The Effect of Free Cash Flow, Leverage, Financial Distress, and Ownership Structure on Earnings Management in Consumer Non-Cyclical Companies (2022-2024)

Original Article

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Abstract

Earnings management involves managers adjusting financial reports to achieve specific objectives, which can affect the transparency of information received by stakeholders. Earnings management is conditioned by a constellation of internal firm-level attributes, including free cash flow availability, capital structure intensity, financial vulnerability, and ownership configuration, all of which may recalibrate managerial incentives to intervene in the financial reporting process. Focused on consumer non-cyclicals companies on the IDX, this study tests hypotheses concerning the drivers of earnings management, specifically free cash flow, leverage, financial distress, and ownership structure. The quantitative analysis, using secondary data (2022-2024) and SPSS 27 on a purposively sampled set of 89 observations, confirms the significant roles of free cash flow and leverage. However, it finds no empirical support for the effects of financial distress or managerial ownership. The findings highlight key governance and analytical implications. The significant roles of free cash flow and leverage call for stronger oversight of discretionary cash and debt to limit reporting opportunism. The insignificant effect of managerial ownership suggests weak alignment of manager, shareholder interests, while financial distress does not appear to drive manipulation. For investors and regulators, the results emphasize prioritizing cash flow and leverage analysis when assessing reporting quality.

Keywords: Earnings Management, Financial Distress, Free Cash Flow, Leverage, Managerial Ownership.

1. Introduction

As the key medium of financial communication, statements of financial position and performance provide vital information to major stakeholders, including investors, creditors, and governing authorities. Transparency and accountability in such reporting are essential, as they form the foundation of stakeholder confidence and materially influence financial and regulatory decision-making (Vickneswaran, 2025). However, in practice, not all companies present financial statements objectively. Certain businesses engage in earnings manipulation, where management takes action to interfere in the creation of financial reports intended for external stakeholders, such as manipulating financial data to carry out earnings management based on certain interests (Wardoyo et al., 2023).

In the consumer non-cyclicals sector, dynamic and competitive market conditions often provide significant pressure on companies within it (Bayuny et al., 2025). For example, one of the companies that faced a decline in profit in 2023 is Asta Agro Lestari Tbk. This company experienced a decrease in net profit from Rp1.73 trillion in 2022 to Rp1.06 trillion in 2023. A

similar decline was also experienced by Delta Djakarta Tbk, whose net profit fell 13.5% from the previous year due to decreased consumer demand. In addition, Dharma Samudera Fishing Indust also experienced a profit decline of 43.47% caused by pressure on selling prices and increased production costs. The decline in profit at these companies becomes an indication of financial performance instability that has the potential to motivate management to act opportunistically (Ghazali et al., 2015), such as earnings manipulation practices, in order to maintain the entity's reputation in the eyes of investors.

Prior research identifies several internal factors that may drive such behavior. First, abundant free cash flow can tempt managers to manipulate earnings to avoid scrutiny over how excess cash is utilized (Kurnia & Mulyati, 2023). Second, high leverage may motivate managers to alter financial reports to comply with debt covenants and maintain creditor trust (Wandari, 2023). Third, a state of financial distress can pressure companies to distort information to avoid the negative consequences of perceived financial failure (Wandi, 2022). Finally, ownership structure, particularly low managerial ownership, might reduce alignment with shareholder interests, potentially increasing opportunistic reporting (Bahri & Arrosyid, 2021). The prevalence of public ownership within a firm often creates an incentive for earnings management aimed at fulfilling market expectations and safeguarding stock price consistency. This dynamic necessitates heightened investor scrutiny regarding the potential for distorted financial reporting. However, empirical findings on the influence of these factors, especially within the specific context of Indonesia's consumer non-cyclicals sector, remain inconsistent and inconclusive. This discrepancy highlights a clear research gap. Furthermore, there is a lack of focused study examining this specific combination of variables including free cash flow, leverage, financial distress, and ownership structure simultaneously in a sector facing unique stability pressures.

