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## POLITICAL CONNECTION AND REAL EARNINGS MANAGEMENT: THE MODERATING ROLE OF AUDIT QUALITY AND FOREIGN OWNERSHIP

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### ABSTRACT

**Purpose** – This study investigates the relationship between politically connected boards (PC) (both boards of directors [BODs] and supervisory boards [SBs]) and real earnings management (REM). This paper also discusses about the moderating role of audit quality (AQ) and foreign ownership (FO) on relationship between PC and REM.

**Methodology/approach** – Quantitative research approach using data collection from annual reports and financial reports of listed manufacturing firm on the Indonesia Stock Exchange (IDX) for the last 3 years, from 2020 to 2022.

**Findings** - The results showed that politically connected boards of directors and commissioners have a positive effect on real earnings management. Meanwhile, high audit quality and foreign share ownership as moderation can reduce earnings management behavior. The results support agency theory that political connections increase agency problems through earnings management practices, and good corporate governance suppresses management's deviant behavior

**Practical implications** - The practical implications of this research include improving the quality of audits and internal controls, periodic checks, communication, reporting, and future research directions in the field of management control. These implications can be utilized by practitioners, organizations, shareholders, and researchers in avoiding earnings management behavior.

**Originality/value** - The originality and novelty of this research lies in the addition of good corporate governance variables, foreign ownership as moderating variables.



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**Keywords** – Manufacturing Firm, Political Connection; Real Earnings Management.

**ABSTRAK**

**Tujuan** – Penelitian ini bertujuan untuk mendeskripsikan dan menganalisis hubungan antara perusahaan dengan direktur yang terkoneksi politik (PC) dan perilaku manajemen laba riil di Indonesia (REM). Penulis juga membahas mengenai peran moderasi kualitas audit (AQ) dan kepemilikan asing (FO) pada hubungan antara PC dan REM.

**Metode/pendekatan** – Pendekatan penelitian kuantitatif dengan data yang didapatkan dari laporan tahunan dan laporan keuangan Perusahaan Manufaktur yang terdaftar di Bursa Efek Indonesia (BEI) selama 3 tahun terakhir, yaitu dari tahun 2020 hingga 2022.

**Hasil** – Hasil penelitian menunjukkan bahwa dewan direksi dan komisaris terkoneksi politik berpengaruh positif terhadap manajemen laba riil. Sementara itu, tingginya kualitas audit dan kepemilikan saham pihak asing sebagai moderasi mampu menurunkan perilaku manajemen laba. Hasil penelitian ini juga mendukung teori agensi di mana koneksi politik meningkatkan masalah agensi melalui praktik manajemen laba, dan good corporate governance menekan perilaku menyimpang manajemen.

**Implikasi praktik** – Implikasi praktis dari penelitian ini meliputi peningkatan kualitas audit dan pengendalian internal, pemeriksaan berkala, komunikasi, pelaporan, dan arah penelitian di masa mendatang pada bidang pengendalian manajemen. Implikasi ini dapat dimanfaatkan oleh praktisi, organisasi, pemegang saham, dan peneliti dalam menghindari terjadinya perilaku manajemen laba.

**Orisinalitas/kebaharuan** – Orisinalitas dan novelty pada penelitian ini terletak pada penambahan variabel good corporate governance, kepemilikan asing sebagai variabel moderasi.

**Kata kunci:** Koneksi Politik; Manajemen Laba Riil; Perusahaan Manufaktur.

## INTRODUCTION

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The important information for shareholders regarding company performance is contained in the financial statements. Through financial reports, stakeholders are able to assess responsibility and how management manages resources and earns profits ([Panjaitan & Muslih, 2019](#)). The income statement is one of the parts of the financial statement ([Setiawati et al., 2023](#)). The profit disclosed in this report include important information that becomes a benchmark for stakeholders in assessing company performance ([Supatmi & Handayani, 2022](#)).

In financial statement preparation activities, management is often involved in financial statement manipulation activities, to obtain a higher share price to fulfill investor and company expectations and show adherence to financing arrangements, and obtain financing or more favorable financing terms ([Narsa et al., 2023](#)). This accounting violation is called earnings management ([Enomoto et al., 2015](#)).

