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Corporate Governance Mechanism Towards Earnings Management: Does Financial Distress Could Make It Better?

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Abstract
This study aims to assess the impact of institutional ownership, managerial ownership, board size, and audit committee size on earnings management, with a focus on the intervening variable of financial distress. Employing a causality research design, secondary data were derived from the annual financial reports of State-Owned Enterprises listed on the Indonesia Stock Exchange for the period 2017–2021, encompassing 20 companies. A purposive sampling technique was applied to select a sample of 11 companies, and data processing and analysis employed path analysis and t-tests through the IBM SPSS 25 analysis tool. The findings reveal that managerial ownership exerts a negative influence on financial distress, while audit committee size exhibits a positive impact on financial distress. In contrast, institutional ownership and board size do not significantly affect financial distress. Financial distress, in turn, influences earnings management and serves as a mediator in the relationship between audit committee size and earnings management. However, financial distress does not act as a mediator for the effects of institutional ownership, managerial ownership, and board size on earnings management. The study underscores that the implementation of good corporate governance practices within companies can effectively mitigate earnings management practices and safeguard against the onset of financial distress.
Keywords: institutional ownership, managerial ownership, size of board of directors, audit committee size, financial distress, earnings management.
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1.Introduction

State-owned enterprises (SOEs) represent business entities with capital derived either wholly or partially from state assets, with a minimum state capital participation of 51%. These entities play a crucial role in national development through their direct and indirect involvement in strategic projects. Seeking profits to sustain operations, SOEs rely on financial health indicators to convey their well-being to stakeholders.

In the realm of financial reporting, adherence to established principles is essential for maintaining transparency. However, certain companies engage in financial manipulation, particularly about earnings management, leading to information asymmetry and consequential losses for stakeholders. Information asymmetry arises from the management's possession of more information than shareholders, enabling them to manipulate reported earnings. Earnings management obscures the true financial status of a company in its financial reports. Pressure on companies to meet predetermined profit targets significantly contributes to the prevalence of earnings management. 1. 1,An examination of PT Waskita Karya (Persero) Tbk's financial statements for the 2004-2007 period revealed an inflated net profit of approximately IDR 400 billion, a sum that should have been recognized in subsequent years.

Recognizing the challenges posed by earnings management, the Ministry of State-Owned Enterprises has implemented regulations mandating the adoption of good corporate governance by SOEs. While it serves as a monitoring tool to mitigate the risk of earnings management, the optimal implementation of good corporate governance remains a challenge for several SOEs. Notably, the bribery case involving Wisnu Kuncoro, Director

of Technology and Production at PT Krakatau Steel (Persero) Tbk, underscores the repercussions of suboptimal governance within SOEs.

By the Law of the Republic of Indonesia Number 19 of 2003 concerning State-Owned Enterprises, the board of directors assumes the responsibility of managing an SOE for its interests and objectives. Furthermore, Regulation PER-01/MBU/2011 stipulates that the Board of Directors must disclose their share ownership in the relevant SOE or other companies.

This research builds upon the findings of a prior study by Riadiani and Wahyudin (2015), which asserted that good corporate governance does not impact earnings management. Instead, financial distress negatively affects earnings management, while institutional ownership, managerial ownership, and board size exhibit a negative influence on earnings management when mediated by financial distress. The audit committee, however, was found to not affect earnings management.

The research aims to contribute to academic understanding and practical insights. Academic benefits include serving as a reference for future research on the interplay of good corporate governance, earnings management, and financial distress. Meanwhile, practical benefits extend to informing company management that robust implementation of good corporate governance can generate quality profits and safeguard against potential bankruptcy. Additionally, for regulators, this research serves as a valuable tool for enhancing supervision of good corporate governance implementation in SOEs, aiming to optimize its effectiveness and curb the prevalence of earnings management practices.

In instances of financial distress, companies may resort to earnings management practices to present favorable information to stakeholders. A notable case is observed in the financial statements of PT Garuda Indonesia (Persero) Tbk for the fiscal year 2018, where earnings management practices were identified. The company deviated from the generally accepted Statement of Financial Accounting Standards in its accounting treatment, prompting the Financial Services Authority, as the regulatory body, to issue a written directive for PT Garuda Indonesia (Persero) Tbk to restate its 2018 financial statements. The revised statements, released on July 26, 2019, revealed a transformation of the initially reported profit of US$ 5.018 million into a loss of US$ 175.028 million.

