

## The Effect of Good Corporate Governance and Cash Holding on Income Smoothing in Indonesian Manufacturing Companies

Desmiwerita<sup>1</sup>, Yuli Ardiany<sup>2</sup>, Melli Herfina<sup>1</sup>, Dorris Yadewani<sup>2</sup>, Miftahul Jannah<sup>3</sup> 

<sup>1</sup>Akademi Akuntansi Indonesia Padang  
Jalan Veteran Dalam No. 26 B, Kelurahan Belakang Tangsi, Kecamatan Padang Barat,  
Kota Padang, Provinsi Sumatera Barat, 25113

<sup>2</sup>Universitas Ekasakti Padang  
Jl. Veteran Dalam No. 26B, Bandar Purus, Kecamatan Padang Barat, Kota Padang,  
Sumatera Barat, 25115

<sup>3</sup>Politeknik Negeri Lhokseumawe  
Jl. Banda Aceh-Medan Km. 280,3, Buketrata, Kec. Blang Mangat, Kota Lhokseumawe,  
Aceh, 24301

\*Corresponding Email: [desmiwerita03@gmail.com](mailto:desmiwerita03@gmail.com)<sup>1</sup>

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### ABSTRACT

This study examines the effect of Good Corporate Governance (GCG) on income smoothing and investigates the moderating role of cash holding in the relationship between GCG and income smoothing among manufacturing companies listed on the Indonesia Stock Exchange during 2012–2023. A quantitative approach was employed using panel data regression and Moderated Regression Analysis (MRA). The sample consisted of 390 firm-year observations selected through purposive sampling. Income smoothing was treated as the dependent variable, GCG as the independent variable, cash holding as the moderating variable, and profitability (ROA) and leverage (DER) as control variables. The results reveal that GCG has a significant negative effect on income smoothing, indicating that stronger governance mechanisms reduce managerial opportunism in financial reporting. Cash holding has a significant positive effect on income smoothing and significantly moderates the relationship between GCG and income smoothing, suggesting that liquidity conditions influence governance effectiveness in limiting opportunistic behavior.

**Keywords:** Good Corporate Governance; Cash Holding; Income Smoothing

## **INTRODUCTION**

Income smoothing has become one of the most persistent issues in accounting and corporate finance literature because it directly affects the credibility of financial reporting and the quality of information available to investors, creditors, regulators, and other stakeholders. Financial statements are expected to reflect firms' actual economic conditions; however, managers often possess incentives to manipulate accounting numbers to achieve certain objectives. One of the most common forms of earnings management is income smoothing, where managers intentionally reduce fluctuations in reported earnings to create the appearance of stable financial performance over time (Pinatih & Astika, 2020). Stable earnings are generally perceived by investors as an indicator of lower business risk, stronger operational performance, and better future prospects. Consequently, managers may engage in income smoothing practices to maintain investor confidence, stabilize stock prices, avoid reporting losses, and preserve corporate reputation (Auliana et al., 2023; Firdaus et al., 2025; Maurice et al., 2020).

The issue of income smoothing has become increasingly important in emerging markets, particularly in manufacturing firms that operate under highly competitive and capital-intensive environments. Manufacturing companies require substantial operational funding, maintain complex production activities, and frequently face fluctuations in raw material prices and market demand. These conditions place considerable pressure on management to maintain stable financial performance and meet market expectations. As a result, managers may possess stronger incentives to smooth earnings to reduce perceived financial risk and maintain access to external financing (Abogun et al., 2020; Adiputra & Hermawan, 2020; Mariana et al., 2020; Mariana & Ramadana, 2020).

Previous studies suggest that income smoothing behavior is influenced by both financial characteristics and governance quality within firms. Pinatih and Astika (2020) found that cash holding, profitability, leverage, and firm size significantly influence income smoothing practices. Firnanti (2019) reported that profitability and income tax positively affect income smoothing behavior, while firm size negatively affects such practices. Maurice et al. (2020) demonstrated that earnings management is associated with debt maturity decisions, indicating that managers may adjust reported earnings in response to financing pressures and debt-related incentives. Osesoga et al. (2021) confirmed that real earnings management is linked to firm performance and corporate governance mechanisms. These findings indicate that managerial reporting behavior is closely related to both financial conditions and monitoring effectiveness within firms.

Agency theory explains that earnings management, including income smoothing, arises because managers, acting as agents, possess more information regarding corporate conditions than shareholders as principals (C. Jensen & Meckling, 1976). This information asymmetry creates opportunities for managers to pursue personal interests that may conflict with shareholders' objectives. Under such conditions, managers may manipulate accounting information to maximize compensation, secure employment stability, maintain market reputation, or fulfill contractual obligations. Therefore, firms require effective governance mechanisms capable of reducing opportunistic managerial behavior and improving monitoring effectiveness.

Good Corporate Governance (GCG) has been widely recognized as an important mechanism for reducing agency conflicts and improving the credibility of financial reporting. Governance mechanisms such as institutional ownership, independent commissioners, audit committees, and external audit quality are expected to strengthen oversight over managerial decisions and reduce managerial discretion in financial reporting practices. Prior studies consistently support the role of corporate governance in limiting income smoothing behavior.

