Assessing the Impact of Good Corporate Governance, Tax Planning, and Financial Distress on Earnings Management with Internal Control as Mediating

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Abstract. With internal control functioning as a mediator, this study aims to understand how financial distress, tax planning, and strong corporate governance affect earnings management. This study used PLS-SEM approach, and it was applied to a sample of 20 manufacturing companies that were listed on the Indonesia Stock Exchange between 2017 and 2021. The results showed that while tax planning has no substantial effect on internal control, financial distress, and good corporate governance do. Internal control acts as a mediating between financial distress, tax planning, and good corporate governance, rather than having a direct impact on earnings management. Analysis results indicated that financial distress and good corporate governance have an impact on internal control, but tax planning does not. Only internal control, which showed a substantial link, showed a meaningful relationship between financial distress, tax planning, and good company governance. These findings underscore the importance of robust internal control measures in mitigating unlawful earnings management actions. Enhancing internal control should be a top priority for manufacturing organizations, especially in the context of financial distress and good corporate governance, to proactively reduce the danger of undesirable earnings management practices.

Key words: earnings management, good corporate governance, tax planning, financial distress, internal control.

Introduction

Earnings management refers to a managerial strategy that exploits loopholes in Generally Accepted Accounting Principles (GAAP) during the process of financial reporting. It involves making economic decisions, implementing changes in accounting policies, and utilizing other triggers to manipulate financial statements, taking advantage of gaps in GAAP that result from contractual restrictions, stakeholder rationality restrictions, and market knowledge asymmetry (El Diri, 2018: 44). The purpose of earnings management is to show better performance or to achieve certain goals by reporting higher, constant, or lower profits in a certain period (Astari & Suryanawa, 2017: 290–319). Managers tend to practice earnings management if the bonus to be received is large, so they try to show the best performance results through earnings management (Astuti et al., 2017). In the business world, there are several major cases related to earnings management practices mentioned in research by (Chairunesia et al., 2018: 232). One notable case is the Enron scandal in 2002, where the largest energy company in the United States experienced a decline in total revenue and manipulated its financial statements, resulting in Enron's bankruptcy and loss of confidence in its financial statement information. This scandal also tarnished the reputation of auditors and resulted in the loss of hundreds of millions of dollars in investments (Utama & Rohman, 2013: 56–64).

Similarly, Worldcom experienced a financial scandal in the United States in 2002. Arthur Andersen, the external auditing firm responsible for independently reviewing Worldcom's financial reports, did not identify the fraudulent activities that were taking place in Worldcom's financial reporting (Tjahyadi &; Yustina, 2019). Worldcom reported a profit of $1.4 million in 2001, but it involved incorrect capitalization. Worldcom capitalized costs that should have been recorded as operating expenses, amounting to USD 3.8 billion (Adhikara, 2011: 109–135).

Research by Riadiani and Wahyudin (2015), Implies that the adoption of effective corporate governance (CG) measures can reduce or prevent earnings management within a company. The adoption of GCG practices can significantly impact a company's success or failure (Agustia, 2013: 27–42; Ashbaugh-Skaife et al., 2017: 166–192). Hence, the adoption of robust GCG practices in a company is crucial as it can enhance shareholder confidence, ensure equitable treatment for all stakeholders, and provide effective, efficient, and appropriate protection for shareholders and investors (Mahrani & Soewarno, 2018:).

Earnings management actions are further exacerbated when the company's condition experiences a financial crisis (Campa, 2015). This can be attributed to increased pressure arising from challenging circumstances, while the company is still expected to deliver optimal performance. Past studies have indicated that companies facing financial distress often tend to conceal their situation. (Hassanpour & Ardakani, 2017: 213–219).

In addition to financial distress, another factor that influences companies to carry out profit management is tax planning (Achyani & Lestari, 2019: 77–88). Tax planning is an effort made by companies to manage taxes well, efficiently, and economically to make a maximum contribution to the company. Good and quality internal control can also be one way to control profit management practices. According to Wali & Masmoudi (2020), Internal control reporting refers to the specifications outlined in the Sarbanes-Oxley Act of 2002, which aims to increase the reliability and accuracy of financial statements while promoting investor confidence.