Notably, in the fiscal year 2020, PT Garuda Indonesia (Persero) Tbk accumulated a total debt of US$ 12 billion, surpassing its total assets of US$ 10 billion. This imbalance raises concerns about the company's ability to meet its obligations to lenders and vendors. Earnings management, understood as a strategic choice in accounting policies, becomes a critical tool for management to influence reported earnings and achieve specific goals, as outlined by Scoot (2015). Consequently, investigating the relationship between corporate governance mechanisms, earnings management, and the impact of financial distress emerges as a pertinent research problem. Specifically, the inquiry seeks to determine whether financial distress enhances or mitigates the practice of earnings management within corporations.

Given the context, the issues about profit management are evident in certain State-Owned Enterprises (SOEs) that exhibit heightened profits while concurrently engaging in profit management practices. Additionally, although some SOEs have adopted good corporate governance, there remains a discrepancy in the optimal implementation of corporate governance, contrary to the stipulations outlined in the Regulation of the Minister of State-Owned Enterprises. Furthermore, the presence of financial challenges within certain SOEs contributes to the adoption of profit management practices by these companies. This research aims to explore and understand the intricate dynamics between corporate governance mechanisms, earnings management, and the influence of financial distress on such practices within the framework of State-Owned Enterprises.

2. LITERATURE REVIEW

Agency theory, an offshoot of game theory, delves into the design of contracts aimed at incentivizing rational agents to align their actions with the principal's desires (Scoot, 2015). According to Jensen and Meckling (1976), agency theory involves a contract wherein one or more principals enlist another party (the agent) to execute services on their behalf, thus entrusting decision-making authority to the agent. Imbalances in information, known as information asymmetry, between management and shareholders give rise to agency problems, leading to conflicts of interest and subsequent agency costs. Effective implementation of corporate governance in state-owned enterprises (SOEs) revolves around investor control over managers, to minimize agency costs (Idawati, Wiwi, Muchlis & Retno Dwi Ningtyas, 2022).

Signaling Theory, elucidated by Spence (1973), revolves around actions undertaken by company management to offer insights into the prospects of the company (Brigham and Houston, 2019). Companies must provide signals to users of financial reports, whether positive or negative, to convey their position effectively. In the face of significant financial distress, companies often resort to earnings management, manipulating profits to signal their predicament to stakeholders in hopes of mitigating share price declines (Lo, 2012). Good corporate governance encompasses systems, processes, and structures fostering harmonious relationships between management and stakeholders, with mechanisms categorized as external (influenced by factors outside the company) and internal (influenced by factors within the company), as outlined by Sutedi (2012).

Regulation number PER-01/MBU/2011 defines members of the Board of Commissioners/Independent Supervisory Board as individuals without financial, management, share ownership, or family ties to other supervisory board members, directors, controlling shareholders, or the SOE itself, ensuring their independence. The audit committee, mandated by the Law of the Republic of Indonesia Number 19 of 2003 concerning State-Owned Enterprises, assists the commissioners and supervisory boards in assessing activities and audit results, recommends improvements to management control systems, ensures thorough review procedures for all issued information, and identifies critical matters for consideration by the commissioners and the supervisory board (Idawati, Wiwi & AN Hanifah, 2022).

Financial distress ensues when a company lacks cash flow to meet obligations or operates under an unsustainable business model requiring asset restructuring (Altman et al., 2019). Types of financial difficulties include failure (inadequate return on invested capital), insolvency (inability to meet obligations), default (failure to meet contractual agreements), and bankruptcy (liabilities surpassing assets).

Earnings management entails management's manipulation of financial report information to mislead stakeholders about the company's performance and condition (Sulistyanto, 2018). Strategies include income increasing (boosting current profits), income decreasing (lowering current profits), and income smoothing (maintaining consistent profits over time).

3. Hypothesis Development

Institutional ownership and financial distress

Institutional share ownership can replace or strengthen the oversight function in a company, thereby reducing the risk of financial distress (Laurenzia and Sufiyati, 2015). Younas et al. (2021) in their research stated that institutional ownership has a significant positive effect, which means that institutional investors can play an active role in monitoring managerial decisions to keep companies out of financial difficulties.
H1: Institutional ownership has a positive effect on financial distress.