Earnings management is an accounting manipulation by changing the nominal amount in the financial statements which results in users of financial statements not obtaining valid and adequate information ([Agustia & Suryani, 2018](#)). This activity can include accounting activities in good faith, but can also refer to a negative orientation due to the discretion provided by Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), so that it can manipulate earnings, as well as cause other deliberate actions designed to mislead investors ([Davis & Khadivar, 2024](#)).

In Indonesia, a case regarding earnings management has been experienced by PT Tiga Pilar Sejahtera Food Tbk (AISA). AISA's Board of Directors allegedly carried out accounting engineering in the form of overstatement of receivables amounting to IDR 1.4 trillion from six affiliated distributor companies which were recorded as third parties in the company's 2017 financial statements ([Soenarso, 2021](#)).

Because earnings management strategies have the potential to render earnings information meaningless, investors need to exercise greater caution when thoroughly examining earnings data. Furthermore, research indicates that earnings management may present false information to investors, deceiving them and ultimately lowering stock prices and corporate value ([Ramadan, 2021](#)).

The value of the company is negatively impacted by earnings management, according to a number of earlier research. The credibility of financial statements can be weakened by earnings management techniques in addition to lowering the quality of results ([Nelwan & Tansuria, 2019](#)). The conclusion is that when managers manipulate results to gain from compensation plans ([Athanasakou et al., 2009](#); [Walker, 2013](#)) or lower the stock price to increase the benefits of employee stock option plans ([Garanina, 2024](#)), the market perceives such opportunistic behavior adversely.

There are various factors that can influence management decisions in practicing earnings management ([Susanto & Majid, 2017](#)). These factors can come from internal companies, such as audit committees, profitability, leverage, cash flow, boards of commissioners and directors, and ownership concentration ([Aljughaiman et al., 2023](#); [Ardillah & Vesakhadevi, 2021](#); [Karina, 2021](#); [Narsa et al., 2023](#); [Setiawati et al., 2023](#); [Syarif et al., 2022](#); [Tang & Fiorentina, 2021](#); [Wulandari & Suganda, 2021](#)) as well as external to the company, such as KAP size, auditor turnover, market orientation, and company political relations ([Boubakri et al., 2012](#); [Braam et al., 2015](#); [Harianto, 2022](#); [Hu et al., 2017](#); [Narsa et al., 2023](#); [Supatmi & Handayani, 2022](#); [Syarif et al., 2022](#); [Yang et al., 2022](#)).

This study focuses on reviewing the connection between political connection and real earnings management. From 2010 to 2019, in addition to IFRS implementation, Indonesia also experienced major changes that could potentially impact the connection between profit management practices and political affiliations. Enhanced stability in both politics and the economy throughout the second term of President Susilo Bambang Yudhoyono resulted in firmly formed political ties from 2009 to the present ([Joni et al., 2020b, 2020a](#)).

The existence of political connections on board is one of the determinants of company performance, since governmental policies greatly impact business operations and decision-making ([Joni et al., 2020b](#)). Political ties mean that the board of directors and commissioners of a company have a politician and bureaucrat relationship with the government ([Ahmad et al., 2023](#); [Kamarudin et al., 2021](#)). Companies that establish relationships with the government are able to overcome various kinds of conflicts, challenges, limitations, to market competition and bureaucratic problems. In addition, the presence of politicians in companies, especially in developing countries, can easily provide loopholes in obtaining important contracts, resulting in higher company performance and shareholder value ([Baig et al., 2023](#)).

Based on resource-based view (RBV) theory and agency theory ([Jensen & Meckling, 1976](#)), there is a growing body of research investigating the connection between real earnings management and political relationships. In the context of PCB-REM relationships, it seems that PCBs have special resources-like access to government resources and political connections-that provide them a competitive edge over non-PCBs ([Ben Cheikh & Loukil, 2023](#)). It is evident from REM that PCBs use their political ties as a tool to control their revenue. They can also have an impact on regulatory or governmental choices, allowing them to participate in REM without worrying about being discovered. This ability allows them to manage their income according to their interests ([Ahmad et al., 2023](#)).

Meanwhile, a fundamental idea in corporate governance and organizational economics, agency theory addresses the possibility of conflicts of interest and the processes by which agents' and principals' interests might be aligned. This theory explains how political connections (PCB) can be involved in real earnings management (REM) activities that have the potential to harm the interests of company owners. The potential losses caused by earnings management practices arise due to disparities in interests between company owners (principal) and company management (agent) ([Feviana & Supatmi, 2021](#)). [Ghorbani & Salehi, \(2021\)](#) also revealed that one of the agency problems is when companies carry out earnings management. The increase in earnings management behavior is driven by the mismatch of goals between managers and shareholders.

