

THE EFFECT OF FREE CASH FLOW AND CORPORATE GOVERNANCE ON EARNINGS MANAGEMENT: THE MODERATING ROLE OF STOCK LIQUIDITY

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Abstract: *This study examines the influence of free cash flow and corporate governance index (CGI) on both accrual and real earnings management practices, with a focus on the moderating role of stock liquidity, with standard firm-level controls, including ROA, dividend yield, and firm size. Using a quantitative approach, this research analyzes data listed on the Indonesia Stock Exchange (IDX) during the period from 2019 to 2023. A sample of 90 companies with 450 company-year observations was used, which were then analyzed using balanced panel regression. The results show that free cash flow has a significant positive effect on accrual earnings management and a negative effect on real earnings management. CGI, stock liquidity, as well as the moderating role of stock liquidity on the relationship between CGI, were found to have no significant effect on earnings management.*

Keywords: *Earnings management, corporate governance index, free cash flow.*

INTRODUCTION

Earnings management remains a critical concern in financial accounting, with firms sometimes altering reported earnings to meet certain objectives or to achieve desired outcome (Habib et al., 2022). Companies often engage in two forms: accrual earnings management, which involves adjusting accounting entries, and real earnings management, characterized by actual changes in operational activities (Alex Johanes Simamora et al., 2022; Nguyen et al., 2023). These practices can distort financial information, affecting perceptions and market efficiency. Understanding the factors that influence earnings management is crucial to maintain fair financial reporting (Tulcanaza-Prieto & Lee, 2022).

One such factor that influences earnings management is corporate governance. Effective corporate governance is designed to limit opportunistic behaviors like earnings management by improving oversight and accountability (Black et al., 2017; Claessens & Yurtoglu, 2012). Another

factor is free cash flow (FCF), which may lead to conflicts where managers use excess cash to pursue personal goals, potentially through earnings manipulation if left unmanaged (Fatmala & Riharjo, 2021; Islam et al., 2021; Toumeh et al., 2023).

While there is extensive literature on earnings management, research often focuses separately on real earnings management and accrual earnings management or examines individual effects of corporate governance and free cash flow. As a result, little is known about whether excess cash affects managers' choice between REM and AEM. However, the combination of corporate governance and free cash flow on both real and accrual earnings management has received less attention, especially when examining the moderate role of stock liquidity. Stock liquidity may impact the extent to which earnings management occurs, as more liquid stock could attract more scrutiny, thereby reducing likelihood of manipulative behaviors (Ezzine & Olivero, 2016; H.-Y.

Huang & Ho, 2020; Hunjra et al., 2020; Sayari & Omri, 2017).

This study aims to fill these gaps by investigating and examining the influence of corporate governance index and free cash flow on real earnings management and accrual earnings management practices, with stock liquidity as a moderating factor. Specifically, this study investigates whether corporate governance influences the likelihood of earnings manipulation in the form of accrual adjustments and operational changes. It also examines the role of free cash flow in driving earnings management, particularly in companies with abundant cash, which can create incentives for managers to manipulate earnings to meet financial targets or justify excess cash retention as firms with higher free cash flow possess greater discretion over operational decisions, which may allow real earnings management to be implemented easily compared to accrual earnings management (García Osma et al., 2022).

In addition, the study explores the moderating role of stock liquidity in the context of earnings management. Liquidity in the stock market can influence the extent to which corporate governance mechanisms are effective in reducing earnings manipulation, as more liquid stocks attract greater investor scrutiny (H.-Y. Huang & Ho, 2020; Hunjra et al., 2020). This study will analyze how stock liquidity may enhance or diminish the effectiveness of corporate governance in curbing both accrual and real earnings management, providing new insights into the interactions between corporate governance, liquidity, and earnings quality.