Managerial ownership and financial distress

The existence of managerial ownership in a company makes managers more careful in making decisions because they will bear the risk of these decisions. Large managerial share ownership causes management to be more active in fulfilling the interests of shareholders thereby reducing the occurrence of financial distress (Jannah and

Khoiruddin, 2017). Hanifah and Purwanto (2013) state that managerial ownership has a significant negative effect on financial distress. Companies that have high managerial ownership are able to reduce the potential for financial difficulties.

H2: Managerial ownership has a negative effect on financial distress

Size of the board of directors and financial distress

The board of directors is needed to reduce agency problems between owners and managers to create an alignment of interests between parties. The size of the board of directors has an impact on financial performance, namely reducing the potential for financial difficulties in the future (Putri and Aminah, 2019). Hanafi and Breliastiti (2016) in their research stated that the size of the board of directors has a significant negative effect, in which a large size of board of directors reduces the potential for financial difficulties in the company because it means the board of directors oversees the financial reporting process more effectively.

H3: The size of the board of directors has a negative effect on financial distress.

Audit committee size and financial distress

The existence of an effective audit committee in a company can change different policies on achieving accounting profits in the next few years so as to avoid financial problems due to lack of good performance in the company (Nuresa and Hadiprajitno, 2013). Damayanti and Kusumaningtias (2020) state that the smaller the size of the audit committee, the less the possibility of financial distress.

H4: Audit committee size has a positive effect on financial distress

Financial distress and earnings management

Conditions in which companies experience financial difficulties cause management to carry out earnings management, in which they report higher earnings than they should. Profit information shows the performance of managers and is highly regarded by investors. Profits are also used in decision-making. Therefore, earnings management makes investors increase their confidence so that financial information is presented correctly (Putri and Rachmawati, 2018). Ghazali et al. (2015) stated that financial distress has a negative effect on earnings management, which means that companies practice earnings management when the company is under stress, and vice versa if the company is not.

H5: Financial distress has a negative effect on earnings management

Financial distress, institutional ownership, and earnings management

Institutional investors monitor earnings management behavior by managers (Chen and Zhang, 2014). The existence of institutional share ownership is expected to reduce financial distress so that the level of earnings management will also decrease. Riadiani and Wahyudin (2015) in their research stated that institutional ownership has a significant negative effect. An increase in the value of the company indicates a decrease in the bankruptcy of the company, decreasing the potential for earnings management by managers.

H6: Institutional ownership has a negative effect on earnings management after being mediated by financial distress

Financial distress, managerial ownership, and earnings management

Managerial ownership as a good corporate governance mechanism helps control agency problems and reduces company costs so that firm value increases (Jensen and Meckling, 1976). Share ownership by managers is able to reduce the potential for financial distress and earnings management. Riadiani and Wahyudin (2015) in their research stated that managerial ownership has a significant negative effect, in which increased managerial ownership can encourage a reduction in financial distress. Managerial ownership suppresses the potential for earnings management and provides a positive signal to investors after financial distress.

H7: Managerial ownership has a negative effect on earnings management after being mediated by financial distress

Financial distress, size of the board of directors, and earnings management

A company's directors can improve supervision in decision making and carry out their work when financial distress occurs. Riadiani and Wahyudin (2015) in their research stated that the size of the board of directors has a significant negative effect, in which strict supervision of the board of directors makes the directors improve their performance and reduces the potential for earnings management by the board of directors.

H8: The size of the board of directors has a negative effect on earnings management after being mediated by financial distress

Financial distress, audit committee size, and earnings management

The audit committee is tasked with assisting the board of commissioners in providing overall oversight, so its existence is able to reduce earnings management actions by management. If a company experiences financial distress, the audit committee will be more stringent in supervising financial reporting by managers. Riadiani and Wahyudin (2015) in their research stated that audit committees have a significant positive effect because in general audit committees in companies are appointed based on closeness to the board of commissioners, not based on competence and capability. Earnings management practices are caused by a lack of oversight by the audit committee of the company.

