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SYNERGISTIC SHIELD OR OPPORTUNISTIC SMOKESCREEN? ESG PERFORMANCE, ACCOUNTING CONSERVATISM, AND ACCRUAL-BASED EARNINGS MANAGEMENT

YAN CHRISTIANTO SETIAWAN
FELIZIA ARNI RUDIAWARNI
DEDHY SULISTIAWAN

Universitas Surabaya, Jl. Raya Kalirungkut, Surabaya, Indonesia
yanchristianto@staff.ubaya.ac.id

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Abstract: *The link between corporate sustainability and financial reporting quality remains conceptually controversial, especially in emerging markets. This research analyzes the impact of environmental, social, and governance (ESG) performance on future accrual-based earnings management, alongside the moderating role of accounting conservatism in the Indonesian capital market from 2019 to 2024. Fixed-effects panel regressions demonstrate that greater ESG performance significantly reduces opportunistic earnings management. Importantly, conditional conservatism creates a synergistic monitoring environment that complements these sustainability measures. By contrast, unconditional conservatism produces a detrimental substitution effect by generating opaque accounting slack, enabling managers to weaponize their sustainable reputation to conceal financial manipulation. Robustness tests using directional sub-samples reveal that this governance ecosystem operates asymmetrically. ESG and conditional conservatism effectively mitigate artificial earnings inflation, whereas unconditional conservatism actively facilitates opportunistic downward manipulation. Furthermore, additional analyses deconstructing the ESG pillars demonstrate that substantive environmental and social initiatives drive this ethical discipline, while formal governance compliance serves primarily as a symbolic practice. Crucially, unconditional conservatism perverts this dynamic, enabling managers to exploit symbolic governance and weaponize substantive environmental initiatives as a smokescreen for earnings manipulation. Thus, investors and regulators should simultaneously assess sustainability metrics and unconditional conservatism to prevent managerial wealth expropriation.*

Keywords: Accrual-Based Earnings Management, Conditional Conservatism, ESG Performance, Unconditional Conservatism

INTRODUCTION

The integrity of financial reporting is a necessity for the efficient operation of capital markets and for the efficient deployment of resources. However, corporate scandals in emerging economies have proved repeatedly that accrual-based earnings management can destroy stakeholders' confidence and skew decision making process (Le-Bao et al. 2025; Lestari and Muthmainnah 2025). To understand the root of such opportunism, the specific institutional context of the capital market must be highlighted. Within the Association of Southeast Asian Nations region, Indonesia presents a uniquely compelling institutional paradox compared to developed neighboring markets such as Singapore. The Singaporean market operates within a comprehensive legal framework that ensures strong investor protection. Conversely, the Indonesian market is defined by a high concentration of corporate ownership, severe information asymmetry, and relatively weaker security regulations (Elvina et al. 2024). This kind of institutional friction produces a dangerous loophole, where managerial opportunism is often hidden behind corporate sustainability facades.

A major empirical example of this phenomenon is the recent massive ecological and governance scandal involving the state-owned business, PT ABC. This high-profile case is an example of the widespread use of CSR programs and sustainability claims as a strategic smokescreen by firms. The underlying objective is to hide major financial and environmental problems from public scrutiny (Wandira 2024). This particular case fully confirms the view of agency theory, demonstrating how extensive environmental and social initiatives frequently serve as mere camouflage for profound corporate governance failures.

Such opportunism can be tackled by promoting real Environmental, Social and Governance (ESG) performance rather than simple voluntary disclosure. Hence, this genuine commitment has become an essential non-financial governance mechanism that should punish managerial conduct (Nguyen 2024; Tohang, Hutagaol-Martowidjojo, and Pirzada 2024). The Indonesian government requires the sustainability report based on the Financial Services Authority Regulation No. 51/POJK.03/2017, which is technically supported by Circular Letter No. 16/SEOJK.04/2021. However, its institutional enforcement still looks conspicuously undeveloped. It is empirically unclear if internal accounting systems can close this enforcement gap, in a setting where ambitious sustainability goals are often ahead of regulatory scrutiny in practice.

While the direct relationship between corporate sustainability and the quality of financial reporting has been widely discussed, a critical research gap remains. The existing literature has largely overlooked the moderating role of stringent reporting constraints in determining the nexus between ESG performance and accrual-based earnings management. Current accounting research generally does not distinguish the moderating effects of accounting conservatism into *conditional ex post* and *unconditional ex ante* dimensions. This neglect remains even though they have fundamentally distinct effects on managerial discretion and the timeliness of loss identification (Beaver and Ryan 2005; Elvina et al. 2024; Kousenidis, Ladas, and Negakis 2014). Therefore, to bridge this gap, the purpose of this study is to examine whether strict conservative accounting can properly attach ESG's ethical claims to actual financial reporting quality. Finally, this research investigates the effectiveness of such an anchoring mechanism in reducing opportunistic behaviour in the form of accrual-based earnings management.

By addressing this gap, this study extends agency theory and the accounting conservatism literature with new empirical evidence from a developing market. Specifically, it reveals how two distinct dimensions of conservatism interact with non-financial ESG performance to constrain managerial opportunism, offering key theoretical and practical contributions. In practice, the results give vital information for the policy makers such as the Financial Services Authority (OJK) and the investors. The study is a reminder for regulators that sustainability reporting requirements should be accompanied by strong accounting enforcement to avoid ESG from being a strategic smokescreen. For investors, it gives a stronger basis for assessing business sustainability, highlighting that real ESG commitments need to be backed by quality and conservative financial reporting.

Recent literature examining the nexus between corporate sustainability and financial reporting quality remains highly polarized, presenting a significant theoretical tension between stakeholder and agency perspectives. On one side of the spectrum, contemporary studies assert that genuine Environmental, Social, and Governance (ESG) commitments effectively restrain managerial opportunism. Recent evidence from emerging markets indicates that robust sustainability performance aligns with ethical stakeholder theories, fundamentally deterring aggressive earnings management and enhancing corporate transparency (Kim, Park, and Wier 2012; Liu et al. 2025; Nguyen 2024; Özer, Aktaş, and Çam 2024; Sun et al. 2024). Under this ethical framework, highly sustainable firms prioritize long-term reputational capital and stakeholder trust, which inherently discourages short-term earnings manipulation (Kim, Park, and Wier 2012; Liu et al. 2025).

Conversely, a growing body of current empirical research provides an opportunistic, agency-driven perspective. Recent studies argue that managers frequently exploit ESG initiatives as a strategic diversion or greenwashing tool to build corporate legitimacy, which paradoxically facilitates the concealment of earnings management practices (Almubarak, Chebbi, and Ammer 2023; Lestari and Muthmainnah 2025; Mao, Wang, and Lin 2024; Tohang, Hutagaol-Martowidjojo, and Pirzada 2024). In these scenarios, opportunistic managers strategically disclose favorable non-financial information to deflect critical stakeholder scrutiny, thereby escaping detection for financial reporting irregularities (Mao, Wang, and Lin 2024; Lestari and Muthmainnah 2025). This ongoing polarization in the latest literature underscores a critical gap: the efficacy of ESG as an internal governance mechanism is not absolute but is likely contingent upon the accounting boundaries set by the firm. Therefore, this study integrates accounting conservatism, both conditional and unconditional, as the moderating mechanism to reconcile these conflicting contemporary findings.

