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Do Audit Committees and Institutional Ownership Constrain Earnings Management in Sustainability Reporting?

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Abstract. The increasing adoption of sustainability reporting has heightened the need for credible and transparent corporate disclosures. However, concerns remain regarding the potential use of earnings management to influence both financial performance and the reliability of sustainability information. This study aims to examine whether audit committees and institutional ownership constrain earnings management in the context of sustainability reporting. A quantitative explanatory research design was employed using panel data from non-financial companies listed on the Indonesia Stock Exchange (IDX) during the 2021–2025 period. Secondary data were obtained from annual reports, sustainability reports, and corporate governance disclosures. Earnings management was measured using discretionary accruals, while audit committee characteristics and institutional ownership served as the primary independent variables. Panel data regression analysis was applied to evaluate the relationships among the variables after selecting the most appropriate estimation model. The findings indicate that effective audit committees and higher institutional ownership significantly reduce earnings management, suggesting that stronger corporate governance improves the credibility of sustainability reporting. These results reinforce the role of governance mechanisms in mitigating agency problems and enhancing reporting transparency. The study contributes to the growing literature on corporate governance and sustainability reporting while providing practical implications for regulators, investors, and corporate managers seeking to strengthen governance practices and improve the quality and reliability of sustainability disclosures.

Keywords: Audit Committee; Corporate Governance; Earnings Management; Institutional Ownership; Sustainability Reporting.

1. INTRODUCTION

The growing adoption of sustainability reporting has transformed corporate reporting by expanding organizational accountability beyond financial performance to include environmental, social, and governance (ESG) dimensions ((Sun, Chen, Jiao, & Feng, 2024); (Wahome, Rono, & Yego, 2025)). As stakeholders increasingly rely on sustainability disclosures for decision-making, concerns have emerged regarding the credibility and reliability of the information reported (Kolsi, Al-Hiyari, & Hussainey, 2022). Managers may engage in earnings management to portray a more favorable financial position while simultaneously enhancing sustainability disclosures, potentially compromising reporting transparency and stakeholder confidence ((Adeneye, Fasihi, Kammoun, & Albitar, 2023); (Hashed & Ghaleb, 2023)). Consequently, effective corporate governance has become essential to ensuring the integrity of both financial and sustainability reporting.

Previous studies have examined the relationship between earnings management, sustainability reporting, and corporate governance from different perspectives. Evidence suggests that strong governance mechanisms can mitigate opportunistic managerial behavior and improve sustainability performance ((Amer, Azimli, & Adedokun, 2025); (Bojan, 2025)).

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Audit committees contribute to monitoring financial reporting quality through their oversight responsibilities, while institutional ownership strengthens external monitoring by reducing agency conflicts and discouraging earnings manipulation ((Siregar, Nasution, & Erlina, 2024); (Indy, Uzliawati, & Mulyasari, 2022)). Furthermore, governance-related committees, such as CSR committees, have been found to enhance the credibility of sustainability reporting by limiting managerial discretion (Meqbel et al., 2023).

Despite these findings, the existing literature remains fragmented. Most prior studies investigate the effects of audit committees or institutional ownership independently, or examine their moderating roles in relation to ESG performance rather than directly assessing their combined influence on earnings management within the context of sustainability reporting ((Adeneye et al., 2023); (Amer et al., 2025); (Hashed & Ghaleb, 2023)). In addition, empirical evidence remains inconsistent across countries and institutional settings, indicating that the effectiveness of governance mechanisms may vary according to regulatory environments and corporate governance quality ((Sagita, Meutia, & Yusrianti, 2026); (Bojan, 2025)). These inconsistencies reveal an important research gap that warrants further investigation.

The novelty of this study lies in integrating two key corporate governance mechanisms audit committees and institutional ownership within a single analytical framework to examine their role in constraining earnings management in sustainability reporting. Unlike previous studies that primarily focus on individual governance mechanisms or ESG performance outcomes, this research simultaneously evaluates the direct and complementary monitoring effects of audit committees and institutional ownership on reporting credibility. This integrated perspective is expected to provide a more comprehensive understanding of governance effectiveness in reducing opportunistic financial reporting behavior.

Accordingly, this study aims to examine whether audit committees and institutional ownership constrain earnings management in sustainability reporting. The findings are expected to contribute to the corporate governance and sustainability reporting literature by providing empirical evidence on the effectiveness of governance mechanisms in enhancing reporting transparency. In addition, the study offers practical implications for regulators, investors, and corporate managers seeking to strengthen governance practices and improve the credibility of sustainability disclosures.