The findings of studies on the influence of political connections on REM practices are found to vary. Some studies were conducted on financial companies, such as ([Baig et al., 2023](#); [Supatmi & Handayani, 2022](#)). PCBs are seen as more effective and focused on the trading industry than non-PCBs. This success is considered to be the influence of political connections or government relations that generate additional funds to support preferential business, as well as improve company performance during crisis periods ([Saeed et al., 2019](#)).

However, other studies have found that political connections have a negative impact on firm performance ([Ahmad et al., 2023](#); [Cheema et al., 2016](#)). This negative impact is caused because they recognize the impact of government as a big deal between companies and political figures, where companies and political figures give up some of their management rights in exchange for protection and financial support. Politically influenced businesses are subject to a variety of limitations, including a decreased propensity to reestablish their

operations, a reduced budget for R&D, a reliance on instantaneous investments, and a lower actual growth and performance in sales compared to fewer powerful businesses ([Cheema et al., 2016](#); [Jackowicz et al., 2014](#)). The following theory is supported by the rationale surrounding the impact of PCB on real earnings management and the gap in earlier research:

**H<sub>1</sub> : PCB has a positive effect on real earnings management**

In line with agency theory, management only acts in the shareholders' best interests when their interests are not aligned ([Felicio & Galindo Villardon, 2015](#)). When there is a greater asymmetry in information between ownership and management, this leads to agency issues. In the end, this knowledge gap makes using external audit services more popular among businesses. Through the process of auditing, businesses can update their financial data and guarantee its accuracy and legitimacy. It can be said that audits can help improve the credibility of financial statements ([Khalil et al., 2022](#)).

According to earlier studies, PwC, EY, KPMG, and Deloitte are the four large, international public accounting firms that offer higher-quality audits ([Butar, 2020](#); [Shahzad et al., 2019](#)). Because of their greater skill levels, they are also thought to be better able to identify potentially earnings management actions and dubious accounting procedures ([Choi et al., 2018](#)). High audit quality is seen as an appropriate a method to lessen information asymmetry and match shareholders' and principals' interests. This can be seen when the quality of auditors rises, the tendency of audit effectiveness improves, credibility also increases, thus the ability to limit management's opportunistic behavior also increases ([Baig et al., 2023](#); [Nguyen et al., 2024](#)). This study's second hypothesis asserts that:

**H<sub>2</sub> : Audit quality (AQ) can reduce the positive relationship between PCB and real earnings management.**

From the standpoint of agency theory, conflicts of interest, which result from information asymmetry, define the interaction between management and shareholders ([Felicio & Galindo Villardon, 2015](#)). In order to accomplish their own objectives, PCBs may demonstrate a propensity to participate in REM, which could lead to a misalignment of their concern with those of shareholders ([Cohen & Zarowin, 2010](#); [Saeed et al., 2019](#); [Yusnandar et al., 2020](#); [Zhang et al., 2023](#)). However, PCBs depend on ownership concentration as corporate governance to restrain managers' opportunistic conduct in developing nations where concentrated ownership is a prominent characteristic.

According to the literature, foreign investors reduce management's engagement in self-serving opportunistic conduct by increasing oversight of the management because they're more autonomous compared to domestic investors with connections to management ([Giannetti & Laeven, 2008](#)), limiting management's engagement in opportunistic activity to profit themselves. In addition, foreign investors also obey the rules and laws of their home and host countries ([Alghemary et al., 2024](#)). Thus, the third hypothesis in this investigation suggest that:

**H<sub>3</sub> : Foreign ownership (FO) can reduce the positive relationship between PCB and real earnings management.**

The goal of this study is to observe whether REM is related to ownership structure, particularly in PCBs. It focuses on the possibility that management's opportunistic behavior tends to be higher when politically connected than those who are not politically connected. This study also analyzes the moderating effects of good corporate governance (audit quality and foreign ownership) on the connection between PCBs and REM, so as to reduce opportunistic behavior in PCBs which in turn reduces REM behavior.

