

How Corporate Governance Quality and Carbon Risk Shape Earnings Management: Evidence from Indonesian Consumer Non-Cyclical Companies

Nurul Rezeqiyah^a, Arum Ardianingsih^b

^{ab} Department of Accounting, Faculty of Economics and Business, Universitas Pekalongan, Pekalongan, Indonesia

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ABSTRACT

Earnings management remains a persistent concern because it can reduce the credibility of financial reporting and weaken stakeholders' confidence in corporate disclosures. This study investigates whether corporate governance quality, carbon risk, corporate social responsibility (CSR), and auditor independence explain variations in earnings management among Indonesian consumer non-cyclical companies. A quantitative explanatory approach was employed using secondary data obtained from audited annual reports of firms listed on the Indonesia Stock Exchange during the 2019–2023 observation period. Sample selection followed purposive sampling criteria, resulting in firm-year observations that met the research requirements. Multiple linear regression analysis was applied after all classical assumption tests confirmed the suitability of the empirical model. The findings demonstrate that corporate governance quality and auditor independence significantly restrain earnings management practices by strengthening monitoring effectiveness and improving the reliability of financial reporting. Conversely, carbon risk increases managerial incentives to engage in earnings management, reflecting greater pressure arising from environmental and business uncertainties. Corporate social responsibility also exhibits a significant relationship with earnings management, indicating that sustainability-related activities influence managerial reporting behavior. These findings contribute to the corporate governance and sustainability literature by providing empirical evidence that financial reporting quality is jointly shaped by governance mechanisms, environmental risk exposure, and corporate responsibility practices. The results also offer practical implications for investors, regulators, auditors, and corporate management in promoting transparent reporting and reinforcing governance systems to mitigate opportunistic financial reporting behavior.

1. Introduction

The credibility of financial reporting has become an increasingly important issue in modern capital markets because investment decisions largely depend on the quality of accounting information disclosed by companies. Financial statements are expected to present a fair representation of a firm's financial position and operating performance. However, managerial discretion in applying accounting policies may create opportunities for earnings management,

*Corresponding author:

Email address: arumbundavina@gmail.com

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reducing the reliability of reported financial information and increasing information asymmetry between management and external stakeholders. Although earnings management may remain within the boundaries of accounting standards, excessive managerial intervention can distort the economic reality reflected in financial reports and ultimately weaken investor confidence.

The consumer non-cyclical sector represents one of the most stable industries in Indonesia because it provides products that are continuously demanded regardless of changes in economic conditions. Despite its relatively resilient performance, companies operating in this sector continue to face challenges arising from increasing market competition, tighter regulatory oversight, and growing public expectations regarding corporate transparency. These conditions encourage managers to achieve favourable financial performance while simultaneously maintaining market confidence. Consequently, managers may experience incentives to adjust reported earnings in order to satisfy investors, creditors, and other stakeholders.

Corporate governance has long been recognized as an essential mechanism for reducing agency conflicts between shareholders and managers. Effective governance practices strengthen monitoring functions, improve accountability, and encourage transparent financial reporting. Strong governance structures are expected to limit managerial opportunistic behaviour by enhancing board oversight, protecting shareholders' interests, and improving the overall quality of corporate decision-making. Nevertheless, empirical findings concerning the effectiveness of corporate governance in mitigating earnings management remain inconclusive, suggesting that governance mechanisms may perform differently across industries and institutional environments.

Environmental issues have also emerged as strategic concerns affecting corporate financial reporting. Increased attention to climate change, carbon emissions, and environmental sustainability has exposed firms to greater carbon-related risks. Carbon risk reflects the potential financial consequences arising from environmental regulations, carbon reduction policies, operational adjustments, and reputational pressures associated with greenhouse gas emissions. Companies facing higher carbon risk may encounter additional uncertainty regarding future cash flows and operating performance, potentially creating incentives for managers to influence reported earnings in order to maintain favourable market perceptions. Despite the growing importance of environmental risk, evidence regarding the relationship between carbon risk and earnings management remains relatively limited, particularly within emerging economies.

