



Corporate Social Responsibility and Earnings Management: The Moderating Role of Corporate Governance

*Erna Wati, Abdul Qadir Malik

Universitas International Batam, Batam, Kepulauan Riau, Indonesia

*Corresponding Author: 1842058.abdul@uib.edu

Abstract

Objective – This study investigates the relationship between corporate social responsibility (CSR) and earnings management (EM) with corporate governance (CG) as the moderating variable.

Design/methodology – This study uses data collected from public companies listed in Indonesia Stock Exchange which include the audited annual reports and published sustainability report during the year 2016 – 2019. The regression model was used to estimate the coefficient of EM and CSR.

Results – This study finds EM has an insignificant negative relationship with CSR and CG as a moderating effect. This indicates that the implementation of CSR in Indonesia does not affect EM with the involvement of CG as moderating variable. CG is playing an important role in monitoring the management so that managers do not override the company' interest. Thus, CG has an effort to maintain the stability of interest between the stakeholders and managers.

Limitation/Suggestion – This study is limited in its sample size resulted from the unavailability of some annual reports and sustainability reports. The findings of this study has implications for company managers, and shareholders. It assists the company management to develop and implement strategies that will strengthen the CG structure, especially in developing countries, to protect shareholders and increase stock exchange confidence. It also contributes in enhancing the previous literature research on the relationship between CSR and EM moderated by CG by showing how CG can influence the relationship between CSR and EM.

Keywords: Corporate Governance, Corporate Social Responsibility, Earning Management, Stakeholder Engagement.

1. Introduction

One of the main purposes of accounting information is to inform stakeholders regarding the real condition of the company. The accounting quality can impact significantly on stakeholders' decision making, the capital market's level of trust and efficiency, and also the proper distribution of limited economic resources (Dimitropoulos, 2020). The practice of EM could be seen negatively when it manipulates the actual company financial conditions. For decades, EM has received special attention because of the manipulation practices in reporting financial statements. This also draws a serious concern for investors in Indonesia. Some studies have proven the significant relationship between Corporate social responsibility (CSR) and earnings management (EM). Thus, this research initiates to find empirical evidence whether there is a relationship between CSR and EM in Indonesia. CSR currently focuses not only on employees who work in the company but also on the environment and residents within the company's area. The issue of CSR has become global and has gained wider acceptance from both stakeholders and corporate organizations. CSR is acceptable among all forms of business organization. CSR can also act as an intermediary

through which companies secure their reputation, this research becomes important to look for empirical evidence whether companies that carry out CSR also practice EM (López et al., 2019).

However, there is an opinion that explains the mechanism of CG in reducing problems that occur between the interests of managers and stakeholders. CG is a system for companies to monitor, resolve, and take interest between managers and stakeholders to make the company more cooperative. According to Buerterey, Sun, Lee, & Huang (2019), this can reduce the impact of EM and implement an effective monitoring mechanism. Moreover, in this study, this paper argues that CG can reduce CSR and make corporate reporting more cooperative by displaying reports that embody the company itself.

Although many studies explain the relationship between EM and CSR but still lack focus on involving CG as moderating variable, particularly for Indonesian public companies. This study was conducted to determine whether there is a relationship between CSR and EM with influence of CG in Indonesia and to examine whether CG consisting of board size, board independent, institutional ownership, and block ownership can impact on CSR and EM. Next section describes the conceptual and theoretical views of studied variables along with the development of the hypotheses. Then, the paper highlights the measurement and statistical analysis tools used, and finally it explains the result and present the conclusion.

2. Literature Review and Hypotheses Development

Literature Review

According to Abdelkarim and Zuriqi (2020), problems in agency theory always lead to EM; even though the accounting principles used in reporting financial statements are given in general, but this provides choices for accounting assumptions and methods. Sometimes there are irregularities in the published financial statements. This always refers to what managers benefit from using existing controls and applying practices and techniques to enrich themselves. EM changes in working capital are calculated based on a scale with market value as a measure of EM. Another method used to overcome EM is cash flows from operating activities scaled to market value. The discussion of research on the relationship between CSR, CG, and EM originating from Korea explains that the company is an important factor in determining the involvement of CSR with EM by using CG as moderation (Choi et al., 2013). Martínez-Ferrero et al., (2016) stated companies can deliberately hide the occurrence of EM. This was followed by the case that had happened to Enron Energy by committing a corporate accounting scandal that resulted in EM. EM-related CG in the UK has a relatively low percentage when they have a smaller but dominated board with independent outside directors and a relatively low number of female directors. Meanwhile, EM in Egypt revealed that having a giant board of directors dominated by independent outside directors and lower female directors could reduce EM (Abdou et al., 2020).