H9: The audit committee has a positive effect on earnings management after being mediated by financial distress

4. Research methods

The study was conducted to determine and examine the effect of institutional ownership, managerial ownership, the size of the board of directors, and the size of the audit committee on profit management and its effect through *financial distress*. The object of this study is non-financial State-Owned Enterprises listed on the Indonesia Stock Exchange. The study focuses on State-Owned Enterprises (SOEs) listed on the Indonesia Stock Exchange, possessing comprehensive data for the research span from 2017 to 2021. Employing a purposive sampling technique, a sample of 11 SOEs was selected based on specific criteria: (1) Inclusion of non-financial industry SOEs listed on the Indonesia Stock Exchange between 2017 and 2021; (2) Availability of complete data for the entire study period. A causality research design was employed to explore causal relationships between variables. Research data, sourced from secondary data obtained indirectly or through documentation, comprises annual information for non-financial SOEs over the 2017-2021 timeframe. Data collection involved accessing the www.idx.co.id page and the respective websites of each SOE via the internet.

Variable measurement

This study consists of three variables: earnings management as the dependent variable (Y); institutional ownership (X1), managerial ownership (X2), board size (X3), and audit committee size (X4) as independent variables (X); and financial distress as intervening variable (Z). The operational definitions and measurements of each variable are shown in Table 1.

Table 1. Variable Measurement

Variable	Label	Measurement	Reference
Independent variable			
Institutional ownership	IO	IO = TSI / TOS X 100	(Kolsi and Grassa, 2017)
Managerial ownership	MO	MO = TSM / TOS X 100	(Anggana and Prastiwi, 2013)
Size of board of directors	BD	Total number of members of the board of directors	(Riadiani and Wahyudin, 2015)
Audit committee size	AC	Total number of audit committee members	(Kolsi and Grassa, 2017)
Dependent variable			
Earnings management	EM	DACit = (TACit/ At-1) – NDAit	(Dechow et al., 1995)
Intervening Variable			
Financial distress	FD	Z = 1.03A + 3.07B + 0.66C + 0.4D	(Springate, 1978)

Source: results of processed data by the authors, 2022

Data Analysis

Path analysis

This study uses the panel data regression analysis method in which panel data of several companies is observed over a certain period (Ghozali, 2018). Path Analysis is an extension of multiple linear regression analysis which is used to estimate the causality relationship between variables that has been previously determined based on theory (Ghozali, 2018). The regression equations in this study are:
Equation 1:

$$FD_{it} = \beta_0 + \beta_1 IO_{it} + \beta_2 MO_{it} + \beta_3 BD_{it} + \beta_4 AC_{it} + \epsilon_{it} \quad (1)$$

Equation 2:

$$EM_{it} = \alpha_0 + \alpha_1 IO_{it} + \alpha_2 MO_{it} + \alpha_3 BD_{it} + \alpha_4 AC_{it} + \alpha_5 FD_{it} + \omega_{it} \quad (2)$$

5. Research Results

The results of this descriptive statistical analysis provide information and descriptions of the mean, median, standard deviation, maximum and minimum values for each variable which were calculated based on the overall data. Table 2 shows the results of descriptive statistics in this study.

Table 2. Descriptive statistic result

Variable	EM	IO	MO	BD	AC	FD
Mean	0.00047	0.93271	0.00006	6.18	4.07	0.64709
Maximum	0.01966	0.99425	0.00023	9	9	1.56981
Minimum	-0.01557	0.82280	0.00000	5	5	-0.22874
Std. dev.	0.00797	0.05110	0.00006	1.06	0.92	0.37551
Observers	55	55	55	55	55	55

Source: reprocessed IBM SPSS 25 output, 2022

Table 2 shows; Profit management is the dependent variable used in this study, based on Table 4.3. shows that the profit management variable has a minimum value of -0.01557 originating from PT Waskita Karya (Persero) Tbk in 2020, the maximum value of 0.01966 comes from PT Semen Baturaja (Persero) Tbk in 2017, the average value of BUMN profit management for the 2017-2021 period is 0.00047. The standard deviation of the profit management variable is 0.007968740912075 which means that the study sample has profit management with a deviation of 0.00797 from its average value. This study used 2 (two) model regression analyses so that a partial test is carried out on those 2 (two) equations. This study accepts the hypothesis if the probability value is greater than the significance value (0.05). Based on the Table 3 and Table 4, the results of the following regression equation are obtained:

Table 3. Model regression analysis I

Coef.	Coefficient	Std. Error	t-Statistics	Sig.	Conclusion
(Constant)	-0.121	0.858	-0.141	0.888	-
IO	0.088	0.943	0.093	0.926	Rejected
MO	-1515.436	721.742	-2.100	0.041	Accepted
BD	0.022	0.050	0.445	0.658	Rejected
AC	0.157	0.058	2.723	0.009	Accepted
		Adjusted R-Squared			0.214
		R-Squared			0.272
		R			0.522

Source: reprocessed IBM SPSS 25 output, 2022

Table 3 shows that the institutional ownership variable has a significant value of 0.926 > 0.05, meaning that institutional ownership does not affect financial distress, so H1 is rejected. Research shows that no matter how large share ownership by institutions is, it does not reduce the possibility of financial distress, because share

ownership by institutions that is centralized and not spread causes shareholder control over management to be weak, so they do not have sufficient ability to control management to make decisions that benefit management. The results of the research follow the research of (Purba, 2019; Sastriana and Fuad, 2013; Widyasaputri, 2012) which state that institutional ownership does not affect financial distress, meaning that no matter how large the percentage of institutional ownership is, it can prove there is a possibility of financial distress. Unequal ownership causes a lack of transparency of company funds and balance between interests, making shareholders unable to control management properly so that management takes policies that only benefit themselves. This research is not in line with Aritonang (2013) which states that the positive relationship between institutional ownership and financial distress can be explained if the company is owned by institutional investors, indicating that management is considered unable to hide the losses experienced, which triggers financial distress.

The managerial ownership variable has a significant value of 0.041 < 0.05, indicating managerial ownership has a negative effect on financial distress, which means that H2 is accepted. The increase in managerial share ownership can reduce the potential for financial distress because management does not only act as the party that runs the company's operations but also owns company shares so that management acts more carefully and responsibly in making policies for the company. The results of this study are in line with the research of (Hanifah and Purwanto, 2013; Maryam and Afri Yuyetta, 2019) which state that managerial ownership has an effect on financial distress, which indicates that the greater the managerial ownership, the smaller the potential for financial distress to occur. The results of this study are not in line with (Cinantya and Merkusiwati, 2015; Sastriana and Fuad, 2013) which state that managerial ownership does not affect financial distress, which means that managerial ownership is a symbol that is used to attract investors' attention so that they think that company value is increasing along with managerial ownership. If the managers of the company own a portion of the company's shares, then the agency problem between the owner and the managers of the company can be resolved and the managers will maximize the value of the company.

The board of directors size has a significant value of 0.658 > 0.05, which indicates that the size of the board of directors has no effect on financial distress, so H3 is rejected. Regardless of the number of the board of directors, it does not reduce the potential for financial distress to occur because the board of directors has limitations in managing the company. Research conducted by (Arrum and Wahyono, 2021; Cinantya and Merkusiwati, 2015; Vionita and Lusmeida, 2019) state that the size of the board of directors does not affect financial distress, which means that it is consistent with the results of research which states that the board of directors has limitations in making decisions because policies must be decided at the General Meeting of Shareholders. This means that the large number of directors does not affect the occurrence of financial distress. This study is not in line with the research conducted by (Hanifah and Purwanto, 2013; Sastriana and Fuad, 2013) which stated that the size of the board of directors has a significant negative effect on financial distress because the existence of a board of directors is one of the corporate governance mechanisms, so the larger the size of the board of directors, the smaller occurrence of financial distress in the company.

The audit committee has a significant value of 0.009 <0.05 so the size of the audit committee has a positive effect on financial distress, which means H4 is accepted. Financial distress can be avoided or reduced when the company has a small audit committee size because the committees become effective and participate in focusing on monitoring internal audit activities. The results of this study are consistent with the research of (Damayanti and Kusumaningtias, 2020; Haziro and Negoro, 2017) which state that the more members of the audit committee, the higher the potential for financial distress due to the ineffectiveness of the committee in carrying out its duties. However, the results of this study are not in line with Masak and Noviyanti (2019) who state that audit committee size has a negative effect because large audit committee sizes, with their knowledge and work experience, can improve the quality of internal control to reduce financial distress.