Corporate social responsibility (CSR) has become another important component of corporate sustainability strategies. Through CSR activities, companies seek to strengthen stakeholder relationships, improve corporate

legitimacy, and demonstrate their commitment to sustainable business practices. While CSR is generally associated with ethical corporate behaviour and enhanced transparency, previous studies have reported inconsistent conclusions regarding its association with earnings management. Some researchers argue that socially responsible firms tend to produce higher-quality financial reports because they emphasize accountability and long-term value creation. Conversely, other studies suggest that CSR initiatives may occasionally be used to strengthen corporate reputation while simultaneously concealing opportunistic reporting behaviour. These contrasting findings indicate that the interaction between CSR and earnings management remains an important area for further investigation.

Auditor independence constitutes another critical factor influencing financial reporting quality. Independent auditors provide external assurance regarding the fairness of financial statements and play a vital role in constraining managerial manipulation. Higher levels of auditor independence are expected to improve audit quality, strengthen stakeholder confidence, and reduce the likelihood of earnings management. Nevertheless, variations in audit quality, auditor-client relationships, and organizational characteristics may influence the effectiveness of auditor independence in preventing opportunistic accounting practices.

Although previous studies have examined corporate governance, CSR, carbon-related issues, and auditor independence separately, limited empirical evidence simultaneously evaluates these factors within Indonesian consumer non-cyclical companies. Most earlier studies have concentrated on manufacturing firms or broader industrial classifications, while relatively little attention has been devoted to the consumer non-cyclical sector despite its strategic contribution to the Indonesian economy and its increasing exposure to sustainability-related challenges. This research gap highlights the need for a more comprehensive examination integrating governance mechanisms, environmental risk, sustainability practices, and audit quality into a unified analytical framework.

Accordingly, this study aims to investigate the influence of corporate governance quality, carbon risk, corporate social responsibility, and auditor independence on earnings management among consumer non-cyclical companies listed on the Indonesia Stock Exchange during the 2019–2023 period. The findings are expected to enrich the literature on corporate governance and financial reporting by providing updated empirical evidence from an emerging market context. Furthermore, the study offers practical implications for regulators, investors, auditors, and corporate managers in strengthening governance systems, improving reporting transparency, and supporting sustainable business practices that enhance the credibility of financial information.

2. Theoretical Framework and Hypotheses Development

2.1. *Theoretical Framework*

The present study employs Agency Theory and Stakeholder Theory as complementary perspectives to explain the determinants of earnings management in Indonesian consumer non-cyclical companies. These theories provide a comprehensive foundation for understanding how internal governance mechanisms, environmental challenges, sustainability initiatives, and external assurance collectively influence managerial financial reporting decisions.

Agency Theory proposes that the delegation of decision-making authority from shareholders to professional managers creates the possibility of conflicting interests. Because managers have direct access to operational and financial information, they may possess informational advantages that are not fully available to investors or creditors. Such asymmetry enables managers to exercise accounting discretion when preparing financial statements. Although managerial judgment is an inherent component of financial reporting, excessive discretion may result in earnings management that does not accurately reflect a firm's underlying economic performance. Consequently, effective monitoring mechanisms become essential for aligning managerial actions with shareholder interests.

From the perspective of Agency Theory, corporate governance represents a systematic framework that regulates managerial accountability and strengthens organizational oversight. Governance quality is reflected in the effectiveness of supervisory functions, decision-making transparency, accountability, and compliance with established regulations. An effective governance system reduces managerial opportunities to manipulate accounting information because strategic decisions are continuously monitored through internal control mechanisms. Therefore, stronger governance quality is expected to promote more reliable financial reporting and discourage opportunistic earnings management.

Stakeholder Theory broadens the organizational perspective by recognizing that companies operate within a network of stakeholders whose expectations extend beyond financial performance alone. Investors, employees, customers, creditors, regulators, local communities, and environmental groups all influence corporate sustainability. To maintain long-term legitimacy, organizations are expected to balance economic objectives with social and environmental responsibilities. Transparent financial reporting therefore becomes an important instrument for maintaining stakeholder confidence and preserving organizational legitimacy.

Corporate social responsibility constitutes one practical manifestation of stakeholder-oriented management. CSR reflects organizational commitment to integrating economic, environmental, and social considerations into business

activities. Firms that consistently implement responsible business practices generally seek to establish long-term trust rather than pursue short-term financial gains. Consequently, managers operating in organizations with strong CSR commitments are expected to demonstrate greater transparency in preparing financial reports. Nevertheless, the effectiveness of CSR in limiting earnings management remains an empirical issue that requires further investigation because previous studies have produced inconsistent findings across different institutional settings.