In this research, internal control was employed as a mediating variable. The reason for choosing this methodology is that internal control, apart from its potential impact on earnings management practices, can also be influenced by numerous other factors. Previous research, including the research done by Li et al. (2020), has demonstrated that internal control can mitigate the behaviors of an organization's accounting and real profit manipulation, acting as a bridge between financial hardship and earnings management strategies.

Literature Review

Agency Theory

The idea of agency theory was first developed by Jensen and Meckling in (1976: 305–360), which explains the dynamics between owners (principals) and management (agents) within a contractual relationship, where the agent carries out delegated duties on behalf of the principal. Nonetheless, divergent interests and motivations between principals and agents can give rise to conflicts of interest, stemming from information asymmetry between the two parties. Therefore, agency theory can be used to explain the phenomenon of earnings management that occurs due to information asymmetries that allow agents to be opportunistic. The agency theory also addresses three basic human traits: self-interest, limited thinking power about the future, and a tendency to avoid risk.

The application of agency theory can assist in addressing two major issues that might arise in agency relationships: agency issues, which arise when the goals of the principal and agent are not in alignment, and risk-sharing issues, which develop when the principal and agent have different perspectives on risk. This theory can be particularly useful in controlling and mediating the performance of agents, such as auditors, especially in situations of financial distress and tax planning, where the agent's opportunistic motivations may be heightened in pursuit of their economic and psychological needs through activities such as investments, loans, and compensation contracts (Achyani & Lestari, 2019).

Earnings Management

Earnings management refers to managers' efforts to falsify financial statement information to mislead shareholders who require the information to comprehend the performance and state of the company (Sulistyanto, 2008). From the contractual standpoint and the financial reporting perspective, the concept of earnings management can be examined. The contractual point of view involves choosing a lower cost to protect the company from the influence of unforeseen facts in a rigid and incomplete contract (Scott, 2008). While a point of view financial reporting entails the manipulation of information in financial statements to affect the market value of a company's stock.

Internal Control

Following the recommendations made by the Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2013). The COSO guidelines identify five essential elements of internal control, which comprise monitoring, information and communication, risk assessment, control actions, and control environment. To effectively achieve the objectives of internal control, companies must establish policies and procedures as control activities that involve all employees. Evaluation of the effectiveness and efficiency of the internal control system requires constant supervision and effective information sharing within the company. Companies can ensure that their internal control goals are met by putting these elements into practice.Good Corporate Government

Corporate governance is a process that includes rules, laws, market mechanisms, recording standards, best practices, and the efforts of corporate governance participants to establish a system of checks and balances to increase shareholder value and protect the interests of other stakeholders. The level of audit quality, the efficiency of the audit committee, institutional ownership, the percentage of independent board members, and the number of directors are all elements that can be used as indications of strong corporate governance. The advantages of implementing good corporate governance practices include reducing agency costs and capital costs, enhancing the value of shares and the company's reputation in the public domain in the long term, and gaining support from stakeholders. A company's commitment to upholding good corporate governance is crucial for sustainable business continuity and garnering support from shareholders and other stakeholders. By adhering to the principles of good corporate governance, companies can enhance their performance, minimize costs, and generate long-term benefits for all stakeholders.

Tax Planning

According to Wardoyo et al. (2017), taxes are one of the important sources of financing for the state to run its government. Taxes have several characteristics that can be used to describe their nature, including the fact that they are levied by legal requirements and regulations, are subject to enforcement, do not result in immediate rewards from the government for payment, and are collected by both the central and local governments on behalf of the state. Taxes are also earmarked for government spending, and if there is still a surplus, can be used to finance public investment.