CSR is also influenced by corporate governance (CG), which can affect EM. However, board directors and shareholders controlling CSR will improve EM when the board and shareholders have decided. CSR is a problem faced by companies engaged in services, trade, and manufacturing. This problem is how a company manages and is responsible for the business actions that are carried out. This study aims to explain the effect of CSR on EM with the moderating effect of CG (Buerterey et al., 2019). Martínez-Ferrero et al., (2016) revealed that the company could get a positive response and a good reputation when implementing this CSR policy. However, at the same time, EM gives a negative response and could reduce the company's reputation. Jordaan et al., (2018) also found that managers often take action to make personal profits. For example, they will conduct earnings manipulation or EM to improve the company's public image. Usually, a company that implements CSR also applies EM in its company.

One way to reduce EM is by implementing effective CG practices that include all rules and systems to protect stakeholders. In this case, CG is tasked with aligning the

interests of shareholders and company managers. With good CG in influencing the moderation of the relationship between CSR and EM, it can minimize abuse of CSR by controlling the government system. Studies have been conducted to find out the relationship between CSR and EM, the role of CG by reducing the personal profits of managers. This CG includes independent boards, board size, institutional ownership, and concentration of ownership (Choi et al., 2013).

Previous studies and hypothesis development

The discussion on CSR, CG, and EM in Korea explains that the company is an essential factor in determining CSR with EM by using ownership, and foreign ownership moderation as significant to negative EM (Choi et al., 2013). While for the size of the board and the proportion of external board members as moderating variables are significantly positive. As well as having the independence of CSR as a significant negative to the research that has been done (Kumala & Siregar, 2020). In a study that has been conducted in Korea on the relationship between CSR and EM, Buerthey et al., (2019) argue that stakeholder efforts can promote CSR by being carried out together with institutional monitoring aimed at monitoring the interests of managers so as not to override the ethical objectives of CSR. This study is also moderated by the mechanism of CG, which is positively related to CSR with the variables used in CG as follows, board size, board independence, institutional ownership, and block ownership, which have a significant influence on CSR and EM.

A study in Jordan explains the relationship between EM and ownership structure including, inside management ownership, outside management ownership, institutional ownership, outside shareholder ownership, family ownership, and foreign ownership, as significantly negative on earnings management (Alzoubi, 2016). Corporate governance and earnings management using a quantitative regression approach that has been carried out using variables that support this research including variables, board size, and audit committee ownership as a significant and independent board, audit committee size, and audit committee as significantly negative on EM, this is followed along with the large value of the audit committee the practice then practice EM will getting smaller (Feng & Huang, 2020).

According to the study conducted by Habbash & Haddad (2019) in Saudi Arabia which showed a positive relationship between CSR and EM. Managers who manipulate earnings have incentives to develop a social friendly image or good reputation to gain stakeholders' support. This turn will reduce the likelihood of the manager being terminated. Therefore, the CSR report is used as an entrenchment mechanism. The results have important implications for policymakers, regulators, investors, and managers. Investigations like this allow them to challenge directors in EM. More efforts should be made to improve the quality of financial reporting and disclosure systems to reduce information asymmetry.

Firms with more excellent social responsibility performance exhibit higher discretionary behavior by promoting actions that mask the firm's actual financial and economic performance. However, this positive relationship was found to be lower – moderate – in family-owned firms, mainly because family firms exhibited more significant socially responsible behaviors aimed at preserving their socio-emotional endowments and were negatively associated with EM practices. There is a positive relationship between CSR and EM (López et al., 2019). The higher CSR activities make banks more involved in EM activities. Many banks in Indonesia can use their wisdom to increase CSR activities to improve the bank's image. However, not a few banks also use their discretion to carry out more excellent EM activities. The Bank manages its earnings to meet the various interests of shareholders due to these stakeholder pressures. Thus, banks aggressively manage earnings to increase revenue by using their discretion. Moreover, this reveals that there is a positive relationship to EM (Setiawan et al., 2019).