Environmental sustainability has introduced additional challenges for corporate financial management through the emergence of carbon-related risks. Carbon risk represents potential financial exposure associated with climate policies, emission regulations, technological transitions, environmental litigation, and market responses to sustainability performance. Companies experiencing greater carbon-related uncertainty may face increasing pressure to maintain stable financial performance while simultaneously adapting to environmental requirements. Under such conditions, managers may become more likely to employ discretionary accounting choices to reduce perceived business risk or stabilize reported earnings. Accordingly, carbon risk constitutes an important contextual factor that may influence earnings management behaviour.

The credibility of financial reporting is further strengthened through external assurance provided by independent auditors. Auditor independence ensures that audit opinions are formulated objectively without managerial interference. Independent auditors evaluate the fairness of financial statements based on professional standards and sufficient audit evidence, thereby increasing the reliability of accounting information disclosed to capital market participants. When auditor independence is maintained, the probability that material earnings manipulation remains undetected is expected to decline. Accordingly, auditor independence serves as an important external governance mechanism supporting financial reporting quality.

The integration of Agency Theory and Stakeholder Theory provides a coherent explanation of the proposed research model. Agency Theory emphasizes the role of governance structures and external auditing in minimizing managerial opportunism arising from information asymmetry. Stakeholder Theory complements this perspective by highlighting that environmental responsibility and social accountability influence managerial behaviour through stakeholder expectations and organizational legitimacy. Combining these theoretical perspectives enables this study to explain how corporate governance quality, carbon risk, corporate social responsibility, and auditor independence jointly contribute to variations in earnings management among Indonesian consumer non-cyclical companies.

Based on these theoretical arguments, this study develops a conceptual framework in which corporate governance quality, carbon risk, corporate social responsibility, and auditor independence are proposed as key determinants of earnings management. The theoretical foundation presented above serves as the basis for formulating the research hypotheses discussed in the following section.

2.2. Hypotheses Development

Corporate governance quality represents the effectiveness of organizational mechanisms designed to supervise managerial activities and ensure that corporate decisions are consistent with shareholders' interests. Within the Agency Theory perspective, governance mechanisms reduce information asymmetry by strengthening oversight and improving managerial accountability. Effective governance practices encourage transparent reporting, reinforce internal control systems, and limit opportunities for managers to manipulate accounting information for personal benefit.

Companies characterized by stronger governance quality generally establish more effective monitoring processes that discourage opportunistic financial reporting. The existence of accountable governance structures increases managerial responsibility for presenting financial information that faithfully represents corporate performance. Consequently, stronger governance quality is expected to reduce earnings management because managers face greater monitoring pressure and higher reputational consequences when engaging in discretionary accounting practices. Accordingly, the first hypothesis is formulated as follows:

H1: Corporate governance quality has a negative effect on earnings management.

Carbon risk reflects the financial uncertainty associated with environmental regulations, climate-related obligations, emission reduction policies, technological adaptation, and stakeholder expectations concerning sustainability. Increasing environmental pressure may alter corporate operating conditions and expose firms to additional financial risk. Managers operating under higher levels of uncertainty may attempt to maintain stable financial performance by exercising greater discretion in financial reporting.

Agency Theory suggests that managers respond to external pressure by adopting reporting strategies that preserve investor confidence and organizational reputation. Carbon-related uncertainty may therefore create incentives for earnings management when managers seek to minimize negative market reactions arising from environmental challenges. Consequently, firms experiencing greater carbon risk are expected to demonstrate a higher likelihood of earnings management. Based on these arguments, the second hypothesis is proposed as follows:

H2: Carbon risk has a positive effect on earnings management.

Corporate social responsibility reflects an organization's commitment to integrating ethical, environmental, and social considerations into business operations. Stakeholder Theory argues that organizations seeking sustainable relationships with stakeholders should maintain transparency and accountability in all aspects of corporate reporting. Responsible business conduct encourages management to prioritize long-term organizational legitimacy rather than short-term financial objectives.