Tax planning serves as a tool and serves as the initial step of tax management, acting as a reservoir for strategies and aspirations that arise from human nature (Pohan, 2016). Tax planning refers to the organizational process undertaken by taxpayers to minimize their tax liabilities while adhering to applicable tax laws. On the other hand, tax management encompasses comprehensive efforts by tax managers within a company to efficiently and economically handle corporate taxation, to make the maximum possible contribution to the company. While tax planning and tax management share similarities in their approach to tax optimization, tax management has a broader scope compared to tax planning, as it encompasses various aspects of tax-related activities within a company.

Pohan (2016) described many tax methods, such as tax avoidance, taxsavings, tax payment postponement, maximizing permitted tax credits, avoiding tax audits by avoiding overpayment, and avoiding tax law infractions. Tax strategy is a purposeful method that can be used by taxpayers to lower their tax obligations whilestill abiding by the applicable tax regulations.

Financial Distress

A corporation is said to be in financial distress when it is experiencing significant financial difficulties, but before it enters a state of bankruptcy or liquidation. In conditions of financial distress, companies face difficulties in fulfilling financial obligations and often have to face difficult situations with creditors. This condition can trigger the company to experience a continuous recession during the financial crisis.

In a more detailed sense, financial distress can be identified by several clear signs. A company can be said to be in a state of financial distress if it experiences negative operating profit on an ongoing basis, does not pay dividends for several years, lays off employees, has a low-interest coverage ratio, negative EBITDA or EBIT, termination of operations, negative book value of equity or net income, debt that exceeds the value of assets or equity, and inadequate operating cash flow to paycommitments. If the company continues to experience signs of financial distress, then mostlikely the company will face the risk of bankruptcy. Therefore, companymanagement needs to identify signs of financial distress and immediately take appropriate action to improve the company's financial situation before it is too late.

Hypotheses Development

In this study, internal control serves as a mediating variable between theeffects of Good Corporate Governance (GCG), tax planning, and financial distresson earnings management. The models and hypotheses below are constructed, building on prior literature:

H1: Internal control is impacted by good corporate governance

H2: Internal control is affected by tax planning.

H3: Internal control is affected by financial distress.

H4: Effective earnings management is affected by good corporate governance.

H5: Tax planning significantly affects the management of earnings.

H6: Earnings management is affected by financial distress.

H7: Earnings management is affected by internal control.

H8: Internal control has a substantial impact on earnings management as a result offinancial distress.

H9: Through internal control, tax planning significantly affects earnings management

H10: Effective internal control contributes to good corporate governance's major impact on earnings management.

Methodology

In this study, audit quality is used as a stand-in for the main independent variable of good corporate governance (GCG). The second independent variable is tax planning, measured through the calculation of effective tax ratio (ETR) and cash effective tax ratio (CETR). The third independent variable is financial distress, measured by interest coverage ratio (ICR), basic earnings per share (BEPS), and dividend distribution.

Earnings management is the outcome being investigated, and it is measured using Roychowdhury's actual earnings management approach (Roychowdhury, 2006: 335–370). The mediating variable is internal control, which is measured using 17 indicators from the COSO internal control framework. With a sample of 20 manufacturing companies listed on the Indonesia Stock Exchange between 2017 and 2021, the data analysis was carried out using the Partial Least Square Structural Equation Modeling (PLS-SEM) methodology.

Results and Discussion

Evaluation of the Measurement Model (Outer Model)

According to Hair et.al. (2019: 2–24), individual reflective measures are considered to correlate if their loading factor values are higher than 0.70 with the measured construct. Based on Table 1, the outer loading values in this study have met the criteria, as all of them are above 0.70.

Table 1. Outer Loading

	Earning Management	Financial Distress	GCG	Internal Control	Tax Planning
BEPS		0,834			
CETR					0,949
COSO				1,000	
DIV		0,890			
ETR					0,957
ICR		0,870			
KA			1,000		
REM	1,000				
Source: SmartPLS V.3.0 Data Processing					

Reliability Test

Composite reliability and Cronbach's alpha values can be used to evaluate the dependability of constructs. A construct is regarded to have high reliability if both Cronbach's alpha and the composite reliability value are higher than 0.70 (Ghozali & Latan, 2015).

