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The Influence of Audit Quality and Capital Structure on Firm Performance with Earnings Management as a Mediating Variable

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Abstract

Purpose: This study aims to examine the effect of audit quality on company performance with earnings management as a mediating variable. These variables consist of audit quality, capital structure, firm performance, and earnings management. The uniqueness of this study lies in the use of mediating variables in earnings management.
Methodology: The data source taken is the financial statements of service companies listed on the Indonesia Stock Exchange (IDX) in 2017-2023, which were obtained through the official IDX platform. By using the purposive sampling technique, this study collected 154 data for further analysis.
Findings: The results of this study indicate that audit quality and capital structure have an effect on earnings management, earnings management has a negative effect on ROA and ROE, audit quality and capital structure have an effect on ROA and ROE, and audit quality and capital structure have a direct effect on both ROA and ROE, so earnings management cannot mediate the effect of audit quality and capital structure on firm performance (ROA and ROE).
Novelty: This study combines the four variables (audit quality, capital structure, firm performance, and earnings management), which is still relatively rare, so there is an opportunity to explore new relationships and how quality audits can limit earnings management and ultimately improve company performance. Also, earnings management is often used to cover up the negative impacts of certain capital structures.

Keywords: audit quality, capital structure, firm performance, earnings management

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Introduction

Earnings management is an effort to maximise or reduce returns to achieve certain goals, such as tax avoidance or showing the development of the company's potential so as to improve the company's reputation in the eyes of shareholders, creditors, and other interested parties. Hasty & Herawaty (2017) and Zaid et al., (2020) consider audit quality to increase investor confidence in the quality of financial reporting and assist in making the right decisions. One of the factors that influences earnings management is audit quality. The next factor that influences earnings management is Return on Assets (ROA) and Return on Equity. The higher the ROA generated by the company, the higher the net profit generated from each fund embedded in total assets. So, it is better if the lower the ROA generated, the lower the net profit generated from each fund embedded in total assets.

Several cases of fraud on financial reports have occurred in Indonesia, one of which was PT WK. PT WK is a state-owned company that operates in the building construction sector. A case of financial report manipulation at PT WK emerged in 2023. This case was revealed by the Financial and Development Supervisory Agency (Badan Pengawasan Keuangan dan Pembangunan/BPKP), which has

completed auditing the investigation into PT WK's financial reports. BPKP received an assignment to audit the financial reports of PT WK in mid-2023. The initial suspicion was that there was manipulation of financial reports starting in the 2016 period (Liputan6.com). We gathered data from companies in the service sector that are listed on the IDX, covering the period from 2016 to 2023. The following researchers present a table of data on the results of profit/loss calculations for the current year and cash flow reports from PT WK Tbk for the 2016-2023 period:

Table 1. Profit/Loss and Net Cash Flow Period 2016-2023

Year	Profit/Loss for the Year	Net Cash Flow
2016	1.813.068.616.784	(7.762.413.775.203)
2017	4.201.572.490.754	(5.959.562.435.459)
2018	4.513.002.992.426	(1.545.555.019.836)
2019	1.102.950.087.235	(4.875.804.304.453)
2020	(9.287.793.197.812)	411.061.644.702
2021	(1.838.733.441.975)	192.784.236.637
2022	(1.672.733.807.060)	(106.580.889.785)
2023	6.148.621.649	120.811.660.447

Source: IDX

In table 1, it is stated that PT WK in 2016-2017 achieved an increase in profit of 131% or IDR 2.39 trillion from IDR 1.8 trillion to IDR 4.2 trillion and operating cash flow was minus IDR 1.8 trillion. During 2017-2018, net profit for the current year continued to increase. However, in 2019, net profit for the year fell by IDR 1.1 trillion. In the end, we recorded a loss of IDR 12.79 trillion in 2020-2022, but we recorded positive net cash in 2020-2021. In 2022 net cash will experience a minus of IDR 106 billion.