ESG Performance and Accrual-Based Earnings Management

Stakeholder theory suggests that managers of high ESG performing organisations match their firm's operations to society norms in order to gain social acceptability and preserve long term organizational legitimacy. Inherently, these organisations are reluctant to engage in aggressive accrual-based earnings management out of a desire to preserve their reputation and their trust with their stakeholders, which is a natural reflection of their ethical convictions by providing greater financial reporting quality (Sabirali, Mahalakshmi, and Sahoo 2025; Sun et al. 2024). Integrating ESG principles into corporate strategy fundamentally demands a high level of accountability that deters executives from manipulating financial records. Empirical evidence using data from developing economies shows that real ESG performance constrains company profitability management and managerial opportunism (Sun et al. 2024; Tohang, Hutagaol-Martowidjojo, and Pirzada 2024).

Conversely, the combination of agency theory and legitimacy theory offers a darker view. Under this perspective, entrenched managers are intrinsically subject to moral hazard. They opportunistically use ESG participation as a reputational shield. Consistent with Bunadi and Tarjo (2022), executives may strategically implement such such socio-environmental actions can be used by managers as a way of protecting their careers, gaining regulatory benefits, and minimizing external scrutiny. Thus, sustainability initiatives serve as a greenwashing tool to build external legitimacy. This allows firms to hide their earnings management practices from market strategically (Bunadi and Tarjo 2022; Almubarak, Chebbi, and Ammer 2023; Mao, Wang, and Lin 2024). Companies in the Indonesian capital market are under immense pressure to demonstrate their true internal quality to external investors (Lestari and Muthmainnah 2025). In such an environment of high information asymmetry, voluntary disclosures are highly susceptible to manipulation. However, firms with superior and independently rated ESG performance metrics are theoretically compelled to maintain actual accounting integrity to prevent catastrophic reputational collapse. Aligning with the stakeholder theory perspective within this high risk institutional context, robust sustainability performance acts as a genuine ethical deterrent against opportunistic financial reporting. Thus, we formulated the first hypothesis as follows:

H_1: Firms with superior ESG performance exhibit lower levels of AEM.

ESG Performance, Accrual-Based Earnings Management, and Conditional Conservatism

To further understand this dynamic, the second hypothesis incorporates conditional conservatism into the ESG and earnings management nexus. From an agency theory perspective, the asymmetric timeliness of conditional conservatism which mandates the immediate recognition of economic losses can paradoxically be exploited by opportunistic managers. These tight rules could be wielded by entrenched executives to rationalize huge downward accrual manipulation, sometimes known as big bath accounting. Here, managers leverage their positive ESG image to convince the market that these excess write-downs are merely good governance, and not opportunistic earnings management (Daryaei et al. 2022). The traditional view, in line with stakeholder theory, believes that conditional conservatism is a flawless ex post governance mechanism that instantaneously resolves agency issues. Conditional conservatism imposes strong constraints on the manager's ability to inflate earnings artificially through requiring higher thresholds of verification when recognizing economic gains relative to losses (Elvina et al. 2024).

When integrated with strong ESG performance, conditional conservatism acts as a powerful complementary enforcement mechanism. Empirical literature shows that asymmetric timeliness strictly limits opportunistic upward accruals. Furthermore, accounting mechanism substantially reduces information asymmetry between external stakeholders and internal managers (Meqbel et al. 2024). Currently, the Indonesian business landscapes is characterized by high information asymmetry, and growing regulatory enforcement. This causes external investors to rely on internal accounting mechanisms heavily, intended to verify company sustainability claims (Lestari and Muthmainnah 2025). Conditional conservatism prevents managers from using sustainability initiatives as a cover to overstate corporate earnings. Strict verification requirements ensure that the transparency promised by ESG is translated into verifiable financial figures. Consequently, the second hypothesis is proposed:

H_2: The mitigating effect of ESG performance on accrual-based earnings management is more pronounced in firms with higher conditional conservatism.

ESG Performance, Accrual-Based Earnings Management, and Unconditional Conservatism

The third hypothesis addresses a mechanism distinct from unconditional conservatism. Unlike the conditional conservatism, unconditional conservatism is an ex-ante mechanism that continuously reduces net asset values based on predetermined accounting principles and independent of current economic data (Beaver and Ryan 2005). By continuously reducing asset values and accelerating expenditures, unconditional conservatism generates unrecorded accounting slack. These concealed reserves could be exploited by opportunistic management in succeeding periods to smooth income while their strong ESG reputation acts as a protective facade to escape detection (Elvina et al. 2024).

However, from the stakeholder theory perspective, unconditional conservatism sets a hard and reasonable baseline from the very beginning of the reporting process. Conservative policies, predetermined, limit managerial ambition and inherently limit accounting flexibility (Barrak, Sahib, and Salman 2025). The argument is that rigid accounting baselines constrain the accounting space for upward profits manipulation, hence strengthening the disciplinary effect of corporate governance (Barrak, Sahib, and Salman 2025; Le-Bao et al. 2025). Furthermore, the consistent application of conservative accounting principles ensures that the recognition of expenses and revenues is strictly grounded in actual economic occurrences. This inherently curtails financial statement manipulation by management and significantly enhances overall earnings quality (Maulia and Handojo 2022). In the Indonesian research setting, the adoption of strict ex ante accounting standards is a strong internal indicator of risk aversion and prudence. This rigid accounting framework is expected to complement the ESG performance ethics framework. Unconditional conservatism adds an additional layer of constraint that strengthens the effect of ESG performance disciplines on financial reporting quality, by systematically lowering the carrying value of net assets. Anticipating that the strict nature of unconditional conservatism aligns with stakeholder commitments to reduce managerial opportunism, the third hypothesis is stated as follows:

H_3: The mitigating effect of ESG performance on accrual-based earnings management is more pronounced in firms with higher unconditional conservatism.

Building upon the established theoretical framework, this paper is driven by a dual purpose. Our initial step is to assess the direct consequences of ESG performance on AEM. We then expand the investigation to see whether the ESG and AEM dynamic is moderated by conditional as well as unconditional conservatism. To answer these questions while robustly tackling endogeneity issues, we adopt a research design that incorporates lagged variables alongside firm fixed effects. This specific approach is essential for managing reverse causality and accounting for unobservable company characteristics that remain constant (Sun et al. 2024). This research sample consists of companies listed on the Indonesian stock exchange, systematically excluding the utilities and financial sectors because their unique regulatory environments and accrual structures could heavily bias the empirical analysis (Elvina et al. 2024; Sabirali, Mahalakshmi, and Sahoo 2025). This study gives three main contributions to the existing literature. First, it extends the literature on the relationship between nonfinancial performance and earnings quality, by providing novel evidence on how accounting conservatism defines the boundaries of ESG efficacy. Second, this study contributes to the conservatism literature by disentangling the distinct moderating effects of conditional and unconditional conservatism on managerial opportunism. Thus, offering a granular perspective on how ex post and ex ante accounting policies interact with sustainability commitments. Third, it provides robust empirical evidence from a unique emerging market setting where real world sustainability scandals offer an excellent testing ground for the ongoing theoretical tension between stakeholder, legitimacy, and agency theories.