The information in Table 2 makes it evident that all variables exhibit composite reliability values that are greater than 0.70, demonstrating that they satisfy the dependability requirements. All of the variables have Cronbach's Alpha values that are higher than 0.60, demonstrating that they all meet the reliability requirement. The Average Variance Extracted (AVE) values used to measure convergent validity show that all constructs have AVE values of more than 0.50, which means they meet the standards for convergent validity put forth by Hair et al. (2019: 2–24).

Table 2. Composite Reliability, Cronbach Alpha, and AVE

	Cronbach's Alpha	rho_A	Composite Reliability	(AVE)
Earning Management	1,000	1,000	1,000	1,000
Financial Distress	0,834	0,857	0,899	0,748
Gcg	1,000	1,000	1,000	1,000
Internal Control	1,000	1,000	1,000	1,000
Tax Planning	0,899	0,904	0,952	0,908
Source: SmartPLS V.3.0 Data Processing				

Discriminant Validity

Discriminant validity can be assessed using the HTMT (Heterotrait-Monotrait) values. The recommended threshold for HTMT values is below 0.90 (Hair et al., 2019: 2–24).

Table 3. Result of HTMT

	Earning Management	Financial Distress	GCG	Internal Control	Tax Planning
Earning Management					
Financial Distress	0,218				
Gcg	0,211	0,147			
Internal Control	0,422	0,740	0,422		
Tax Planning	0,183	0,067	0,071	0,110	
Source: SmartPLS V.3.0 Data Processing					

According to the data in the table, all of the study's variables satisfy the requirement for discriminant validity because their HTMT (Heterotrait-Monotrait) values are less than 0.90. Structural Models (Inner Model)

The first step in data processing using SmartPLS involves determining the R-Square value to evaluate the substantive influence between model variables. An R-Square value of 0.75 is regarded as a strong model, 0.50 as a moderate model, and 0.25 as a weak model, according to Ghozali and Latan (2015). Financial distress, tax planning, and excellent corporate governance together account for 58.7% of the variance in the internal control variable, according to Table 4 above, where the R-Square value for the internal control variable is found to be 0.587. Internal control is influenced by a variety of factors, both internal and external to the organization, according to the fairly sized R-Square value for this variable. Similarly, the R-Square value for the earnings management variable is determined to be 0.080, indicating that the variables of financial distress, tax planning, internal control, and good corporate governance collectively explain only 8% of the variance in the earnings management variable, with the remaining 92% being attributed to other variables not hypothesized in this study. As a result, itcan be concluded that the earnings management variable's R-Square value is weak since it is influenced by a variety of factors both inside and outside the organization.

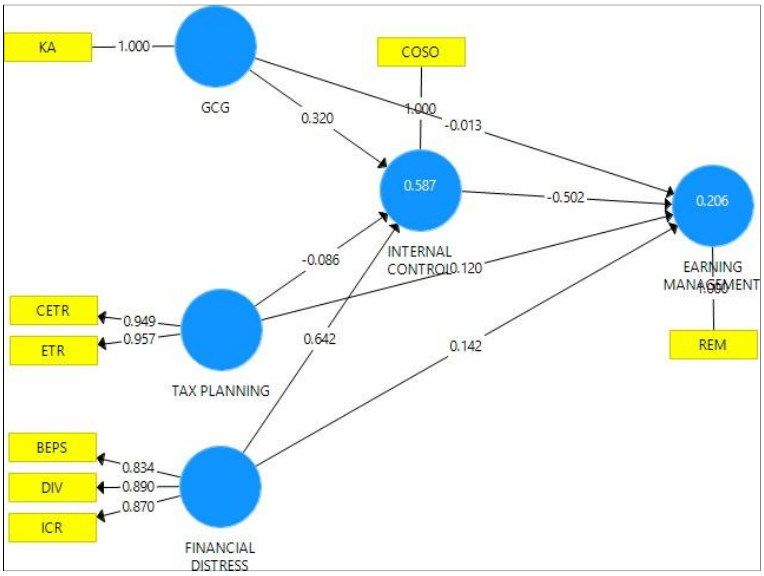

Fig. 1. Output PLS Algorithm. *Source*: SmartPLS V.3.0 Data Processing

Table 4. R-Square

	R Square	Adjusted R Square
Earning Management	0,206	0,172
Internal Control	0,587	0,574
Source: SmartPLS V.3.0 Data Processing		

Model Fit

The SRMR (Standardized Root Mean Square) value must be less than 0.08 to satisfy the fit model criterion. (Hair et al., 2019: 2–24).

