical reporting behavior (Ferdous et al., 2025).

However, the impact of ESG disclosure on earnings management is not consistent and may vary based on a firm's revenue level. High-revenue firms are more effective in using ESG disclosure to reduce earnings management due to better governance structures and stricter oversight. In contrast, low-revenue firms may still engage in earnings management despite disclosing ESG commitments (Mao et al., 2024). The use of ESG component to suppress earnings manipulation, particularly in firms with weak governance mechanisms, supports the agency theory notion that managers may exploit ESG disclosure for self-serving purposes and to conceal earnings manipulation (Dissanayake et al., 2023). Therefore, revenue level serves as a moderating factor in the relationship between ESG disclosure and earnings management, indicating that different revenue levels reflect different agency conflicts across firms of varying sizes.

H4: ESG disclosure has a positive and significant effect on earnings management.

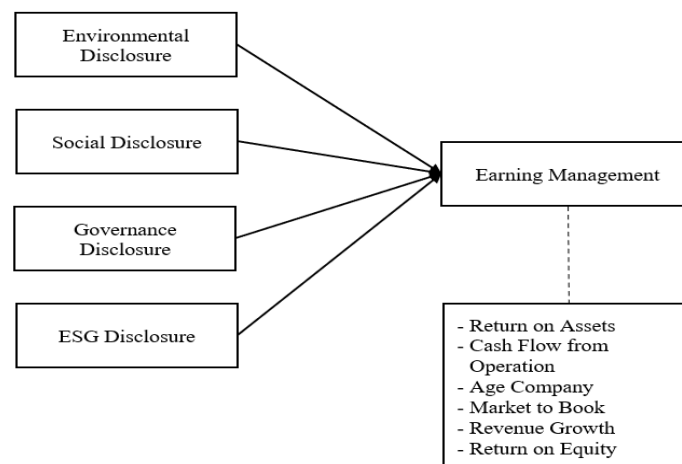


Figure 1. *Research Model*

RESEARCH METHODOLOGY

This study focuses on companies listed on the Indonesia Stock Exchange (IDX) that consistently report ESG information. The data used in this research is sourced from Thomson Reuters, covering the period from 2019 to 2023, with 86 companies. This sample selection ensures that the analysis is based on consistent and relevant data, providing a deeper understanding of the impact of ESG practices during the specified timeframe. A review was also performed to examine, analyze, and evaluate relevant books, journals, articles, and studies related to ESG. For data analysis, this study will apply panel regression using STATA.

Independent Variables

ESG disclosure refers to a company's practice of reporting its environmental, social, and governance activities and performance. Such disclosure is critical for enhancing corporate transparency and accountability, which in turn can improve governance and attract sustainable investment (Kartal et al., 2024). It represents a business's commitment to promoting social welfare and delivering fair, long-term benefits to all stakeholders (Mohammad & Wasiuzzaman, 2021). ESG disclosure encompasses a range of factors essential for sustainable business practices and affects corporate performance, stakeholder engagement, and decision-making processes. Measuring ESG disclosure involves quantifying a company's environmental, social, and governance (ESG) performance and reporting practices through Global Reporting Initiative (GRI).

Dependent Variable

Earnings management is used as the dependent variable in this study. The Modified Jones Model is employed, based on the premise that discretionary accruals are strongly correlated with a firm's current performance. This version addresses the limitations of the original Jones Model, particularly when applied to firms with exceptionally strong financial performance (Borralho et al., 2022; Dechow et al., 1995).

Calculate total accruals (TAC) by subtracting cash flow from operations in year (t) from net income in year (t) using the following formula:

$$TAC = NI_{it} - CFO_{it}$$

Subsequently, the Ordinary Least Squares (OLS) method is employed to calculate the total accruals (TA):

$$\frac{TA_{it}}{A_{it-1}} = \beta_1 + \left(\frac{1}{A_{it-1}}\right) + \beta_2 + \left(\frac{\Delta Rev_{it}}{A_{it-1}}\right) + \beta_3 \left(\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon$$