To synthesize the theoretical arguments and the formulated hypotheses, Figure 1 illustrates the conceptual framework of this study.

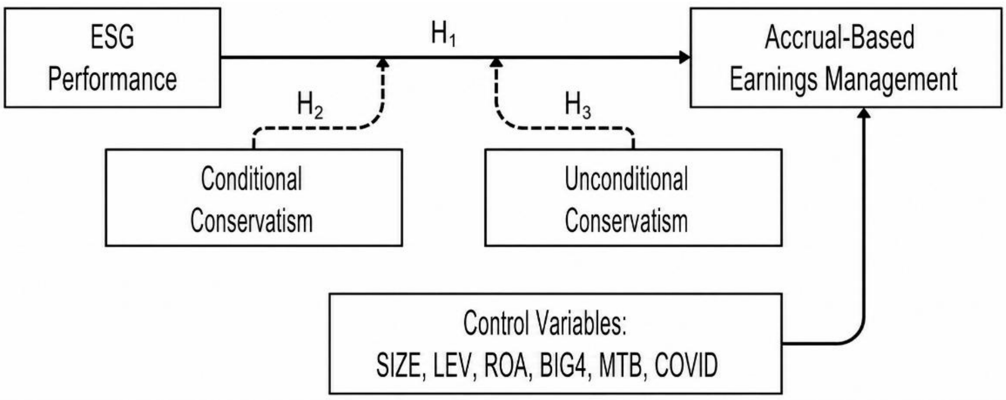

Figure 1. Research Conceptual Framework

METHOD

The population of this study is 368 firm-year observations of companies listed on the Indonesia Stock Exchange (IDX) from 2019 to 2024 with available Environmental, Social, and Governance (ESG) scores in the London Stock Exchange Group (LSEG) database. The observation period in 2019–2024 was selected due to three factors. The Indonesian Financial Services Authority (OJK) issued sustainability reporting regulations in 2019, which significantly increased the availability of ESG data. As a result, 2019 is a suitable starting point. Moreover, this period covers three different macroeconomic stages: before the pandemic, during the crisis, and post-recovery. This allows for an evaluation of managerial behaviour in different market conditions. Last but not least, the latest full and audited firm-level data available for analysis is for the year 2024. This time frame is structurally split to address the problem of reverse causality and to accommodate the lagged research design. The independent and moderating variables are measured in year t (2019-2023) whereas the dependent variable is measured in year t+1 (2020-2024).

Data were acquired from the LSEG database, corporate annual reports and IDX. From this initial set, 87 observations from the financial sector and 10 from the utilities sector were excluded because they operate under different regulatory frameworks and have reporting procedures that could distort accrual estimates. Further exclusions were implemented in the interests of continuity of data and reliability of the model as presented in Table 1. Observations missing historical data for the CC_{it} and UC_{it} calculations (12 observations) were removed. To maintain the structural validity of our estimation models, we deleted two anomalous observations from the final data set. First, we removed one data that record negative equity. Companies in deep financial difficulties fundamentally change their regular accrual methods. They often resort to massive asset impairments or big bath accounting methods to survive. These extreme conditions severely distort the proper measurement of Accrual Earnings Management. Second, we eliminated another observation displaying an abnormal MTB ratio of 147. This particular outlier is purely a mathematical artifact from an equity denominator approaching zero, not real economic development. Keeping this extreme value would strongly bias the regression coefficients and lead to false statistical inferences in the panel analysis. Thus, this strict selection process resulted in a reliable final sample of 257 firm-years.

Table 1. Sample Selection Process

	2019	2020	2021	2022	2023	Total
Total Firms with ESG Score	46	51	83	92	96	368
(-) Financial sectors	(6)	(6)	(24)	(25)	(26)	(87)
(-) Utilities Sector	(1)	(1)	(2)	(3)	(3)	(10)
(-) Missing data for CC_{it} & UC_{it} calculation	(0)	(0)	(0)	(5)	(7)	(12)
(-) *Outliers:* Negative equities	(0)	(0)	(0)	(0)	(1)	(1)
(-) *Outliers:* MTB ratio too high	(0)	(0)	(0)	(0)	(1)	(1)
Total Observations	**39**	**44**	**57**	**59**	**58**	**257**

The main driver of the significant decrease is the emerging required ESG reporting structure in Indonesia which greatly reduces the number of LSEG ratings in a standardized format. Furthermore, the estimation of the cross-sectional Accrual Earnings Management (AEM_{it+1}) and conditional conservatism (CC_{it}) models needs strictly continuous, forward-looking financial and market data, implying further exclusions. This rigorous selection process ultimately underscores the importance of internationally comparable ESG data and comprehensive financial continuity to avoid missing-value biases and to generate highly reliable parameter estimations, with a preference for methodological accuracy over quantity.

To transform this carefully sampled population into an understandable empirical model, this research uses AEM_{it+1} as the dependent variable to measure managerial discretion. The main independent variable is corporate ESG performance. We employ conditional and unconditional conservatism as moderators to explore the boundary condition of the relationship. All independent, moderating and firm-specific control variables are measured carefully at period t to control for endogeneity and reverse causation. We lag these predictors by one period behind AEM (t+1) so that they are preset factors affecting future accounting choices. Table 2 provides thorough operational definitions and mathematical steps.

Building upon this framework, we utilized panel data regression to test the hypotheses. The main estimating method used in this work is the Fixed Effects Model (FEM). FEM is able to control for firm-specific characteristics that are unobservable and do not change over time. The use of FEM to successfully absorb these constant individual effects reduces the possibility of omitted variable bias and provides more consistent and accurate parameter estimations for the sample. After validating the classical assumption tests of the regression model, FEM equations for empirically testing the direct influence of ESG performance on Accrual Earnings Management (AEM) and the moderating function of conservatism are constructed as follows:

$$AEM_{it+1} = \beta_0 + \beta_1 ESG_{it} + \beta_2 CC_{i,t} + \beta_3 UC_{it} + \beta_4 (ESG \times CC)_{it} + \beta_5 (ESG \times UC)_{it} + \Sigma Controls_{it} + \mu_i + \varepsilon_{\mathrm{i}} \quad (1)$$

Where, AEM_{it+1} represents the Accrual Earnings Management for firm *i* in the subsequent year *t+1*; ESG_{it} is the ESG performance score; CC_{it} and UC_{it} are the moderating variables representing conditional and unconditional conservatism, respectively; $(ESG \times CC)_{it}$ and $(ESG \times UC)_{it}$ are the interaction terms; and $\sum Controls_{it}$ represents the vector of firm-level and market-level control variables (SIZE, LEV, ROA, BIG4, MTB, and COVID.