Table 5.Model Fit

	Saturated Model	Estimated Model
SRMR	0,061	0,061
d_ULS	0,135	0,135
d_G	0,113	0,113
Chi-Square	72,929	72,929
NFI	0,797	0,797
Source: SmartPLS V.3.0 Data Processing		

It is clear from the table above that the study's SRMR (Standardized Root Mean Square) score is 0.061, which denotes a satisfactory model fit. This is in line with the requirement set by Schermelleh et al. (2003: 23–74) that the SRMR value should be < 0.08 for a well-fitting model, and in this study, the model fit criteria have been met.

Hypothesis Test

The hypothesis testing is conducted using the bootstrapping method toevaluate the impact of one construct on another construct. Examining the parameter coefficients and t-statistic values is done to achieve this (Ghozali & Latan, 2015).

Table 6. Path Coefficients (Mean, STDEV, T-Value)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistik	P Values
Financial Distress → Earning Management	0,142	0,152	0,096	1,482	*0,139*
Financial Distress → Internal Control	0,642	0,646	0,061	10,585	0,000
Gcg → Earning Management	-0,013	-0,018	0,107	0,118	*0,906*
Gcg → Internal Control	0,320	0,320	0,063	5,069	0,000
Internal Control → Earning Management	-0,502	-0,519	0,171	2,936	0,003
Tax Planning →Earning Management	0,120	0,101	0,086	1,392	*0,164*
Tax Planning → Internal Control	-0,086	-0,067	0,061	1,414	*0,158*
Source: SmartPLS V.3.0 Data Processing					

The values in the output path coefficient for testing structural models serve as the basis for hypothesis testing. The magnitude of the t-statistical value is used to evaluate the results of the proposed hypothesis. The comparison of t-values and statistics with t-tables is determined based on values above 1.96 or p-values less than 0.05. The hypothesis is accepted if the t-statistic value is higher than 1.96 or the p-value is lower than 0.05, and vice versa. As shown by the t-statistic value of 1.482 and the p-value of 0.139 (>0.05), the results of the analysis in Table 6 point to the possibility that financial distress has little effect on earnings management. Internal control is significantly impacted by financial distress, nevertheless, as indicated by the t-statistic's value of 10.585 and the p-value of 0.000 (0.05).

Furthermore, with a t-statistic of 0.118 and a p-value of 0.906 (>0.05), good corporate governance had no discernible impact on earnings management.Nevertheless, as shown by a t-statistic value of 5.069 and a p-value of 0.000 (0.05), good corporate governance does significantly affect internal control. Contrarily, internal control has a considerable impact on earnings management, as shown by its significant p-value of 0.000 (0.05) and t-statistic value of 2.936. A t-statistic value of 1.392 and a p-value of 0.164 (>0.05) indicate that tax planning does not significantly affect earnings management, though. A t-statistic value of 1.414 and a p-value of 0.158 (>0.05) indicate that tax planning has a negligible impact on internal control.

Intervening Effect Test

Testing of the intervening effect is conducted to ascertain the indirect influence of one construct on another construct. This test is performed using the bootstrapping method and involves examining the parameter coefficients and t- statistical values. The value obtained from the output of the specific indirect effect serves as the basis for testing the intervening effect.