This study also aims to offer a comprehensive understanding of the factors that drive earnings management in firms

listed on the Indonesia Stock Exchange (IDX). The findings are expected to contribute to the broader literature on corporate governance and earnings management by providing empirical evidence on the combined effects of governance practices, free cash flow, and liquidity on financial reporting behavior.

LITERATURE REVIEW

Agency Theory

Agency theory emerged due to the separation between company owners (shareholders) and those who run day-to-day operations, namely managers or agents (BOSSE & PHILLIPS, 2016). The main problem with this theory is the potential for conflicts of interest, as agents do not always act in accordance with the owner's wishes (Ramadana et al., 2023). Agents have direct access to company information, while owners can only rely on reports and oversight (Wood, 2025). This theory is also based on three basic assumptions about human nature, which assume that humans are selfish, have limitations in seeing the future, and tend to avoid risks (Eisenhardt, 1989). Therefore, agency theory explains the importance of oversight and incentive systems to align the interests of both parties.

Free Cash Flow and Earnings Management

Free cash flow (FCF) has a significant impact on earnings management behavior. High levels of FCF can lead to problems, where managers may engage in earnings manipulation to justify excess cash distributions (Dewasiri et al., 2019; Islam et al., 2021; Rahmatillah et al., 2024). Studies have shown that firms with abundant free cash flow are more prone to real earnings management, as managers exploit operational decisions to manipulate reported

earnings (H. L. Huang et al., 2021; Rezki Zurriah et al., 2025). Consistent with this view, several studies find a positive association between free cash flow and earnings management (Irawan & Apriwenni, 2021; Rezki Zurriah et al., 2025). In contrast, other studies find a weak or insignificant relationship, arguing that monitoring mechanism and accounting standards can limit opportunistic behavior (Hu & Lin, 2011). These mixed findings imply that excess free cash flow may not uniformly affect all forms of earnings management, leaving open the question of whether managers rely more heavily on real or accrual-based methods due to differing constraints

H1: Free Cash Flow has positive effect on Accrual Earnings Management.

H2: Free Cash Flow has positive effect on Real Earnings Management.

Corporate Governance Index and Earnings Management

Menurut Kotler dan Amstrong (Mahardika, 2020:82). Strategi pemasaran adalah logika pemasaran dimana kelompok bisnis berharap untuk menciptakan nilai dan mendapatkan profit dari hubungannya dengan konsumen. Menurut Philip Kotler dalam (Mahardika, 2020:82) mendefinisikan bahwa strategi pemasaran adalah suatu pemikiran pemasaran yang akan digunakan untuk meraih tujuan pemasaran, dimana di dalamnya terdapat strategi rinci mengenai pasar sasaran, penetapan posisi, bauran pemasaran, dan budget untuk pemasaran.

Bauran Pemasaran

Corporate governance plays a pivotal role in constraining earnings management practices (Al-Haddad & Whittington, 2019; Wati & Malik, 2021). A well-structured governance framework enhances oversight

and accountability, thereby reducing the likelihood of both real and accrual earnings management (T. T. H. Nguyen et al., 2023; Sayari & Omri, 2017).

Corporate governance can be measured through the Corporate Governance Index (CGI), which evaluates various aspects (Itan et al., 2024). However, the effectiveness of the CGI varies depending on contextual factors (Mardianto & Simdy, 2024). Research indicates that firms with stronger corporate governance tends to report lower levels of earnings manipulation (Mahrani & Soewarno, 2018). For instance, the independence of board members has been linked to a reduction in aggressive accounting practices, as independent directors can more effectively monitor managerial actions (Chen et al., 2015).

H3: CG Index has a negative effect on Accrual Earnings Management.

H4: CG Index has a negative effect on Real Earnings Management.