The calculation of nondiscretionary accruals (NDA) can be performed using the regression coefficients derived from the equation mentioned above:

$$NDA_{it} = \beta_1 + \left(\frac{1}{A_{it-1}}\right) + \beta_2 + \left(\frac{\Delta Rev_{it}}{A_{it-1}} - \frac{\Delta Rec_{it}}{A_{it-1}}\right) + \beta_3 \left(\frac{PPE_{it}}{A_{it-1}}\right)$$

Finally, the following formula was employed to calculate discretionary accruals (DA), which serve as a measure of earnings management:

$$DA_{it} = \frac{TA_{it}}{A_{it-1}} - NDA_{it}$$

- DA_{it} = Discretionary Accruals of company i in year t
- NDA_{it} = Nondiscretionary Accruals of company i in year t
- TA_{it} = Total Accruals of company i in year t
- NI_{it} = Net Income of company i in year t
- CFO_{it} = Cash Flow from Operating Activities of company i in year t
- A_{it-1} = Total Assets of company i in year t-1
- ΔRev_{it} = Revenue of company i in year t minus the revenue of company i in year t-1
- PPE_{it} = Property, Plant, and Equipment of company i in year t
- ΔRec_{it} = Accounts Receivable of company i in year t minus the accounts receivable of company i in year t-1.
- ε = Error

Control Variables

We selected Return on Assets (ROA), Cash Flow from Operations (CFO), Firm Age (AC), Market-to-Book Ratio (MtoB), Revenue Growth (RG), Return on Equity (ROE), and Sector Industry (SI) classification as control variables. ROA is calculated by dividing net income by total assets, while CFO is commonly measured as the ratio of cash flows from operations to total assets at the beginning of the year. Age Company (AC) is measured by calculating the difference between the year the company began operations and the sample year.

The M/B ratio serves as a metric for market participants to anticipate future earnings management. A high M/B ratio may warrant further scrutiny due to the possibility of earnings manipulation aimed at meeting market expectations (Donnelly, 2014). Revenue Growth (RG) is measured by calculating the percentage change in revenue from one period to the next, indicating how well a company is growing its sales.

Return on Equity (ROE) is calculated by dividing net income after tax by total equity. Sector Industry (SI) classification based on the IDX Industrial Classification (IDX-IC) is used to categorize listed companies by industry sector (Elfiswandi et al., 2021). This classification aids in market analysis, investment decision-making, and portfolio diversification.

RESULTS AND DISCUSSION

Descriptive Statistics

Descriptive Statistics shows that earnings Management has an average value of 0.066, with a wide range, indicating considerable variation in earnings management practices across

companies. Environmental disclosure has an average score of 37.427, with large variability between the minimum and maximum values, reflecting differing levels of commitment to environmental responsibility across sectors. Social Disclosure tends to be higher, with an average of 53.038, suggesting a stronger emphasis on social responsibility.

The Market-to-Book Ratio averages 2.873, indicating that some companies are valued by the market significantly above their book value. Revenue Growth shows moderate growth with an average of 0.096, although some firms experienced negative growth. Overall, the descriptive statistics reveal substantial variation across companies in terms of earnings management, ESG disclosure, and financial metrics. This variability provides a strong foundation for further analysis related to corporate transparency and sustainability.

Table 1. Descriptive Statistical

	Mean	Median	Minimum	Maximum
EM	0.066	0.046	-0.216	0.426
ENVIR	37.427	34.124	0.000	83.097
SOCIAL	53.038	52.727	8.871	94.536
GOVERN	49.955	49.098	8.455	90.381
ESG	48.735	46.374	13.583	85.634
REV	30.402	30.455	25.792	33.084
ROA	0.062	0.041	-0.193	0.408
CFO	0.100	0.083	-0.163	0.562
AC	41.538	39.000	9.000	125.000
MTOB	2.873	1.307	0.157	44.857
RG	0.096	0.065	-0.480	1.266
ROE	0.157	0.104	-0.698	2.182
SI	5.406	5.000	1.000	10.000

Source: (Data Processed, 2025)

Pearson Correlation

The results of the Pearson correlation test are presented in Table 2 as the second univariate analysis to explore the relationships among the key variables. The findings reveal several significant correlations. For instance, ESG disclosure is positively and significantly correlated with Environmental ($r = 0.800$, $p < 0.01$), Social ($r = 0.906$, $p < 0.01$), and Governance ($r = 0.815$, $p < 0.01$) dimensions. Additionally, ESG shows a positive correlation with ROA ($r = 0.271$, $p < 0.01$) and CFO ($r = 0.156$, $p < 0.01$), indicating a potential link between sustainability practices and financial performance.