Table 7.Specific Indirect Effect (Mean, STDEV, T-Value)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistik	P Values
Financial Distress → Internal Control → Earning Management	-0,322	-0,338	0,124	2,603	0,010
GCG → Internal Control → Earning Management	-0,161	-0,162	0,055	2,935	0,003
Tax Planning → Internal Control → Earning Management	0,043	0,035	0,036	1,198	0,231
Source: SmartPLS V.3.0 Data Processing					

According to the results shown in Table 7, which have a t-statistic of 2.603 and a p-value of 0.010 (0.05), internal control may serve as a mediating factor in the association between financial distress and earnings management. Similarly, a t-statistic of 2.935 and a p-value of 0.003 (0.05) suggest that internal control may act as a mediating factor in the association between good corporate governance and earnings management. Internal control may not mediate the association between tax planning and earnings management, however, since the t-statistic value is 1.198 and the p-value is 0.231 (>0.05), indicating that the influence of tax planning on earnings management through internal control is not supported.

Discussion

The Effect of Good Corporate Governance on Internal Control

The findings of hypothesis testing support the claim made by Jensen and Meckling (1976: 305–360) in agency theory that good corporate governance significantly affects internal control. This study measures audit quality as an indicator of good corporate governance using the KAP measure and found that auditors from the big four KAP are considered to have better expertise in providing advice and input on internal control, becoming a reference for companies in making decisions related to internal control. This research supports previous research by Fang & Zhou (2012), which states that companies with good internal control will achieve good corporate governance, but weaknesses in internal control can affect good corporate governance. As a result, companies must prioritize audit quality and enhance internal control measures to attain effective corporate governance.

The effect of tax planning on internal control

The results of the tests showed that contrary to Jensen and Meckling's (1976: 305–360) agency theory assumptions, tax planning had no statistically significant effect oninternal control. Tax planning carried out by companies is still possible with good internal control, as long as it is within the limits of applicable tax provisions anddoes not lead to excessive opportunist behavior. Tax planning is carried out toreduce the tax burden that can reduce company profits, but companies must avoidtax avoidance practices that harm the company in terms of law and company image. Companies with good internal control are not necessarily effective in conducting tax planning. Tax planning must be carried out within limits following applicable tax provisions, and companies must improve tax burden management to optimize profits generated while avoiding excessive tax avoidance practices.

The Effect of Financial Distress on Internal Control

The findings of this study support the idea put out by Jensen and Meckling (1976: 305–360) in their agency theory that financial difficulty has a substantial impact on internal control. This result is in line with earlier studies, such as the one carried out by Li et al.(2020), which suggests that companies experiencing financial distress may prioritize strengthening their internal control procedures as a part of their recovery efforts. Interestingly, the results of this study differ from earlier studies that reported no significant association between financial distress and internal control. (Rice & Weber, 2012: 811).

The purpose of internal control is to conduct effective supervision of company operations, prevent losses, and waste of resources, and make sure the financial statements are accurate. The effective implementation of internal control measures can help companies avoid financial distress and potential harm. Theresults of this study underscore the significance of enhancing internal control practices in companies facing financial distress, as it can contribute to improved operational performance and overall sustainability of the company.

The Effect of Good Corporate Governance (GCG) on Earnings Management

The hypothesis testing results indicate that despite contradicting agency theory by Jensen & Meckling (1976: 305–360), previous research by Riadiani & Wahyudin (2015), and the current study itself which uses audit quality with KAP size proxies, good corporate governance does not significantly affect earnings management. Earlier studies have also shown that audit quality does not impact earnings management, as companies may still engage in earnings management to improve their perceived performance, even when by the Big Four public accounting firms. While big four public accountants focus on maintaining credible financial statements and minimizing disruptions, their presence does not guarantee the prevention of earnings management practices, as there may still be issues with the integrity of those conducting earnings management.

The Effect of Tax Planning on Earnings Management

The results of the hypothesis testing show that there is no substantial association between corporate tax preparation and the likelihood of earnings management, which is contrary to past studies that suggested there was. This finding is in line with that of other studies, which similarly showed no connection between tax preparation and effective earnings management. While companies may engage in tax optimization to increase profits from investors through share sales, it is crucial to ensure that tax planning activities are conducted in compliance with legal tax regulations to avoid potential tax sanctions in the future. Therefore, in this context, the impact of tax planning on earnings management cannot be established, as tax planning is carried out within the confines of applicable tax laws.