To prevent biased calculation results, this research also adds many variables that have been used in earlier research as control variables, namely company size, ROA, and leverage ([Harianto, 2022](#); [Kumala & Siregar, 2021](#); [Wan Mohammad & Wasiuzzaman, 2020](#)).

The novelty in this research is to use an indicator of GCG, foreign ownership as a moderating variable. Foreign investors who invest in developing countries generally have better business skills than domestic investors. With the entry of foreign investors or institutions into Indonesia, it is expected to provide a positive knowledge spillover effect for domestic business people to avoid problems that may occur due to real earnings management actions.

## METHOD

This research looks at the political connections of corporate board members to real earnings management behavior. This research using a numerical method. Empirical testing is performed to analyze factors that can reduce opportunistic behavior in politically connected board members, using good corporate governance variables, which is audit quality, and foreign ownership as moderating variables. This is related to the empirical findings of several prior research which state that the moderating role of good corporate governance can be an effective attribute to reduce real earnings management behavior ([Paramita & Hidayanti, 2021](#)).

Manufacturing enterprises registered on the Indonesia Stock Exchange (IDX) include both the population and samples used in this study. Purposive sampling was utilized to pick the sample based on a set of criteria, such as firms that were not delisted during the 2020–2022 study period, regularly released annual reports and entire company financial reports, and stated the data required for research. Upon sample identification, 145 firms were found.

The variables under investigation in this study are political connections and real earnings management, with audit quality and foreign ownership as moderating variables. This study also tested three control variables, namely company size, company performance, and leverage. A politician is a person who belongs to a local, national, or ministerial council, or as a member of a political party ([Ahmad et al., 2023](#); [Braam et al., 2015](#)). PCB is proxied by a dummy variable, which takes the value 1 if the company's directors or commissioners are or have served as politicians, and 0 otherwise.

The model ([Roychowdhury, 2006](#)) that assesses the anomalous level of three activities-sales, production, and discretionary costs-is applied to the real earnings management variable. The residual value in each estimation model shows evidence of real earnings management through these three actions.

### ***Abnormal Cash Flow Operation (AbnCFO)***

$$CFO_t/At-1 = \alpha_0 + \alpha_1*(1/At-1) + \alpha_2*(St/At-1) + \alpha_3*(\Delta St/At-1) + \epsilon_t \dots (1)$$

CFO<sub>t</sub> = Cash flow from operating activities period t

At-1 = Asset year t-1

St = Sales year t

ΔSt = Difference sales from year t to year t-1

### ***Abnormal Discretionary Expenses (Abn-DISEXP)***

$$DISEXP_t/At-1 = \alpha_0 + \alpha_1*(1/At-1) + \alpha_2*(St-1/At-1) + \epsilon_t \dots (2)$$

DISEXP<sub>t</sub> = Discretionary Expense (R&D expense+ promotion expense

+ sales cost, general & administration) year t

**Abnormal Production Cost (AbnPROD)**

$$PROD_t / A_{t-1} = \alpha_0 + \alpha_1 * (1 / A_{t-1}) + \alpha_2 * (S_t / A_{t-1}) + \alpha_3 * (\Delta S_t / A_{t-1}) + \alpha_4 * (\Delta S_{t-1} / A_{t-1}) + \epsilon_t \dots (3)$$