Organizations that consistently implement CSR initiatives are generally expected to maintain higher standards of disclosure because stakeholder confidence depends on both operational responsibility and financial reporting credibility. Greater commitment to social responsibility therefore reduces managerial incentives to engage in opportunistic accounting behaviour. Consequently, CSR is expected to discourage earnings management by strengthening ethical decision-making and improving organizational accountability. Accordingly, the third hypothesis is formulated as follows:

H3: Corporate social responsibility has a negative effect on earnings management.

Auditor independence represents the ability of external auditors to conduct examinations objectively without influence from management. Independent audits improve the credibility of financial statements by increasing the probability that material misstatements or discretionary accounting practices will be identified during the audit process. As an external governance mechanism, auditor independence strengthens market confidence by providing assurance regarding the reliability of reported financial information.

Agency Theory emphasizes that external monitoring complements internal governance in reducing agency conflicts. When auditors maintain professional independence, managerial opportunities to manipulate accounting information become more limited because the risk of detection increases substantially. Therefore, stronger auditor independence is expected to constrain earnings management and improve overall financial reporting quality. Based on this theoretical reasoning, the final hypothesis is proposed as follows:

H4: Auditor independence has a negative effect on earnings management.

The four hypotheses collectively explain the proposed relationships between corporate governance quality, carbon risk, corporate social responsibility, auditor independence, and earnings management. These hypotheses constitute the analytical foundation for the empirical testing conducted in the subsequent research method and results sections.

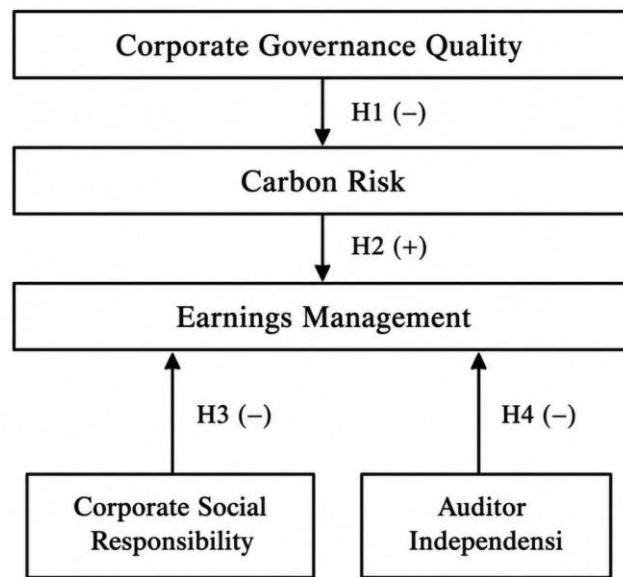


Figure 1. Conceptual Framework

Figure 1 illustrates the conceptual framework developed in this study to examine the determinants of earnings management in Indonesian consumer non-cyclical companies. The framework proposes that corporate governance quality, carbon risk, corporate social responsibility (CSR), and auditor independence function as the independent variables, while earnings management serves as the dependent variable. Guided by Agency Theory and Stakeholder Theory, the model assumes that effective corporate governance, responsible CSR practices, and strong auditor independence enhance monitoring and reporting transparency, thereby reducing managers' opportunities to engage in earnings management. In contrast, greater carbon risk may increase managerial pressure arising from environmental uncertainty, creating stronger incentives to exercise accounting discretion. Accordingly, the proposed framework provides the theoretical basis for testing the four research hypotheses and evaluating the individual influence of each explanatory variable on earnings management.

Source: Developed by the authors based on Agency Theory and Stakeholder Theory.

3. Research Method

This research adopted a quantitative explanatory design to evaluate the influence of corporate governance quality, carbon risk, corporate social responsibility, and auditor independence on earnings management among Indonesian consumer non-cyclical companies. The explanatory approach was

selected because it allows empirical testing of causal relationships between independent and dependent variables using statistical procedures.

The study focused on companies classified within the consumer non-cyclical sector and listed on the Indonesia Stock Exchange (IDX) during the 2019–2023 period. This sector was chosen because its business continuity, sustainability commitments, and reporting obligations provide an appropriate setting for examining financial reporting behaviour. The research sample was determined through purposive sampling to ensure that only firms meeting the established selection criteria were included in the analysis. Eligible companies were required to publish complete audited annual reports throughout the observation period and disclose sufficient information for measuring every research variable.