The issue of income smoothing has become increasingly important in emerging markets, particularly in manufacturing firms that operate under highly competitive and capital-intensive environments. These conditions place considerable pressure on management to maintain stable financial performance and meet market expectations. As a result, managers may possess stronger incentives to smooth earnings to reduce perceived financial risk and maintain access to external financing (Abogun et al., 2020; Adiputra & Hermawan, 2020). The presence of strong corporate governance mechanisms has been shown to mitigate these opportunistic reporting behaviors. Specifically, good corporate governance and audit committee effectiveness have been found to influence earnings management practices (Eriandani et al., 2020), while governance mechanisms such as independent commissioners significantly affect real earnings management (Wiguna et al., 2023). Research on UK listed companies confirms that corporate governance characteristics, including board composition and audit committee structure, impact earnings management levels (Paiva, 2020). Cross-country evidence from ASEAN countries also demonstrates that disclosure quality and good corporate governance can reduce earnings management manipulation (Nguyen et al., 2024). Collectively, these findings indicate that stronger governance quality improves monitoring effectiveness and reduces managerial opportunism in financial reporting.

Corporate governance research also demonstrates broader implications beyond income smoothing. Putra et al., (2024) found that Good Corporate Governance improves firm performance and mitigates the negative effects of the COVID-19 pandemic. Corporate governance mechanisms have been extensively studied in the context of Indonesian manufacturing firms. The presence of boards of directors and independent commissioners has been found to positively influence manufacturing firm performance (Wujarso et al., 2022). Corporate governance has also been shown to positively affect firm value through financial performance (I. Pamungkas et al., 2023). Furthermore, good corporate governance positively influences corporate sustainability performance (Tjahjadi et al., 2021), while earnings quality mediates the relationship between governance implementation and firm performance (Istianingsih, 2021). These findings suggest that governance mechanisms contribute not only to monitoring efficiency but also to long-term corporate sustainability and financial credibility.

Despite extensive literature on corporate governance and income smoothing, previous findings remain inconsistent. While many studies report that governance mechanisms effectively reduce earnings management, other studies suggest that governance effectiveness depends on certain organizational or financial conditions. Political connection has been found to moderate the relationship between corporate governance and earnings management (Auliana et al., 2023). Furthermore, corporate governance moderates the effects of efficiency, intellectual capital, and liquidity on earnings management (Sari & Murtanto, 2023). These findings imply that governance mechanisms may not operate uniformly across firms and that their effectiveness may vary depending on firms' internal financial conditions.

One important factor potentially influencing governance effectiveness is cash holding. Cash holding refers to the amount of cash and cash equivalents maintained by firms to support operational activities, investment opportunities, and precautionary motives. Firms with higher cash reserves possess greater liquidity flexibility and stronger ability to withstand financial uncertainty. However, agency theory suggests that excessive cash reserves may also increase agency conflicts because managers gain greater discretion over liquid corporate resources (M. C. Jensen, 1986).

Prior studies indicate that cash holding is closely related to governance quality and managerial behavior. Firms with high liquidity may have greater financial flexibility, but

excessive cash reserves can also increase managerial opportunism and encourage income smoothing practices (Azis et al., 2021; Chen et al., 2020b). Although Good Corporate Governance is considered capable of reducing earnings management, previous studies mostly examine direct relationships and rarely position cash holding as a moderating variable. In addition, liquidity conditions may influence the effectiveness of governance mechanisms in limiting managerial opportunism and maintaining financial reporting quality (Auliana et al., 2023). Therefore, this study examines the effect of Good Corporate Governance on income smoothing with cash holding as a moderating variable in manufacturing companies listed on the Indonesia Stock Exchange. Profitability and leverage are also included as control variables because both are closely associated with income smoothing behavior (Maurice et al., 2020).

## **LITERATURE REVIEW**

### **Agency Theory**

Agency theory explains the relationship between shareholders as principals and managers as agents in managing corporate resources. Conflicts arise because managers often possess greater access to internal information than shareholders, creating information asymmetry and opportunities for opportunistic behavior. Under these conditions, managers may prioritize personal interests rather than shareholder value, including manipulating accounting information to achieve certain objectives such as maintaining compensation, preserving corporate reputation, or avoiding negative market reactions (Auliana et al., 2023; C. Jensen & Meckling, 1976; Lewis, 2016; Maurice et al., 2020). Income smoothing is therefore considered a consequence of agency conflicts and weak monitoring mechanisms within firms.

To reduce agency conflicts, firms require effective governance systems capable of limiting managerial discretion and strengthening oversight over financial reporting processes. Good Corporate Governance (GCG) functions as a monitoring mechanism intended to align managerial actions with shareholders' interests through principles of transparency, accountability, responsibility, independence, and fairness (Indarti et al., 2021).