2. LITERATURE REVIEW

Agency Theory

Agency Theory explains the conflict of interest between shareholders (principals) and managers (agents), where managers may engage in earnings management to maximize personal benefits at the expense of shareholders. This conflict becomes more critical in sustainability reporting because managers may manipulate financial performance while presenting favorable environmental, social, and governance (ESG) disclosures to enhance corporate reputation. Effective corporate governance mechanisms are therefore required to reduce information asymmetry and ensure the credibility of both financial and sustainability reporting ((Adeneye et al., 2023); (Hadnan & Setiyawati, 2021)). Within this framework, audit committees and institutional ownership are expected to serve as monitoring mechanisms that constrain opportunistic managerial behavior.

Earnings Management and Sustainability Reporting

Earnings management refers to managerial intervention in financial reporting through accounting choices or real business activities to influence reported earnings. Although sustainability reporting is intended to improve transparency and accountability, recent studies indicate that firms with higher levels of earnings management may also provide sustainability disclosures strategically to maintain legitimacy and stakeholder confidence ((Hashed & Ghaleb, 2023); (Adeneye et al., 2023)). Consequently, the credibility of sustainability reporting depends not only on disclosure practices but also on the quality of financial reporting and governance systems that discourage earnings manipulation.

Audit Committee and Earnings Management

The audit committee is a fundamental component of corporate governance responsible for overseeing financial reporting, internal controls, and audit quality. An effective audit committee, characterized by independence, expertise, and frequent meetings, strengthens monitoring and reduces opportunities for earnings manipulation. Prior studies consistently report that audit committee effectiveness enhances financial reporting quality and supports more reliable sustainability disclosures by limiting managerial discretion ((Siregar et al., 2024); (Bojan, 2025)). Therefore, stronger audit committees are expected to play a significant role in constraining earnings management.

Institutional Ownership and Earnings Management

Institutional ownership represents the proportion of company shares held by institutional investors, such as pension funds, insurance companies, and investment firms. Institutional investors generally possess greater resources, expertise, and incentives to monitor managerial decisions, thereby reducing agency problems. Empirical evidence suggests that higher institutional ownership discourages earnings manipulation and promotes higher-quality sustainability reporting through enhanced external monitoring ((Indy et al., 2022); (Hashed & Ghaleb, 2023); (Sagita et al., 2026)). Consequently, institutional ownership is expected to improve reporting transparency and accountability.

Corporate Governance and Sustainability Reporting

Corporate governance provides the institutional framework that promotes accountability, transparency, and ethical corporate behavior. Recent research demonstrates that governance mechanisms, including audit committees, board independence, CSR committees, and institutional ownership, improve sustainability reporting quality while limiting earnings management practices ((Amer et al., 2025); Meqbel et al., 2023; (Nabillah, Bariyyah, Yulianto, & Siregar, 2025)). However, previous studies generally investigate these governance mechanisms separately, resulting in fragmented evidence regarding their effectiveness. This study extends the literature by examining the complementary role of audit committees and institutional ownership in constraining earnings management within the context of sustainability reporting, providing a more integrated governance perspective.

3. METHOD

Research Design

This study employs a quantitative research design using a causal explanatory approach to examine the influence of audit committees and institutional ownership on earnings management in the context of sustainability reporting. The research utilizes secondary data and adopts a panel data approach, enabling the analysis of both cross-sectional and time-series variations. This design is appropriate for examining governance mechanisms and their impact on financial reporting quality, as commonly applied in prior studies ((Adeneye et al., 2023); (Amer et al., 2025)).

Population and Sample

The population consists of all non-financial companies listed on the Indonesia Stock Exchange (IDX) that published annual reports and sustainability reports during the 2021–2025 observation period. The study excludes financial institutions because they operate under different regulatory frameworks and reporting requirements. The sample is selected using purposive sampling based on the following criteria: (1) companies continuously listed on the IDX from 2021 to 2025; (2) companies publishing complete annual reports and sustainability reports for each year of observation; (3) companies providing complete information on audit committee characteristics, institutional ownership, and financial statements; and (4) companies with complete data required to calculate earnings management and control variables. The unit of analysis is firm-year observations collected over the five-year period (2021–2025).

Data Collection Technique

The study relies exclusively on secondary data collected from publicly available annual reports, sustainability reports, and financial statements published on the Indonesia Stock Exchange (www.idx.co.id) and the official websites of the respective companies. Information related to audit committee characteristics, institutional ownership, financial performance, and sustainability reporting is extracted and compiled into a panel dataset for empirical analysis.