Secondary data constituted the primary source of information. Financial statements, annual reports, sustainability reports, and other corporate disclosures were collected from the official IDX website together with publicly available information published on each company's corporate website. The collected documents were reviewed, classified, and transformed into a research database suitable for statistical analysis.

Earnings management served as the dependent variable because it reflects managerial discretion in preparing financial reports. The independent variables consisted of corporate governance quality, carbon risk, corporate social responsibility, and auditor independence. Corporate governance quality represents the effectiveness of governance practices in supervising managerial decisions. Carbon risk describes the potential financial consequences arising from climate-related regulations, environmental obligations, and carbon exposure. Corporate social responsibility reflects corporate commitment to sustainable economic, environmental, and social activities, whereas auditor independence represents the objectivity of external auditors when evaluating the fairness of corporate financial statements.

Data analysis was conducted in several sequential stages. Initially, descriptive statistics were employed to summarize the characteristics of the research data. Subsequently, classical assumption tests were performed to evaluate data normality, multicollinearity, heteroscedasticity, and autocorrelation before estimating the regression model. The proposed hypotheses were then examined using multiple linear regression to determine the individual and simultaneous effects of the explanatory variables on earnings management. The significance of each coefficient was evaluated using the t-test, while the overall regression model was assessed through the F-test. The coefficient of determination (R^2) was calculated to determine the proportion of variation in earnings management explained by the independent variables. Statistical computations were performed using IBM SPSS Statistics with a significance

level of 5 percent. The empirical model employed in this research is expressed as follows:

$$[EM = \alpha + \beta_1 CGQ + \beta_2 CR + \beta_3 CSR + \beta_4 AI + \varepsilon]$$

where **EM** denotes earnings management, **CGQ** represents corporate governance quality, **CR** indicates carbon risk, **CSR** refers to corporate social responsibility, **AI** denotes auditor independence, α is the constant, β_1 – β_4 are the regression coefficients, and ε represents the random error term.

The methodological procedures were designed to ensure that the empirical findings provide reliable evidence regarding the association between governance quality, environmental risk, sustainability practices, auditor independence, and earnings management in Indonesian consumer non-cyclical companies.

3.1 Technical Analysis and Variable Measurement

This study employed quantitative techniques to examine the relationship between corporate governance quality, carbon risk, corporate social responsibility, auditor independence, and earnings management. The analysis was conducted using multiple linear regression because the research model investigates the simultaneous influence of several explanatory variables on a single dependent variable. Before estimating the regression model, descriptive statistics were generated to summarize the distribution and characteristics of the research data. The validity of the regression model was subsequently evaluated through classical assumption tests, including normality, multicollinearity, heteroscedasticity, and autocorrelation tests. These procedures were undertaken to ensure that the estimated coefficients were unbiased and statistically reliable. The hypotheses were assessed using partial significance tests (t-test), simultaneous significance tests (F-test), and the coefficient of determination (R^2) at a significance level of 5 percent.

Variable Measurement: Earnings management represents the dependent variable and reflects managerial discretion in the financial reporting process. The variable captures management's tendency to adjust reported accounting earnings while remaining within the boundaries of applicable financial reporting standards. Higher values indicate a greater likelihood of discretionary financial reporting behaviour.

Corporate governance quality refers to the effectiveness of governance mechanisms in promoting transparency, accountability, responsibility, independence, and fairness within corporate decision-making. A higher level of governance quality indicates stronger monitoring functions and more effective oversight of managerial actions, thereby reducing opportunities for opportunistic financial reporting.

Carbon risk represents the potential financial exposure arising from environmental regulations, climate-related obligations, carbon emissions, technological transition, and sustainability-related uncertainty. Companies facing greater carbon-related risk may experience increasing operational and financial pressure, which can influence managerial reporting incentives.

Corporate social responsibility reflects a firm's commitment to integrating economic, environmental, and social responsibilities into its business activities. The extent of CSR implementation is assessed through sustainability-related disclosures contained in annual reports or sustainability reports. Greater CSR engagement demonstrates stronger accountability to stakeholders and is expected to enhance reporting transparency.