Table 2. Variable Definitions

Variable Name	Definition and Measurement	Data Source & References
Dependent variables		
Accrual Earnings Management (**AEM_{it+1}**)	The difference between the total reported accruals and normal accruals is the portion considered to be the result of manipulation or management policy (discretionary), also known as DACC. The AEM_{it+1} value is derived from the absolute value of $DACC_{it+1}$. $$DACC_{it} = \frac{TAC_{it}}{A_{it-1}} - NDA_{it}$$ Discretionary accruals ($DACC_{it}$) are derived from a cross-sectional estimation model by industry and by year. $$\frac{TAC_{it}}{A_{it-1}} = \alpha_0 + \alpha_1\left(\frac{1}{A_{it-1}}\right) + \alpha_2\left(\frac{\Delta REV_{it}}{A_{it-1}}\right) + \alpha_3\left(\frac{PPE_{it}}{A_{it-1}}\right) + \alpha_4\frac{Net\ Income}{A_{it-1}} + \varepsilon_{it}$$ After obtaining the values of α_0, α_1, α_2, α_3, and α_4, from the regression above, these coefficient values are substituted into the following equation to calculate the normal accrual value (NDA_{it}). $$NDA_{it} = \alpha_0 + \alpha_1\left(\frac{1}{A_{it-1}}\right) + \alpha_2\left(\frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}}\right) + \alpha_3\left(\frac{PPE_{it}}{A_{it-1}}\right) + \alpha_4\frac{Net\ Income}{A_{it-1}}$$ Where, TAC_{it} = Net $Income_{it}$ – CFO_{it}; CFO_{it} is the cash flow from operations at the end of period t; A_{it} is the total assets at the end of period t; ΔREV_{it} is the change of revenue during period t; and ΔREC_{it} is the change of receivables during period t.	LSEG; Fedora et al. (2025); Kothari, Leone, and Wasley (2005)
Independent variable		
ESG Performance (**ESG_{it}**)	Environmental, Social, and Governance (ESG) performance score are sourced from the London Stock Exchange Group (LSEG), formerly Refinitiv Eikon. LSEG's 0-100 sector-relative percentile ranking effectively mitigates size and transparency biases, objectively reflecting a company's sustainability commitment.	LSEG; Palacín-Sánchez et al. (2026); Rojahn and Zechser (2026)
Moderating variables		
Conditional Conservatism (**CC_{it}**)	The measurement of conditional conservatism (CC_{it}) is represented by the C-Score from the Khan & Watts (2009) model, which modifies the asymmetric earnings timeliness model of Basu (1997). Khan & Watts (2009) assume that the timeliness of good news (G-Score) and bad news (C-Score) are linear functions of yearly firm-specific characteristics, firm size (SIZE), market-to-book ratio (MTB), and leverage (LEV). To capture these scores, the equations are defined as follows: $$G - Score = \beta_2 = \mu_1 + \mu_2 SIZE_j + \mu_3 MTB_j + \mu_4 LEV_j$$ $$C - Score = \beta_3 = \lambda_1 + \lambda_2 SIZE_j + \lambda_3 MTB_j + \lambda_4 LEV_j$$	LSEG; Khan & Watts (2009)

Variable Name	Definition and Measurement	Data Source & References
	The constant parameters (μ and λ) are estimated by substituting both equations into the consolidated cross-sectional Basu (1997) regression model. Finally, the fitted values of the C-Score lagged by one year are utilized as the final proxy for CC_{it}: $$CC_{it} = C\_Score_{it-1} = \lambda_0 + \lambda_1 SIZE_{it-1} + \lambda_2 MTB_{it-1} + \lambda_3 LEV_{it-1}$$	
Unconditional Conservatism (**UC_{it}**)	UC_{it} is the measurement of accrual-based accounting conservatism (Negative Non-Operating Accruals). This proxy utilizes a three-year moving average of total accruals. The measurement is conducted as follows: $$CONS_{ACC_{it}} = (-1) \times \frac{\sum_{\tau=t-2}^{t} TAcc_{i\tau}}{3}$$ Where, $TAcc_{it} = Net\ Income_{it} + Depreciation_{it} - CFO_{it}$	LSEG; Givoly and Hayn (2000); Ahmed and Duellman (2013); Kousenidis et al. (2014); Guo, Huang, and Zhang (2020)
Control variables		
Firm Size (**$SIZE_{it}$**)	The natural logarithm of the company's total assets at the end of the fiscal year.	LSEG; Rojahn and Zechser (2026)
Leverage (**LEV_{it}**)	The ratio of total liabilities to total assets.	LSEG; Zhang, Lee, and Lee (2026)
Profitability (**ROA_{it}**)	The level of operational profitability of the company, measured by the ratio of net income to total assets.	LSEG; Rojahn and Zechser (2026)
Audit Quality (**$BIG4_{it}$**)	Dummy variable for external audit quality. Valued at 1 if the company is audited by a Public Accounting Firm from the Big 4 network, and valued at 0 otherwise.	Annual Reports; Zhang, Lee, and Lee (2026)
COVID-19 Pandemic (**$COVID_{it+1}$**)	A dummy variable equal to 1 if the observation year is 2020-2022, and 0 for 2023-2024.	Observation Period; Moalla and Dammak (2023)
Market to Book Value (**MTB_{it}**)	To captures stock's valuation level, which measured by the ratio of the company's market value of equity to its book value of equity.	LSEG; Rojahn and Zechser (2026)

RESULTS

Table 3 present the descriptive statistics of the research sample. The study of 257 observations gives insight into the corporate behavior and the institutional characteristics of the Indonesian capital market. The descriptive statistics reveal that accrual-based earnings management exhibits a mean of 0.104. In terms of corporate sustainability, the average ESG performance score is 49.0833 out of a maximum of 100. This moderate mean coupled with a standard deviation of 18.6615 indicates an increasing adoption of sustainability, but there is a significant cross-sectoral difference among listed companies.

Regarding internal accounting mechanisms, the sample exhibits an average conditional conservatism score of 0.3934. This positive mean signifies an overall tendency among the sampled firms to fundamentally apply asymmetric timeliness by recognizing economic losses more rapidly than economic gains. Conversely, the unconditional conservatism metric presents a very marginal mean of 0.0073. This exceptionally low figure reflects that predetermined asset deflation policies are less utilized across the observed non-financial and non-utility sectors. Furthermore, the control variables paint a fundamentally stable picture of the corporate ecosystem. The firms are generally profitable with an average return on assets of 0.0702 and maintain a prudent reliance on external debt with an average leverage ratio of 0.2483. The overall market valuation is captured by an average market to book ratio of 3.3048. Contextually the COVID control variable indicates that 62.26 percent of the observations coincide with the pandemic period. Finally, 65.76 percent of the observations are audited by Big 4 accounting firms implying that a substantial majority are subject to high quality external monitoring.