Research on leverage and earnings management yields contradictory evidence. From one perspective, higher leverage incentivizes earnings manipulation as managers seek to satisfy covenant requirements, avoid defaults, and uphold creditor relations (Franz et al., 2014; Dyreng et al., 2022). On the other hand, some empirical findings suggest that firms with high leverage are subject to more intensive monitoring by creditors and external parties (Tung, 2021), which can constrain managerial discretion and reduce opportunities for earnings manipulation. These divergent viewpoints suggest that the influence of leverage on earnings management is neither uniform nor universal, but rather contingent upon industry-specific conditions and institutional contexts, thereby warranting further examination within Indonesia's consumer non-cyclicals sector. Therefore, this study is designed to address this gap. This research is motivated by the ongoing uncertainty regarding the impact of internal corporate variables on earnings management within the Indonesian consumer non-cyclicals sector. Its objective is to contribute more definitive empirical evidence by investigating the concurrent effects of free cash flow, leverage, financial distress, and ownership structure on earnings management in firms traded on the Indonesia Stock Exchange.

2. Literature Review

2.1. Agency Theory

As noted by Jensen and Meckling (1976) in Wardoyo et al. (2023), agency theory characterizes the contractual relationship in which management is entrusted by shareholders to operate the entity on their behalf. According to Setiawati et al. (2019), there is potential for differences in interests between management which is the internal party of the entity and shareholders as well as creditors who act as external parties of the company. This information

asymmetry opens opportunities for managers to develop opportunistic behavior that is not aligned with the interests of owners, while trying to maximize personal benefits (Jensen, 1993) in Kouaib and Jarboui (2014). Therefore, accurate and honest presentation of financial statements is needed to reduce the potential for agency conflicts.

2.2. Signal Theory

Grounded in Spence (1973), signal theory is widely applied in the financial and accounting fields to explain how companies communicate information to the market in order to reduce information asymmetry. Financial statements such as profit and loss statements act as a way to communicate the company's situation and future possibilities to outside individuals (Fridson & Alvarez, 2022). Derived from Purwaningsih and Lestari (2021), signal theory conveys that information owners provide relevant data that can be used by information recipients. The theory rests on the assumption of information asymmetry, which generates an imbalance between managerial insiders and external parties in need of corporate data (Karuniawati & Purwatiningsih, 2024). Asymmetric information drives improvements in the quality of financial reports, which is proven to improve information comparability and market response (Ho et al., 2023).

2.3. Earnings Management

Earnings management encompasses measures taken by managers in determining specific accounting policies or carrying out certain activities with the intention of influencing the amount of reported earnings, in order to realize specifically desired certain goals (Scott (2015) in Harisandi and Sufina (2024). Company managers are often seen as manipulating information in financial statements to portray a positive financial image (Wardoyo et al., 2023). Earnings management is related to two types of accruals, namely discretionary accrual and nondiscretionary accrual (Jamadar et al., 2022). A distinction exists between discretionary accruals, which are flexible and determined by management pursuant to certain policies, and nondiscretionary accruals, which constitute the fair recording of accruals in adherence to generally accepted accounting principles and standards (Musofwan & Widyaningsih, 2022).

2.4. Free Cash Flow

Free cash flow reflects the availability of money after meeting all needs for operational capital or investment expenditures from company operational activities, because these funds can be allocated to creditors and shareholders (Kurnia & Mulyati, 2023). High free cash flow without proper supervision or management indicates that management has not been able to utilize cash flow efficiently. The potential fallout from this scenario could cast a shadow over the company's long-term viability, leading to potential clashes between the leadership team and stakeholders (Agustin, 2013 in Ananada & Wahidahwati, 2024). Conditions where free cash flow is high but investment opportunities are inadequate have the potential to encourage managers to engage in earnings management practices, one of which is through increasing recorded profits in financial statements (Putri & NR, 2023). This position is further corroborated by the work of Ihsan and Haryo (2021), also Irawan and Apriweni (2021), which establishes a significant link between free cash flow and earnings management. Therefore, the following hypothesis is derived.