### **Income Smoothing**

Income smoothing is one of the most common forms of earnings management in which managers intentionally reduce fluctuations in reported earnings to present a more stable financial performance over time. Stable earnings are generally interpreted by investors as indicators of lower business risk and better future prospects, encouraging managers to smooth earnings to maintain investor confidence and stock price stability (Abogun et al., 2020). Previous studies indicate that income smoothing is influenced by multiple financial and managerial factors. Cash holding, profitability, leverage, and firm size significantly affect income smoothing practices (Mariana et al., 2018; Mariana & Ibrahim, 2022; Mariana & Ramadana, 2020). Profitability and income tax positively influence income smoothing behavior, whereas firm size negatively affects such practices (Elzahaby, 2021). Earnings management is also associated with financing structures and debt maturity decisions because firms may attempt to present stable earnings to maintain favorable financing conditions (Maurice et al., 2020).

### **Good Corporate Governance and Income Smoothing**

Good Corporate Governance (GCG) refers to a system used to direct and control corporate activities in order to improve accountability, transparency, and monitoring effectiveness. Governance mechanisms such as institutional ownership, independent commissioners, audit committees, and external auditors are expected to reduce managerial opportunism and improve financial reporting quality. Previous studies show that Good Corporate Governance

negatively affects earnings management and income smoothing practices (Indarti et al., 2021; Mariana et al., 2020; Wiguna et al., 2023). Audit committees and external auditor quality also contribute to reducing earnings manipulation (Auliana et al., 2023; Oktaviani et al., 2020). In addition, Good Corporate Governance improves firm performance, firm value, and corporate sustainability (Saputro & Rijal, 2022; Tjahjadi et al., 2021). However, the effectiveness of governance mechanisms may vary depending on firms' financial and organizational conditions, such as political connection, liquidity, and efficiency (Auliana et al., 2023; Rehman et al., 2025; Sari & Murtanto, 2023).

### **Cash Holding**

Cash holding refers to the amount of cash and cash equivalents maintained by firms to support operational needs, investment opportunities, and precautionary motives. Firms with high cash reserves generally have stronger liquidity flexibility and greater ability to face financial uncertainty. However, excessive cash holding may also increase agency problems because managers possess greater discretion over liquid corporate resources (C. Jensen & Meckling, 1976). Previous studies indicate that corporate governance significantly influences cash holding policies (Azis et al., 2021; Chen et al., 2020b; Mariana & Ibrahim, 2022; Ogundipe et al., 2012). In relation to income smoothing, cash holding may reduce financial pressure, but excessive liquidity can also encourage opportunistic managerial behavior. Prior studies found that cash holding positively affects income smoothing and earnings management practices (Agriyanto et al., 2016). These findings suggest that liquidity conditions may influence managerial incentives and the effectiveness of governance mechanisms in limiting income smoothing practices.

### **Research Gap and Conceptual Development**

Although previous studies have extensively examined corporate governance, cash holding, and income smoothing, several gaps remain in the literature. First, prior studies primarily focus on the direct relationship between corporate governance and income smoothing without considering firms' liquidity conditions. Second, most previous studies position cash holding as an independent variable rather than as a moderating factor. Third, limited studies examine the interaction between Good Corporate Governance and cash holding in explaining income smoothing practices, particularly in Indonesian manufacturing firms.

Research related to cash holdings and corporate governance still offers substantial opportunities for further development, particularly concerning opportunistic managerial behavior and financial reporting quality (Khatib et al., 2021). Therefore, this study extends prior literature by positioning cash holding as a moderating variable. This study also incorporates profitability and leverage as control variables because both variables are frequently associated with income smoothing practices (Mahendra & Jati, 2020; Maurice et al., 2020).

### **Hypotheses Development**

#### **Good Corporate Governance and Income Smoothing**

Agency theory explains that managers may engage in opportunistic behavior because they possess greater access to internal information than shareholders. One form of such behavior is income smoothing, where managers intentionally reduce fluctuations in reported earnings to maintain stable financial performance and preserve investor confidence (Maurice et al., 2020). Good Corporate Governance (GCG) is expected to reduce income smoothing practices because governance mechanisms such as institutional ownership, independent commissioners, audit committees, and external auditor quality strengthen monitoring effectiveness and limit managerial discretion. Prior studies consistently show that corporate governance negatively affects earnings management and real activity manipulation ((Mariana et al., 2020; Momtaz & Parra,

2025; Wiguna et al., 2023). Therefore, stronger governance quality is expected to reduce income smoothing practices.

**H1: Good Corporate Governance negatively affects income smoothing.**

### **Cash Holding and Income Smoothing**

Cash holding reflects the amount of liquid resources maintained by firms to support operational activities and financial flexibility. Although high cash reserves may reduce financial pressure, excessive liquidity may also increase agency problems because managers possess greater discretion over highly liquid corporate resources (Burke & Wieland, 2017). Under such conditions, managers may use available liquidity to maintain stable earnings and avoid negative market perceptions (Gryko et al., 2026). Prior studies found that cash holding positively affects income smoothing practices, while free cash flow significantly influences earnings management behavior (Agriyanto et al., 2016). Furthermore, aggressive income-increasing real earnings management is associated with higher cash holdings, particularly in weakly governed firms (Burke & Wieland, 2017). Companies with greater information asymmetry related to poor earnings quality also tend to hold larger cash reserves (Gryko et al., 2026). In the Indonesian manufacturing context, free cash flow has a positive significant influence on real earnings management (Zurriah et al., 2025). These findings indicate that firms with higher cash reserves are more likely to engage in income smoothing practices.