$$PROD_t = COGS + Inventory \text{ year } t$$

$$\Delta S_{t-1} = \text{Difference sales from year } t-1 \text{ to year } t-2$$

**The sum of real earnings management is called REM**

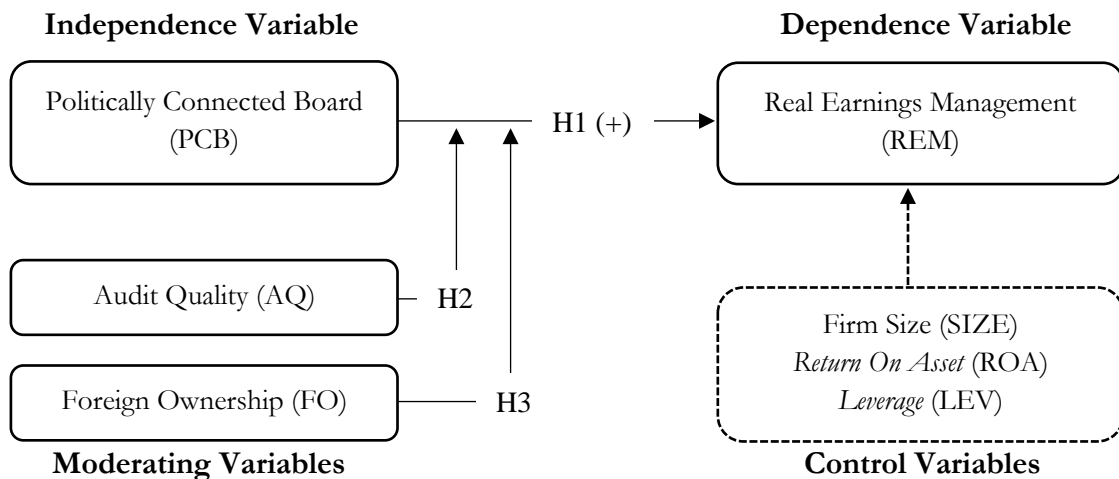
$$REM = AbnCFO * (-1) + AbnDISEXP * (-1) + AbnPROD \dots \dots \dots (4)$$

The good corporate governance variables used as moderating variables in this study are audit quality and foreign ownership. Audit quality is proxied by a dummy variable, which takes the value 1 for companies with Big-4 auditors, and 0 otherwise. Foreign ownership is proxied by the proportion of common shares owned by foreign parties, both individuals and organizations.

The natural logarithm of total assets for company size, ROA for firm size, and leverage make up the measurement of the control variables.

The data analysis utilized to test the study model utilizes many statistical processes. First, calculating the amount of each real earnings management of the three activities using SPSS software, then, multiple regression analysis conducted using EViews 12 software to analyze the influence of political relations on real earnings management through moderating variables.

The connection of a dependent variable (endogenous variable) and the variable of independence can be reinforced or weakened through the mediating variable. In accordance with the structural equation above, the research design can be described as follows:



**Figure 1.** Research Framework Model

**JRAK RESULT AND DISCUSSION**

**15.1**

Table 1 shows summary data for the major variables, were first reported as the analysis got underway. The complete sample, PCBs, and nonPCBs are the three distinct categories for which the results are reported individually in the descriptive statistics. 91 of the 435

enterprises' years in the sample were PCB years, and 344 were nonPCB years, based on the data provided in Table 2. The significance of the mean differences between PCBs and nonPCBs for the basic and control variables was examined using mean difference analysis. PCBs exhibit higher levels of REM engagement than non-PCBs, according to Table 2, and Table 3 presents the mean differences in REM between PCBs and non-PCBs. At the traditional thresholds of 1%, 5%, and 10%, Table 3's results indicate a substantial mean difference between PCBs and nonPCBs for a number of control variables.

Table 4 shows that the correlation between PCB and REM is negative and significant, and significant correlation of other variables with REM with probability less than 0.8. This indicates that the relevant variables survive the issue of multicollinearity.

Variable	Label	Nature of variable	Description
<i>Dependent variables</i>			
Real earnings management	REM	Numerical	The abnormal cash flow from discretionary expenses is multiplied by -1 before being added to the abnormal cash flow from output.
<i>Independent variables</i>			
Political Connection	PCBs	Categorical	Coded "1" if a minimum of one member of the board of directors is a politician or member of parliamentary; else coded "0"
Audit quality	AQ	Categorical	BIG 4 Firm Audit classified as 1, else = 0
Foreign ownership	FO	Numerical	Percentage of shares owned by foreigners
<i>Control variables</i>			
Firm size	FS	Numerical	Natural log of total assets
Return on asset	ROA	Numerical	Ratio of total profit to total asset is known as ROA.
Leverage	LEV	Numerical	Ratio of total debt to total asset value is known as leverage.

**Table 1.** Description of Variable  
**Source(s):** Data from researchers, 2023

Variable	Mean	SD	Min	Max
<i>Full sample (N = 435)</i>				
<i>Dependent variable</i>				
REM	0.847865	1.280118	-0.1952	16.36030
<i>Control Variables</i>				
FS	28.54682	1.655495	25.35115	33.65519
ROA	0.032261	0.106553	-0.450858	0.978078
LEV	0.536822	0.560984	0.0000430	5.167738
<i>PCBs (N = 91)</i>				
<i>Dependent variable</i>				
REM	0.691637	0.622252	-0.0309	3.456400
<i>Control Variables</i>				
FS	29.84277	1.766249	26.67287	33.65519
ROA	0.054134	0.116020	-0.30266	0.599025
LEV	0.591207	0.866170	0.0000430	5.167738
<i>Non-PCBs (N = 344)</i>				
<i>Dependent variable</i>				
REM	0.889192	1.401311	-0.1952	16.36030
<i>Control Variables</i>				
FS	28.20399	1.444216	25.35115	32.55008