H1: Free cash flow affects earnings management

2.5. Leverage

Leverage becomes an indicator that explains how far a company utilizes debt-based financing in funding its assets. The use of debt can increase profits received by shareholders when company conditions are favorable, but can also worsen losses when situations deteriorate, thus creating a financial leverage effect (Odhiambo et al., 2025). A high leverage level indicates a large proportion of company financing originating from debt, so the company's financial risk also increases (Rahayu & Wahyono, 2019). The higher the leverage level, management tends to be more likely to act opportunistically, such as by practicing earnings management in order to maintain the image of entity performance (Bahri & Arrosyid, 2021). Studies indicate a significant link between leverage and earnings management (Hidayat & Adityaningsih, 2023), specifically a positive effect when measured by DER Yulianto and Aryati (2022), who found evidence that, operationalized as the debt-to-equity ratio (DER), positively influences earnings management. Based on this proposition, the following hypothesis is formulated:

H2: Leverage affects earnings management

2.6. Financial Distress

Financial distress refers to a scenario in which a company encounters monetary challenges and struggles to fulfill its financial responsibilities because of insufficient cash flow, heavy debt load, or ongoing deficits (Riadiani & Wahyudin, 2015). According to Tsaqif and Agustiningsih (2021), financial distress is a condition where deviations and financial pressure occur which can potentially lead to bankruptcy. Financial distress can trigger the emergence of agency theory, because management's inability to manage the company well will create conflicts of interest arising from company asymmetry (Smith, 2010). Managers, in this situation, may present incorrect information regarding the financial state of the company, leading to mistakes in decision-making among stakeholders and exacerbating financial challenges (Ananada & Wahidahwati, 2024). Studies demonstrate that financial distress influences earnings management, showing a positive and significant effect (Afni & Setiany, 2023; Setyaningrum & Nursita, 2024). Accordingly, the hypothesis is formulated as:

H3: Financial distress affects earnings management

2.7. Ownership Structure

Ownership structure reflects the division of tasks between management and company owners. Owners or shareholders as parties who provide funds, while managers as individuals chosen by owners to manage and make decisions in the company with the assumption that these decisions align with the owners' goals (Bahri & Arrosyid, 2021). Ownership structure has a significant role in the management supervision mechanism and can influence the tendency for earnings management practices to occur. Based on the view of Jensen & Meckling (1976), share ownership by managers can align interests between shareholders and managers, thus the risk of conflicts of interest can be reduced. Consistent with this, Tatar and Sujana (2021), suggests that managerial ownership is proven to affect earnings management, where when managerial ownership is increased by managers it tends to be followed by increased earnings management. As per this reasoning, the potential hypothesis to be proposed is:

H4: Managerial ownership affects earnings management

Figure 1 provides a visual representation of the study's conceptual framework. This model hypothesizes that earnings management (the outcome) is affected by four predictor variables: free cash flow, leverage, financial distress, and managerial ownership.
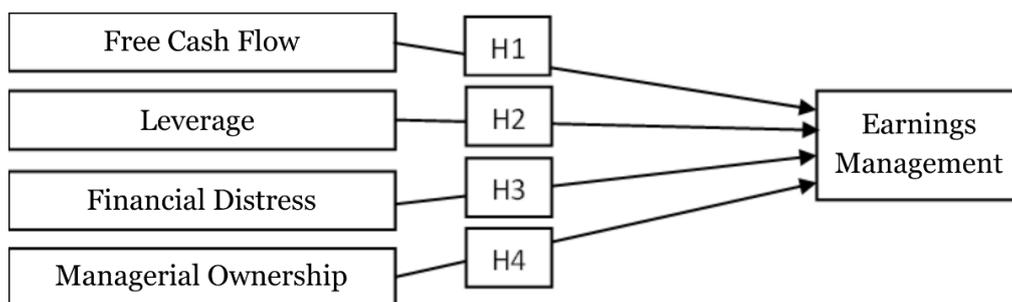
Figure 1. Conceptual Framework

3. Methods

A quantitative causal-associative approach guides this study in analyzing the determinants of earnings management. The analysis is based on a purposively selected sample from the population of IDX-listed consumer non-cyclicals firms (2022-2024). Firms were included if they: (1) were listed throughout the entire period, (2) published complete annual reports, and (3) had all necessary variable data available. This process resulted in 30 companies providing 89 usable firm-year observations. A purposive sampling technique was employed to ensure conformity with these criteria. Data were collected exclusively from secondary sources officially disseminated by the Indonesia Stock Exchange (www.idx.co.id).

