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The Relationship between Earnings Management, Financial Transparency, and Auditor Independence on Investor Trust

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ABSTRACT

This study investigates the relationship between earnings management, financial transparency, and auditor independence on investor trust in Indonesia. Using a quantitative research design, data were collected from 150 active investors through a questionnaire measured on a five-point Likert scale. The data were analyzed using SPSS version 25, employing descriptive statistics, validity and reliability testing, correlation analysis, and multiple regression. The results show that earnings management has a negative and significant effect on investor trust, indicating that manipulative reporting practices reduce investors' confidence in financial information. In contrast, financial transparency and auditor independence both have positive and significant effects on investor trust, highlighting the importance of clear disclosures and professional audit integrity in strengthening investor confidence. Among the variables, financial transparency demonstrates the strongest influence, emphasizing its critical role in reducing information asymmetry and enhancing credibility. The study concludes that strengthening governance practices, improving reporting transparency, and ensuring auditor independence are essential strategies to enhance investor trust in Indonesia's capital market.

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1. INTRODUCTION

Investor trust is a fundamental component in maintaining the stability and long-term sustainability of capital markets. In Indonesia, where financial reporting quality and corporate governance practices continue to evolve, investor trust often becomes a critical issue influencing investment decisions. Trust enables investors to perceive lower risk, commit more capital, and engage actively in financial markets [1], [2]. Conversely, when trust is compromised, investors may withdraw, hesitate to invest, or demand higher returns as compensation for perceived risks. Therefore, identifying the determinants that strengthen or weaken investor trust is essential for enhancing market efficiency and corporate accountability [3], [4].

One of the key factors affecting investor trust is earnings management, a practice in which managers intentionally manipulate financial reports to meet specific targets or influence market perceptions [5], [6]. Although earnings management can be conducted within acceptable accounting standards, it often raises doubts about the reliability and integrity of financial statements. Investors who detect or suspect earnings manipulation may lose confidence in the company's financial health, leading to reduced investment interest.

At the same time, financial transparency plays a crucial role in mitigating negative perceptions related to earnings management. Transparency reflects the extent to which companies disclose relevant, accurate, and timely financial information [6], [7]. A transparent financial reporting environment helps investors interpret financial performance more clearly, thereby increasing credibility and reducing information asymmetry. In Indonesia, regulatory frameworks continue to emphasize transparency, but the level of implementation among firms varies widely, making it an important variable to examine.

Another significant determinant of investor trust is auditor independence. Independent auditors are responsible for providing objective assessments of a company's financial statements. When auditors maintain impartiality and professional skepticism, they enhance the reliability of financial reports and reinforce investor confidence. Conversely, impaired auditor independence—whether due to economic ties, personal relationships, or other conflicts of interest—can undermine audit quality and damage investor perceptions.

Despite the importance of earnings management, financial transparency, and auditor independence, empirical studies in Indonesia have reported mixed results regarding their influence on investor trust, with some findings indicating strong relationships while others show insignificant or context-dependent effects, thereby highlighting the need for further investigation using more robust quantitative methods and updated statistical tools. In response to this gap, this study aims to analyze the relationships among earnings management, financial transparency, and auditor independence on investor trust in Indonesia by employing a quantitative approach with 150 respondents and data analysis using SPSS version 25, with the expectation that the findings will provide valuable insights for policymakers, companies, auditors, and investors in strengthening trust and improving corporate governance practices in the Indonesian capital market.

2. LITERATURE REVIEW

2.1 Earnings Management

Earnings management refers to the deliberate manipulation of financial reporting by managers to achieve certain financial objectives, such as meeting market expectations, influencing investor perceptions, or fulfilling contractual requirements; according to [8], [9], it occurs when managers use judgment in financial reporting and in structuring transactions to alter financial results, and although it may be conducted within the boundaries of accounting standards, it nonetheless raises serious concerns about the authenticity and reliability of reported earnings. Previous studies have shown mixed results regarding the impact of earnings management on investor trust, as some research indicates that investors respond negatively to the detection of earnings manipulation because it undermines the credibility of financial statements; [10]–[12], for example, found that firms engaging in income smoothing often face skepticism from investors. In the Indonesian context, several cases involving manipulated earnings have further heightened investor awareness of potential risks, making earnings management a crucial variable to be examined in relation to investor trust.

2.2 Financial Transparency

Financial transparency is defined as the extent to which companies openly disclose relevant and accurate financial information that enables stakeholders to make informed decisions; [13], [14] describe transparency as a mechanism that reduces information asymmetry between managers and investors, while transparent financial reporting also enhances accountability, ensures compliance with regulatory standards, and strengthens investor confidence. Empirical evidence further supports the positive influence of transparency on investor trust, as studies by [15]–[17] indicate that transparent firms are perceived as more credible and are more likely to attract long-term investors. In emerging markets such as Indonesia, where regulatory enforcement varies across firms, transparency plays a pivotal role in mitigating uncertainty and reinforcing market integrity, making financial transparency essential for creating an environment that supports informed investment decisions.