A significant negative relationship was also found between SI (Social Investment) and ESG ($r = -0.236$, $p < 0.01$), suggesting a potential trade-off in resource allocation. Other noteworthy findings include positive correlations between ESG and AC (Audit Committee) ($r = 0.338$, $p < 0.01$), and between ESG and ROE ($r = 0.279$, $p < 0.01$).

Overall, the results suggest that while ESG practices are positively aligned with financial and governance metrics, there are certain trade-offs in specific areas such as social investment. These findings underscore the need for further multivariate analysis to explore these relationships more deeply and to control for potential confounding factors.

Table 2. Pearson Correlation

	EM	Envir	Social	Govern	ESG	ROA	CFO	AC	MtoB	RG	ROE	SI
EM	1.000											
Envir	0.038 (0.480)	1.000										
Social	-0.023 (0.678)	0.686***	1.000									
Govern	-0.029 (0.595)	0.499***	0.599***	1.000								
ESG	-0.011 (0.840)	0.800***	0.906***	0.815***	1.000							
ROA	0.233*** (0.000)	0.358***	0.201***	0.212***	0.271***	1.000						
CFO	-0.130** (0.016)	0.220***	0.125**	0.121**	0.156***	0.626***	1.000					
AC	0.005 (0.921)	0.344***	0.273***	0.262***	0.338***	0.019	-0.157***	1.000				
MtoB	0.012 (0.830)	0.198***	0.111**	0.094*	0.144***	0.407***	0.396***	0.102*	1.000			
RG	-0.006 (0.906)	0.057	0.024	0.016	0.024	0.199***	0.274***	-0.123**	-0.022	1.000		
ROE	0.112** (0.039)	0.295***	0.222***	0.236***	0.279***	0.735***	0.451***	0.067	0.585***	0.074	1.000	
SI	-0.12 (0.000)	-0.44	-0.18	-0.12	-0.23	-0.41	-0.22	-0.08	-0.14	-0.04	-0.26	1.000

EM	Envir	Social	Govern	ESG	ROA	CFO	AC	MtoB	RG	ROE	SI
8**	5***	6***	3**	6***	0***	1***	5	2***	1	2***	
(0.018)	(0.000)	(0.000)	(0.023)	(0.000)	(0.000)	(0.000)	(0.18)	(0.009)	(0.455)	(0.000)	

Source: (Data Processed, 2025)

Regression Results

The regression findings reveal how ESG disclosure influences corporate earnings management decisions. Agency theory examines the interaction between shareholders (principals) and company management (agents), emphasizing how information transparency can reduce conflicts of interest.

The Environmental Disclosure variable (ENVIR) demonstrates a significant negative relationship with earnings management (coefficient = -0.001, $t = -2.97$). This indicates that higher levels of environmental disclosure are associated with lower levels of earnings management (Alodat et al., 2024; Yan, 2024). This supports H2, which posits that environmental disclosure has a significant impact on earnings management. The relationship is significant at the 1% level ($p < 0.01$), suggesting that environmental transparency can reduce a firm's inclination to engage in earnings manipulation.

Furthermore, Social Disclosure (SOCIAL) also shows a significant negative correlation with earnings management (coefficient = -0.000, $t = -2.15$). This finding implies that companies offering extensive social information including employee policies, CSR initiatives, and community donations tend to engage less in earnings management (Kolsi et al., 2022). This supports H3, which tests the effect of social transparency on earnings management. A high-trust social environment reduces earnings management by encouraging more ethical managerial behavior, thereby lowering the likelihood of manipulative accounting practices (Chen et al., 2021).