**H2: Cash holding positively affects income smoothing.**

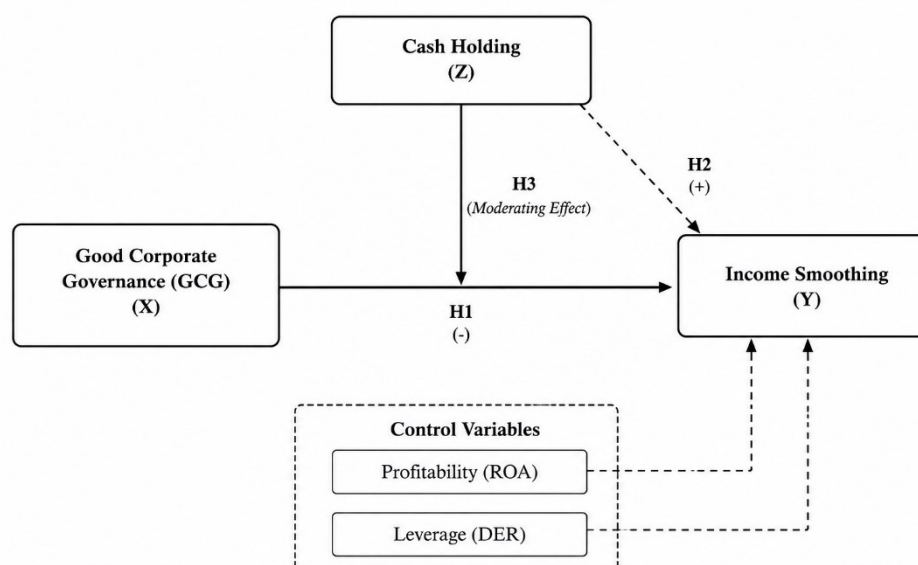
### **The Moderating Role of Cash Holding**

The effectiveness of Good Corporate Governance in reducing income smoothing may depend on firms' liquidity conditions. High cash holding increases managerial flexibility and discretion over corporate resources, potentially creating greater opportunities for opportunistic behavior. In this situation, stronger governance mechanisms become increasingly important in limiting income smoothing and strengthening monitoring effectiveness. Prior studies indicate that governance effectiveness may vary depending on firms' financial conditions and liquidity levels (Auliana et al., 2023; Sari & Murtanto, 2023). Therefore, cash holding is expected to moderate the relationship between Good Corporate Governance and income smoothing.

**H3: Cash holding moderates the relationship between Good Corporate**

### **Governance and income smoothing.**

Based on the theoretical framework and previous empirical studies, this study develops a conceptual framework to explain the relationship between Good Corporate Governance, cash holding, and income smoothing. The framework illustrates the direct effect of Good Corporate Governance and cash holding on income smoothing, as well as the moderating role of cash holding in the relationship between Good Corporate Governance and income smoothing. In addition, profitability and leverage are included as control variables because both variables are considered capable of influencing income smoothing practices. The conceptual framework of this study is presented in Figure 1.



**Figure 1. Conceptual Framework**

Source: Processed Research Data (2026)

## RESEARCH METHOD

This study employs a quantitative approach with an explanatory research design to examine the effect of Good Corporate Governance on income smoothing practices and the moderating role of cash holding in the relationship between the two variables. The quantitative approach is considered appropriate because the study focuses on testing hypotheses and analyzing causal relationships among variables using numerical data and statistical procedures. The study applies panel data analysis because the dataset combines cross-sectional data from several manufacturing companies and time-series data over multiple observation periods.

### Sampling and Data Collection

The population of this study consists of all manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2012–2023 observation period. Manufacturing firms are selected because the sector is characterized by complex operational activities, high capital intensity, and greater incentives for income smoothing practices (Alviandy & Handojo, 2025; Sagita et al., 2024). The sample is determined using purposive sampling based on several criteria: (1) manufacturing companies consistently listed on the Indonesia Stock Exchange during 2012–2023, (2) companies publishing complete annual reports and financial statements throughout the observation period, (3) companies providing complete data related to Good Corporate Governance, cash holding, profitability, leverage, and income smoothing variables, and (4) companies with incomplete financial information excluded from the sample. Purposive sampling is widely employed in manufacturing sector studies to ensure data completeness and relevance (Iriani et al., 2024). Based on these criteria, the study obtained 390 firm-year observations from manufacturing companies listed on the Indonesia Stock Exchange during 2012–2023. The study uses secondary data collected from the official IDX website, annual reports, and financial statements published by each company. The observation period from 2012 to 2023 is selected to provide sufficient panel data observations and capture variations in corporate governance practices, liquidity conditions, and income smoothing behavior over time (Sagita et al., 2024).