The Moderating Role of Stock Liquidity

Stock liquidity may play a moderating role in the relationship between corporate governance and earnings management. More liquid stocks tend to attract greater investor scrutiny, which can deter earnings manipulation (H.-Y. Huang & Ho, 2020; Sayari & Omri, 2017). High liquidity can enhance the effectiveness of corporate governance by increasing market discipline on managerial actions (Ezzine & Olivero, 2016; Prommin et al., 2014). Studies suggest that firms with liquid stocks are less likely to engage in real earnings management (REM) and accrual earnings management (AEM), as the potential for negative market reactions serves as a check on managerial discretion (Sayari & Omri, 2017). Thus, stock liquidity may reinforce the positive effects of corporate governance on financial reporting quality.

H5: Stock Liquidity negatively moderates the effect of CGI on Accrual Earnings Management

H6: Stock Liquidity negatively moderates the effect of CGI on Real Earnings Management

RESEARCH METHOD

The Indonesia Stock Exchange (IDX) in 2019 had 943 listed companies under it, that were categorized further into two main sectors, which is financial sector and non-financial sector that comprises two categories of industries. This study did not use financial sector for various reasons as financial institutions have a different working capital structure and contain different financial statements components from those in the non-financial structure.

The sample of this study incorporated all non-financial companies listed on the IDX from 2019 to 2023, and the financial reports of the selected companies must be available on the website and cover all of periods. Companies that went bankrupt in 2019 - 2023 and did not meet the category or requirements for collecting variables, were not used in this study. Therefore, this study used 90 companies as sample data with 450 firm-year observations.

This quantitative study used balanced panel data with all the needed data came from secondary data sources. Except for the data required for the moderating variables which must be obtained using the IDX website and other financial websites, data related to earnings management, free cash flow, corporate governance index, and control variables are collected from the annual reports of non-financial companies on the IDX.

Operational Definition of Variables and Measurements

The variables that will be used as the dependent variables in this study are accrual earnings management and real earnings management. The measurement for calculating accrual earnings management in this study used the Modified Jones formula (Dechow et al., 1995) as follows.

$$\text{Total Accruals (TAC}_{it}) = \text{NI}_{it} - \text{CFO}_{it}$$

$$\frac{\text{TAC}_{it}}{\text{TA}_{it-1}} = \alpha_0 + \alpha_1 \left(\frac{1}{\text{TA}_{it-1}} \right) + \alpha_2 \left(\frac{(\Delta \text{REV}_{it} - \Delta \text{REC}_{it})}{\text{TA}_{it-1}} \right) + \alpha_3 \left(\frac{\text{PP\&E}_{it}}{\text{TA}_{it-1}} \right) +$$

$$\frac{\text{NDAC}_{it}}{\text{A}_{it-1}} = \hat{\alpha}_1 \left(\frac{1}{\text{A}_{it-1}} \right) + \hat{\alpha}_2 \left(\frac{(\Delta \text{REV}_{it} - \Delta \text{REC}_{it})}{\text{A}_{it-1}} \right) + \hat{\alpha}_3 \left(\frac{\text{PP\&E}_{it}}{\text{A}_{it-1}} \right)$$

Discretionary Accruals (DA) $\text{DAC}_{it} = \text{TAC}_{it} - \text{NDAC}_{it}$

Where:	
TA _{it}	Total company accruals in that year
At-1	Total assets in the year before the research
ΔREV _{it}	Difference between income from year t and year t-1
PPE _{it}	Total tangible assets of the company in that year
NDA _{it}	Nondiscretionary accruals of the company in that year
N _{it}	The company's net profit in that year
CFO _{it}	The company's operational cash flow in that year
ΔREC	Difference between the year t's accounting and year t-1
DA _{it}	The company's discretionary accruals in that year

The measurement to calculate real earnings management is based on Roychowdhury Model (Dechow et al., 1995) as follows.