Before proceeding to the hypothesis testing the bivariate correlation matrix is examined to evaluate the fundamental associations among the variables. Table 4 show that ESG score is significantly positively correlated with BIG4 and ROA, and significantly negatively correlated with LEV. This structural profile suggests that highly profitable firms equipped with high quality external monitoring and lower debt reliance are more capable of driving superior sustainability performance. Furthermore, ROA is positively correlated with AEM providing early indications of opportunistic managerial behavior within highly profitable entities. Interestingly the matrix reveals a contrasting dynamic during the pandemic shock where the COVID indicator is negatively correlated with CC but positively correlated with UC. This divergence provides a preliminary signal that managers might have strategically substituted their accounting prudence mechanisms during extreme economic uncertainty. Crucially, the highest correlation coefficient observed across the matrix is 0.617 between CC and MTB. Because this specific magnitude remains well below the conventional critical threshold, multicollinearity is not a serious concern ensuring that the dataset is structurally robust for the subsequent estimations.

Table 3. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Dev.
AEM_{it+1}	257	0.0001	0.8742	0.1047	0.1476
ESG_{it}	257	9.7914	88.5872	49.0833	18.6615
CC_{it}	257	-4.5383	39.6762	0.3934	2.8053
UC_{it}	257	-0.1718	0.2565	0.0073	0.0482
$SIZE_{it}$	257	20.6503	33.7306	29.2783	3.7583
LEV_{it}	257	0.0000	0.7437	0.2483	0.1884
ROA_{it}	257	-0.2806	0.8337	0.0702	0.1048
$BIG4_{it}$	257	0.0000	1.0000	0.6576	0.4754
MTB_{it}	257	0.1607	60.6718	3.3048	7.0722
$COVID_{it+1}$	257	0.0000	1.0000	0.6226	0.4857

Table 4. Correlation

	AEM$_{it+1}$	**ESG$_{it}$**	**CC$_{it}$**	**UC$_{it}$**	**SIZE$_{it}$**	**LEV$_{it}$**	**ROA$_{it}$**	**BIG4$_{it}$**	**MTB$_{it}$**	**COVID$_{it+1}$**
AEM$_{it+1}$	1									
ESG$_{it}$	0.097	1								
CC$_{it}$	0.016	0.105*	1							
UC$_{it}$	0.056	-0.019	-0.102	1						
SIZE$_{it}$	-0.034	-0.149**	-0.017	0.068	1					
LEV$_{it}$	-0.094	-0.200***	-0.038	0.015	0.058	1				
ROA$_{it}$	0.273***	0.249***	0.229***	-0.209***	-0.153**	-0.336***	1			
BIG4$_{it}$	0.109*	0.337***	0.050	0.030	0.127**	-0.239***	0.213***	1		
MTB$_{it}$	0.148**	0.181***	0.617***	0.010	-0.010	-0.083	0.481***	0.116*	1	
COVID$_{it+1}$	0.040	0.002	-0.138**	0.183***	-0.010	0.029	-0.040	-0.004	0.013	1

Notes: *,**,*** indicates significance at the level of 10%, 5%, and 1%, respectively.

To determine the appropriate panel data specification, this study employs standard diagnostic tests. The Chow test (p = 0.0059), which shown in Table 5, rejects the pooled OLS approach, indicating that the Fixed Effects Model (FEM) is more suitable.

Subsequently, the Hausman test (p = 0.0449), which shown in Table 6, rejects the random-effects assumption at the 5% significance level, confirming that FEM is also preferred over the Random Effects Model (REM). Guided by these results, this study utilizes FEM as the primary estimation method to effectively control for unobserved, time-invariant firm characteristics.

A Variance Inflation Factor (VIF) analysis is performed to evaluate the multicollinearity. As presented in Table 7, the VIF for all independent variables are well below the critical threshold of 10, indicating no severe multicollinearity.

To test for groupwise heteroskedasticity, a panel cross section likelihood ratio test was conducted. The test result (p-value = 0.0000) confirms the presence of heteroskedasticity across the panel entities. However, the Durbin Watson statistic of 2.078 exceeds the upper critical bound, suggesting that the data is free from first order serial correlation. Because heteroskedasticity is present, the Fixed Effects Model reported in Table 8 is estimated using firm clustered standard errors. This approach adjusts the covariance matrix to account for unobserved firm heterogeneity, ensuring that the standard errors and statistical inferences presented in the results remain valid.

Table 8 confirms the structural validity of the empirical model yielding an adjusted R squared of 0.1808 and a highly significant F-statistic. Addressing the primary research objective, the baseline estimation documents that corporate ESG performance exerts a significant negative effect on forward AEM (coefficient = 0.0038, p < 0.05). Consequently, H_1 is accepted. This empirical outcome robustly demonstrates that sustainability engagement functions as an effective internal governance mechanism that significantly constrains opportunistic financial reporting within the observed firms.

Table 5. Chow Test Result

Effects Test	**Statistic**	**d.f.**	**Prob.**
Cross-section F	1.6564	(59,186)	0.0059
Cross-section Chi-square	108.5227	59	0.0001

Table 6. Hausman Test Result

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	20.0298	11	0.0449

Theoretically, this finding provides profound validation for the stakeholder theory while explicitly rejecting the agency theory perspective of sustainability. According to agency theory, managers opportunistically use ESG disclosure as a reputational insurance or as a cover for unethical accounting manipulation (Mao, Wang, and Lin 2024). On the contrary, the negative coefficient in these emerging countries demonstrates that organizations with high ESG standards do not use sustainability as a greenwashing tool, but really connect their operational ethics with the interests of wider stakeholders. The companies are actively engaged in embedding environmental, social and governance (ESG) concepts into the core of their strategy, thus raising the standards of corporate transparency and ethical integrity. These high requirements, in turn, deter managerial intention to alter financial accounts (Liu et al. 2025; Özer, Aktaş, and Çam 2024; Sun et al. 2024).

Moreover, in the long run, this mitigating effect exposes the role of ESG in curing managerial myopia, which is the root cause of earnings manipulation. The managers with high commitment to sustainability initiatives are essentially forced to shift their strategic focus from short term profit maximization to long term value creation. This paradigm shift reduces the immediate capital market pressures and the obsession with meeting short term earnings benchmarks thereby eliminating the primary economic incentives for accrual manipulations. Contextually this finding is exceptionally vital for an emerging market. The current business environment is often characterized by evolving regulatory scrutiny and concentrated ownership structures. In such complex settings, the transparent corporate sustainability performance can serve as a substitute for formal legal enforcement (Nguyen 2024). It proves that when formal external monitoring is still evolving the internal ethical discipline generated by rigorous ESG compliance is powerful enough to protect minority shareholders and external investors from the detrimental wealth extraction associated with earnings management.