Allegations of manipulation of WK's financial reports were initially raised by Deputy Minister of BUMN II, who stated that WK's financial reports did not correspond to real conditions. The reason is, the financial condition report still states that their situation is always profitable. In fact, the company's cash flow is never positive. The case involving PT WK Tbk reflects the company's lack of transparency in disclosing financial report information, which results in a gap between parties who have strong access to information and parties who have weak access to information, as stated by Mayasari & Trisnaningsih (2023).

Research from Tarigan & Saragih (2020) stated that audit quality has a positive effect on earnings management. But research from Robik et al., 2022) stated that audit quality has no effect on earnings management. Then, Prawida & Sutrisno (2021) shows company performance has a negative effect on earnings management. Meanwhile, according to Stiawati & Hidayatulloh (2024), company performance has no effect on earnings management. Robik et al. (2022) revealed that audit quality has a negative impact on earnings management. However, Tarigan & Saragih (2020) revealed that audit quality has a positive impact on earnings management.

The formulation of the problem in this study is, is there an influence of audit quality and capital structure on profitability (ROA, ROE) mediated by earnings management? While the purpose of this study is to empirically test the influence of audit quality and capital structure on profitability (ROA, ROE) mediated by earnings management

Literature Review

Agency Theory

According to Jensen and Meckling (1976), agency theory is a design that explains the contextual relationship between a principal and an agent, namely between two or more people, a group, or an organisation. The principal decides the company's future and delegates authority to agents. According to Tarigan & Saragih (2020), agency theory explains that the relationship between management (agents)

and shareholders (stakeholders) is called the principal. Conflicts of interest arise when internal and external parties' interests diverge. So a mediator is needed to deal with this conflict, namely an external auditor whose job is to evaluate and provide an opinion regarding the company's financial reports, which have been created and prepared by management in accordance with applicable accounting standards. The relationship between agency theory and this research is that good company performance will be achieved due to the fact that there are good government practices too. This is done by providing better monitoring and protection to its shareholders.

Company Performance

Mazhfiyani et al. (2022) state that financial performance is an analysis carried out to determine the extent to which a company has implemented financial practice regulations adequately and accurately. Company performance is an important factor that investors must pay attention to before making an investment (Andriza & Yusra, 2019; Suhartono & Yusra, 2019).

Earnings Management

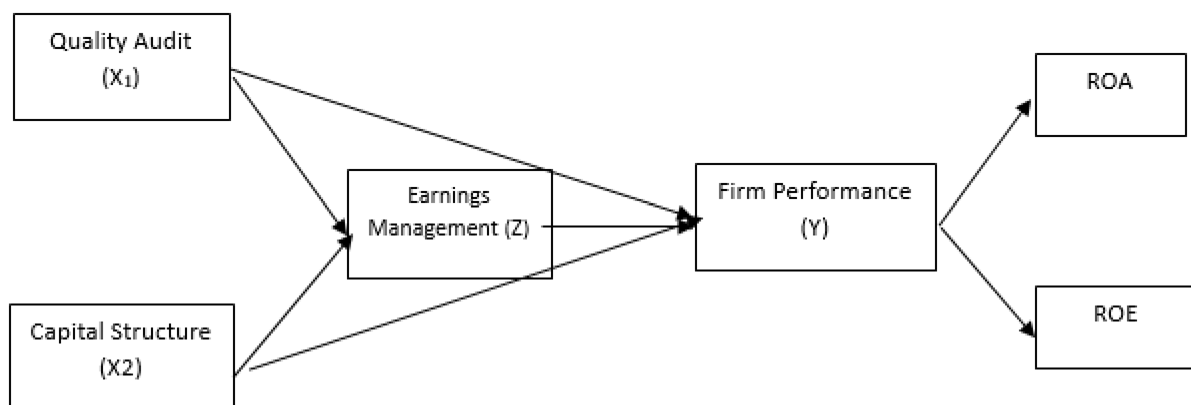
Indriaty et al., 2023) earnings management is an effort made by management to influence or manipulate reported profits by using certain accounting methods or speeding up expenditure or income transactions or using other methods designed to influence short-term profits. Scott (2006: 344) divides ways of understanding earnings management into two. First, see it as opportunistic behaviour by managers to maximise their utility in dealing with compensation contracts, debt contracts, and political costs (Opportunistic Earnings Management). Second, when examining earnings management from the perspective of efficient contracting (Efficient Earnings Management), it becomes clear that earnings management provides managers with the flexibility to protect both themselves and the company by anticipating unexpected events, ultimately benefiting all parties involved in the contract. Thus, managers can influence the market value of their company's shares through earnings management, for example, by income smoothing and profit growth over time.