$$\frac{\text{CFO}_{it}}{\text{TA}_{it-1}} = \alpha_0 + \beta_1 \left(\frac{1}{\text{TA}_{it-1}} \right) + \beta_2 \left(\frac{S_{it}}{\text{TA}_{it-1}} \right) + \beta_3 \left(\frac{\Delta S_{it}}{\text{TA}_{it-1}} \right) +$$

$$\frac{\text{PROD}_{it}}{\text{TA}_{it-1}} = \alpha_0 + \beta_1 \left(\frac{1}{\text{TA}_{it-1}} \right) + \beta_2 \left(\frac{S_{it}}{\text{TA}_{it-1}} \right) + \beta_3 \left(\frac{\Delta S_{it}}{\text{TA}_{it-1}} \right) + \beta_4 \left(\frac{\Delta S_{it-1}}{\text{TA}_{it-1}} \right) +$$

$$\frac{\text{DISXP}_{it}}{\text{TA}_{it-1}} = \alpha_0 + \beta_1 \left(\frac{1}{\text{TA}_{it-1}} \right) + \beta_2 \left(\frac{S_{it}}{\text{TA}_{it-1}} \right) + \varepsilon_{it}$$

$$REM_t = APROD_t - ACFO_t - ADISX_t$$

Where:	
REM_t	Real earnings management in year t
CFO_t	Cash flow from operations in year t
$DISEXP_t$	Total selling, general and administrative expenses in year t
$PROD_t$	Cost of goods sold in year t + ΔINV_t
ΔINV_t	Change in inventory from year t-1 to t
TA_{t-1}	Total asset in year t-1
S_t	Sales in year t
ΔS_t	Change in sales from year t-1 to t
ΔS_{t-1}	Change in sales from year t-2 to t-1
ε	Error in year t

The following are the measurement formulas of the independent, control, and moderating variables used in the study. Free Cash Flow (FCF) reflects the availability of internal funds, as firms with higher FCF may have more discretion over investments and earnings management decisions (Toumeh et al., 2023). Corporate Governance Index (CGI) controls for governance quality, since stronger governance mechanisms are expected to limit managerial opportunism and earnings manipulation (Elmagrhi et al., 2020; Mardianto & Simdy, 2024).

Dividend Yield (DYID) controls for firms' dividend policy, as high dividend payouts can reduce free cash flow available for managerial discretion, thereby influencing both accrual and real earnings management (Kim, 2020). Return on Assets (ROA) captures firm profitability, since more profitable firms may have different incentives to manage earnings compared to less profitable firms. Firm Size (FSIZE), measured as the natural logarithm of total assets, accounts for the fact that larger firms are typically subject to greater monitoring by regulators and auditors, which may constrain managerial opportunism (Okoro & Ihenyen, 2020).

Table 1. Independent Variable Formulas

Variables		Formula	
Free Cash Flow (FCF)		(Operating Income Before Depreciation - Tax Expense - Interest Expense - Dividends on Ordinary Shares - Dividends on Preferred Shares) / Total Assets t-1	
CG Index (CGI)		Where:	
Code	CGI	Operational Definition of CGI	Scoring
CGI-1	Board of Directors Independence	$\frac{BOD\ Independence}{Total\ BOD} \times 100\%$	<60% = 0, >60% = 1
CGI-2	Institutional Ownership	Average institutional shares per total outstanding shares multiplied by 100%	If > average = 1, if < average = 0
CGI-3	Ownership Concentration	Average individual share ownership per total outstanding shares multiplied by 100%	If > average = 1, if < average = 0
CGI-4	Stability of BOD	There is a change of directors within two years = 0, otherwise 1.	<2 years = 0, >2 years = 1
CGI-5	Related Parties	Sales transactions to related parties per total sales multiplied by 100%	If the % of sales to related parties is greater = 1, otherwise 0