The Effect of Financial Distress on Earnings Management

According to the results of the hypothesis test, managing earnings is not significantly impacted by financial difficulties. Companies in financial trouble put more effort into preventing bankruptcy than they do towards managing their earnings. The use of earnings management in times of financial distress can damage the credibility of the company in the future and result in biased information in decision-making, which has an impact on the smooth running of financial markets. This result is consistent with the agency hypothesis proposed by Jensen &; Meckling (1976: 305–360), as well as previous research by Khairunisa (2020: 1114) and Kristyaningsih et al. (2021: 151). The results of this study, however, differ from those of other studies that claimed that financial difficulty had an impacton earnings management because, in the study, businesses used earnings management to cut losses or keep profits to demonstrate strong performance amid a crisis.

The Effect of Internal Control on Earnings Management

The results of the hypothesis testing show that internal control significantly affects profits management, which is consistent with the ideas of Jensen and Meckling's agency theory. (1976). These findings also align with previous research conducted in this area. (Chen et al., 2018: 234–238; Makhdalena, 2011 (1–14); Khairunnisa, 2020: 114–1131) which showed that internal control affects earnings management.

Good internal control encourages management not to display more financial statements and avoid earnings management practices, especially those that lead to illegal actions. Contrarily, the findings of this study do not agree with those of other studies conducted by Hadi & Afriyenti (2022), which implied that internal control does not affect how earnings are managed.

The Effect of Good Corporate Governance Mechanism on Earningsmanagement through Internal Control

The use of Smart PLS 3.0 to investigate the influence of intervening variables has shown that good corporate governance has a substantial impact on earnings management, with internal control mediating this relationship using the COSO framework 2013. This result is consistent with the agency theory principles established by Jensen and Meckling in 1976, which contend that good corporate governance and internal controls can lessen the effects of profits management practices.

Additionally, these outcomes support a prior study carried out by Soleman (2013: 57–74), which concluded that internal control and good corporate governance significantly influence good governance within the organizational environment. However, in managing the company, management is faced with a conflict between good financial conditions and compliance with applicable regulations. In this context, internal control can help overcome these conflicts to maintain the creation of good corporate governance.

Effect of Tax Planning on Earnings management through Internal Control

According to the results of a hypothesis test conducted using Smart PLS 3.0, tax planning does not significantly affect earnings management when it is mediated through internal control. This finding goes against some earlier studies that claimed effective internal control can lessen mismanagement in the administration of corporate tax policies Schermelleh. The findings of this investigation, however, are consistent with Jensen and Meckling's (1976) agency theory which states that earnings management actions can occur despite good internal controls.

This research also shows that manufacturing companies as research objects tend to rarely carry out earnings management actions through tax planning. This result supports the argument of Sari & Pinasthika (2021: 164–181), which states that management will have a split focus between earnings management and tax planning in the current year's financial statements.

The Effect of Financial Distress on Earnings management through Internal Control

According to the research, financial distress has a major impact on earnings management, and internal control acts as a bridge between the two. This emphasizes the crucial role internal control plays in bridging the gap between managing earnings and financial distress. Additionally, this research implies that weak internal controls may encourage businesses in financial crisis to engage in actions related to earnings management, whereas enhancing internal control measures can reduce such behaviors in businesses in financial distress.

Conclusion

According to the study, internal control in manufacturing organizations plays a mediating role in the link with earnings management. While the overall implementation of internal control is satisfactory, there is room for improvement to prevent illicit earnings management practices. Analysis results indicated that financial distress and good corporate governance have an impact on internal control, but tax planning does not. Only internal control, which showed a substantial link, showed a meaningful relationship between financial distress, tax planning, and good company governance. These findings underscore the importance of robust internal control measures in mitigating unlawful earnings management actions. Enhancing internal control should be a top priority for manufacturing organizations, especially in the context of financial distress and good corporate governance, to proactively reduce the danger of undesirable earnings management practices.

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