However, Governance Disclosure (GOVERN) does not show a significant relationship with earnings management (coefficient = -0.000, $t = -0.15$), meaning that information related to corporate governance does not directly influence managerial decisions related to earnings management. This finding does not support H4, which hypothesizes that governance disclosure impacts earnings management. According to agency theory, while governance disclosure may enhance oversight, if internal control mechanisms are ineffective, disclosure alone may not be sufficient to deter earnings management practices.

Overall, ESG disclosure exhibits a significant negative relationship with earnings management (coefficient = -0.000, $t = -1.66$), although the effect is weaker compared to the individual dimensions. This supports H1, which states that overall ESG disclosure collectively has a negative association with earnings management, with the relationship being significant at the 10% level ($p < 0.1$).

Multiple studies have demonstrated a significant negative correlation between ESG performance and earnings management. Research by (Sun et al., 2024; Wu et al., 2024) indicates that firms with higher ESG ratings are less likely to engage in earnings management. This suggests that stronger ESG performance can enhance corporate governance and transparency, thereby reducing manipulative financial practices. From the perspective of agency theory, ESG disclosure functions as a control mechanism that reduces agency conflicts between managers and shareholders. Managers who engage in more transparent ESG disclosure are less able to participate in earnings manipulation (Mao et al., 2024).

Table 3. Regression Result

	(1) EM	(2) EM	(3) EM	(4) EM
ENVIR	-0.001*** (-2.97)			
SOCIAL		-0.000** (-2.15)		
GOVERN			-0.000 (-0.15)	
ESG				-0.000* (-1.66)
ROA	0.853*** (8.10)	0.844*** (7.99)	0.850*** (7.98)	0.850*** (8.07)
CFO	-0.626*** (-9.19)	-0.621*** (-8.98)	-0.626*** (-8.84)	-0.621*** (-8.96)
AC	0.000 (0.78)	0.000 (0.13)	-0.000 (-0.42)	0.000 (0.11)
MTOB	-0.001 (-0.82)	-0.001 (-1.03)	-0.001 (-1.08)	-0.001 (-1.04)
RG	0.067*** (2.78)	0.066*** (2.73)	0.067*** (2.77)	0.065*** (2.72)
ROE	-0.008 (-0.37)	-0.008 (-0.37)	-0.012 (-0.50)	-0.009 (-0.37)
_cons	0.151*** (5.78)	0.149*** (5.14)	0.120*** (4.52)	0.144*** (4.94)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
r2	0.594	0.588	0.582	0.586
r2_a	0.568	0.562	0.556	0.560
N	340	340	340	340

Source: (Data Processed, 2025)

CONCLUSION AND SUGGESTION

This study aimed to analyze the influence of Environmental, Social, and Governance (ESG) disclosure on earnings management practices in Indonesia, focusing on 86 companies listed on the Indonesia Stock Exchange (IDX) during the 2019–2023 period. Based on regression analysis, the key findings indicate that environmental and social disclosures significantly reduce earnings management. This suggests that greater transparency in these two dimensions helps mitigate information asymmetry between managers and shareholders, thereby reducing the likelihood of financial statement manipulation. Although governance disclosure did not show a significant effect in this study, the finding still aligns with agency theory, which posits that increased transparency can reduce conflicts of interest between managers (agents) and shareholders (principals).

The study also finds that firms with higher revenues tend to be more effective in leveraging ESG disclosure to reduce earnings manipulation. This implies that larger companies, with stronger governance structures and tighter oversight mechanisms, are better positioned to utilize ESG disclosure to enhance transparency and discourage earnings manipulation.

Overall, this study provides compelling evidence that ESG disclosure plays a critical role in reducing earnings management, particularly in large firms with high sales. These findings support agency theory, which asserts that ESG transparency helps reduce conflicts of interest

between managers and shareholders, ultimately lowering the risk of earnings manipulation and enhancing firm value.

It is therefore recommended that companies especially those with high sales increase transparency in their ESG disclosures to foster greater investor trust and discourage unethical earnings management practices. This research enriches the existing literature on the impact of ESG disclosure on earnings management, particularly in emerging markets like Indonesia, and offers practical implications for corporate regulation and policy. It also opens opportunities for future research on the sector-specific effects of ESG disclosure.

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