H1: There is a significant relationship between corporate social responsibility and earning management.

Corporate
Governance,
Corporate
Social
Responsibility,
Earning
Management,
Stakeholder
Engagement

The Moderating Effect of Corporate Governance on The Corporate Social Responsibility and Earning Management Relationship

According to Kumala & Siregar (2020), opportunistic management is limited when the system includes an effective supervisory mechanism. CG is one such mechanism. An effective CG system promotes "corporate transparency and accountability, and maintains a balance between maximizing share ownership and the interests of various stakeholders. Buerter et al., (2019), strengthening the CG system will further protect the interests of shareholders and further enhance capital market confidence. By improving the system, will further minimize EM for the personal benefit of a manager. In the context of different countries in implementing CSR, EM will improve quality if the requirements are low. This suggestion tightens accounting guidelines and mechanisms to protect investors by reducing EM behavior, encouraging more skeptical and independent CG in emerging markets. Sial et al., (2019). CG mechanisms such as board independence, board size, institutional ownership, and block ownership have an essential role in aligning the interests of managers with larger stakeholder groups. The following sections discuss how various CG mechanisms can potentially influence the relationship between CSR and EM.

Board Size

Larger boards are more likely to carry out significant responsibilities for management better than having smaller boards. Larger corporate boards have more diversity in their previous business backgrounds, skills, and expertise to help deal with management issues and help with better business strategy. This is explained in the research that Buerter et al., (2019) have done, showing a positive relationship between CSR and EM. There is a positive relationship between board size and EM, and it is explained that the larger the size of the board in the company, the less likely the occurrence of EM (Abdelkarim & Zuriqi, 2020).

Moreover, research states that there is a negative relationship moderating between board size on CSR and EM; this is because the research that has been done has a small board size in companies (Sial et al., 2019). Pekovic & Vogt, (2020) stated that they had found a positive moderating relationship between board size on EM and CSR. Contrarily, Feng & Huang (2020) found that board size has a significant negative on EM in the study.

H2: There is a significant relationship between board size moderation on corporate social responsibility and earning management

Board Independence

Independent directors have a role in uniting managers, and independent directors also function as reducing agency problems between directors and management parties. According to Khalil & Ozkan (2016), there is a relationship between an independent board and EM in a study conducted, which has a significant negative relationship. As for the independent board's research does not significantly influence CSR and EM through research developed by the prominent director to develop CSR (Buerter et al., 2019). According to Habbash & Haddad (2019), the independent boards significantly influence CSR and EM because managers as stakeholders can take advantage of their good reputation to gain support and lower the chance of being terminated.

Pekovic and Vogt (2020) revealed a board independent relationship between CSR and EM, which is significantly positively related. The higher the influence of the board independence on the agency, the greater the CSR and EM practices that occur. The more critical the board, the smaller the occurrence of CSR and EM practices (Sial et al., 2019).

H3: There is a significant relationship between board independence moderation on corporate social responsibility and earning management.

Institutional ownership

Institutional owners have a responsibility to protect their interests by overseeing managers' interests, not overriding the interests of shareholders. Institutional ownership has a greater risk because the large number of shares owned by institutional investors is higher than individual shareholders, and this is their motivation to supervise managers more. Institutional ownership is more efficient than individual investors gathering and interpreting specific information about managerial decisions and operations. Because of their significant shareholdings, they can sue for disclosing accounting information from companies to assist their investment decisions. Institutional ownership can influence corporate decisions through their voting rights (Kumala & Siregar, 2020). Due to their potential to monitor corporate disclosures, they can limit the managerial use of detrimental CSR. Li et al. (2019) conducted a study that revealed a relationship between institutional ownership and EM, which has a significant positive effect. It is shown that the greater the influence of institutional ownership, the greater the EM occurs. Setyastrini & Wirajaya (2017) revealed in the research conducted that there is a moderating relationship between institutional ownership of CSR and EM. It is shown in their study that this relationship is significantly harmful. The smaller the influence on institutional ownership, the smaller the relationship between CSR and EM.

H4: There is a significant relationship between institutional ownership moderation on corporate social responsibility and earning management.