### Sample Size Justification

The sample size used in this study is considered adequate for panel data regression analysis because it consists of 390 firm-year observations from manufacturing companies listed on the Indonesia Stock Exchange during the 2012–2023 period. The use of panel data increases the number of observations by combining cross-sectional and time-series data, thereby improving the statistical power and robustness of the analysis. In addition, previous studies examining corporate governance, cash holding, and income smoothing commonly use panel datasets with similar observation sizes to ensure reliable hypothesis testing and more consistent estimation results. Therefore, the number of observations employed in this study is sufficient to examine the direct and moderating relationships among Good Corporate Governance, cash holding, and income smoothing practices.

### Measurement

This study employs income smoothing as the dependent variable, Good Corporate Governance as the independent variable, cash holding as the moderating variable, and profitability and leverage as control variables. The measurement of each variable is adapted from previous studies commonly used in corporate governance and income smoothing literature to ensure the validity and reliability of the research model. The operational definitions, proxies, and measurement formulas of the variables used in this study are presented in Table 1.

**Table 1. Operationalization of Variables**

Variable	Proxy	Measurement	Scale
Income Smoothing	Eckel Index	$Eckel\ Index = \frac{CV(\Delta I)}{CV(\Delta S)}$	Ratio
Good Corporate Governance	Corporate Governance Index	Composite governance index consisting of institutional ownership, independent commissioners, audit committee, and managerial ownership	Ratio
Cash Holding	Cash and Cash Equivalent Ratio	$CH = \frac{Cash\ and\ Cash\ Equivalents}{Total\ Assets}$	Ratio
Profitability	Return on Assets (ROA)	$ROA = \frac{Net\ Income}{Total\ Assets}$	Ratio
Leverage	Debt to Equity Ratio (DER)	$DER = \frac{Total\ Debt}{Total\ Equity}$	Ratio

Source: Processed Research Data (2026)

### Data Analysis

This study employs panel data regression analysis to examine the effect of Good Corporate Governance on income smoothing and the moderating role of cash holding in the relationship between the two variables. Panel data analysis is considered appropriate because the dataset combines cross-sectional data from manufacturing companies and time-series observations over the 2012–2023 period, thereby increasing the number of observations and improving estimation efficiency.

The data analysis procedures consist of several stages. First, descriptive statistics are used to describe the characteristics and distribution of the research variables. Second, classical assumption tests consisting of normality, multicollinearity, and heteroscedasticity tests are conducted to ensure the validity of the regression model. Third, hypothesis testing is performed using Moderated Regression Analysis (MRA) by including the interaction term between Good Corporate Governance and cash holding to

identify the moderating effect. The statistical analysis in this study is conducted using STATA software. The regression model used in this study is formulated as follows:

$$IS_{it} = \alpha + \beta_1 GCG_{it} + \beta_2 CH_{it} + \beta_3 (GCG_{it} \times CH_{it}) + \beta_4 ROA_{it} + \beta_5 DER_{it} + \varepsilon_{it}$$

Where:

- IS = Income Smoothing
- GCG = Good Corporate Governance
- CH = Cash Holding
- GCG×CH = Interaction between Good Corporate Governance and Cash Holding
- ROA = Profitability
- DER = Leverage
- ε = Error term

The moderating effect of cash holding is identified based on the significance of the interaction coefficient between Good Corporate Governance and cash holding.

## RESULTS

### Descriptive Statistics

Descriptive statistics are employed to describe the characteristics and distribution of the variables used in this study. The analysis includes the minimum value, maximum value, mean, and standard deviation of each variable. The descriptive statistics results are presented in Table 2.

**Table 2. Descriptive Statistics (N. 390)**

Variable	Mean	Std. Deviation	Minimum	Maximum
GCG	86.04	2.32	81.12	91.91
Cash Holding	29.59	1.45	27.12	31.45
Income Smoothing	4.61	5.84	0.03	18.77
ROA	6.98	3.92	0.25	16.83
DER	0.56	0.39	0.12	2.01

Source: Processed Research Data (2026)

Table 2 shows that Good Corporate Governance (GCG) has an average value of 86.04 with a standard deviation of 2.32, indicating relatively stable governance quality among manufacturing firms. Cash Holding has an average value of 29.59, suggesting that firms maintain relatively high liquidity levels during the observation period.

Income Smoothing has an average value of 4.61 with a standard deviation of 5.84, indicating that earnings smoothing practices vary considerably among firms. The average ROA value of 6.98 indicates that the sampled firms generally generate positive profitability, while the average DER value of 0.56 suggests moderate leverage conditions.

### Multicollinearity Test

Before conducting regression analysis, a multicollinearity test is performed to examine whether strong correlations exist among independent variables. The test is conducted using the Variance Inflation Factor (VIF). The results are presented in Table 3.

**Table 3. Multicollinearity Test**

Variable	VIF
GCG	1.92
Cash Holding	1.31
Interaction	1.08
ROA	2.76
DER	2.11

Source: Processed Research Data (2026)

Table 3 indicates that all variables have VIF values below 10, suggesting that the regression model does not suffer from multicollinearity problems. Therefore, all independent variables can be included simultaneously in the regression model without causing estimation bias.

### **Panel Data Model Selection**

This study employs panel data analysis because the dataset combines cross-sectional and time-series observations. Therefore, model selection tests are conducted to determine the most appropriate panel regression model for the analysis. The tests include the Chow test, Hausman test, and Lagrange Multiplier (LM) test.