Table 4. Model Regression Analysis II

Coef.	Coefficient	Std. Error	t-Statistics	Sig.	Conclusion
(Constant)	-0.037	0.017	-2.214	0.039	-
IO	0.049	0.019	2.549	0.014	-
MO	55.083	15.338	3.591	0.001	-
BD	-0.001	0.001	-0.828	0.412	-
AC	-0.003	0.001	-2.424	0.019	-
FD	0.010	0.003	3.359	0.02	Accepted
		Adjusted R-Squared			0.276
		R-Squared			0.343
		R			0.585

Source: reprocessed IBM SPSS 25 output, 2022

Table 4 shows that the financial distress variable has a significant value of 0.005 <0.05 so financial distress affects earnings management, which means H5 is rejected. Increased financial distress also causes an increase in earnings management carried out by the company. Shareholders have a desire for the company to achieve maximum profit while the company's management cannot always fulfill the wishes of shareholders, resulting in agency conflicts that can cause information asymmetry. Management's interest in making the company look healthy causes earnings management behavior to arise, preventing shareholders from getting real information about the condition of the company. The results of this study are in line with (Farhad and Amini, 2016; Paramita et al., 2017) which state that companies experiencing increased financial distress will have an increased possibility of earnings management. The results of this study are not in line with Ghazali et al. (2015) which states that financial distress hurts earnings management, which means that companies do not practice earnings management when conditions are depressed. Companies in depressed conditions are not involved in earnings management because management has run out of ways to manipulate earnings.

Table 5. Sobel test results

Hypothesis	Path	Sobel Test Statistic	Result
H6	IO → FD → EM	0.093	Not Accepted
H7	MO → FD → EM	-1.776	Not Accepted
H8	BD → FD → EM	0.043	Not Accepted
H9	AC → FD → EM	2.101	Accepted

Table 5 shows t-value < t-table (0.093 < 1.96), meaning that financial distress is unable to mediate the effect of institutional ownership on earnings management, so H6 is rejected. Institutional ownership that focuses on the last profit earned by the company causes management to increase short-term profits through earnings management. Large institutional ownership increases the utilization of company assets thereby reducing the occurrence of financial distress. The results of this study are consistent with Sari and Fanani (2016) who state that public companies in Indonesia tend to be centralized, resulting in a lack of transparency in the use of company funds and balance of interests between company management, controlling shareholders, and minority shareholders. As a result, shareholders do not have sufficient ability to control management, potentially resulting in management taking advantage that benefits a certain party. Research by (Ewanto et al., 2014; Fathoni et al., 2014) states that institutional ownership makes companies bound to meet profit targets set by investors, causing management to tend to do earnings management. Issuers with large shareholdings reflect power so that they can intervene in the company's operations and prepare financial reports. Earnings management arises from the desire of company owners to save the company from financial distress. This research does not follow Riadiani and Wahyudin (2015) who state that an increase in firm value which indicates a decrease in the level of corporate bankruptcy will lead to a decrease in earnings management by managers.

Table 5 shows t-value < t-table (-1.776 < 1.96), which means that financial distress is unable to mediate the effect of managerial ownership on earnings management, so H7 is rejected. Financial distress in the company is not triggered by the size of managerial share ownership but is more influenced by management's ability to manage the

company's operations and finances, influencing management to make earnings management decisions in the company. This research is consistent with Sari and Fanani (2016) who state that the majority of public companies in Indonesia originate from family companies so managerial share ownership worsens the company's condition because it triggers the possibility of misappropriation by management for personal gain. This means that the health of a company is not only caused by the size of the shares owned by the board of directors and the board of commissioners but is also influenced by the ability of the board of directors to manage the company. This research is not in line with Riadiani and Wahyudin (2015) who stated that managerial ownership pressures earnings management to give good signals to investors after financial distress.

Table 5 shows t-value < t-table (0.043 < 1.96), which means that financial distress is unable to mediate the effect of board size on earnings management, so H8 is rejected. The larger the size of the board of directors, the lower the level of supervision over decisions taken by the directors in the company's operations, causing the use of funds that are not following their functions and earnings management that only benefits certain parties. This research follows Sari and Fanani (2016) who state that the large size of the board of directors reduces its effectiveness in carrying out its functions, making it difficult to control. Public companies in Indonesia generally start as family companies so that the owner of the company also acts as a director, giving rise to the possibility of abuse by the board of directors for personal gain. This research is inconsistent with Riadiani and Wahyudin (2015) who state that strict supervision and control of the board of directors will improve performance and reduce earnings management practices by the board of directors.