Table 2. Control and Moderating Variable Formulas

Control Variables

Dividend Yield (DIYD) Dividend per Share / Market Value per Share

Return on Assets (ROA) Net income / Total Assets

Firm Size (FSIZE) Natural logarithm (Ln) of Total Assets

Moderating Variable

$$CSA = \frac{2(e^{\alpha_t} - 1)}{1 + e^{\alpha_t}}$$

$$\alpha_t = \frac{\sqrt{2\beta_t} - \sqrt{\beta_t}}{3 - 2\sqrt{2}} - \sqrt{\frac{\gamma_t}{3 - 2\sqrt{2}}}$$

$$\beta_t = \left(\log\left(\frac{H_t}{L_t}\right) \right)^2 + \left(\log\left(\frac{H_{t+1}}{L_{t+1}}\right) \right)^2$$

Stock Liquidity (SL)

$$\gamma_t = \left(\log \frac{\max(H_t, H_{t+1})}{\min(L_t, L_{t+1})} \right)^2$$

Where each parameter (α_t , β_t , γ_t) uses the ratio of H_t , the highest stock value on day t, H_{t+1} , the highest stock value on day t+1, and the ratio of L_t , the lowest stock value on day t, and L_{t+1} , the lowest stock value on day t+1.

This research uses SPSS and EViews software to process the data. Data analysis methods used in this research include descriptive statistics, panel regression, Chow test, Hausman test, Lagrange multiplier test, F test, t-test, and coefficient determination test. Data processing carried out using panel regression aims to evaluate the research hypotheses. Before conducting regression, this study needs to select the most suitable model in the panel regression technique. Chow test and Hausman test are used to determine whether Pooled Least Square (PLS), Fixed Effect Model (FEM), or Random Effect Model (REM) is the most suitable model to be used. Descriptive statistics include mean, median, minimum, and maximum values to provide an initial summary of the general distribution of the data studied. To analyze the collected data and interpret the results, a panel regression

test is conducted to decide the most appropriate model for use during the testing phase. There are three types of panel regression models: the Pooled Least Squares (PLS) model, which utilizes both time series and cross-sectional data; the Fixed Effect Model (FEM), which allows for comparison across different entities; and the Random Effect Model (REM), which incorporates residuals associated with individual units over time. The choice of model depends on the characteristics of the available dataset. To identify the most suitable model, several tests are required, namely the Chow test, the Hausman test, and the Lagrange Multiplier test.

The Chow test is used to decide whether the Pooled Least Squares (PLS) or Fixed Effect Model (FEM) is more appropriate for estimating panel data. If the probability value is greater than 0.05, the PLS model is preferred; however, if the probability is less than 0.05, the Random Effect Model (REM) is chosen. This differs from the Hausman test, which helps whether to use the REM or FEM. The Hausman test results are based on the chi-square statistic: if the probability exceeds 0.05, the REM is selected, but if it is below 0.05, the FEM is recommended. Meanwhile, the Lagrange Multiplier test compares the common effects model with the Random Effects Model. A probability value below 0.05 suggests that the REM is more suitable, whereas a value above 0.05 indicates that the common effects model should be used.

The F test is applied to assess whether there is a significant relationship between independent and dependent variables. If the probability value is greater than 0.05, it indicates no significant effect; otherwise, if it is less than 0.05, the effect is significant. Additionally, the t-test is performed to examine the impact of each independent

variable on the dependent variable within the research model. A significance level below 0.05 means the independent variable significantly influences the dependent variable, while a value above 0.05 suggests no significant effect.

RESULT AND DISCUSSION

Descriptive Analysis

Table 3. Descriptive statistics

	Mean	Std. Deviation	Minimum	Maximum
AEM	0.0209106	0.1374612	-0.6299324	0.5511605
REM	-0.0000712	0.387472	-1.621.638	1.125.896
CGI	1.277.778	0.8312893	0	3
FCF	0.1168454	0.1069287	-0.1541393	0.9121124
SL	-0.0648924	0.500917	-1.830.383	1.983.243
DIYD	0.0475887	0.0667535	0.000000147	0.4910324
ROA	0.0935871	0.0915244	-0.2032107	0.5925829
FSIZE	29.405	1.427.551	2.549.553	3.349.453

Source: Processed secondary data (2025)

Based on Table 3, the average value for accrual earnings management (AEM) and real earnings management (REM) are 0.0209106 and -0.0000712, respectively. This suggests that earnings management measures are incredibly low. In addition, the maximum and minimum values of both variables indicate that the observation results can be confirmed by the standard deviation, which is at a low number, namely 0.1374612 and 0.387472. These results imply that most companies listed on the Indonesia Stock Exchange (IDX) are not heavily involved in AEM or REM practices.