Table 7. Multicollinearity Test

Variables (*N* =*257*)	VIF
ESG_{it}	1.2261
CC_{it}	1.7286
UC_{it}	1.1303
$SIZE_{it}$	1.0965
LEV_{it}	1.1928
ROA_{it}	1.6840
$BIG4_{it}$	1.2380
MTB_{it}	2.1636
$COVID_{it+1}$	1.0666

Notes: This table reports the Variance Inflation Factor (VIF) values for the independent and control variables included in the primary regression models for the sample.

Table 8. Regression Result

Dependent Variable: AEM_{it+1}		
Independent Variables	**Coefficient**	**t-Statistic**
C	-3.3912**	-2.2604
ESG_{it}	-0.0038**	-2.3239
CC_{it}	0.0305*	1.4121
UC_{it}	-0.4467	-0.5093
$ESG_{it} \times CC_{it}$	-0.0005*	-1.5885
$ESG \times UC_{it}$	0.0252*	1.5659
$SIZE_{it}$	0.1204**	2.2961
LEV_{it}	0.0226	0.1435
ROA_{it}	0.3698**	1.7651
$BIG4_{it}$	0.1324**	2.3061
MTB_{it}	0.0088**	1.7024
$COVID_{it+1}$	0.0038	0.2014
Adjusted R^2	0.1808	
F-Statistic	1.8072***	
Fixed Effect	YES	
Durbin-Watson stat.	2.078	
N	257	

Notes: *,**,*** indicates significance at the level of 10%, 5%, and 1%, respectively.

Crucially, the multivariate analysis uncovers profound theoretical dynamics regarding the moderating role of internal accounting mechanisms on the sustainability performance and reporting quality nexus. The empirical estimation reveals that the interaction between ESG performance and conditional conservatism exerts a significant negative effect on future AEM (coefficient = -0.0005, $p < 0.10$). Therefore, H_2 is accepted. This finding confirms the existence of a strong synergistic governance effect in the corporate structure. The conditional conservatism sets a strict asymmetric timeliness demanding the early recognition of economic losses that intrinsically restricts the managerial discretion and limits the opportunities to manipulate the financial performance (Le-Bao et al. 2025; Elvina et al. 2024). When this rigid internal accounting discipline merges with the actual operational ethics of high ESG performance, it establishes an impenetrable dual monitoring mechanism. This synergy ensures that managers cannot opportunistically delay bad news, effectively eliminating the accounting flexibility required for discretionary accrual manipulation. It proves that strict ex post conservatism acts as a fundamental prerequisite for maximizing the ethical benefits of substantive corporate sustainability achievements.

In stark contrast, the interaction between ESG performance and unconditional conservatism yields a significant positive effect on future AEM (coefficient = 0.0252, $p < 0.10$). Because this positive direction fundamentally contradicts the predicted mitigating effect, H_3 is definitively rejected. This empirical rejection is theoretically fascinating providing the absolute novelty of this study by exposing a detrimental substitution effect within the governance ecosystem. Unconditional conservatism dictates predetermined asset deflation policies that systematically create unrecorded reserves and opaque accounting slack (Kimouche and Charchafa 2024).

From an agency theory perspective, this structural opacity provides managers with the exact financial mechanism needed to manipulate accruals. More alarmingly, when combined with high ESG performance, these hidden reserves become highly problematic. Recent literature suggests that opportunistic managers tend to use their better ESG achievements as a reputation shield or a legitimizing halo to divert stakeholders and to mitigate intense external scrutiny (Mao, Wang, and Lin 2024; Meqbel et al. 2024). Consequently, managers exploit the accounting slack created by unconditional conservatism while hiding behind the stellar reputation of their sustainability performance. This outcome precisely corroborates recent evidence that unconditional conservatism inherently increases AEM particularly within the institutional context of the Indonesian market (Elvina et al. 2024). Ultimately, it proves that while conditional conservatism perfects sustainability implementation, predetermined unconditional conservatism actively sabotages the actual financial integrity that high ESG performance aims to represent.

Further, the control variables' evaluation provides valuable information about the corporate environment that promotes opportunistic behavior. The estimation shows that firm size, profitability, market to book ratio, and audit quality have significant positive effects on future AEM. The positive associations of firm size and market to book valuation indicate that large, growth oriented firms face immense capital market pressures to maintain their earnings trajectories, utilizing their greater capacity for financial reporting aggressiveness and sophisticated accounting strategies to heavily incentivize the use of discretionary accruals (Barrak, Sahib, and Salman 2025). Moreover, the positive effect of ROA confirms that highly profitable entities manage their accruals to maintain their performance illusion, strategically. COVID and LEV have no significant impact on AEM. The insignificance of COVID indicates that managerial opportunism is driven by internal firm targets and short-term financial incentives, rather than external macroeconomic health shocks (Liu et al. 2025).

Table 9. Robustness Test

Dependent Variables	**$AEM_{it+1} > 0$**		**$AEM_{it+1} < 0$**	
Independent Variables	**Coefficient**	**t-Statistic**	**Coefficient**	**t-Statistic**
C	-9.9815***	(-3.9726)	-4.3653	(-1.1069)
ESG_{it}	-0.0110***	(-4.0231)	-0.0014	(-0.3752)
CC_{it}	0.0677**	(1.8606)	0.0057	(0.1601)
UC_{it}	-3.3561**	(-1.7379)	5.4442***	(2.4669)
$ESG_{it} \times CC_{it}$	-0.0010**	(-1.7242)	-0.0001	(-0.1544)
$ESG_{it} \times UC_{it}$	0.0163	(0.5135)	-0.0625*	(-1.3831)
$SIZE_{it}$	0.3765***	(4.0976)	0.1379	(1.0269)
LEV_{it}	-1.0105***	(-3.5860)	0.6886**	(1.7462)
ROA_{it}	0.4469	(0.9007)	-0.4115	(-0.7689)
$BIG4_{it}$	0.3331**	(1.8109)	-0.0355	(-0.3263)
MTB_{it}	0.0326***	(2.4209)	-0.0109	(-1.0332)
$COVID_{it+1}$	-0.0869**	(-2.3119)	-0.0028	(-0.0628)
Adjusted R^2	0.4720		0.6368	
F-Statistic	2.6119***		4.3513***	
Fixed Effect	YES		YES	
N	111		146	

Notes: *,**,*** indicates significance at the level of 10%, 5%, and 1%, respectively.

In our baseline FEM estimation (Table 8), the BIG4 control variable is not automatically dropped because a small portion of the sample (6 out of 60 firms) switched auditor tiers during the observation period. Relying on this limited within-firm variation, however, can yield inefficient estimates. A supplementary check using a Random Effects Model (REM) shows that BIG4 loses its statistical significance when broader cross-sectional variation is considered. This suggests the initial significance of BIG4 in the FEM is largely driven by estimation inefficiency. Therefore, the coefficient of this specific control variable should be interpreted with caution. This limitation is isolated to the BIG4 dummy and does not affect the main inferences drawn from our primary variables of interest.

