



Exploring Spirituality and Ethical Judgement in Earnings Management

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Abstract

Purpose – This study explores how spirituality and ethical judgment interact in shaping managerial behavior related to earnings management in the banking sector, particularly within Indonesia's unique cultural and regulatory context. **Research Methods** – Adopting a phenomenological qualitative approach, this research investigates the lived experiences of six high-level executives from rural banks (BPR) in East Java. Data were collected through focus group discussions, in-depth interviews, and document analysis. Thematic analysis and data triangulation were employed to ensure analytical rigor. **Findings** – The findings reveal that earnings management is commonly perceived as a legitimate and strategic business practice, especially during high-pressure periods such as year-end reporting or pre-merger preparations. However, participants with deeply internalized spiritual values demonstrated greater ethical awareness and empathy, using spirituality as a moral filter when assessing the permissibility of financial actions. Rather than simply adhering to formal compliance, these individuals viewed regulatory rules as aligned with spiritual peace and professional integrity. Ethical judgments were not solely based on legality but also on fairness, responsibility, and broader stakeholder impact. **Implication** – The study contributes to the literature on ethical financial behavior by highlighting spirituality as a moderating force in ethically ambiguous decisions. It suggests that fostering spiritual and ethical awareness in financial institutions may enhance organizational integrity and transparency. The research calls for integrating ethical-spiritual development into leadership training and regulatory frameworks, particularly in high-context and religious societies.

Keywords: spirituality, ethical judgment, earnings management, banking ethics, Indonesia

1. Introduction

In today's increasingly complex and competitive business environment, the banking sector—given its critical role in economic stability and growth—is confronted with a range of ethical challenges. One of the key ethical issues in business management is earnings management, which can significantly undermine public trust and the integrity of financial statements prepared by bank management (Ajina et al., 2016; Yadollah Tariverdi, 2012). Indeed, the integrity of financial reporting affected by earnings management can lead to irrational decision-making (Arayesh, 2019).

Earnings management refers to managerial intervention in financial reporting with the intent and motivation to gain advantage and mislead users of financial information (Beneish, 2001; Schipper & Katherine, 1989). It is often employed as a strategic tool to meet external expectations regarding a firm's financial performance (Degeorge et al., 1999; Desfitrina, 2016; Wahyuni et al., 2022). Managers frequently face ethical dilemmas arising from earnings management, as they must balance their responsibilities to stakeholders with the pressure to achieve financial targets.

Ethical decision-making is considered crucial by both individuals and organizations, as it reflects how they respond to ethical dilemmas and how they make choices under such circumstances (Jones, 1991). One factor that may influence ethical decision-making is spirituality. Spirituality and religious beliefs can serve as ethical frameworks guiding individual decisions (Creighton-Smith et al., 2017), although some studies suggest that individuals with higher levels of spirituality may not necessarily make more ethical decisions (Anderson & Burchell, 2021; Beekun & Westerman, 2012).

Within organizational settings, spirituality can be understood as a deep orientation of values and beliefs that guide individuals in their decisions and actions. In professional life, spirituality may influence how managers respond to ethical dilemmas and whether they choose to engage in earnings management practices. Several studies have shown that spirituality can enhance individual

commitment to ethical values, which in turn may influence workplace behavior, including financial decision-making.

Spirituality, in particular, is often proposed as an internal compass that can help individuals resist unethical behavior. The role of spirituality in shaping moral decisions in business, however, remains contested and underexplored—particularly through qualitative lenses in high-context, religious societies such as Indonesia. While some studies indicate a positive link between religiosity and ethical behavior, others find that spiritual values may be overridden by organizational pressures, incentives, or rationalizations (Kashif et al., 2017; Koufie et al., 2024).

For individuals operating in the financial sector, particularly in banking management, integrity is essential to ensuring a healthy, transparent, and ethical business ecosystem. Therefore, both individual and organizational support for an ethical culture is urgently needed in the banking industry. However, in-depth research examining the relationship between spirituality, ethical behavior, and earnings management remains relatively scarce. This study adopts a qualitative approach to explore the lived experiences, perceptions, and motivations of individuals more profoundly. A qualitative methodology enables a deeper investigation into how spirituality and internal ethical values are interpreted and manifested by managers in the context of earnings management practices, and how these factors influence their decision-making under financial and regulatory pressure.

In Indonesia, especially in the context of rural banks or Bank Perkreditan Rakyat (BPR), pressures to meet financial targets, comply with regulations, and maintain public trust create a complex ethical landscape. Directors of BPR are expected to demonstrate both technical competence and ethical integrity in their decision-making. However, existing studies on earnings management in Indonesian banks primarily focus on quantitative indicators of accrual manipulation, with limited attention to the behavioral and ethical underpinnings of such actions.