### **Chow Test**

The Chow test is conducted to determine whether the Fixed Effect Model (FEM) is more appropriate than the Common Effect Model (CEM). The results are presented in Table 4.

**Table 4. Chow Test**

Test	Statistic	Probability
Chow Test	4.281	0.000

Source: Processed Research Data (2026)

Table 4 shows that the probability value of the Chow test is 0.000, which is lower than 0.05. This result indicates that the Fixed Effect Model is more appropriate than the Common Effect Model.

### **Hausman Test**

The Hausman test is conducted to determine whether the Fixed Effect Model or Random Effect Model is more appropriate for the regression analysis. The results are presented in Table 5.

**Table 5. Hausman Test**

Test	Statistic	Probability
Hausman Test	12.174	0.032

Source: Processed Research Data (2026)

Table 5 shows that the probability value of the Hausman test is 0.032, which is lower than 0.05. Therefore, the Fixed Effect Model is considered more appropriate than the Random Effect Model for this study.

### **Lagrange Multiplier (LM) Test**

The LM test is conducted to compare the Common Effect Model and Random Effect Model. The results are presented in Table 6.

**Table 6. Lagrange Multiplier Test**

Test	Statistic	Probability
Breusch-Pagan LM	18.401	0.000

Source: Processed Research Data (2026)

Table 6 indicates that the probability value is lower than 0.05, suggesting that the Random Effect Model is preferable to the Common Effect Model. However, based on the Chow test and Hausman test results, the Fixed Effect Model is selected as the most appropriate regression model for this study.

### **Moderated Regression Analysis**

After determining the appropriate panel regression model, the study performs Moderated Regression Analysis (MRA) using the Fixed Effect Model with robust standard errors to

examine the effect of Good Corporate Governance on income smoothing and the moderating role of cash holding. The regression results are presented in Table 7.

**Table 7. Moderated Regression Analysis Results**

<b>Variable</b>	<b>Coefficient</b>	<b>t-Statistic</b>	<b>Probability</b>
Constant	-1.982	-1.542	0.124
GCG	-0.284	-2.017	0.044
Cash Holding	0.418	1.982	0.048
GCG × Cash Holding	0.271	2.146	0.032
ROA	0.491	2.337	0.020
DER	1.884	1.401	0.162
<b>Model Summary</b>		<b>Value</b>	
F-Statistic		14.771	
Prob > F		0.011	
Adjusted R-Square		0.087	

Source: Processed Research Data (2026)

Table 7 shows that the regression model is statistically significant, as indicated by the F-statistic value of 14.771 and a probability value of 0.011. The Adjusted R-Square value of 0.087 indicates that Good Corporate Governance, Cash Holding, the interaction variable, ROA, and DER explain approximately 8.7% of the variation in income smoothing practices, while the remaining variation is explained by other variables outside the model.

## **DISCUSSION**

### **The Effect of Good Corporate Governance on Income Smoothing**

The regression results indicate that Good Corporate Governance negatively and significantly affects income smoothing, as reflected by the coefficient value of -0.284 and the probability value of 0.044. This finding indicates that stronger governance mechanisms reduce managerial opportunism and improve monitoring effectiveness in financial reporting practices.

Agency theory explains that governance mechanisms function to reduce information asymmetry between managers and shareholders by strengthening oversight over managerial decisions. Firms with stronger governance structures are less likely to engage in income smoothing practices because managers face greater monitoring pressure and accountability. Governance mechanisms such as institutional ownership, independent commissioners, audit committees, and external auditor quality improve transparency and reduce managerial discretion in financial reporting (DeAngelo, 1981; Indarti et al., 2021).

This finding supports previous studies demonstrating that Good Corporate Governance reduces earnings management behavior and real activity manipulation. Good Corporate Governance negatively affects earnings management in manufacturing companies (Edi & Jessica, 2020), while governance mechanisms significantly influence real earnings management (Indarti et al., 2021). Corporate governance also significantly affects earnings management practices in Indonesian firms (Fathiha et al., 2024; Indarti et al., 2021; Yuwono et al., 2008). In addition, audit committees and external auditor quality reduce earnings management practices, indicating that governance quality strengthens the credibility of financial reporting (Dharmawati et al., 2025; Eriandani et al., 2020). Good Corporate Governance and investor protection also reduce real activity manipulation in ASEAN countries (Fajar & Setyorini, 2021). These findings indicate that

stronger governance quality improves monitoring effectiveness and limits opportunistic managerial behavior.

The findings also align with broader corporate governance literature suggesting that governance quality improves organizational accountability and corporate transparency. Governance implementation improves firm value through financial performance (I. D. Pamungkas & Sari, 2023), while Good Corporate Governance positively affects sustainability performance (Tjahjadi et al., 2021). Therefore, stronger governance quality not only improves organizational performance but also reduces managerial incentives to smooth earnings.

### **The Effect of Cash Holding on Income Smoothing**

The regression results show that Cash Holding positively and significantly affects income smoothing, with a coefficient value of 0.418 and a probability value of 0.048. This finding indicates that firms with higher liquidity levels are more likely to engage in income smoothing practices.