2.3 *Auditor Independence*

Auditor independence refers to the ability of auditors to perform their duties objectively and without bias, where according to the International Federation of Accountants (IFAC), independence encompasses both independence of mind and independence in appearance to ensure that auditors maintain professional skepticism and avoid conflicts of interest; this independence significantly influences audit quality, which in turn affects the reliability of financial statements [1], [2]. Research consistently shows that auditor independence enhances investor trust, as [5], [7] argues that independent auditors increase the perceived credibility of audit reports, making investors more confident that financial statements have been examined fairly and accurately. However, auditor independence can be impaired by factors such as long-term auditor–client relationships, the provision of non-audit services, and economic dependence on clients. In Indonesia, the importance of auditor independence has gained increasing attention due to regulatory reforms and several high-profile auditing scandals, positioning it as a critical factor in investor decision-making.

2.4 *Investor Trust*

Investor trust is the confidence investors place in the reliability, integrity, and competence of companies and capital markets, reflecting their perceptions of financial information quality, corporate governance, and regulatory enforcement; according to [18]–[20], trust is built upon the principles of ability, benevolence, and integrity, which translate into an investor's willingness to take financial risks. Numerous studies highlight that trust plays a central role in investment decisions, as high levels of trust encourage investors to commit capital and engage in long-term participation in financial markets, whereas low trust increases risk perception, triggers investment withdrawal, or leads to demands for higher returns. In the context of Indonesia's capital market, investor trust therefore remains a crucial determinant of market participation, resilience, and overall stability.

2.5 *Theoretical Framework*

This study is guided by three main theoretical foundations, namely Agency Theory, Information Asymmetry Theory, and Stakeholder Theory. Agency Theory suggests that managers may engage in earnings management due to conflicts of interest with shareholders, while financial transparency and auditor independence function as key mechanisms to reduce agency problems. Information Asymmetry Theory explains that the lack of transparent information creates unequal knowledge between managers and investors, which ultimately weakens investor trust. Meanwhile, Stakeholder Theory emphasizes that companies have a responsibility to act in the best interests of all stakeholders by providing reliable and credible information that can enhance trust. Based on these theoretical perspectives, this study examines how earnings management, financial transparency, and auditor independence influence investor trust in Indonesia.

Empirical literature indicates that the relationships among earnings management, financial transparency, auditor independence, and investor trust are complex and multidimensional. Earnings management generally tends to reduce investor trust because manipulation erodes confidence in reported financial outcomes, whereas financial transparency strengthens trust by providing clarity, reducing information asymmetry, and supporting more accurate market valuations. Auditor independence further reinforces trust by ensuring unbiased and objective verification of financial statements. However, the strength and direction of these relationships may vary across different markets, industries, and regulatory environments. In the Indonesian context, where corporate governance practices are still evolving, these variables are likely to interact in unique ways that require deeper empirical investigation.

3. RESEARCH METHODS

3.1 Research Design

This study employs a quantitative research design to examine the relationship between earnings management, financial transparency, auditor independence, and investor trust in Indonesia. A quantitative approach was chosen because it enables systematic measurement of variables, statistical testing of hypotheses, and objective evaluation of relationships among variables. The research design is explanatory, aiming to determine the extent to which the independent variables influence the dependent variable.

3.2 Population and Sample

The population of this study consists of individual investors in Indonesia who actively participate in the capital market. Due to the large and heterogeneous population, a sample was taken using a purposive sampling technique, ensuring that respondents meet specific criteria: (1) actively investing in stocks, bonds, or mutual funds, and (2) having basic knowledge of financial reports. A total of 150 respondents were selected as the sample. This sample size meets the minimum requirement for regression analysis in SPSS and allows for adequate statistical power to detect relationships among variables.

3.3 Data Collection Method

Primary data in this study were collected through a structured questionnaire distributed online using Google Forms. The questionnaire comprised four main sections representing the research variables, namely Earnings Management (EM), Financial Transparency (FT), Auditor Independence (AI), and Investor Trust (IT). Each item was measured using a five-point Likert scale ranging from 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, to 5 = Strongly Agree. The use of a Likert scale was chosen because it is widely recognized as an effective instrument for capturing attitudes, perceptions, and judgments in quantitative social research, particularly in studies related to behavioral aspects of finance and accounting.