Free cash flow (FCF) has an average value of 0.1168454, it shows that companies on the IDX on average have positive free cash flow. For the next independent variable, corporate governance index (CGI) with a value of 0 as the minimum, indicates that there are companies with poor governance, especially with an average value of 1.277778 out of a maximum of 3, where the highest distribution score for CGI is 5.

Chow Test and Hausman Test Results

Based on the outcome of Table 4 and Table 5, the most appropriate model to test the hypotheses of the effect of the variables studied on accrual earnings management (AEM) is the Random Effect Model. The results of the Hausman Test and Lagrange Test for AEM produced probabilities of 0.1640 and 0.0000, respectively, therefore, the model used in examining the AEM variable is the Random Effect Model.

Table 4. Chow Test on AEM

Effects Test	Statistic	d.f.	Prob.
Cross-section F	6.278.985	-89,353	0.0000
Cross-section Chi-square	427.043.300	89	0.0000

Table 5. Hausman Test on AEM

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	12.247.488	7	0.0927

Table 6. Lagrange Test on AEM

	Cross-section	Test Hypothesis Time	Both
Breusch-Pagan	2.127.769 (0.0000)	1.253.260 (0.2629)	2.140.302 (0.0000)

Unlike accrual earnings management, the model used for real earnings management (REM) is the Fixed Effect Model. This is due to the Hausman test for real earnings management which produces a probability of 0.0009 as seen in Table 8 does not exceed the threshold of 0.05. Therefore, the Langrage Multiplier (LM) test is not necessary, as the Fixed Effects Model (FEM) was chosen on the basis that this model it is the optimal model.

Table 7. Chow Test on REM

Effects Test	Statistic	d.f.	Prob.
Cross-section F	15.976.714	-89,353	0.0000
Cross-section Chi-square	726.771.019	89	0.0000

Table 8. Hausman Test on REM

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	24.604.597	7	0.0009

Hypothesis Test of Free Cash Flow and Corporate Governance Index on Accrual Earnings Management and Real Earnings Management

Table 9. FCF and CGI on AEM

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.066743	0.224141	0.297774	0.7660
FCF	0.243992	0.094634	2.578272	0.0103
CGI	0.002368	0.008697	0.272271	0.7855
DIYD	-0.105553	0.105294	-1.002457	0.3167
ROA	0.374553	0.124215	3.015373	0.0027
FSIZE	-0.003652	0.007569	-0.482567	0.6296

Source: Processed secondary data (2025)

The free cash flow (FCF) variable in Table 9 shows a coefficient of 0.243992 with a probability of 0.0103. From these results, it can be concluded that H1 is proven true as FCF has a significant positive effect on accrual earnings management (AEM). The positive direction of the coefficient supports the theoretical hypothesis that companies with high levels of free cash flow tend to have a greater incentive to engage in earnings management through accrual methods (Oktaviani & Mochklas, 2020). This aligns with agency theory which states that when a company has excess funds, managers have greater flexibility to act in their own best interests, including manipulating accounting to achieve specific profit targets. Thus, this indicates that FCF can increase the likelihood of accrual-based earnings management practices. This research aligns with research by Inten Gemi Nestiti et al. (2025), Irawan & Apriwenni (2021), and Nuriyah & Amir (2023). However, it contrasts with research by Santoso (2023), Alif Alafiyah et al. (2024), and Wawo et al. (2023), which concluded that free cash flow negatively impacts accrual earnings management.