Audit Quality

Audit quality is an image or good name obtained from the audit's trust in its responsibilities as a quality auditor and also good performance (Mulyanti & Rimawan, 2022). Financial report audits are carried out by auditors and carried out transparently; auditors must report violations or transaction errors found during the financial report audit so that the audit report indicates a quality audit (Mira & Purnamasari, 2020). Audit quality can control managers' actions and prevent them from manipulating accounting and all fraudulent activities (Sihono & Febyansyah, 2023). Therefore, it is important for the audit industry to maintain a balance between providing appropriate compensation for high-quality audits and maintaining the independence and integrity of auditors so that they are not influenced by purely financial factors (Hadi & Tifani, 2020).

Research Model

Figure 1. Research Framework



This section contains at least three important things that the author should state is clearly. These three important things are:

1. Theoretical Background: It contains theoretical grounds that support the research
2. Previous Studies: It describes relevant, comprehensive, and updated past studies related to the topic, as well as summarizes the past studies of what seems to be consensus, settled, and what remains a puzzle.
3. Research Framework (optional): It describes and conceptualize the approach to answer the research questions in a visual framework.

Methodology

The population in this study includes infrastructure and property service companies listed on the Indonesia Stock Exchange during the 2017-2023 period. Data collection via the websites www.idx.co.id and https//emiten.kontan.co.id. According to Sugiyono (2022) the sample is part of the total number of characteristics possessed by the population. We used a purposive sampling method in this research to select the sample, ensuring its representativeness according to predetermined criteria.

The criteria used as research samples are

a. Infrastructure and energy companies listed on the Indonesia Stock Exchange (BEI)
b. Companies that do report financial reports in the 2017-2023 period
c. Companies that do use the Rupiah currency

Variable Measurement

Dependent Variable (Company Performance)

To measure a company's financial performance, financial ratio analysis is usually used by Shenurti et al. (2022). These ratios include Return on Assets and Return on Equity.

a. ROA

(Mulyanti & Rimawan, 2022). Return on assets is a comparison between net profit and total assets. This ratio shows how much net profit the company earns when measured by the value of its assets.

$$\text{Return On Asset} = \frac{Earnings\ After\ Tax}{Total\ Assets}\ X\ 100\%$$

b. ROE

Return on Equity is a tool for measuring net profit after tax with own capital. This Return on Equity ratio shows the efficiency of using one's own capital. (Hidayah & Alwi, 2022)

$$\text{Return on Equity} = \frac{Earnings\ After\ Tax}{Total\ Equity}\ \text{x}\ 100\%$$

Independent Variable

a. Audit Quality

In this research, the independent variable used is audit quality, where this activity is to examine, supervise, and report accounting activities recorded in the financial statements that are to be reported to a company. In providing an assessment, auditors need to have good skills in terms of ability, technical experience, work reputation, and performance that has been achieved so that the size of the KAP really has an influence on audit quality; therefore, it can be measured using a dummy variable proxy, with the following criteria:

1. Audit quality is worth 1 if the company is audited by a big four KAP
2. Audit quality is worth 0 if the company is audited by a non-big four KAP

b. Capital Structure

Capital structure is the balance between long-term debt and equity used by a company to finance its assets. Choosing the right capital structure is very important because it affects the value of the company, the cost of capital, and the market price of shares. (Wagisuwari & Sitorus, 2024)

$$\text{DER} = \frac{Total\ Debt}{Total\ Equity}$$

Mediation Variables

The mediating variable used in this research is earnings management. Earnings management is measured using Jones' modified discretionary accruals.

a. To obtain discretionary accruals, first calculate total accruals using the following formula:

$$TAC = NI - CFO$$

TAC : Total Accruals
NI : Net Profit
CFO : Operating Cash Flow

The next step involves dividing the total accrual components into discretionary and non-discretionary categories. This composition was carried out by referring to the modified Jones model of (Dechow et al., 1995)
the following:

$$\frac{TACt}{TAit-1} = \alpha 1 \left(\frac{1}{TACit-1} \right) + \alpha 2 \left(\frac{\Delta REVt}{TAt-1} \right) + \alpha 3 \left(\frac{PPEt}{TAt-1} \right) \text{eit}$$

TAit-1 : Total assets in the previous year
ΔREVit : Change in income or income difference
PPEit : Plant, property and equipment (fixed assets)
A : Coefficient

b. Then look for the nondiscretionary accrual (NDAC) value calculated using the following formula:

$$NDA = \alpha 1 \left(\frac{1}{TAt-1} \right) + \alpha 2 \left(\Delta REVt - \frac{\Delta RECt}{TAt-1} \right) + \alpha 3 \left(\frac{PPEt}{TAt-1} \right)$$

NDAC : Nondiscretionary accruals
ΔREC : Changes in receivables

c. The following formula yields the discretionary accrual (DAC) value, a measure of earnings management:

$$DAt = \frac{TAct}{TAt-1} - NDA$$

DAC : Discretionary Accruals

Data Analysis Techniques

Descriptive Statistical Analysis

According to Sugiyono (2022) Descriptive analysis is used to analyse data by describing or illustrating the data that has been collected as it is without intending to make general conclusions orgeneralisationss.

Classical Assumption Test

To test classical assumptions, this research uses the normality test, multicollinearity test, heteroscedasticity test, and correlation test.

Hypothesis Testing

a. F Test (Simultaneous Significance Test)
Purpose: To test whether all independent variables simultaneously or together have a significant effect on the dependent variable.
Steps:
Determine the hypothesis:
H_0: All regression coefficients ($\beta_1, \beta_2, ..., \beta n$) = 0 (no significant effect simultaneously).
H_1: At least one regression coefficient $\neq 0$ (there is a significant effect simultaneously).

b. t-Test (Partial)
The t-test was carried out to see the partial influence of each independent variable on the dependent variable with the following conditions.
1. If the P value is <0.05, Ho is rejected; the independent variable has a significant effect on the dependent variable.

2. If the P-value is greater than 0.05, Ho is acceptable; the independent variable has no significant effect on the dependent variable.

c. Coefficient of Determination (R^2)

The coefficient of determination is an indicator that can show the ability of the independent variable to explain changes in the dependent variable. The R^2 value is zero to 1 (0-1). If the coefficient of determination value is close to zero (0), then there is a very small or limited ability of the independent variable to explain the dependent variable. On the other hand, if the coefficient of determination value is close to 1 (one), then there is the ability of the independent variable to provide almost all the information needed to interpret the dependent variable

d. Mediation Test (Sobel Test)

Testing the mediation hypothesis can be carried out using a procedure developed by Sobel (Abu-bader & Jones, 2021) and is known as the Sobel test. We carry out the Sobel test by assessing the strength of X's indirect influence on Y through Z. The Sobel test formula is as follows:

$$Sab = \sqrt{b^2 sa^2 + a^2 sb^2 + sa^2 sb^2}$$

Sab : the size of the standard error of indirect influence
a : path of variable X with variable Z
b : path of variable Z with variable Y
sa : standard error coefficient a
sb : standard error coefficient b

To test the significance of the indirect effect, it is necessary to calculate the t value of the ab coefficient using the following formula:

$$T = \frac{ab}{sab}$$

This calculated t value is compared with the t table value; if t calculated is greater than the t table value, then it can be concluded that there is a mediation effect.