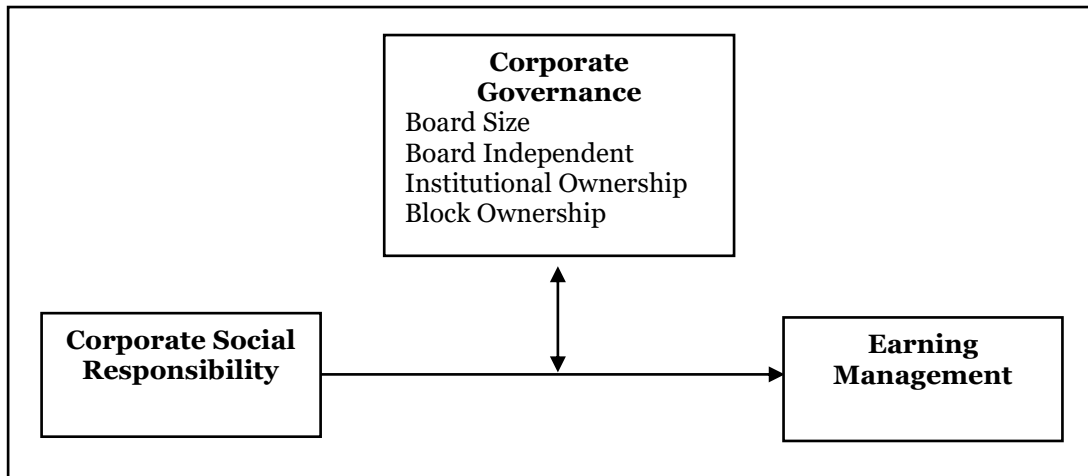
Block ownership

Shareholders who own an insignificant proportion of their outstanding company shares lack the ability and no incentive to monitor their management activities effectively. However, studies show that the concentration of shareholding improves the quality of management monitoring. More significant shareholders have an information advantage over other shareholders in that they can hold managers accountable. It can also monitor the activities of managers to reduce the use of CSR to the detriment of the managerial (Buertey et al., 2019). According to Mellado and Saona (2020) research, there is a relationship between ownership concentration on EM, which has a significant negative effect. The greater the block ownership, the smaller the EM that will occur. According to research conducted by Kao et al., (2019), there is a relationship between block ownership and EM, which is significantly positive. In their research, Pekovic and Vogt (2020) reveal that there is a moderating relationship between block ownership on CSR and EM; this relationship has a significant negative.

H5: There is a significant relationship between block ownership moderation on corporate social responsibility and earning management.

There are other variables in this study that support the relationship between CSR and EM. Another variable that can support this relationship is firm size, which is a large company that must publish a sustainability report (Godos-Díez et al., 2020). Previous research also used leverage as variable control, which is high liabilities in the company can lead to manipulation of EM to set off financial statements. Another variable that the study use is return on assets (ROA), measured by the ratio of earnings before interest. Using company growth variables that allow more involvement in CSR activities is more likely to attract investors' concerns (Buertey et al., 2019). The influence of the company's financial resources can also affect the relationship of CSR and EM, measured from cash operating activities to total assets. The type of auditor used in this study can also affect this relationship; in this study,

the auditor is measured as a dummy variable 1 if the company uses big 4 auditors and 0 if not.



Corporate Governance, Corporate Social Responsibility, Earning Management, Stakeholder Engagement

Figure 1. Conceptual Framework

3. Research Method

This study uses a purposive sampling method for selecting the samples. The samples are selected publicly listed companies in Indonesia Stock Exchange which meet the criteria as those that 1) publish sustainability reports for the year 2016-2019, and 2) publish annual audited financial statements for the year 2016-2019. The total number of companies listed on the Indonesian Stock Exchange is 727 companies, but only 69 companies are demanded to publish their sustainability reports by 2016 – 2019 (Undang-Undang No. 4 Tahun 2009). Therefore, this study uses 69 companies as research samples and utilize GRI (Global Reporting Initiative) G4 index for scoring the corporate sustainability reports. As reported in previous studies (Buerter et al., 2019; Jordaan et al., 2018; Kumala & Siregar, 2020), EM are proxied using the discretionary accrual by estimating the value using a cross-sectional model. The four CG variables are taken from the company's integrated financial and annual reports as a sample. This report is available on the Indonesian capital market website, providing capital market data and information on publicly listed companies in Indonesia. This study measures the CG variable by following Pekovic & Vogt (2020); Buerter et al., (2019); Kumala & Siregar (2020). Board size is calculated from the total number of directors in the company. The independent board is calculated from the non-executive directors who are in the company. Institutional ownership is taken from the percentage of share ownership owned by the institution. Moreover, block ownership is taken from the percentage of share ownership owned by investors at least 5% of the company's shares.