Agency theory explains that excessive liquidity may increase agency conflicts because managers possess greater discretion over highly liquid corporate resources (M. C. Jensen, 2001). Firms with substantial cash reserves provide managers with greater flexibility in controlling operational and financial decisions, thereby increasing opportunities for opportunistic reporting behavior. Under such conditions, managers may smooth earnings to maintain stable financial performance and avoid negative market perceptions. Free cash flow theory argues that managers can benefit from larger firm size and thus have incentives to overinvest even in projects with negative net present value, and the retention of free cash flow in lieu of payout creates opportunities for managers to destroy value by using excess resources in ways that serve their own self-interests (DeAngelo, 1981; M. C. Jensen, 2001).

Findings are consistent with previous studies showing that cash holding positively affects income smoothing practices (Zurriah et al., 2025). Research also shows that firms with greater information asymmetry related to poor earnings quality tend to hold larger cash reserves, and that aggressive income-increasing real earnings management is associated with higher cash holdings (Burke & Wieland, 2017; Gryko et al., 2026). Maurice et al. (2020) further found that earnings management is associated with financing structure and debt maturity decisions, indicating that financial flexibility influences managerial reporting incentives. These findings suggest that high liquidity may increase managerial discretion and create greater opportunities for income smoothing practices.

The result also supports studies linking liquidity management and governance quality. The moderating effect of corporate governance on the cash holding-financial performance relationship has been documented, with board size and CEO duality strengthening this association (I. D. Pamungkas & Sari, 2023). Governance reforms reduce excessive cash holdings, while internal control and risk management significantly influence corporate cash holding policies (Chen et al., 2020a). Therefore, liquidity conditions are closely associated with managerial behavior and financial reporting practices.

### **The Moderating Role of Cash Holding**

The interaction term between Good Corporate Governance and Cash Holding has a positive and significant coefficient value of 0.271 with a probability value of 0.032. This finding indicates that Cash Holding significantly moderates the relationship between Good Corporate Governance and income smoothing.

The result suggests that liquidity conditions influence the effectiveness of governance mechanisms in constraining managerial opportunism and income smoothing practices. Firms with high liquidity levels may experience greater agency conflicts because managers possess broader discretion in controlling liquid corporate assets. Under such conditions, governance mechanisms become increasingly important in limiting opportunistic managerial behavior and strengthening monitoring effectiveness.

This finding supports prior studies suggesting that governance effectiveness depends on firms' financial conditions and liquidity levels. Auliana et al. (2023) found that political connection moderates the relationship between corporate governance and earnings management, while Sari and Murtanto (2023) demonstrated that corporate governance moderates the effects of efficiency, intellectual capital, and liquidity on earnings management. These findings indicate that governance mechanisms may not operate uniformly across firms because financial conditions can influence managerial incentives and monitoring effectiveness.

The present study extends previous literature by demonstrating that liquidity conditions represented by cash holding significantly influence governance effectiveness in reducing income smoothing practices. This finding also supports agency theory, which argues that governance mechanisms become increasingly important when firms possess substantial free cash flow and liquid assets because liquid resources provide managers with greater flexibility and opportunities for opportunistic behavior.

## **CONCLUSION**

This study examines the effect of Good Corporate Governance on income smoothing and the moderating role of cash holding among manufacturing companies listed on the Indonesia Stock Exchange during the 2012–2023 period. The results indicate that Good Corporate Governance negatively and significantly affects income smoothing practices, suggesting that stronger governance mechanisms improve monitoring effectiveness and reduce managerial opportunism in financial reporting. The findings support agency theory, which emphasizes the importance of governance mechanisms in reducing information asymmetry between managers and shareholders.

The results also show that Cash Holding positively and significantly affects income smoothing. This finding indicates that firms with higher liquidity levels possess greater flexibility in controlling corporate resources, thereby increasing opportunities for opportunistic reporting behavior. Furthermore, the interaction effect between Good Corporate Governance and Cash Holding is positive and significant, indicating that Cash Holding moderates the relationship between Good Corporate Governance and income smoothing. This result suggests that liquidity conditions influence the effectiveness of governance mechanisms in limiting income smoothing practices.

Overall, the study contributes to the corporate governance and income smoothing literature by demonstrating that governance effectiveness in reducing income smoothing depends not only on governance quality itself but also on firms' liquidity conditions.

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#### **DECLARATION OF CONFLICTING INTERESTS**

The authors have declared no potential conflicts of interest concerning the study, authorship, and/or publication of this article.