3.1. Variable Operationalization and Measurement

The definitions and measurements of the research variables are presented in Table 1.

Table 1. Operational Definition and Variable Measurement

Variable	Measurement	Source
Free Cash Flow	$$FCFit = \frac{CFOit - DIVit}{TAit - 1}$$	Wandari (2023)
Leverage	$$DAR = \frac{Total\ debt}{Total\ Asset}$$	Yolanda et al. (2024)
Financial Distress	Altman Z-Score Model $$Z = 6,56X1 \times +3,26X2 \times +6,72X3 \times +1,05X4$$	Rachmaturrizqi & Mayangsari (2025)
Managerial Ownership	$$KM = \frac{Total\ management\ shares}{Total\ outstanding\ shares}$$	Yolanda et al. (2024)
Earnings Management	Calculating Total Accrual: $$TAt = NIt - CFOt$$ Calculating total accrual value through multiple linear regression equation: $$\frac{TAt}{At-1} = \beta1\frac{1}{At-1} + \beta2\frac{\Delta REVt}{At-1} + \beta3\frac{PPEt}{At-1} + e$$ Calculating Non-discretionary Accrual (NDA) value: $$NDAt = \beta1\frac{1}{At-1} + \beta2\frac{\Delta REVt - \Delta RECt}{Ait-1} + \beta3\frac{PPEt}{At-1}$$ Calculating Discretionary Accrual (DA) value: $$DAt = \frac{TAt}{At-1} - NDAt$$	Wandari (2023)

3.2. Data Analysis

3.2.1. Classical Assumption Tests

Before proceeding with hypothesis testing, the study performed the requisite classical assumption tests to verify the robustness of the regression model.

1) Normality Test: The Kolmogorov-Smirnov test was used to assess whether the residual data were normally distributed.
2) Multicollinearity Test: The Variance Inflation Factor (VIF) and Tolerance values were examined to detect high correlations between independent variables.
3) Heteroscedasticity Test: The Glejser test was employed to identify the presence of unequal variances in the residuals.
4) Autocorrelation Test: The Durbin-Watson (DW) statistic was calculated to test for correlation between residuals in the time-series data.

3.3. Hypothesis Testing

After ensuring no violations of regression assumptions, the hypotheses were tested. The significance of individual variable coefficients was determined via t-tests, while the F-test examined the collective effect of all predictors. The proportion of variance accounted for by the model was quantified using R^2. The entire analysis was conducted in IBM SPSS Statistics version 27, a software package favored for its statistical reliability, widespread adoption in academia, and integrated tools for regression diagnostics.

4. Results and Discussion

4.1. Research Results

4.1.1. Descriptive Statistical Test

Descriptive statistics is a statistical technique that aims to produce a data summary by presenting key information about the observed variables. The descriptive statistics, which summarize the sample characteristics through measures of minimum, maximum, mean, and standard deviation for each variable, are compiled and displayed in Table 2.

Table 2. Descriptive Statistics Analysis Results

Description	N	Min	Max	Mean	Std. Dev
FCF	89	-0.194805	0.324661	0.07861889	0.089402146
Lev	89	0.067154	3.332226	0.39917758	0.358019150
FD	89	0.422346	42.081211	10.51417130	8.614038467
KM	89	0.000000	0.848066	0.15231080	0.239221596
ML	89	-0.374890	0.241430	-0.12715111	0.106793569

Source: Data analysis results, 2025

Descriptive statistics outlining variable distributions are provided. The Free Cash Flow variable shows a mean of 0.07861889 and a standard deviation of 0.089402146, within a range of -0.194805 to 0.324661. Meanwhile, Leverage, as represented by the Debt to Asset Ratio (DAR), has a mean of 0.39917758 and a standard deviation of 0.358019150, ranging from a minimum of 0.067154 to a maximum of 3.332226. Financial Distress exhibits a mean of 10.51417130 (SD = 8.614038467), with a minimum of 0.422346 and a maximum of 42.081211. Managerial Ownership ranges from 0.000000 to 0.848066, averaging 0.15231080 (SD = 0.239221596). Lastly, Earnings Management has a mean of -0.12715111 (SD = 0.106793569), with values between -0.374890 and 0.241430.