According to the stated hypothesis, the panel data analysis mentioned in Buerter et al., (2019) previous research is used to test the data according to the attached hypothesis. The fixed effect regression model was used to estimate the coefficients. A model has used model examines the moderating effect of CG on CSR and EM.

Model:

$$EM_{it} = \alpha_0 + \lambda_1 CSR_{it} * CG_{it} + \lambda_2 CSR_{it} + \lambda_3 CG_{it} + \sum \lambda_i CONTROLS_{it} + \sum IND + \sum YD + \epsilon_t$$

The model consists of CSR as a net score of corporate social responsibility from sustainability report with G4 as a reference score, CG as corporate governance variables (board size, board independence, institutional ownership, and block ownership), EM as earning management by discretionary accruals as a variable dependent. The control of the model consist of (leverage, firm size, profitability, growth, firm financial resources, and type of audit firm), $\sum IND$ as industry dummy, also $\sum YD$ as a year dummy.

4. Results and Discussions

Descriptive Statistics

From the research that has been done, there are research results in table A1 which show descriptive statistics for each variable used. There are 206 data samples used by displaying CSR scores obtained from 58 to a minimum of 5 from 91. These results indicate that there are variations in companies implementing CSR in Indonesia. The total EM using discretionary accruals has a maximum value of 0,622 to a minimum of -2.736. The average value that has been known is -0.722, which is where the company tends to do EM. The board size has a maximum score of 11 and a minimum of 2, while the independent boards have an average of 9.9%. Indonesia has relatively few independent directors in companies, which explains more executive directors in Indonesia. Heterogeneity of results using measures on executive directors and independent directors. On average, institutional and block shareholders have a value of 52.5% and 56.9% of outstanding shares. Finally, the percentage of companies that use the Big 4 audit firm is 68%.

Table. 1
Descriptive Sta-
tistics

Description	Mean	Median	Min	Max	Standard Deviation
EM	-0.722	-0.586	-2.736	0.622	0.544
CSR	0.277	0.264	0.055	0.637	0.116
Board Size	6.024	6.000	2.000	11.000	1.815
Board Ind.	0.099	0.100	0.000	0.500	0.112
Inst. Own.	0.525	0.596	0.000	1.000	0.298
Block Own.	0.569	0.650	0.000	0.990	0.260
ROA	0.049	0.039	-0.558	0.467	0.092
Leverage	0.532	0.545	0.013	1.931	0.262
Firm Size	30.536	30.558	27.507	33.495	1.208
OCF	0.071	0.067	-0.247	0.461	0.096
Growth	0.058	0.069	-1.246	0.985	0.226
Audit F.	0.680	1.000	0.000	1.000	0.467

EM = Earning Management

ROA = Profitability

CSR = Corporate Social Responsibility

OCF = Firm Financial Resource

The moderating effect of corporate governance on the relationship of CSR – EM.

In the results of the tests carried out, it can be seen that CSR has a negative effect on EM, but it is not significant (T statistic $0.512 < 1.96$) this is because the greater CSR can affect smaller earnings management. This is because the level of corporate image increases and companies in Indonesia tend not to carry out earning management. This result is not aligned with some previous studies carried out by Buerthey et al., (2019); López et al., (2019); Setiawan et al., (2019).

Table 2 shows that board size negatively moderates EM, but it is insignificant (T statistic $0.667 < 1.96$) a larger board size can decrease earnings management practices, also is due to the presence of a larger board size not allowing earnings management to occur within the company because the large board can improve the managing companies and the concentration contained in the company is improving. This result is not the same as the previous studies that have been conducted by Abdelkarim & Zuriqi (2020); Buerthey et al., (2019); Feng & Huang (2020); Pekovic & Vogt (2020); Sial et al., (2019).