Results and Discussion

The Indonesia Stock Exchange listed a large number of infrastructure and property companies between 2017 and 2023.

Table 2. Sampling criteria

Sample criteria	Amount
1. Infrastructure and property companies for the 2016-2023 period	70
2. Companies that do report financial reports in 2016-2023	25
3. Companies that do use the Rupiah currency	22
Sample	22
Sample total (22 x 7)	154

Source: Processed data, 2024

After going through the classical assumption test, the result is that the research has passed the normality test, heteroscedasticity test, multicollinearity test, and correlation test.

Discussion

Table 3. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviasi
AQ	154	-0,7813	0,6977	-0,0400	0,2823
CS	154	0,1373	6,3673	1,3878	1,1793
ROA	154	0,0977	2,0691	0,4730	0,2866
ROE	154	0,1682	0,4922	0,0819	0,0903
EM	154	0,0917	2,6879	1,1230	0,4391

Source: Processed secondary data, 2025

Audit Quality: The mean is close to zero (-0,0400) with a range from -0,7813 to 0,6977. The standard deviation (0,2823) indicates that audit quality tends not to vary much from its mean. Capital Structure: Shows very high variation, as evidenced by the wide range (0,1373 to 6,3673) and large standard deviation (1,1793) compared to its mean (1,3878). This indicates significant differences in capital structure across entities. Return on Assets (ROA): The mean value is 0,4730 and all positive values (0,0977 to 2,0691) indicate healthy overall asset profitability. The standard deviation of 0.2866 indicates moderate variation.

ROE (Return on Equity): Has a mean of 0,0819 with a relatively narrow range (0,1682 to 0,4922) and a very small standard deviation (0,0903). This indicates high consistency in return on equity across observations, although its mean is lower than ROA. Earnings Management: Shows a mean of 1,1230 with a wide range (0,0917 to 2,6879) and a fairly large standard deviation (0,4391). This indicates significant variation in earnings management practices across entities.

Table 4. Hypothesis Test Results 1st Model

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	3,390	4,127		0,821	0,414
Quality Audit	-1,799	7,922	0,028	0,227	0,021
Capital Structure	0,53	0,94	0,153	2,432	0,043

Dependent Variable: Earnings Management

The Influence of Audit Quality on Earnings Management

Based on the significance test, it was found that the audit quality value had a coefficient of -1,799 and a significance level of 0,021 which was greater than 0.05. The higher the audit quality, the lower the level of earnings management carried out by the company. In other words, high-quality audits tend to limit or prevent earnings management practices. This is in accordance with agency theory: This theory explains the separation between the owner (principal) and management (agent) of the company. Management has the potential to act not in accordance with the interests of the owner, including conducting earnings management for personal gain. A quality external audit functions as a monitoring mechanism to reduce information asymmetry and limit opportunistic management behaviour, including earnings management practices. Independent auditors provide higher assurance of financial statements, thereby reducing management's incentive to manipulate earnings. This is in accordance with his research (Boukrami, 2022), (Yasmin et al., 2024)

The Influence of Capital Structure on Earnings Management

Based on the table above, the sig value is 0.043 and the coefficient value is 0.53, which means there is a capital structure on earnings management. This positive coefficient indicates the higher the level of earnings management that tends to be carried out by the company. Companies with higher leverage tend to use both real earnings management and accrual-based earnings management practices to meet shareholder and creditor expectations. Reports may indicate statistical significance and positive coefficients for the leverage variable in earnings management. Companies with high debt have greater incentives to engage in earnings management, especially if their corporate governance is weak. This is according to his research (Hoang & Phung, 2019), (Khlifi & Zouari, 2022), (Nguyen & Huynh, 2023)