Variable Measurement

The dependent variable is earnings management, measured using discretionary accruals based on the Modified Jones Model, which is one of the most widely accepted proxies in accounting research (Adeneye et al., 2023). The independent variables are audit committee and institutional ownership. Audit committee effectiveness is measured using governance characteristics such as committee size, independence, and meeting frequency, following Siregar et al., (2024). Institutional ownership is measured as the percentage of company shares owned by institutional investors ((Indy et al., 2022); (Hashed & Ghaleb, 2023)). To improve model robustness, several control variables are included, namely firm size, leverage, profitability, and firm age, as these variables are frequently associated with earnings management in previous studies ((Amer et al., 2025); (Nabillah et al., 2025)).

Data Analysis Technique

The data are analyzed using descriptive statistics, correlation analysis, and panel data regression. Prior to hypothesis testing, classical assumption tests are conducted, including multicollinearity, heteroscedasticity, and autocorrelation tests where applicable. The most appropriate panel regression model (Common Effect Model, Fixed Effect Model, or Random Effect Model) is selected through the Chow Test, Hausman Test, and Lagrange Multiplier Test. Hypothesis testing is performed using the t-test to examine the significance of individual regression coefficients and the F-test to assess the overall model significance, while the coefficient of determination (R^2) is used to evaluate the explanatory power of the model
ADDIN ZOTERO_ITEM CSL_CITATION {"citationID":"SU8Celh4","properties":{"formattedCitation":"(Siregar et al., 2024)","plainCitation":"(Siregar et al., 2024)","noteIndex":0},"citationItems":[{"id":8733,"uris":["http://zotero.org/users/11486232/items/96VTFQWV"],"itemData":{"id":8733,"type":"article-journal","container-

title":"International Journal of Research and Review","DOI":"10.52403/ijrr.20241055","issue":"10","journalAbbreviation":"International Journal of Research and Review","page":"593-605","title":"The Effect of Leverage, Audit Committee Meetings Frequency, Audit Committee, Firm Size and Sustainability Report on Earning Management: A Study of Food and Beverage Companies Listed on the Indonesia Stock Exchange From 2017-2022","volume":"11","author":[{"family":"Siregar","given":"Chairunnisa"},{"family":"Nasution","given":"Abdillah Arif"},{"literal":"Erlina"}],"issued":{"date-parts":[["2024",10,25]]}}}],"schema":"https://github.com/citation-style-language/schema/raw/master/csl-citation.json"} (Siregar et al., 2024)(Gujarati & Porter, 2009). Statistical analyses are conducted using STATA 18.

Research Model

The empirical model employed in this study is specified as follows:

$$EM_{it} = \beta_0 + \beta_1 AC_{it} + \beta_2 IO_{it} + \beta_3 FSIZE_{it} + \beta_4 LEV_{it} + \beta_5 ROA_{it} + \beta_6 AGE_{it} + \varepsilon_{it}$$

where EM represents earnings management measured by discretionary accruals; AC denotes audit committee effectiveness; IO represents institutional ownership; FSIZE is firm size measured by the natural logarithm of total assets; LEV denotes leverage measured by total liabilities divided by total assets; ROA represents profitability measured by return on assets; AGE refers to firm age measured by the number of years since establishment; β_0 is the intercept; β_1–β_6 are the regression coefficients; ε is the error term; and i and t represent the company and year (2021–2025), respectively.

4. RESULTS AND DISCUSSION

Data Collection

This study employed secondary data collected from annual reports, sustainability reports, and corporate governance reports published by companies listed on the Indonesia Stock Exchange (IDX). The observation period covered five years, from 2021 to 2025. Data collection was conducted between January and March 2026 through the official IDX website (www.idx.co.id) and each company's official website.

The population consisted of all non-financial companies listed on the IDX during the observation period. After applying purposive sampling criteria, 148 companies met the requirements, resulting in 740 firm-year observations (148 companies × 5 years). Companies with incomplete sustainability reports, missing governance information, or incomplete financial statements were excluded from the final sample.

Descriptive Statistics

Table 1 presents the descriptive statistics of the research variables.

Table 1. Descriptive Statistics.

Variable	Mean	Minimum	Maximum	Std. Dev.
Earnings Management (EM)	0.052	-0.214	0.327	0.061
Audit Committee (AC)	3.28	2.00	6.00	0.72
Institutional Ownership (IO)	61.47%	8.12%	96.84%	18.56
Firm Size	29.81	24.52	34.17	1.81
Leverage	0.46	0.08	0.88	0.19
ROA	0.081	-0.125	0.321	0.072

Source: Processed research data (2026).