This study seeks to fill this gap by examining whether and how spirituality influences earnings management behavior among directors of BPR in East Java. Adopting a phenomenological approach, the research investigates the lived experiences, value conflicts, and moral reasoning of bank leaders when facing situations involving the ethical dilemma of financial reporting. Specifically, it asks: Can spirituality prevent earnings management in practice, or does it merely coexist with behavioral rationalization under organizational pressure?

The study contributes to the literature by offering a deeper understanding of how spiritual values are interpreted, internalized, and enacted by decision-makers in a regulated financial environment. It also expands the ethical behavior literature within the framework of the Theory of Planned Behavior (Ajzen, 1991), supplemented by insights from cognitive dissonance theory and moral development theory. This integrated approach aims to uncover the cognitive and contextual mechanisms that enable or inhibit ethical resistance in earnings management decisions.

Literature Review

This literature review aims to provide a theoretical foundation to explore the relationship between spirituality, ethical behavior, and earnings management within the banking sector. Relevant theories and previous studies are discussed as follows:

Spirituality in Organizations

The concepts of spirituality and religiosity offer normative guidance on how individuals should behave in relation to others, potentially influencing social dynamics and individual behavior in organizational settings (Loue, 2017). According to Rocha and Pinheiro (2021), spirituality can be categorized into three dimensions: individual spirituality, workplace spirituality, and organizational spirituality. Individual spirituality is shaped by leadership, organizational members, environment, culture, and personal knowledge. Spirituality is often associated with ethical decision-making in organizations and is frequently linked to business ethics (Anderson & Burchell, 2021; McLaughlin, 2005).

Individual spirituality typically encompasses values such as honesty, integrity, and quality of work, as well as a sense of responsibility and care toward colleagues. In the context of spiritual practices, it may involve prayer, meditation, and intuitive guidance at work. From a broader business perspective, spirituality also reflects a corporate responsibility to consider the social and environmental impacts of business activities, ultimately striving to contribute to a better world (McLaughlin, 2005).

Ethical Behavior in Organizations

Business ethics has become an indispensable element in contemporary decision-making processes (Tijmstra, 1978). High organizational performance has been directly associated with the ethical standards upheld by both companies and individuals (Chen, 2002). Numerous studies have examined how factors such as awareness, individual and organizational influences, intentions, and moral intensity shape ethical decision-making (Loe et al., 2013). Ethical decisions are widely acknowledged to have significant consequences for both the organization and external stakeholders (Treviño et al., 2006; Woiceshyn, 2011). Ethical behavior refers to actions aligned with cultural expectations related to morality and fairness, and both individuals and organizations have a responsibility to act ethically and be accountable for the outcomes of their actions (Morahan, 2015).

Earnings Management

Earnings management refers to managerial decisions aimed at reporting financial outcomes that are justifiable and legally acceptable, though potentially misleading (Sari & Widaninggar, 2021). According to Dahbeh and Mogharebi (2013), earnings management involves manipulating financial statements—albeit within the bounds of accounting standards—in ways that can obscure the company's true economic condition (Healy et al., 1998; Skinner et al., 2000). Common motivations for earnings management include the bonus plan hypothesis, debt (equity) hypothesis, and political cost hypothesis (Watts et al., 1990). Such practices reduce the reliability and integrity of financial statements, diminish public trust, and can lead to flawed decision-making (Ajina et al., 2016; Arayesh, 2019; Yadollah Tariverdi, 2012).

The Relationship between Spirituality, Ethical Behavior, and Earnings Management

Spiritual values held by individuals within an organization can enhance moral awareness and strengthen ethical behavior, especially in interactions with the organization, regulators, and top management. Usman and Danish (2010) emphasize that organizations should foster a spiritually oriented culture to guide ethical conduct. Spiritual values enable individuals to distinguish between right and wrong and cultivate a strong commitment to ethical work practices.

Spirituality serves as a basis for ethical behavior, reflecting an internalized belief that such actions are appropriate and morally sound (Morahan, 2015; Treviño et al., 2006). Furthermore, individual spirituality has been shown to reduce the propensity for engaging in earnings management by discouraging financial misrepresentation (Abdelsalam et al., 2021; Cai et al., 2020). It also promotes a stronger commitment to transparency and accountability, thereby enhancing the overall integrity of financial reporting (Ajina et al., 2016; Arayesh, 2019; Yadollah Tariverdi, 2012).

2. Methods

This research aims to better understand how spirituality and ethical behavior affect profit management practices in the banking sector. Using a qualitative approach, this research will explore the experiences and views of compliance directors, operations directors, president directors and banking commissioners related to the ethical dilemmas they face, as well as how the spiritual values they adopt affect their decisions in managing financial statements.