Table 5. Hypothesis Test Results 2nd Model

Model	Unstandardized Coefficients		Standardized Coefficients	
	B	Std. Error	Beta	t
1 (Constant)	2,270	3,027		0,021
EM_ROA	-1,549	3,342	0,048	0,047
EM_ROE	-0,153	0,094	0,153	0,028

a. Dependent Variable: ROA, ROE

The Influence of Earnings Management on ROA

Based on data analysis, the sig value obtained was 0,047 and the coefficient was -1,549, which means that the effect of earnings management on ROA is statistically significant. This means that changes in earnings management practices have a real and non-coincidental impact on the company's ROA level. This negative value indicates that the higher the level of earnings management, the lower the company's ROA level. Earnings management can reduce the quality of earnings, making them less representative of the company's real economic performance. Investors and creditors may have less confidence in manipulated financial statements, which can increase the cost of capital and lower the company's valuation, which in turn can affect ROA. This is in accordance with research (Rashidi, 2025), (Habib et al., 2022).

The Influence of Earnings Management on ROE

Based on the data analysis, the results show that the effect of earnings management on ROE is statistically significant. This means that changes in earnings management practices have a real impact, and this negative value indicates that the higher the level of earnings management, the lower the company's ROE level. Earnings management reduces the quality of earnings, making them less reflective of a company’s fundamental economic performance. Investors and other stakeholders may have less confidence in manipulated financial statements, which can increase investment risk and the cost of capital, which in turn can depress ROE. Accordance with Agency Theory: Management as an agent of shareholders may engage in earnings management for personal interests (e.g., bonuses based on profits). However, this action is not always in line with the best interests of shareholders and can damage the company's value and long-term performance, such as ROE. According to research (Dharma et al., 2024)

Table 6. Hypothesis Test Results 3rd Model

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig
1	(Constant)	2,270	3,027		1,821	0,021
	QA_ROA	1,648	3,342	0,083	1,367	0,037
	CS_ROA	0,265	0,094	0,421	0,002	0,048
	QA_ROE	2,531	1,324	1,021	2,842	0,024
	CA_ROE	0,210	0,163	0,010	4,283	0,047

a. Dependent Variable: ROA, ROE

The Influence of Audit Quality on ROA

Based on the results of the data analysis, the sig value obtained was 0,037 and the coefficient was 1,648, meaning the effect of audit quality on ROA is statistically significant. This means that changes in audit quality have a real impact and do not occur by chance on the company's ROA level. This positive value indicates that the higher the audit quality, the higher the company's ROA level. A high-quality audit provides investors, creditors, and other stakeholders with greater confidence in the reliability and accuracy of a company's financial statements. This confidence can lower the cost of capital, increase investment, and ultimately improve profitability and ROA. According to Agency Theory: External audit is one of the governance mechanisms used to mitigate agency problems between management (agent) and shareholders (principal). High-quality audits increase oversight of management, ensure that financial statements are presented fairly, and protect shareholder interests, which can ultimately contribute to increasing the value and performance of the company (including ROA). In accordance (Sayyar et al., 2024), (Faysal et al., 2022)

The Influence of Audit Quality on ROE

Based on the results of the data analysis, the sig value obtained was 0,024 and the coefficient was 2,531, meaning that the influence of audit quality on ROE is statistically significant and has a positive influence on ROE. A high-quality audit provides investors with greater confidence that a

company's financial statements are fairly presented and free from material error. Increased investor confidence can encourage further investment, which in turn can increase profitability and ROE. With more transparent and accurate information, investors can make better decisions, which can affect stock prices and ultimately ROE. According to Agency Theory: This theory explains the relationship between the owner (principal) and management (agent). Owners need a monitoring mechanism to ensure that agents act in accordance with their interests. Quality audits act as one of the effective monitoring mechanisms, reducing the risk of opportunistic management behaviour and increasing the reliability of financial information, which ultimately benefits the owner in the form of higher ROE. According to Donaldy & Massoudi, 2025), (IndrayatiI et al. (2023),