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### **ABOUT THE AUTHOR(S)**

#### **1<sup>st</sup> Author**

Desmiwerita is a Lecturer in the Accounting Study Program at Akademi Akuntansi Indonesia Padang. She holds the academic rank of Lektor and earned her Master of Science degree from Universitas Andalas in 2014, after completing her Bachelor of Economics degree at Universitas Ekasakti in 2011. Her teaching and academic interests include intermediate financial accounting, advanced financial accounting, public sector accounting, cost and budgeting practicum, Accurate Accounting applications, financial and business mathematics, capital markets, scientific writing, financial performance analysis, receivables management, internal control, taxation, government budgeting, accounting information technology, audit professionalism, and fixed asset accounting. She has been involved in research on receivables control, cash flow reporting, regional government budget performance, BPJS patient service income calculation, credit sales and profitability, financial reporting quality, auditor ethics and materiality judgment, tax audit control, and fixed asset accounting. She has also contributed to community engagement programs related to cooperative development, BUMNag financial reporting, MSME financial governance, UPK transformation into BUMNag Bersama, tax assistance, green accounting, community income improvement, and small business development.

Email: [desmiwerita03@gmail.com](mailto:desmiwerita03@gmail.com)

#### **2<sup>nd</sup> Author**

Yuli Ardiany is a Lecturer in the Management Study Program at Universitas Ekasakti. She holds the academic rank of Lektor Kepala and earned her Doctoral degree from Universitas Andalas in 2025, after completing her Master of Science degree at Universitas Andalas in 2017 and Bachelor of Economics degree at Universitas Langlang Buana in 2010. Her teaching and academic interests include financial management, international financial management, strategic business management, budgeting, financial statement analysis, sustainability accounting, cost accounting, taxation, tax accounting, VAT and regional taxes, customs, management accounting, business English, earnings management, tax avoidance, audit fees, dividend policy, environmental performance, environmental disclosure, firm value, and accounting conservatism. She has been involved in research on income tax, earnings management, audit fees, PSAK 72 revenue recognition, tax avoidance, managerial performance, environmental accounting, firm value, board characteristics, and tax aggressiveness. She has also contributed to community engagement programs related to student entrepreneurship, digital ecosystem transformation for fishing communities, palm oil

waste utilization, transparent village financial reporting, cost calculation for household businesses, cooperative development, MSME financial governance, tax assistance, and green accounting.

Email: [yuliardiany@gmail.com](mailto:yuliardiany@gmail.com)

### **3<sup>rd</sup> Author**

Melli Herfina is a Lecturer in the Accounting Study Program at Akademi Akuntansi Indonesia Padang. She holds the academic rank of Lektor and earned her Master of Science degree from Universitas Andalas in 2013, after completing her Bachelor of Economics degree at Universitas Muhammadiyah Malang in 2005. Her teaching and academic interests include taxation, tax accounting, financial statement auditing, audit practicum, accounting examination, statistics, statistical practicum, MYOB Accounting, Accurate Accounting, financial and business mathematics, accounting English, banking credit, non-performing loans, financial performance, tax compliance, e-filing, tax avoidance, earnings management, and public sector cash flow reporting. She has been involved in research on unsecured bank credit, non-performing loans and financial performance, adversity quotient in online accounting learning, individual taxpayer compliance, income tax reporting, restaurant tax collection, advertisement tax reporting, and cash flow analysis in public institutions. She has also contributed to community engagement programs related to international community empowerment, palm oil waste utilization, technology-based marketing, cooperative development, tax assistance, green accounting, family financial planning, business mentoring, and e-filing socialization.

Email: [melliherrina@gmail.com](mailto:melliherrina@gmail.com)

### **4<sup>th</sup> Author**

Dorris Yadewani is a Lecturer in the Management Study Program at Universitas Ekasakti. She holds the academic rank of Lektor Kepala and earned her Doctor of Philosophy in Management from Lincoln University College in 2024, after completing her Master of Management degree at Universitas Andalas in 2003 and undergraduate degrees at Universitas Ekasakti in 2000. Her teaching and academic interests include human resource management, entrepreneurial human resource management, marketing management, global marketing, integrated marketing communication, digital business, operational management, organizational leadership, corporate budgeting, research methodology, investment analysis, portfolio management, employee performance assessment, management information systems, digital promotion, and MSME development. She has been involved in research on employee performance assessment information systems and data processing management information systems. She has also contributed to community engagement programs related to social media marketing for MSMEs, balanced scorecard-based MSME performance strengthening, human resource competency development, marketplace utilization, Instagram-based business promotion, youth prevention outreach, health service activities, and online registration system implementation.

Email: [deyadewani@gmail.com](mailto:deyadewani@gmail.com)

### **5<sup>th</sup> Author**

Miftahul Jannah is a Lecturer in the Islamic Financial Institution Accounting Study Program at Politeknik Negeri Lhokseumawe. She holds the academic rank of Asisten Ahli and earned her Master of Science degree from Universitas Syiah Kuala in 2022, after completing her Bachelor of Applied Science degree at Politeknik Negeri Lhokseumawe in 2018. Her teaching and academic interests include introductory accounting practicum, corporate budgeting, budgeting practicum, Islamic financial institution accounting, public finance, regional fiscal sustainability, financial disclosure quality, and local government debt risk. She has been involved in research on regional government debt default risk modelling in Aceh and fiscal dependence, financial

sustainability, and the mediating role of financial statement disclosure quality. She has also contributed to community engagement related to economic empowerment for young women through the reuse of burlap fabric into macramé crafts. Email: [miftahuljannah@pnl.ac.id](mailto:miftahuljannah@pnl.ac.id)