The corporate governance (CGI) variable results show a coefficient of 0.002368 with a probability of 0.7855. This indicates that corporate governance has a positive effect on AEM, but not statistically significant

as the probability value is far above the 5% significance level. Theoretically, according to some research (Mismiwati et al., 2025; Q. Nguyen et al., 2024; Ryad et al., 2024), corporate governance should be able to suppress earnings management practices, through more effective monitoring mechanisms, information transparency, and managerial accountability. However, the results of this study indicate a coefficient direction opposite to theoretical expectations, although not significant. There are several possible causes for this result. One is that corporate governance as measured by CGI has not been fully implemented effectively or is still merely formalities with no real impact on management behavior.

Although H3 is not statistically proven and the direction of the relationship is not established, these results still provide important insights that the role of corporate governance in controlling accrual earnings management (AEM) may depend on the quality of implementation, not just its structural existence. Research by several researcher (Asyiroh & Hartono, 2019; Devi, 2018), states that corporate governance, as proxied by managerial ownership, institutional ownership, and independent commissioners, shows that corporate governance has no effect on AEM. The existence of corporate governance does not always have a significant impact on earnings management, especially in the context of companies in emerging markets such as Indonesia where governance implementation is not yet fully optimal.

Table 10. FCF and CGI on REM

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.284287	1.348593	-3.176857	0.0016
FCF	-1.454957	0.176744	-8.231985	0.0000
CGI	0.006836	0.016390	0.417082	0.6769
DIYD	-0.164956	0.197772	-0.834071	0.4048
ROA	-0.352165	0.243111	-1.448579	0.1483
FSIZE	0.152569	0.046027	3.314780	0.0010

Source: Processed secondary data (2025)

In Table 10, free cash flow (FCF) shows a coefficient of -1.454957 with a probability of 0.0000. The negative coefficient value indicates that FCF has a significant negative effect on real earnings management (REM). Therefore, it can be concluded that H2 is not supported. Although the direction of the relationship between FCF and REM is not as initially expected, the result is significant, thus, this indicates that the greater the value of FCF owned by a company, the less likely management is to manipulate real profits.

In contrast to accrual earnings management, real earnings management (REM) involves deviations from optimal operational decisions and often entails real cash flow consequences. While excess free cash flow may increase managerial incentives to engage in REM (Abubakar et al., 2021; Rezki Zurriah et al., 2025), such activities entail real economic costs that distort optimal operating decisions. When firms possess abundant free cash flow, managers are therefore more likely to rely on AEM rather than engage in value-destroying real activities manipulation. This negative effect is in line with the research conducted by Wandari (2023).

Corporate governance index (CGI) with a coefficient of 0.006836 and a probability of 0.6769, indicates that CGI has a positive effect on real earnings management (REM). The positive direction of the coefficient implies that corporate governance tends to increase REM practices, however, this effect cannot be statistically proven at the 5% significance level. This suggests that the implementation of corporate governance as measured by the CGI is not necessarily effective in limiting real earnings management practices.

Hypothesis Test of Corporate Governance on Accrual Earnings Management and Real Earnings Management Moderating by Stock Liquidity

Table 11. CGI on AEM Moderating by SL

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.039438	0.226574	0.174061	0.8619
FCF	0.258339	0.094622	2.730232	0.0066
CGI	0.001424	0.008694	0.163850	0.8699
SL	-0.028305	0.021859	-1.294883	0.1960
CGIXSL	0.002971	0.012975	0.228980	0.8190
DIYD	-0.114407	0.105187	-1.087652	0.2773
ROA	0.384123	0.124159	3.093812	0.0021
FSIZE	-0.002806	0.007651	-0.366733	0.7140

Source: Processed secondary data (2025)

The results from Table 11 show that Stock Liquidity (SL) has a coefficient of -0.028305 and a probability of 0.1960. Although the coefficient is negative, there is insufficient statistical evidence to say that stock liquidity decreases accrual earnings management (AEM). This is in line with research by Mardianto & Simdy (2024), but differs from research which states that stock liquidity increases accrual-based earnings management by HUANG et al. (2017).

