ABSTRACT

Financial statements are expected to provide relevant and reliable information for decision-making, yet the practice of earnings management often threatens the reliability of reported earnings and reduces Earnings Quality. Agency Theory suggests that information asymmetry between management and shareholders creates incentives for management to manipulate earnings, and that internal control mechanisms are needed to mitigate this opportunistic behavior. This study aims to examine the effect of Internal Control over Financial Reporting (ICoFR) effectiveness on Earnings Quality, both directly and indirectly through earnings management as a mediating variable, in manufacturing companies listed on the Indonesia Stock Exchange (IDX).

The population of this study consists of manufacturing companies listed on the IDX during the 2022–2024 period. Using a purposive sampling technique based on predetermined criteria, 563 firm-year observations were obtained as the final research sample. ICoFR effectiveness is measured using the Internal Control Disclosure Index (ICDI), which reflects the extent of internal control disclosure in annual reports. Earnings management is measured using absolute discretionary accruals derived from the Modified Jones Model, while Earnings Quality is measured using the ratio of operating cash flow to net income. Firm size and leverage are included as control variables. The data are analyzed using multiple linear regression analysis, and the mediating role of earnings management is tested using the Sobel test.

The results of this study show that ICoFR effectiveness has a significant positive effect on Earnings Quality and a significant negative effect on earnings management. Earnings management, in turn, has a significant negative effect on Earnings Quality. Furthermore, the Sobel test results indicate that earnings management partially mediates the relationship between ICoFR effectiveness and Earnings Quality. These findings confirm that effective internal control not only directly enhances Earnings Quality, but also indirectly improves it by restraining earnings management practices. This study contributes to the internal control and earnings management literature by providing empirical evidence from the Indonesian manufacturing sector, and offers practical implications for management, auditors, and regulators in strengthening internal control systems to improve the reliability of financial reporting.

Keywords: *Internal Control over Financial Reporting, earnings management, Earnings Quality, discretionary accruals, agency theory, manufacturing companies.*