Table 2 shows that independent directors negatively moderate EM but are significant (T statistic $2.044 < 1.96$) a larger independent director in the company can't lead to an increase in earnings management with the increase in a wider independent director can be improving the managing concentration in companies, and concentration on reducing earnings management is avoidable, this result is same as the previous

studies that have been conducted by Buerter et al., (2019); Habbash & Haddad (2019); Khalil & Ozkan (2016); Pekovic & Vogt (2020); Sial et al., (2019).

Table 2 shows that institutional ownership negatively moderates EM, but it is insignificant (T statistic $0.698 < 1.96$) an institution that has wider ownership makes a company can't lead to an increase in earnings management in a company, this is because a greater ownership institution creates greater institutional interests, causing earnings management to not occur, also the result is not same as the previous studies that have been conducted by Kumala & Siregar (2020); Li et al., (2019); Setyastrini & Wirajaya (2017).

Table 2 shows that ownership concentration positively moderates EM, but it is insignificant (T statistic $0.758 < 1.96$) an increase in ownership concentration can lead to an increase in earnings management, this is because the greater the increase in ownership, the interest in the company is directed to a personal interest, also the result are not same as the previous studies that have been conducted by Buerter et al., (2019); Kao et al., (2019); Mellado & Saona (2020); Pekovic & Vogt (2020).

Corporate Governance, Corporate Social Responsibility, Earning Management, Stakeholder Engagement

Table 2. Moderating effect CG on CSR – EM

Description	T Statistics (O/STDEV)	O Values
CSR -> EM	0.512	-0.03
BS Mod. -> EM	0.667	-0.042
BI Mod. -> EM	2.044	-0.134
Inst. Own. Mod. -> EM	0.698	-0.039
Block Own. Mod. -> EM	0.758	0.079
BI -> EM	1.368	0.051
BS -> EM	0.182	0.014
Inst. Own. -> EM	0.698	0.101
Block Own. -> EM	2.382	-0.329
Firm Size -> EM	0.313	0.032
Growth -> EM	2.988	-0.239
Leverage -> EM	1.781	0.138
OCF -> EM	6.434	-0.599
Audit Firm -> EM	0.089	-0.122

5. Conclusions

This study findings reveal the relationship between CSR and EM with a moderating effect of CG. First, the findings show that insignificant EM in Indonesia also affects social responsibility activities; CG must monitor this so that managers do not override the company's interests. Second, the study results show that the CG mechanism has an effort to maintain the stability of interests between stakeholders and managers; this also happens in developing countries by strengthening CG activities in companies and can increase the image of trust in the stock exchange, there is also an explanation of the relationship of variables to EM CSR has a negative but not significant effect on EM, which indicates in Indonesia CSR has an influence on the occurrence of EM practices but is not significant and because the social responsibility report indicates that companies financial information more trusted, thus companies disclosing more CSR activities would have fewer EM practices. Board size as a moderating variable has a negative but not significant effect on the relationship between CSR and EM, board independent as a moderating variable has a negative but not significant effect on the relationship between CSR and EM, institutional ownership as a moderating variable has a negative but not significant effect on the relationship between CSR and EM, Concentration of ownership as a moderating variable has a positive but not significant effect on the relationship between CSR and EM.

This study enhances the previous earnings management literature, particularly the role of corporate governance in the relationship between CSR and earnings management. For practical implications, the empirical results shown in this study provide useful insights for the investor in decision making, For future research, other variables

can be added to add variation that can create a new relationship between other variables with EM and can be moderated by CG, as well as show the relationship between CSR and EM. using more suitable measurements on each variable can also improve the quality of research. This finding has implications for company managers, and shareholders. This study contributes to developing and implementing strategies that will strengthen the CG structure, especially in developing countries to protect shareholders and increase stock exchange confidence.

The limited sample size resulted from the unavailability of some annual reports and sustainability reports, which is a limitation of this study. In addition, the evidence from this study brings out that CSR has insignificant on EM. This study also doesn't formally examine whether other companies have an insignificant relationship between CSR and EM. For future research, it is possible to expand another variable CG as the relationship between CSR and EM. Future research can also do the same study in another country with a different feature set.

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