Research Design

This study will use a qualitative case study design (Creswell & Poth, 2018). The case study was chosen because it allows for an in-depth analysis of specific phenomena in a real context, i.e. profit management practices in the banking sector. This research will focus on selected banks as units of analysis to understand how spirituality and ethical behavior affect decisions related to profit management. This research is expected to provide new insights into the role of spirituality in encouraging ethical behavior in the banking sector, as well as contribute to the development of more holistic policies in addressing ethical issues in financial management.

Selection of Informants

The research informants will consist of the president director and commissioner of the People's Economic Bank (BPR) in the East Java-Indonesia region, where they are involved in financial decision-making and have experience in dealing with ethical dilemmas related to earnings management. The selection of informants will be carried out by purposive sampling, where informants are selected based on their relevance and ability to provide in-depth insights on the topic being researched. The

study will involve approximately 5-10 participants, selected from several banks of different sizes and profiles to provide a variety of perspectives. The number of these informants is chosen to ensure the depth of the data without sacrificing the variety required for analysis.

Data Collection

The main technique for data collection in this study is in-depth interviews. The interviews will be semi-structured, allowing researchers to direct discussions based on interview guidelines but also providing space for participants to share their views and experiences freely. Interviews will be conducted face-to-face or through online platforms according to the convenience of the participants.

Furthermore, the researcher will also conduct non-participant observations during the interview process or in a work situation if possible, to observe behavioral dynamics and interactions that may not be revealed in the interview. These observations will be recorded in detail and analyzed along with interview data.

In addition to interviews and observations, the researcher will collect relevant documentation, such as annual reports, ethics policies, and training materials related to ethics and profit management at the bank that is the subject of the study. This documentation will be used to enrich the analysis and provide additional context.

Data Analysis

Data obtained from interviews, observations, and documentation will be analyzed using thematic analysis techniques. This analysis involves identifying, organizing, and interpreting key themes or patterns that emerge from the data. The analysis process will begin with transcription of interviews and observations, followed by a coding stage to identify key themes relevant to the research.

Data Triangulation is used to improve the validity and reliability of research results, researchers will use data triangulation, which is comparing and combining findings from various data sources (interviews, observations, and documentation) to ensure consistency and depth of analysis.

Finally, the researcher will also conduct member checking by giving participants the opportunity to review and comment on the provisional results or preliminary interpretation of their interviews, to ensure that the findings are accurate and representative.

Research Validity and Reliability

The validity of the research will be maintained through the use of triangulation, member checking, and careful recording during the data collection and analysis process. The researcher will also ensure transparency in documenting analytical steps and methodological decisions. The reliability of the research is maintained through consistent data collection procedures, the use of structured interview guidelines, and training for researchers to ensure that interviews and observations are conducted in a uniform manner.

3. Results and Discussion

Description of Research Informant

This research collected data through in-depth interviews starting with the implementation of a Focus Group Discussion (FGD) by inviting the Director and Commissioner of BPR in the East Java. The activity was attended by 10 President Directors and 2 BPR Commissioners, followed by a follow-up meeting in person with each informant. Until the implementation of interviews with the two informants who were willing to continue data mining as many as 6 informants. The informants of this study consisted of 6 informants, namely 4 President Directors and 2 President Commissioners at Rural Banks in the East Java-Indonesia region.

Analysis Results

This research explores the meaning of spirituality and earnings management practices in the banking sector, especially in BPR in Indonesia. Through FGDs and in-depth interviews with informants, they interpreted earnings management practices as management actions in reporting the company's financial statements, to display good performance but still within the permissible rules.

Earnings Management as Business Strategy

The qualitative insights gathered from various banking executives reveal that earnings management is not always perceived as an act of manipulation or unethical conduct, but rather as

a strategic instrument employed to maintain financial stability, stakeholder confidence, and regulatory compliance. Within the context of Bank Perkreditan Rakyat (BPR), several informants explicitly described earnings management as part of a rational and systematic business approach, especially in response to regulatory expectations and organizational goals.

"We have a strategy to improve our profit performance, for example through the preparation of a logical and rational RBB (Bank Business Plan). In addition, we can also increase credit growth by keeping collectibility smooth" (informant A). Informant A emphasized that their institution adopts strategic financial planning through the development of a logical and realistic Bank Business Plan (RBB), which serves as a foundation to manage financial outcomes such as profit levels. By focusing on sustainable credit growth and maintaining good collectibility, the institution seeks to ensure a strong profit performance. This suggests that profit management, in this case, is not merely opportunistic but aligned with long-term performance objectives.