**Table 2.**  
Descriptive  
Statistic

ROA	0.026475	0.103311	-0.450858	0.978078
LEV	0.522435	0.447599	0.061132	4.098801

Source(s): Processing Data, 2023

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Variable	Politically connected business (PCBs)	Non-politically connected business (non-PCBs)	Differences
<i>Dependent variable</i>			
REM	0.691637	0.889192	-0.197555*
<i>Control Variables</i>			
FS	29.842770	28.203990	1.638780***
ROA	0.054134	0.026475	0.027659**
LEV	0.591207	0.522435	0.068772***

Note(s): \* indicates significance at 1%, \*\* indicates significance at 5%, and \*\*\* indicates significance at 10%

Source(s): Processing Data, 2023

**Table 3.**  
Difference of  
Mean Test

	REM	PCBs	AQ	FO	FS	ROA	LEV
REM	1						
PCBs	-0.063	1					
AQ	0.166	0.207	1				
FO	-0.026	0.120	0.401	1			
FS	0.046	0.403	0.501	0.266	1		
ROA	0.370	0.106	0.243	0.077	0.221	1	
LEV	0.058	0.050	-0.098	0.020	-0.056	-0.123	1

Note(s): \* indicates significance at 1%, \*\* indicates significance at 5%, and \*\*\* indicates significance at 10%

Source(s): Processing Data, 2023

**Table 4.**  
Correlation  
Matrix

Table 5 illustrates the consequences of political ties directly on REM, by taking into account a different metric of political connectivity, namely the percentage of politically linked members of boards (henceforth abbreviated as "PC"). Table 5 presents the findings from the Hausman and Chow tests (Hausman, 1978). The findings demonstrate a clear positive and substantial correlation between PCB and REM, PCB ( $\beta = 0.0051$ ,  $p < 0.01$ ). This suggests that companies with political affiliations participate in REM more frequently because they can afford to do so, are subject to less scrutiny, and are motivated to falsify financial accounts in order to satisfy investors and further their own agendas (Ahmad et al., 2023; Amara & Khalif, 2020; Guedhami et al., 2009; Saeed et al., 2019).

Variables	REM
<i>Independent Variable</i>	
PC	0.0051* (2.822375)
<i>Control Variable</i>	
FS	0.00000 (6.202742)
ROA	0.00000 (22.72342)

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15.1

**Table 5.**  
Result of  
Fixed Effect  
Regression

LEV	0.00000 (12.63960)
Industry FE	Yes
Year FE	Yes
Constant	0.0000 (-6.065635)
Observations	435
R-squared	0.991655
Number of companies	145
Chow test	0.0000
Hausman test	0.0349

**Note(s):** \* indicates significance at 1%, \*\* indicates significance at 5%, and \*\*\* indicates significance at 10%. T-statistics are displayed within parenthesis

**Source(s):** Processing Data, 2023

The positive relation of PCB's on REM supports agency theory's monitoring ([Ahmad et al., 2023](#)), when political parties hold posts on the board of directors of the corporation, the greater their chances of achieving individual interests, compared to the interests of the company ([Feviana & Supatmi, 2021](#); [Ghorbani & Salehi, 2021](#)).

According to ([Saeed et al., 2019](#); [Amara and Khalif, 2020](#); [Ahmad et al., 2023](#)), it is implied that companies with political ties participate in REM more frequently because they have a link to financial resources, are under fewer scrutiny, and are motivated to manipulate financial statements in order to satisfy investors and safeguard their goals.

This finding is in line with the idea that firms with politically connected boards may use this opportunity to limit discovery risk and safeguard managers, given the possible benefits of political relationships. This result is consistent with a number of earlier investigations ([Ahmad et al., 2023](#); [Baig et al., 2023](#); [Cohen & Zarowin, 2010](#); [Kamarudin et al., 2021](#)).

This study also found that the control variables FS, ROA and LEV ( $\beta = 0.000, p < 0.01$ ) showed a significant relationship with REM.