To corroborate the baseline results and to examine the asymmetric character of managerial opportunism, we further split the main sample into income-increasing (AEMit+1 > 0) and income-decreasing (AEMit+1 < 0) sub-samples. This directional decomposition is theoretically important since the underlying managerial motivations, ethical considerations, and accounting mechanics driving false earnings inflation are fundamentally different from those driving downward accrual adjustments, as shown in Table 9.

For the AEMit+1 > 0 sub-sample the estimations fully support our baseline hypothesis. The direct effect of ESG still has a considerable negative effect, which acts as a major ethical restriction against opportunistic upward manipulation that is compatible with the transparent financial reporting hypothesis (Kim, Park, and Wier 2012; Lin and Nguyen 2022). Additionally, the interaction between ESG and conditional conservatism (ESG × CC) has a highly significant negative coefficient corroborating the double constraint impact. CC employs a stricter criterion of verification to obtain the recognition, which together with the ethical discipline of ESG, significantly limits the managerial discretion to inflate artificially the earnings (García Lara, García Osma, and Penalva 2020; Khan and Watts 2009). The interaction of ESG and unconditional conservatism (ESG × UC), however, is not statistically significant. This is a reflection of the structural rigidity of unconditional conservatism, which is based on ex-ante accounting procedures (e.g. accelerated depreciation) that are predetermined and intrinsically news-independent (Beaver and Ryan 2005). The ex-ante rules are deterministic and lack any dynamic, current-period flexibility and as such they cannot be opportunistically adjusted on a situational basis. The interaction is structurally irrelevant in the upward accruals sub-sample (Beaver and Ryan 2005; García Lara, García Osma, and Penalva 2020).

The dynamics shift profoundly within the AEM_{it+1} < 0 sub-sample, reflecting the ethical ambiguity of negative accruals. Both the direct ESG variable and the ESG×CC interaction lose statistical significance. The insignificance of the direct ESG effect in the negative accruals sample is empirically consistent with prior emerging market literature, which documents that the mitigating effect of ethical governance is primarily concentrated in suppressing income-increasing adjustments rather than income-decreasing ones (Yoon, Kim, and Lee 2019).

This is conceptually an effect of statistical canceling-out driven by conflicting managerial motives, where true prudent loss recognition is accompanied by opportunistic “big bath” behaviour, often masked strategically through greenwashing disclosures to divert stakeholder attention (Almubarak, Chebbi, and Ammer 2023; Lestari and Muthmainnah 2025). This means that the direct moderating effect of ESG is mixed, because it leads to both genuine and transparent write-downs and opportunistic downward manipulations. Similarly, conditional conservatism is an ex-post, news-dependent mechanism that is driven by real economic difficulty (Beaver and Ryan 2005). Although the implementation of conditional conservatism is partly discretionary and depends on managerial accounting choices (García Lara, García Osma, and Penalva 2020), the recognition of bad news is contractually required once adverse economic events occur, making the moderating effect of ethical ESG supervision statistically redundant in this sub-sample.

The interaction coefficient between ESG performance and unconditional conservatism yields a significant negative effect in this subsample. Given that the dependent variable representing discretionary accruals is already constrained to values below zero, a negative coefficient mathematically drives the accruals further away from zero. Consequently, this dynamic reflects a pronounced escalation in downward earnings management. This behavior completely substantiates the opportunistic framework established in our primary analysis. Instead of representing substantive prudence or sound ethical governance, the result indicates that managers actively utilize the inherent opacity of unconditional conservatism to systematically depress reported earnings.

Unconditional conservatism naturally generates unrecorded reserves through predetermined asset deflation policies. Opportunistic executives capitalize on this structural flexibility to execute aggressive income decreasing accruals, essentially facilitating practices like big bath accounting or the creation of cookie jar reserves for future periods. More importantly, these managers obscure their downward manipulations behind strong ESG profiles. They leverage their sustainability achievements as a legitimizing halo to divert external scrutiny. While stakeholders may misinterpret these conservative adjustments as a shock absorbing mechanism rooted in ethical sustainability, they actually constitute a deliberate distortion of financial information. Ultimately, this partitioned analysis robustly reinforces our baseline model. It confirms that the governance ecosystem functions perversely when unconditional conservatism is involved. Unconditional conservatism supplies the necessary accounting slack.

Table 10. Additional Analysis

Dependent Variable: AEM_{it+1}						
Independent Variables	**(1) ESG = ENV**		**(2) ESG = SOC**		**(3) ESG = GOV**	
	Coef.	**t-Stat.**	**Coef.**	**t-Stat.**	**Coef.**	**t-Stat.**
C	-3,1215**	(-2,1017)	-3,6265***	(-2,4998)	-1,4541	(-1,0539)
ESG_{it}	-0,0025**	(-2,0747)	-0,0038***	(-3,0497)	0,0000	(0,0378)
CC_{it}	0,0324**	(2,0862)	0,0328*	(1,3164)	0,0084	(0,4301)
UC_{it}	-0,0461	(-0,0665)	0,5396	(0,6492)	-0,9283	(-1,1922)
$ESG_{it} \times CC_{it}$	-0,0005**	(-2,2941)	-0,0005*	(-1,5038)	-0,0002	(-0,6604)
$ESG_{it} \times UC_{it}$	0,0219*	(1,4905)	0,0037	(0,2704)	0,0319***	(2,4294)
$SIZE_{it}$	0,1086**	(2,1064)	0,1293***	(2,5644)	0,0484	(1,0182)
LEV_{it}	0,0364	(0,2342)	-0,0181	(-0,1143)	0,0199	(0,1245)
ROA_{it}	0,3507**	(1,6798)	0,3480**	(1,6585)	0,4299**	(2,0433)
$BIG4_{it}$	0,1164**	(2,0521)	0,1434***	(2,4929)	0,1151**	(1,9877)
MTB_{it}	0,0102**	(1,9558)	0,0085*	(1,6521)	0,0091**	(1,7520)
$COVID_{it+1}$	0,0062	(0,3256)	0,0022	(0,1145)	-0,0052	(-0,2739)
Adjusted R^2	0,1947		0,1830		0,1615	
F-Statistic	1,8841***		1,8191***		1,7045***	
Fixed Effect	YES		YES		YES	
N	257		257		257	

Notes: *,**,*** indicates significance at the level of 10%, 5%, and 1%, respectively.

To provide specific operational insights, a disaggregated analysis of the sustainability performance into its environmental, social, and governance pillars is conducted. Table 10 shows that environmental and social performance exert significant negative effects on future AEM. This gives empirical support that substantive environmental and social initiatives serve as a real cultural shield against managerial opportunism (Tohang, Hutagaol-Martowidjojo, and Pirzada 2024). The governance pillar, on the other hand, is insignificantly associated. This suggests that in emerging markets with nascent institutional settings, formal governance mechanisms frequently represent mere symbolic conformity, devoid of the substantive disciplinary power that genuine environmental and social efforts hold (Nguyen 2024).