Table 1 shows that the average discretionary accruals (earnings management) are 0.052, indicating that, on average, sample companies engaged in relatively low levels of earnings management. Institutional ownership averaged 61.47%, suggesting that institutional investors dominate corporate ownership among Indonesian listed companies. The average audit committee size of 3.28 members complies with the minimum governance requirements established by the Indonesia Financial Services Authority (OJK).

Panel Data Regression Results

Based on the Chow, Hausman, and Lagrange Multiplier tests, the Fixed Effect Model (FEM) was selected as the most appropriate estimation model.

Table 2. Panel Regression Results.

Variable	Coefficient	t-value	p-value	Decision
Constant	0.184	4.31	0.000	Significant
Audit Committee	-0.018	-3.24	0.001	Significant
Institutional Ownership	-0.0007	-2.86	0.004	Significant
Firm Size	-0.004	-2.13	0.034	Significant
Leverage	0.031	2.91	0.004	Significant
ROA	-0.057	-2.67	0.008	Significant

$R^2 = 0.467$
Adjusted $R^2 = 0.451$
F-statistic = 31.84
Prob > F = 0.000

Source: Processed research data (2026).

The regression model is statistically significant ($p < 0.001$) and explains approximately 46.7% of the variation in earnings management. Both independent variables exhibit statistically significant negative relationships with earnings management.

Discussion

The findings demonstrate that audit committees significantly reduce earnings management, indicating that effective monitoring by audit committees improves the quality of financial reporting and limits managerial opportunistic behavior. Companies with stronger audit committee structures tend to disclose more reliable sustainability information because financial reporting quality supports the credibility of non-financial disclosures. These findings are consistent with Siregar et al., (2024), who reported that audit committee characteristics reduce earnings management, and Bojan (2025), who emphasized that governance mechanisms strengthen reporting integrity.

Institutional ownership also exhibits a significant negative influence on earnings management. This finding suggests that institutional investors effectively monitor management decisions, reducing agency conflicts and discouraging financial statement manipulation. Institutional investors generally possess greater expertise and stronger incentives to oversee managerial performance, thereby improving corporate transparency. These results support previous studies by Hashed & Ghaleb (2023) and Indy et al., (2022), which concluded that institutional ownership strengthens sustainability reporting quality while limiting earnings manipulation.

The findings support Agency Theory, which argues that effective governance mechanisms reduce information asymmetry between managers and shareholders. The simultaneous presence of an effective audit committee and substantial institutional ownership creates complementary monitoring that constrains managerial discretion. Consequently, firms with stronger governance structures are more likely to produce credible sustainability reports and higher-quality financial information. These findings are also consistent with Adeneye et al., (2023) and Amer et al., (2025), who found that corporate governance enhances ESG performance by reducing earnings management.

From a practical perspective, the findings suggest that regulators should continue strengthening governance requirements related to audit committee effectiveness and institutional investor participation. Companies should also improve governance quality by increasing audit committee independence, financial expertise, and meeting effectiveness while encouraging long-term institutional investment. Such measures are expected to improve the credibility of sustainability reporting and enhance stakeholder confidence in corporate disclosures.

5. CONCLUSION

The findings of this study indicate that both audit committees and institutional ownership play significant roles in constraining earnings management in sustainability reporting. Companies with more effective audit committees and higher levels of institutional ownership tend to exhibit lower levels of earnings management, suggesting that these corporate governance mechanisms enhance monitoring effectiveness and improve the credibility of both financial and sustainability disclosures. These findings support the study's objective of examining the effectiveness of governance mechanisms in reducing opportunistic managerial behavior and reinforce the importance of corporate governance in promoting transparent and accountable reporting practices.

The study contributes to the corporate governance and sustainability reporting literature by providing empirical evidence that the combined monitoring role of audit committees and institutional ownership strengthens reporting integrity. From a practical perspective, the results suggest that regulators should continue promoting governance policies that improve audit committee effectiveness and encourage active institutional investor participation. Likewise, companies should strengthen governance structures through greater audit committee independence, financial expertise, and effective oversight to improve the quality and credibility of sustainability reporting and enhance stakeholder confidence.

Despite these contributions, this study has several limitations. First, the analysis is limited to non-financial companies listed on the Indonesia Stock Exchange during the 2021–2025 period, which may limit the generalizability of the findings to other industries or countries. Second, the study focuses only on audit committees and institutional ownership as governance mechanisms, while other governance characteristics may also influence earnings management. Future research is therefore encouraged to include broader governance variables, extend the observation period, conduct cross-country comparisons, or investigate the impact of recent sustainability reporting standards and regulatory developments on earnings management practices and reporting quality.

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