The Influence of Capital Structure on ROA

Based on the results of the data analysis, the results obtained were that the sig value was 0,048 with a coefficient of 0,265, which means that there is a positive influence of capital structure on ROA. The use of debt in the capital structure can increase shareholder returns relative to total assets if the company is able to generate a rate of return on assets (ROA before interest and taxes) that is higher than the cost of debt (interest rate). Under these conditions, increasing debt (up to the optimal level) can increase ROA. This finding can be supported by capital structure theories that recognise the potential benefits of using debt in increasing profitability through financial leverage effects and tax reductions (to a certain extent). According to research (Daruwala, 2023), Odhiambo et al., 2025),

The Influence of Capital Structure on ROE

Based on the results of the data analysis, the sig value obtained was 0,047 with a coefficient of 0,210, so it can be concluded that the capital structure has a real influence on ROE. The positive coefficient of 0,210 indicates the direction and magnitude of the influence on ROE. When a company uses debt to finance assets, and the rate of return on assets (ROA) exceeds the cost of debt (interest rate), the difference will increase the return received by shareholders, thereby increasing ROE. This finding is supported by financial leverage theory and capital structure theory, which recognise the potential benefits of using debt in increasing returns for shareholders. According to research (Mutumanikam & Adelin, 2024)

Table 7. Mediating Test

Regression	Beta	Sig	Direct Effect	Indirect Effect	Total Effect
QA_ROA_EM	1,648	0,037	1,648	1,648 X -1,549 = -2,553	1,648 - 2,553 = -0,905
CS_ROA_EM	0,265	0,048	0,265	0,265 X -1,549 = -0,410	0,265 - 0,410 = -0,145
QA_ROE_EM	2,531	0,024	2,531	2,531 X -0,153 = -0,387	2,531 - 0,387 = 2,144
CS_ROE_EM	0,210	0,047	0,210	0,210 X -0,153 = -0,032	0,210 – 0,032 = 0,178

Earnings Management Mediates the Effect of Audit Quality on ROA

Based on the results of the data analysis, the results obtained were that the direct influence was 1,648 and the indirect influence was -2,553, so it can be concluded that audit quality has a positive direct effect on ROA. However, audit quality also plays a role in reducing earnings management practices, and the reduction of these practices actually has a negative indirect effect on ROA. This indicates a complex mediation mechanism, where audit quality increases transparency and accountability, which in turn can produce a more realistic picture of ROA, although it may not always be higher. This is in accordance with agency theory: This theory explains the potential for conflict of interest between management (agent) and capital owners (principal). Quality audits act as a monitoring mechanism to reduce information asymmetry and ensure that management acts in accordance with the interests of capital owners. With a good audit, the practice of earnings management can be suppressed so that financial reports become more credible and reflect actual performance. (Mustapha et al., 2019), (Afifa et al., 2023).

Earnings Management Mediates the Effect of Audit Quality on ROE

Based on the results of the data analysis, the direct influence was 2,531 and the indirect influence was -0,387, so audit quality has a strong positive effect on ROE directly. However, audit quality also plays a role in mitigating earnings management practices, which in turn have a negative effect on ROE (as earnings management often aims to "polish" financial performance in the short term, which is not sustainable). This indirect effect suggests that successful auditing ensures more accurate and reliable ROE. In accordance with agency theory, in this context, high-quality audits act as an effective corporate governance mechanism to reduce information asymmetry between management and shareholders. Independent and competent auditors can detect and prevent earnings management practices that are detrimental to shareholder interests so that financial reports become more reliable and ROE reflects actual performance. (Jameel et al., 2024) and (Madhushani & Sujeewa, 2023)