Variables	REM
<i>Independent Variable</i>	
PCBs	0.0000* (27.29335)
<i>Moderating Variable I</i>	
AQ*PCBs	0.0105* (-2.575105)
<i>Independent Variable</i>	
PCBs	0.0000* (33.50492)
<i>Moderating Variable II</i>	
FO*PCBs	0.0000* (-4.470375)

**Note(s):** \* represents significance at 1%, \*\* represents significance at 5%, and \*\*\* represents significance at 10%. T-statistics are presented in parentheses

**Source(s):** Processing Data, 2023

Table 6 shows the effect of PCBs on REM through moderating variables. Based on the results obtained, it can be concluded that companies audited by Big-4 audit firms can suppress management behavior in committing fraud.

This finding suggests that PCBs are subject to audits conducted by Big-4 audit firms, thereby reducing management involvement in earnings manipulation (Baig et al., 2023). This shows that high audit quality can increase transparency, and reduce agency conflicts by convincing shareholders. A higher level of AQ can also increase the veracity of financial reports (Baig et al., 2023; Khalil et al., 2022). When the quality of auditors increases, the tendency of audit effectiveness improves, credibility also builds up, so the ability to limit management's opportunistic behavior also increases. It may be concluded that the strictness of the audit level is very important in reducing management's opportunistic conduct in financial irregularities and income manipulation.

This research also shows the role of strict auditors in increasing the likelihood of detecting financial irregularities (Mnif & Ben Hamouda, 2020). It can be concluded that the strictness of the audit level is very important in suppressing management's opportunistic behavior in financial irregularities and income manipulation.

In addition, it was found that high Foreign Ownership can suppress and limit Real Earnings Management actions. The ability of foreign investors has proven to be able to reduce manipulation by managers by implementing a good corporate governance system. With a concentrated ownership structure pattern in Asian countries including Indonesia, it makes it easier for foreign parties to control and supervise every management decision. In addition, foreign investors also oversee all activities directly related to business operations in great detail (Prakasa & Ekawati, 2020).

## CONCLUSION

This study reveals perspective into the relationship of political connections and REM that increase management opportunistic behavior in manufacturing companies in Indonesia. PCBs show an increasing trend in REM activities that reduce revenue, due to the fact that this link shields business managers from danger and decreases risk detection (Baig et al., 2023). This result shows the significance of investigating how sound company governance influences this correlation.

The presence of big 4 auditors is attached with a decrease REM in PCB. This shows that high audit quality can increase transparency, and reduce agency conflicts by convincing shareholders. A higher level of AQ can also increase the veracity of financial reports (Baig et al., 2023; Khalil et al., 2022). This study also show that the control variables FS, ROA and LEV have a significant effect on REM.

The link between PCB and REM is also lessened by foreign ownership. According to earlier research, international investors keep a closer eye on management since they have a greater autonomous than domestic investors who typically have connections to the management (Giannetti & Laeven, 2008). This keeps management from engaging in self-serving opportunistic conduct. Furthermore, international investors adhere to the legal and regulatory frameworks of both their home and host nations (Alghemary et al., 2024).

This is consistent with earlier studies' findings that GCG can improve financial statements' trustworthiness and provide a better means of identifying abnormalities (Baig et al., 2023; Ikhsan et al., 2023; Paramita & Hidayanti, 2021). This study adds to the body of knowledge

in a number of important ways, including a better understanding of how REM lowers earnings by examining the moderating influence of GCG in the context of PCBs. This distinct viewpoint offers insightful information on how these elements interact and how their combined effects affect earnings management tactics.

Despite the interesting results, this investigation possesses certain restrictions. First, this study has a small sample size, which is from 2020 to 2022. Future research could re-investigate this topic using a different sample, for example, for the period 2018 to the present covering before, during, and after the Covid-19 pandemic. The more evidence that shows the pandemic has an impact on accounting and financial practices, the more interesting it is to find out the extent to which the pandemic affects the relation of political connections and earnings management.

Second, researchers have no sufficient data to examine if corporations that have relationships with powerful parties benefit more than companies that have relationships with other parties. For this reason, future research can add several developing countries where there are many boards of directors with political connections.

Third, this study only uses the real earnings management model. Future research should add an accrual-based earnings management model to assess and contrast various profit management approaches in more detail.

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