Earnings Management (independent variable) refers to managerial practices aimed at influencing reported earnings through accounting judgments or transaction structuring, with operational indicators including income smoothing, accounting policy choices, and the timing of revenue and expense recognition. Financial Transparency (independent variable) reflects the level of clarity, completeness, and accessibility of financial information disclosed by companies, as measured through indicators such as the timeliness of financial reporting, accuracy of disclosed information, and completeness of disclosures. Auditor Independence (independent variable) is defined as the auditor's ability to conduct audit tasks objectively without any conflict of interest, with indicators comprising professional skepticism, objectivity, and avoidance of undue influence. Meanwhile, Investor Trust (dependent variable) represents the level of confidence investors place in the reliability and integrity of corporate financial information, which is operationalized through indicators such as perceived reliability of financial reports, confidence in corporate governance, and willingness to invest.

3.4 Data Analysis Technique

Data collected from respondents were processed using SPSS version 25 and analyzed through several statistical techniques, including descriptive statistics, validity testing, reliability testing, correlation analysis, and multiple regression analysis. Descriptive statistics were used to summarize the demographic profiles of respondents and to provide an overview of respondents' perceptions of each research variable. The validity test was conducted using Pearson correlation to ensure that each questionnaire item accurately measured the intended concept, where items with a significance value of less than 0.05 were considered valid. Reliability testing was performed using Cronbach's Alpha to assess the internal consistency of the instrument, with variables having a Cronbach's Alpha value greater than 0.70 deemed reliable. Correlation analysis was subsequently applied to examine the strength and direction of the relationships among the variables, while multiple regression analysis was employed to test the influence of earnings management, financial transparency, and auditor independence on investor trust. The regression model formulated in this study is expressed as: $IT = \beta_0 + \beta_1 EM + \beta_2 FT + \beta_3 AI + \varepsilon$, where IT represents Investor Trust, EM denotes Earnings Management, FT refers to Financial Transparency, AI signifies Auditor Independence, β represents the regression coefficients, and ε is the error term.

Prior to hypothesis testing, the research instrument underwent rigorous validity and reliability testing to ensure data quality and accuracy. Validity testing was conducted to confirm that all questionnaire items accurately measured the concepts they were designed to represent, while reliability testing aimed to ensure the consistency and stability of respondents' answers across all items. These two testing procedures are essential prerequisites in quantitative research, as they guarantee that the data obtained are both credible and dependable before proceeding to further statistical analyses, particularly the multiple regression analysis used to test the proposed hypotheses.

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics

Descriptive statistics were conducted to provide an overview of respondent characteristics and their perceptions of the study variables. A total of 150 investors participated in the survey, with most respondents falling within the 21–40 age range, indicating the dominance of young and middle-aged investors who are actively involved in Indonesia's capital market. The majority of respondents held undergraduate degrees, reflecting a relatively high level of financial literacy that supports informed participation in investment activities. These demographic characteristics suggest that the respondents possess sufficient educational background and market exposure to evaluate issues related to corporate financial reporting, transparency, and audit practices.

The mean values of each variable illustrate the general tendencies in respondents' perceptions. Earnings Management (EM) recorded a mean score of 3.12, indicating that respondents moderately agree that earnings management practices occur in Indonesian companies, which suggests awareness of potential manipulative reporting. Financial Transparency (FT) obtained a mean of 3.85, showing that respondents generally perceive transparency to be fairly well implemented, although room for improvement remains. Auditor Independence (AI) achieved a mean score of 3.78, reflecting the belief that auditors maintain a reasonable degree of independence, thereby contributing to confidence in audited financial statements. Investor Trust (IT) showed the highest mean value of 3.92, indicating an overall positive level of trust in companies listed on Indonesia's capital market. Taken together, these descriptive findings provide initial evidence that although investor trust remains relatively strong, concerns regarding earnings management continue to persist among market participants.

4.2 Validity and Reliability Test Results

All questionnaire items were tested using Pearson correlation analysis to examine their validity. The results indicate that all items achieved a significance value of $p < 0.05$, thereby fulfilling the statistical requirement for validity. These findings confirm that each questionnaire item is capable of accurately measuring the construct it is intended to represent, ensuring that the data collected are appropriate for subsequent analysis.

Reliability testing was conducted using Cronbach's Alpha, which produced coefficients of 0.812 for Earnings Management, 0.874 for Financial Transparency, 0.861 for Auditor Independence, and 0.889 for Investor Trust. All of these values exceed the minimum threshold of 0.70, indicating a high level of internal consistency for each variable. This demonstrates that the research instrument is reliable and that the responses are consistent across items, making the instrument suitable for further statistical analysis, particularly hypothesis testing and regression analysis.

4.3 Correlation Analysis

Pearson correlation analysis was conducted to identify the strength and direction of the relationships among the study variables. The results indicate a moderate negative relationship between Earnings Management and Investor Trust ($r = -0.421$, $p < 0.01$), suggesting that the higher the perception of earnings management practices, the lower the level of investor trust. This finding implies that investors tend to view earnings manipulation as a signal of reduced financial reporting credibility, which in turn weakens their confidence in the company.