4.1.2. Classical Assumption Test

1) Normality Test

Normality conditions are also considered through the Central Limit Theorem (CLT), with a total sample in this study of 89 data. Because the number of samples is more than 30

observations (89 > 30), the data distribution is considered to approach normal. Hence, the regression model is applicable as the condition of normality is deemed to be satisfied.

2)   Multicollinearity Test

The outcomes of the analysis are reported in Table 3.

Table 3. Multicollinearity Test Results

Variable	Tolerance	VIF	Description
FCF	0.974	1.027	No Multicollinearity Occurs
Lev	0.957	1.045	No Multicollinearity Occurs
FD	0.873	1.145	No Multicollinearity Occurs
KM	0.852	1.174	No Multicollinearity Occurs

Source: Data processing results, 2025

The multicollinearity diagnostics reveal that all tolerance values surpass the acceptable threshold of 0.10, while the corresponding Variance Inflation Factor (VIF) values remain well below the critical value of 10 across all explanatory variables. In particular, Free Cash Flow exhibits a tolerance value of 0.974 with an associated VIF of 1.027, Leverage is characterized by a tolerance of 0.957 and a VIF of 1.045, Financial Distress demonstrates a tolerance of 0.873 alongside a VIF of 1.145, and Managerial Ownership registers a tolerance value of 0.852 with a VIF of 1.174. Therefore, it indicates that the regression model shows no signs of multicollinearity symptoms and is suitable for further analysis.

3)   Heteroscedasticity Test

Detailed results of the analysis are summarized in Table 4.

Table 4. Heteroscedasticity Test Results

Variable	Significance	Description
FCF	0.194	No Heteroscedasticity Occurs
Lev	0.137	No Heteroscedasticity Occurs
FD	0.169	No Heteroscedasticity Occurs
KM	0.112	No Heteroscedasticity Occurs

Source: Data processing results, 2025

Referring to the basis of heteroscedasticity test examination results, it is known that all independent variables show a significant level above 0.05. The Free Cash Flow variable records a significant value of 0.194, Leverage of 0.137, Financial Distress variable of 0.169, and Managerial Ownership variable of 0.112. Therefore, all variables with significant values > 0.05, which indicates the regression model is free from signs of heteroscedasticity.

4)   Autocorrelation Test

Table 5 summarizes the statistical evidence from the test.

Table 5. Autocorrelation Test Results

Variable	Durbin Watson	Description
Unstandardized Residual	1.803	No Autocorrelation Occurs

Source: Data processing results, 2025

Based on the autocorrelation test, the calculated Durbin-Watson statistic is 1.803. The critical upper bound (dU) is 1.7501, resulting in a value of 4 - dU = 2.499. The obtained statistic's position, where 1.7501 < 1.803 < 2.499, satisfies the diagnostic criterion for no autocorrelation. Consequently, it is concluded that the regression model does not exhibit autocorrelation.

4.1.3. Hypothesis Test

1) Multiple Linear Regression

The outcomes of the multiple linear regression analysis are provided in Table 6.

Table 6. Multiple Linear Regression Results

Variable	Coefficient	t value	Significant t	Description
Constant	-0.048			
Free Cash Flow (X1)	-0.984	-13.941	<0.001	H1 Accepted
Leverage (X2)	-0.045	-2.530	0.013	H2 Accepted
Financial Distress (X3)	0.001	1.200	0.234	H3 Rejected
Managerial Ownership (X4)	0.042	1.477	0.144	H4 Rejected
F Value			52.545	
R Square			0.714	
Adjusted R			0.701	
Significant F			<0.001	