Table 5 shows t-value > t-table (2.101 > 1.96), which means that financial distress can mediate the effect of audit committee size on earnings management, so H9 is accepted. Financial distress in a company is not caused by the size of the audit committee if the audit committee is only a formality to comply with the provisions issued by the regulator. Companies that experience financial distress with audit committees that are a formality in nature give rise to earnings management practices in companies. This study is consistent with (Ewanto et al., 2014; Riadiani and Wahyudin, 2015) which stated that the appointment of an audit committee that is not based on adequate competence and capability can result in the audit committee not working professionally, thus triggering earnings management in the company. This research is inconsistent with Sari and Fanani (2016) which states that the existence of an audit committee in Indonesia is mandatory and its competence is limited so financial difficulties are unavoidable.

6.Discussion

Research shows that no matter how large the ownership of shares by institutions does not reduce the possibility of *financial distress* because share ownership by centralized institutions does not spread, causing shareholder control over management to be weak so that they do not have enough ability to control management to make decisions that benefit management. The increase in share ownership by managers can reduce the potential for *financial distress* because management not only acts as a party that runs the company's operations but also owns company shares so that management acts more very carefully and responsibly in making policies for the company. No matter how large the board of directors is, it does not reduce the potential for *financial distress* because the board of directors has limitations in managing the company.

Financial distress can be avoided or reduced when the company has a small audit committee size because the committee becomes effective and participates in focusing on supervising internal audit activities so that the potential for financial distress *is reduced, furthermore,* Financial distress *that has increased causes an increase also in profit management carried out by the company*. Shareholders have a desire for the company to achieve maximum profit while company management cannot always fulfill the wishes of shareholders so agency conflicts arise that can cause asymmetric information.

Institutional ownership focuses on the last profit earned by the company, causing management to take action to increase short-term profits with profit management. Large institutional ownership increases the utilization of company assets to reduce the occurrence of financial distress and *also some of the amounts of managerial*

ownership do not reduce the potential for financial distress in the company, because the potential occurs based on the ability possessed by the board of directors in managing company operations to reduce the potential for financial distress and profit management actions.

The larger the size of the board of directors, the lower the level of supervision of decisions taken by directors in company operations, causing the use of funds that are not per their functions and will carry out profit management that is useful only for personal interests.

7. Conclusions and Implications

Based on the results of the analysis and discussion, it can be concluded that: Institutional ownership variable has no effect on financial distress, which means that no matter how large the share ownership by the institution is, it does not reduce the possibility of financial distress; Managerial ownership variable has a negative effect on financial distress, which means that an increase in managerial ownership can reduce the potential for financial distress to occur; Size of the board of directors has no effect on financial distress, which means that the number of board of directors does not reduce the potential for financial distress; Audit committee size variable has a positive effect on financial distress, which means that financial distress can be avoided or reduced if the company has a large audit committee size; Financial distress variable affects earnings management, which means that companies experiencing financial distress do not always practice earnings management because it will result in greater losses;Financial distress variable is unable to mediate the effect of institutional ownership on earnings management, and institutional ownership which focuses on the last profit earned by the company causes management to increase short-term earnings through earnings management; Financial distress variable is not able to mediate the effect of managerial ownership on earnings management, and financial distress in companies is not due to the amount of managerial ownership but is more influenced by management's ability to manage the company; Financial distress variable is not able to mediate the effect of the size of the board of directors on earnings management, with the larger the size of the board of directors, the lower the level of supervision of decisions taken by the directors in the company's operations; and Financial distress variable is able to mediate the effect of audit committee size on earnings management, with financial distress in a company becoming unavoidable if the size of the audit committee is only a formality.

The study underscores the significance of managerial ownership in mitigating financial distress risks, emphasizing that managers, as shareholders, can adopt responsible policies. State-Owned Enterprise (SOE) managers with share ownership obligations must adhere to reporting requirements outlined in the Regulation of the Minister of State-Owned Enterprises PER – 09 /MBU/2012. The findings also highlight the crucial role of the audit committee in influencing financial distress, emphasizing the need for SOEs to adhere to regulations, such as having a minimum of three members in the audit committee as per the Regulation of the State Minister for State-Owned Enterprises PER-05/MBU/2006. Furthermore, the study recommends the appointment of audit committee members based on relevant backgrounds to effectively mediate the impact of audit committee size on earnings management. Leveraging their knowledge and experience, the audit committee is poised to act as a preventive measure against financial distress that may trigger earnings management practices

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