Based on the results of the interaction between the Corporate Governance Index (CGI) and Stock Liquidity (SL), represented by the moderating variable CGIXSL, it has a coefficient of 0.002971 with a probability value of 0.8190. This positive coefficient value indicates that stock liquidity strengthens the effect of CGI on accrual earnings management. Companies with good governance are expected to have stricter supervision of managerial behavior, which can reduce the possibility of earnings management. However, these results indicate that good corporate governance, as measured by the CGI, is not effective enough in reducing AEM practices, although the combination with However, these results indicate that good corporate governance, as measured by the CGI, is not effective enough in reducing AEM practices, although the combination with high SL should provide a

strong monitoring effect. This interpretation is contrary to the expectations of the hypothesis which should have a negative effect. And with probability results that are much greater than the conventional significance level, it can indicate that there is no strong evidence that the interaction between CGI and SL significantly influences AEM practices in the sample tested. Therefore, H5 is not proven.

Table 12. CGI on REM Moderating by SL

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.328382	1.351181	-3.203406	0.0015
FCF	-1.451365	0.177424	-8.180199	0.0000
CGI	0.006042	0.016428	0.367767	0.7133
SL	0.006918	0.035872	0.192850	0.8472
CGIXSL	-0.013959	0.021275	-0.656120	0.5122
DIYD	-0.158432	0.198408	-0.798514	0.4251
ROA	-0.345812	0.243479	-1.420294	0.1564
FSIZE	0.154015	0.046113	3.339964	0.0009

Source: Processed secondary data (2025)

The results for the CGIXSL interaction variable in Table 12 show a coefficient of -0.013959 with a probability of 0.5122. This coefficient value indicates that Stock Liquidity negatively moderates the relationship between Corporate Governance and Real Earnings Management (REM). Better corporate governance and higher stock liquidity make companies tend to reduce the use of real earnings management (Mahrani & Soewarno, 2018). REM practices often involve operational decisions that are detrimental to the company in the long run. Good corporate governance combined with high stock liquidity makes it more difficult for companies to manipulate profits based on operational decisions as liquid markets are more efficient at detecting such manipulation. This is in line with the hypothesis that SL negatively moderates CGI on REM. However, the probability results exceeding 0.05 indicate that the interaction between CGI and SL on REM has no significance. In other words, H6 is not proven.

KESIMPULAN

This study focuses on the influence of free cash flow and corporate governance on earnings management practices, both accrual and real based, by considering the role of stock liquidity as a moderating variable. The research is conducted within the context of publicly listed companies on the Indonesia Stock Exchange. The findings show that free cash flow has a positive significant effect on accrual earnings management, where firms with excess cash are more likely to manipulate earnings through accounting adjustments. Conversely, free cash flow has a negative effect on real earnings management, suggesting that firms with greater financial flexibility are less inclined to engage in manipulation through operational activities.

Although corporate governance does not show a significant direct effect on either accrual earnings management or real earnings management, the direction of the coefficients suggests that better governance tends to be associated with lower earnings management practices. The interaction between corporate governance and stock liquidity also does not exhibit a significant moderating effect on either type of earnings management. This indicates that, the sample in this period, stock liquidity does not strengthen or weaken the ability of corporate governance to constrain earnings management.

These findings suggest that corporate governance alone may not be sufficient to limit managerial discretion in earnings reporting, especially in environments where market pressures are high or governance practices are more formalistic than substantive. Future research may consider incorporating additional moderating variables to better understand the conditions

under which governance effectively curbs earnings management behavior. Additionally, researchers should explore alternative proxies for corporate governance to capture its multidimensional nature more accurately, as different measures may yield different insights into corporate governance's role in earnings management

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