In contrast, Financial Transparency shows a strong positive correlation with Investor Trust ($r = 0.562$, $p < 0.01$), indicating that transparent financial disclosures significantly enhance investor confidence. Similarly, Auditor Independence also demonstrates a strong positive relationship with Investor Trust ($r = 0.514$, $p < 0.01$), meaning that higher levels of auditor independence are associated with greater confidence in financial reports. These correlation results confirm that all independent variables are significantly related to investor trust, with financial transparency exhibiting the strongest association among the examined factors.

4.4 Regression Analysis

Multiple linear regression analysis was conducted to examine the simultaneous effects of earnings management, financial transparency, and auditor independence on investor trust, yielding a regression model with an R value of 0.682 and an R^2 value of 0.465, which indicates that 46.5% of the variance in investor trust can be explained by the three independent variables, while the remaining 53.5% is influenced by other factors not included in the model. The ANOVA test further supports the model's suitability, as reflected in an F value of 41.732 with a significance level of 0.000, confirming that earnings management, financial transparency, and auditor independence collectively have a statistically significant effect on investor trust.

Table 1. Multiple Regression

Variable	Beta (β)	t-value	Sig.
Earnings Management	–0.231	–3.821	0.000
Financial Transparency	0.398	5.927	0.000
Auditor Independence	0.312	4.685	0.000

The results of the multiple regression analysis indicate that Earnings Management has a negative and statistically significant effect on Investor Trust ($\beta = -0.231$; $t = -3.821$; Sig. = 0.000), meaning that an increase in perceived earnings management practices leads to a decrease in investor trust. In contrast, Financial Transparency shows a positive and significant influence on Investor Trust ($\beta = 0.398$; $t = 5.927$; Sig. = 0.000), indicating that higher levels of transparency substantially enhance investor confidence. Similarly, Auditor Independence also has a positive and significant effect on Investor Trust ($\beta = 0.312$; $t = 4.685$; Sig. = 0.000), suggesting that greater auditor objectivity and independence contribute meaningfully to strengthening investor trust.

4.5 Discussion

The findings of this study provide strong empirical evidence that earnings management, financial transparency, and auditor independence play crucial roles in shaping investor trust in Indonesia's capital market. The significant negative effect of earnings management on investor trust supports the core proposition of Agency Theory, which argues that managers may manipulate financial reports to serve their own interests, thereby creating information asymmetry and weakening shareholder confidence. As investors in Indonesia become more vigilant toward the quality of financial reporting, practices of earnings manipulation are increasingly perceived as serious threats to credibility and trust, ultimately discouraging long-term investment behavior [1], [2].

Financial transparency emerges as the most influential factor in strengthening investor trust. This finding is in line with Information Asymmetry Theory, which emphasizes that transparent disclosures reduce uncertainty and narrow the information gap between managers and investors, enabling more rational and informed investment decisions [3], [4]. In the context of Indonesia's evolving regulatory and governance environment, transparency plays a strategic role in reinforcing market integrity and improving investor participation. The positive and significant relationship between transparency and trust indicates that open, accurate, and timely financial reporting is fundamental in fostering a healthy investment climate.

Furthermore, the positive effect of auditor independence reinforces evidence from prior studies that highlight the importance of objective external assurance in capital markets. Independent auditors enhance the credibility of financial statements by providing unbiased verification, which aligns with Stakeholder Theory that emphasizes the responsibility of governance mechanisms in protecting investor interests. Overall, the results of this study indicate that strengthening financial transparency and ensuring auditor independence can significantly mitigate the negative effects of earnings management. Therefore, companies, regulators, and auditors are urged to continuously improve governance practices to maintain and enhance investor trust, particularly in a dynamic and rapidly growing market such as Indonesia.

5. CONCLUSION

This study concludes that earnings management, financial transparency, and auditor independence significantly influence investor trust in Indonesia, where earnings management is found to negatively affect investor confidence by undermining the credibility of financial reporting and increasing perceived investment risk, while financial transparency demonstrates the strongest positive influence, confirming that clear, accurate, and timely financial disclosures are essential for building and sustaining investor trust. In addition, auditor independence plays an important reinforcing role by providing objective external assurance that enhances the perceived reliability of financial statements. Overall, these findings highlight the critical need for companies to prioritize transparent reporting practices and strengthen internal governance mechanisms, for regulators and policymakers to further enhance the enforcement of disclosure standards, and for audit firms to consistently uphold ethical principles to safeguard independence and audit quality. By addressing these key factors in an integrated manner, Indonesia's capital market can foster a more trustworthy investment environment, encourage broader investor participation, and support long-term market stability and sustainable growth.

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