As for the conditional conservatism, the disaggregated estimation indicates a substantial synergistic governance influence on the environmental and social aspects in particular. The interactions exhibit significant negative coefficients. This proves that the strict asymmetric timeliness of conditional conservatism perfectly complements authentic environmental and social actions, establishing an impenetrable dual monitoring mechanism that requires early loss recognition and leaves no accounting flexibility for opportunistic managers (Elvina et al. 2024; Barrak, Sahib, and Salman 2025).

Most crucially, the decomposition exposes the exact mechanisms driving the substitution effect associated with unconditional conservatism. The interaction between unconditional conservatism and environmental performance yields a significant positive coefficient. Because environmental projects are highly capital intensive, they frequently exert severe short-term cash flow pressures on the firm, which may clash with capital market expectations. To navigate this financial strain, managers weaponize the accounting slack generated by unconditional conservatism to smooth reported earnings. Green initiatives are used as a smokescreen to disguise the inadequate quality of financial information and to avoid scrutiny from stakeholders (Almubarak, Chebbi, and Ammer 2023; Meqbel et al. 2024). Additionally, the link between unconditional conservatism and the governance pillar is significantly positive. This reveals a fundamental structural issue where managers exploit cosmetic governance compliance as a reputational protection. Behind this facade, they influence financial results using the opaque reserves demanded by unconditional conservatism (Elvina et al. 2024). Finally, this disaggregated analysis shows that predefined unconditional conservatism is actively threatening the financial integrity of capital-intensive sustainability initiatives.

To ensure robustness to endogeneity, we first employ a one year lag specification for independent variables (Kim, Li, and Zhang 2011; Lin, Zhu, and Meng 2023), and then formally conduct the regression-based Durbin Wu Hausman test (Wooldridge 2016). Specifically, we evaluate the potential endogeneity of ESG performance and its interactions with conservatism in our Accrual Earnings Management model. We use the industry average ESG score excluding the focal firm (Industry_Average_ESG) along with its interaction with both conditional and unconditional conservatism as instrumental variables.

Panel A of Table 11 reports the first stage regression results. The first stage F statistics for the models predicting the suspected endogenous variables, which are ESG SCORE, ESG x CC, and ESG x UC, are 17.69, 26.63, and 15.22, respectively. These values exceed the threshold of 10 recommended by Staiger and Stock (1997), indicating that the selected instruments are strong and relevant.

Table 11. Endogeneity Test

Panel A: First-Stage Regression Results			
	ESG	**ESG x CC**	**ESG x UC**
Instrumentals Variables (IV) :			
Industry_Average_ESG	0.6466***	0.3503*	-0.0027
Industry_Average_ESG x CC	0.0301	-0.3400***	-0.0003
Industry_Average_ESG x UC	-0.6462	0.2558	0.5907***
Control Variables	Included	Included	Included
Fixed Effects	YES	YES	YES
Constant	8.6428	6.4493	-0.4777
First-Stage F-Statistic	17.6970	26.6369	15.2210
Prob. (F-stat.)	0.0000	0.0000	0.0000

Panel B: Durbin-Wu-Hausman Auxiliary Test		
	Prob. (p-value)	**Endogeneity Status**
RESID_ESG	0.1867	[> 0.05 (Exogenous)]
RESID_ESG x CC	0.1628	[> 0.05 (Exogenous)]
RESID_ESG x UC	0.1607	[> 0.05 (Exogenous)]

Notes: *,**,*** indicates significance at the level of 10%, 5%, and 1%, respectively.

Panel B of Table 11 presents the Durbin Wu Hausman test results. The p-values for ESG SCORE, ESG x CC, and ESG x UC are 0.1867, 0.1628, and 0.1607, respectively. Because all p-values exceed the 0.05 significance level, we fail to reject the null hypothesis of exogeneity, indicating that endogeneity is not a severe issue. Consequently, estimating the model using Instrumental Variables would yield less efficient estimators. We therefore rely on the Fixed Effects Model as our primary specification, as it provides consistent and more efficient estimates for examining Accrual Earnings Management.

CONCLUSION

This study examines the direct effect of firm ESG performance on future AEM and the moderating effects of accounting conservatism in the Indonesian capital market. Based on empirical evidence, we find that substantive overall ESG performance acts as an effective ethical shield that prevents management opportunism and therefore, supports the stakeholder view of corporate governance. Most importantly, the results indicate that conditional conservatism establishes a synergistic monitoring environment that complies perfectly with sustainability goals. In contrast, unconditional conservatism creates a harmful substitution effect, offering opaque accounting slack which enables managers to exploit their overall sustainability reputation as a legitimizing tool to conceal financial misreporting.

To corroborate these baseline dynamics, our robustness analysis partitioning the sample into directional accruals uncovers the asymmetric nature of managerial opportunism. We demonstrate that the "double constraint" of ESG and conditional conservatism strictly limits upward earnings manipulation. Conversely, in the downward accruals sub-sample, managers exploit the structural flexibility of unconditional conservatism to execute aggressive income-decreasing accruals, obscuring opportunistic big baths through their sustainability achievements. Additionally, a disaggregated pillar analysis provides granular evidence regarding these interacting mechanisms. The results show that the mitigating power of corporate sustainability is deeply rooted in substantive environmental and social initiatives, which synergize effectively with conditional conservatism to establish a robust dual monitoring mechanism. However, the analysis also reveals that unconditional conservatism provides the accounting slack for managers to act opportunistically across different pillars. Specifically, managers exploit this slack to systematically depress reported earnings, masking the short-term cash flow pressures induced by capital-intensive environmental projects, while simultaneously utilizing formal governance compliance as a mere symbolic practice to conceal financial misreporting.

However, these theoretical results should be taken in the context of the particular limitations of the study. The empirical scope is limited to one emerging market with particular institutional and regulatory features and consequently the global generalizability of the inferences is necessarily limited. Moreover, the exclusive focus on AEM may not be able to capture the complex nature of management opportunism such as real activities manipulation. Addressing these limitations, future research should expand the institutional scope by conducting comparative cross-country analyses and deploying alternative proxies, such as real earnings management, to corroborate the theoretical framework established in this study.

From an academic perspective, this study significantly enriches the existing literature by resolving the theoretical tension between the agency and stakeholder views of ESG, proving that the economic consequences of sustainability performance are strictly contingent upon the underlying characteristics of internal accounting conservatism and the directional intent of earnings management. The results offer a key caveat for market participants and investors from an economic point of view. The capital providers should not depend solely on better ESG performance as an absolute measure of corporate integrity, but rather combine the sustainability measures with the unconditional conservatism of the firm to avoid the expropriation of wealth and the misallocation of capital. Finally, from a regulatory perspective, policymakers and standard setters need to take into account the structural vulnerabilities of predetermined unconditional conservatism. Strong standardized verification of sustainability disclosures should be made mandatory by regulators to prevent any temptation by corporate executives to resort to ceremonial compliance and greenwashing techniques, and to ensure that capital markets have access to transparent, reliable, and highly credible financial information.

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