Auditor independence measures the ability of external auditors to perform audit engagements objectively and without managerial influence. Higher auditor independence enhances audit credibility by improving the effectiveness of external monitoring and increasing confidence in the reliability of corporate financial statements.

Research Model: To evaluate the proposed hypotheses, the following empirical model was estimated:

$$[EM = \alpha + \beta_1 CGQ + \beta_2 CR + \beta_3 CSR + \beta_4 AI + \varepsilon]$$

where:

EM = Earnings Management

CGQ = Corporate Governance Quality

CR = Carbon Risk

CSR = Corporate Social Responsibility

AI = Auditor Independence

α = Constant

$\beta_1 - \beta_4$ = Regression coefficients

ε = Error term

The estimated coefficients were interpreted to determine both the direction and magnitude of the relationship between each explanatory variable and earnings management. The empirical findings were subsequently evaluated against the proposed hypotheses to identify whether the theoretical expectations were supported by the observed evidence.

4. Results and Discussion

The regression analysis was conducted to examine the influence of corporate governance quality, carbon risk, corporate social responsibility (CSR), and auditor independence on earnings management in Indonesian consumer non-cyclical companies during 2019–2023. The empirical results indicate that all independent variables provide meaningful contributions in explaining variations in earning

Table 1. Hypothesis Testing Resultss management behaviour.

Variable	Relationship	Result
Corporate Governance Quality → Earnings Management	Negative	Supported
Carbon Risk → Earnings Management	Positive	Supported
Corporate Social Responsibility → Earnings Management	Significant	Supported
Auditor Independence → Earnings Management	Negative	Supported

The findings show that corporate governance quality has a significant negative effect on earnings management. This result indicates that companies with stronger governance mechanisms tend to reduce managerial discretion in financial reporting. Effective supervision, accountability systems, and internal control structures limit opportunities for managers to engage in opportunistic reporting practices. This finding supports Agency Theory, which explains that strong monitoring mechanisms can reduce conflicts of interest between managers and shareholders.

Carbon risk is found to have a significant positive effect on earnings management. Companies facing higher environmental uncertainty may experience greater pressure related to regulatory requirements, sustainability commitments, and operational adjustments. These conditions can encourage managers to maintain favourable financial performance through accounting discretion. Therefore, carbon risk represents not only an environmental challenge but also a factor influencing financial reporting behaviour.

The results also demonstrate that corporate social responsibility significantly affects earnings management. CSR implementation reflects corporate commitment to stakeholder expectations and organizational legitimacy. Companies with stronger sustainability orientation are encouraged to

maintain responsible reporting practices because transparency becomes an important element in maintaining stakeholder trust. However, CSR disclosure may also reflect strategic managerial considerations in presenting corporate reputation.

Furthermore, auditor independence has a significant negative relationship with earnings management. Independent auditors strengthen external monitoring by increasing the credibility of financial statements and reducing the possibility of undetected reporting manipulation. This finding confirms the role of external assurance as an important mechanism for improving financial reporting quality.

Overall, the results indicate that earnings management practices in Indonesian consumer non-cyclical companies are influenced by governance effectiveness, environmental risk exposure, sustainability practices, and audit quality. The findings highlight the importance of strengthening corporate governance and independent auditing while managing carbon-related risks to promote more transparent and reliable financial reporting.

5. Conclusions, Limitations, and Recommendations

Conclusions

This study provides empirical evidence that corporate governance quality, carbon risk, corporate social responsibility (CSR), and auditor independence influence earnings management in Indonesian consumer non-cyclical companies during 2019–2023. Strong corporate governance and auditor independence are proven to reduce earnings management by improving monitoring effectiveness and financial reporting reliability. Meanwhile, higher carbon risk increases managerial pressure, which may encourage greater reporting discretion. CSR also contributes to influencing corporate reporting behaviour through sustainability and stakeholder considerations.

Limitations

This study is limited to consumer non-cyclical companies listed on the Indonesia Stock Exchange, so the findings may not represent other industries. In addition, the measurement of carbon risk and CSR depends on corporate disclosures, which may vary across companies.

Recommendations

Future research may expand the sample coverage, extend the observation period, and include additional variables related to ownership structure, audit characteristics, and sustainability performance. Companies are encouraged to strengthen governance practices, manage environmental risks, and maintain auditor independence to improve financial reporting quality.

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