Earnings Management Mediates the Effect of Capital Structure on ROA

Based on the results of the data analysis, the results obtained were that the direct influence was 0,265 and the indirect influence was -0,410, meaning capital structure has a positive direct effect on ROA. However, capital structure can also trigger earnings management practices, which in turn have a negative indirect effect on ROA. This indicates that, although the right capital structure can increase profitability, one that encourages earnings management can erode sustainable financial performance and provide a less accurate picture of ROA in the long run. This is in accordance with agency theory (in the context of capital structure): Different capital structures can affect agency conflicts between management and shareholders, as well as between shareholders and creditors. High debt levels can reduce the free cash flow available to management for personal use but can also increase the pressure to meet debt obligations, which may trigger earnings management. (Fadmawati, 2018), (Ospina & Sanchez, 2022), (Linh et al., 2022)

Earnings Management Mediates the Effect of Capital Structure on ROE

Based on the results of data analysis, it was found that the direct effect was 0,210 and the indirect effect was -0,032, meaning that capital structure has a positive direct effect on ROE, possibly through the mechanism of financial leverage. However, capital structure can also encourage earnings management practices, which, although they may artificially increase ROE in the short term, have a negative indirect effect on more sustainable and accurate ROE. The relatively small indirect effect (-0,032) indicates that the mediation effect of earnings management in this context may not be as strong as the direct effect of capital structure on ROE. According to signalling theory, capital structure decisions can convey information to investors. Companies with high levels of debt may try to send positive signals through good-looking financial statements, which can sometimes involve earnings management. (An et al., 2016)

Conclusions

The conclusions of this research are Audit quality has a negative effect on earnings management. The higher the audit quality, the lower the level of earnings management carried out by the company. Capital structure has a positive effect on earnings management. The higher the level of earnings management the company tends to carry out, the stronger the positive coefficient. Earnings management has a negative effect on ROA. Earnings management can reduce the quality of earnings, making them less representative of the company's real economic performance. Earnings management has a negative effect on ROE. Earnings management reduces the quality of earnings, making them less reflective of a company's fundamental economic performance. Investors and other stakeholders may have less confidence in manipulated financial statements, which can increase investment risk and the cost of capital, which in turn can depress ROE. Audit quality has a positive effect on ROA. A high-quality audit provides investors, creditors, and other stakeholders with greater confidence in the reliability and accuracy of a company's financial statements. Audit quality has a positive effect on ROE. A high-quality audit provides investors with greater confidence that a company's financial statements are fairly

presented and free from material error. Capital structure has a positive effect on ROA. The use of debt in the capital structure can increase shareholder returns relative to total assets if the company is able to generate a rate of return on assets (ROA before interest and taxes) that is higher than the cost of debt (interest rate). Capital structure has a positive effect on ROE. When a company uses debt to finance assets, and the rate of return on assets (ROA) exceeds the cost of debt (interest rate), the difference will increase the return received by shareholders, thereby increasing ROE.

Audit quality has a positive direct effect on ROA. However, audit quality also plays a role in reducing earnings management practices, and the reduction of these practices actually has a negative indirect effect on ROA. Audit quality has a strong positive effect directly on ROE. However, audit quality also plays a role in mitigating earnings management practices, which in turn have a negative effect on ROE. Capital structure has a positive direct effect on ROA. However, capital structure can also trigger earnings management practices, which in turn have a negative indirect effect on ROA. Capital structure has a positive direct effect on ROE, possibly through the mechanism of financial leverage. However, capital structure can also encourage earnings management practices, which, although they may artificially increase ROE in the short term, have a negative indirect effect on more sustainable and accurate ROE.

Based on the conclusions above, the author provides several suggestions that can be considered for future researchers, including the research object can be expanded not only to service companies but also to other types of companies. It would be better for future researchers to add theories related to the research. It is recommended that future researchers use other variables that are outside this research and are thought to have an influence.

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