Source: Data processing results, 2025

The results obtained through analyzing the data in this research led to the formulation of a linear regression equation with multiple variables, represented as:

$$ML = -0.048 - 0.984\,FCF - 0.045\,Lev + 0.001\,FD + 0.042\,KM + e$$

The meaning of this multiple linear regression formula can be explained as follows:

a. The regression model yields a constant (intercept) of -0.048. This coefficient signifies the estimated value of Earnings Management under the condition that all independent variables, namely Free Cash Flow, Leverage, Financial Distress, and Managerial Ownership, are equal to zero.

b. The negative coefficient of -0.984 for Free Cash Flow implies that a unit increase in this variable is linked to a 0.984-unit decrease in earnings management, holding other predictors constant.

c. Leverage shows a coefficient of -0.045, meaning a one-unit increase in this variable is linked to a 0.045-unit reduction in earnings management.

d. The coefficient value of Financial Distress is 0.001. This indicates that an increase in Financial Distress of 1% has the potential to increase earnings management by 0.1%, and vice versa.

e. Managerial Ownership has a positive coefficient of 0.042, meaning that a one-unit increase in managerial shareholding is linked to a 0.042-unit rise in earnings management.

2) Model Feasibility Test (F Test)

As shown in Table 6, the F-test yields a probability value of less than 0.001. This result confirms that the regression model is valid and provides a good fit for the data.

3) Coefficient of Determination Test (R^2)

The analysis yields an Adjusted R^2 of 0.701, suggesting that the independent variables collectively explain approximately 70.1% of the variance in earnings management. The remaining 29.9% of the variation is attributable to factors outside the specified model.

4) T Test

As per Table 6, free cash flow and leverage significantly influence earnings management, with p-values below the 0.05 threshold ($p < 0.001$ and $p = 0.013$, respectively), thereby supporting H1 and H2. Conversely, financial distress and managerial ownership do not demonstrate major effects ($p = 0.234$ and $p = 0.144$), resulting in the rejection of H3 and H4.

4.2. Discussion

4.2.1. Effect of Free Cash Flow on Earnings Management

A significant p-value (<0.001) confirms H1, indicating that Free Cash Flow is a significant determinant of Earnings Management. The agency theory framework explains this relationship, suggesting that high free cash flow can encourage opportunistic behavior, wherein managers leverage accounting flexibility to perform earnings management in pursuit of private gains. Drawing on signal theory, free cash flow is interpreted as a positive indicator of a company's future prospects. The practice of earnings management, however, compromises the integrity of this signal, causing it to deviate from the company's genuine economic reality. These results reinforce agency and signaling theories by indicating that higher free cash flow increases managerial discretion, thereby heightening the propensity for earnings management and weakening the credibility of financial signals conveyed to the market. This result aligns with prior studies Ihsan & Haryono (2021); Irawan & Apriwenni (2021); Setiawati et al. (2019), all of which affirm an influence of free cash flow on earnings management. Conversely, they are at variance with the conclusions of Putri & NR (2023); Wandari (2023), who report no significant effect.

4.2.2. Effect of Leverage on Earnings Management

The assessment of data gathered through testing indicates that Leverage holds a noteworthy value of 0.013, which is less than 0.05. Based on these findings, H2 is validated, or it can be inferred that Leverage has a substantial impact on Earnings Management. According to agency theory studies, high leverage levels can increase the potential for conflicts between managers to keep earnings looking good. This condition provides room for managers to utilize information asymmetry to implement earnings management in order to display company financial stability. From the signal theory perspective, high Leverage has the potential to generate negative signals regarding the company's financial risk. To overcome this perception, managers may be driven to manage earnings reports, thus providing positive signals that the company is still able to meet its obligations. However, this earnings manipulation action can produce signals that do not fully reflect the actual economic condition, so it can cause misunderstanding for external parties. These findings are aligned with research by Adityaningsih & Hidayat (2024); Habibie & Parasetya (2022) suggesting that Leverage has an effect on earnings management. However, the findings of Bahri & Arrosyid (2021); Wardoyo et al. (2023) contradict stating that Leverage does not have a significant effect on earnings management. These inconsistencies might be due to differences between sectors. Companies in the consumer non-cyclicals sector experience more stable demand and cash flow, which can influence how managers are motivated and how they report finances differently than companies in other sectors.

4.2.3. The Effect of Financial Distress on Earnings Management

The hypothesis test yields a significance value of 0.234 for Financial Distress, exceeding the 0.05 threshold; consequently, H3 is rejected, and no significant effect on Earnings Management is found. This finding, interpreted through the lenses of agency and signal theory, suggests that a state of financial distress does not necessarily serve as a primary driver for managers to engage in opportunistic actions or to distort financial signals. This may be because of strong supervision, internal policies, or considerations to maintain company credibility. From the signal theory perspective, companies under financial pressure may choose to convey conditions as they are rather than provide false signals through earnings management, especially when the market is already able to assess company conditions without

having to look at manipulated signals. The inconsistency between this result and prior studies may be explained by differences in sectoral characteristics, as this study focuses on consumer non-cyclicals firms, which tend to operate in relatively stable industries with predictable demand and lower earnings volatility. Such conditions may reduce managerial incentives to manipulate earnings under financial pressure compared to firms in more cyclical or capital-intensive sectors. These results are consistent with studies by Fauziah et al. (2021); Irawan & Apriwenni (2021) which also found no significant impact of financial distress on earnings management. However, these findings contradict another research. For instance, Afni and Setiany (2023); Kurnia and Mulyati (2023) reported a positive relationship, while Ananada and Wahidahwati (2024); Tsaqif and Agustiningsih (2021) documented a negative effect.

4.2.4. Effect of Managerial Ownership on Earnings Management

Hypothesis H4 is rejected (p = 0.144), as the results show no significant statistical relationship between managerial ownership and earnings management. This finding stands in contrast to the agency theory proposition that equity ownership by managers serves as a governance mechanism to curb earnings management by harmonizing principal-agent interests. The empirical results of this analysis, however, demonstrate that such a governance mechanism does not function effectively in the context studied. From the signal theory perspective, the amount of managerial ownership is also not proven to affect their decisions in managing earnings information, so ownership structure does not become a determining factor in forming signals received by the market. The inconsistency with prior studies may be attributed to sectoral differences, as firms in the consumer non-cyclicals sector tend to exhibit greater operational stability, which may limit managerial discretion and reduce the effectiveness of ownership-based incentives in constraining earnings management. While consistent with prior research reporting an insignificant relationship between managerial ownership and earnings management (Putri & NR, 2023; Yolanda et al., 2024) these findings diverge from studies that confirm a significant effect (Oneng et al., 2025; Tatar & Sujana, 2021).

5. Conclusion

The results yield important implications for corporate governance and investment analysis. The significant influence of free cash flow and leverage underscores the necessity for robust monitoring mechanisms over discretionary cash and capital structure, given their potential to induce managerial opportunism in financial reporting. In contrast, the statistically insignificant roles of financial distress and managerial ownership suggest that, within the studied sample, neither acute financial pressure nor insider equity stakes constitute central factors precipitating earnings management. These findings indicate that managerial ownership is not necessarily effective in aligning the interests of managers and shareholders, and financial pressure does not always encourage financial information distortion.

From a theoretical perspective, the findings lend support to both agency theory and signaling theory by indicating that the effectiveness of governance mechanisms in constraining earnings management is inherently contextual. Under relatively stable post-crisis conditions, debt-related monitoring mechanisms and financial reporting signals appear to exert greater influence than ownership-based incentive structures. Practically, this research highlights a critical need for governance systems to shift attention toward regulating free cash flow and leverage, as managerial ownership alone does not effectively restrain earnings manipulation. For investors and regulators, free cash flow and leverage remain important

indicators in assessing earnings quality, while financial distress was not proven to be a primary driver of earnings manipulation during the study period.

This research has a number of limitations, such as a limited observation period, limited selection of independent variables, the existence of companies with incomplete financial data, and the use of one earnings management proxy namely Discretionary Accruals. This study outlines the effects of key financial and governance variables on earnings management. To build upon these findings, future work is encouraged to extend the temporal scope, integrate other pertinent factors, and apply the analysis across a wider range of industries. Such efforts would help to validate and generalize the results, thereby overcoming the constraints inherent in the current research design.

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