"We can use the judgments that are needed and allowed by the rules. For example, in the practice of managing operational expenses, we can postpone the loading to achieve the company's profit target. We also consider the impact of the delay in the load, if it harms employees or customers, we do not do it" (informant B). Similarly, Informant B illustrated how judgment-based discretion within the boundaries of accounting standards is employed to manage operational expenses. Delaying expense recognition, when deemed appropriate and non-harmful to employees or customers, is strategically used to improve the reported profit. This reflects the idea that earnings management is not inherently deceptive, but rather depends on the intent and ethical consideration behind such decisions. More explicitly, Informant C acknowledged that although the company engages in profit management, all actions remain within the regulatory framework established by the Financial Services Authority (OJK).

Although the Director of BPR has the authority to manage the company's profit reporting, they state that they still comply with OJK rules even though in certain situations they also manage profits to display good profit performance.

"We are supervised by the OJK. So for things like that (profit management) we don't dare to violate the rules that have been determined by the OJK. We do sometimes make policies to regulate our profits, but it is still within the rules of the OJK. The owner also knows that we make such a policy so that our financial statements are good. Especially if we want to end the year and when we want to merge, we also do several policies so that our profits look good" (informant C).

"Usually what we often tinker with is employee bonuses. The problem is that the employee bonus is up to the company, whether they want to give it or not. In the Directorate itself, there are no rules. If the company can give it, it's okay. That's why when I do, I usually divide it into two; 40% before closing the book and the rest in the following year. If the children usually say that the important thing is to be able to buy fireworks on New Year's Eve, ma'am. But even if we can't give bonuses, the children will also understand" (informant C).

Earnings management strategies are particularly emphasized during year-end reporting periods or in preparation for institutional mergers—key moments when financial appearance becomes critical for external assessment. The practice of adjusting employee bonuses, for instance, is not only a cost-control mechanism but also serves to manage profit visibility across fiscal years. As bonuses are internally governed and not externally mandated, the timing and structure of these payments can be strategically used to influence profit levels without breaching regulations.

In addition to using a scheme to arrange bonus payments for employees, informant C explained that the demand to comply with the rules sourced from BI and OJK rules is a strong pressure for companies to carry out profit management policies. For example, in the rules related to NPLs that must be owned by banks. When the bank's NPL increases, and indicates high bad loans, which exceed the standard value of 4%, the company under the supervision of the OJK begins to make policies to regulate the value of the NPL.

This is explained in the following statement of informant C: "Yes, we will be supervised by the OJK, every month the OJK goes around to check. For example, the NPL is a maximum of 4%, then in the middle of the semester our NPL is 7%. I was called to the OJK, not only to explain why the NPL increased but also to explain the strategy so that the NPL would decrease within a few months before the end of the year. Yes, usually I explain which collateral is stuck in place, and then asks again about how to do it. This is from the collateral, we usually take over, so that finally the NPL value can go down". Moreover, regulatory compliance pressures, particularly concerning Non-Performing Loans (NPLs), further drive the use of earnings management as a defensive strategy. Informant C noted that when NPLs exceeded the 4% threshold set by the regulator, active interventions were made, such as collateral takeovers, to reduce NPL ratios before the financial year-end. These actions demonstrate

how earnings management in banking is often reactive, shaped by external institutional pressures to meet quantitative performance indicators.

Taken together, these findings indicate that earnings management is viewed as a legitimate strategic tool, particularly when used within the bounds of regulation and with consideration of ethical implications. In the banking industry, where performance is constantly scrutinized by regulators, shareholders, and the public, such practices are employed not merely to enhance financial optics but also to ensure organizational resilience and continuity. However, while technically permissible, these practices still raise important ethical considerations, especially regarding transparency, stakeholder impact, and the potential normalization of financial engineering behaviors in the long term.

Spirituality and Ethical Judgement in Earnings Management

Banking regulations not only regulate, but also create ethical choices that must be applied in the banking business. OJK regulations in this case are BPR guidelines in managing their business in an accountable and ethical manner. Not solely pursuing profits, the banking industry must be able to maintain the trust of customers and the public. Even in the selection of BPR director candidates, one of the important assessments is to have integrity.

Based on POJK Number 62/POJK.03/2020, prospective BPR Directors must have integrity and compliance with applicable banking regulations, understand banking risks, improve knowledge through education and continuous training, understand the development of trends in the banking industry, must be domiciled in the same district or city or different districts or cities in the same province, and are prohibited from holding dual positions in banks or other financial institutions and or other institutions.

One of the values of religious teachings that individuals have a strong moral character is to have personal integrity. The internalization of spiritual values can further strengthen the moral character of individuals, which will eventually be able to realize ethical behavior in decision-making.

The findings from this study highlight that internalized spiritual values play a crucial role in shaping ethical judgment, particularly in contexts where managerial discretion can influence the presentation of financial outcomes. Participants emphasized that personal integrity, grounded in spiritual teachings, becomes the foundation for resisting unethical practices such as earnings manipulation.

"Religious symbols do not always guarantee that individuals in them are able to apply ethical behavior, manipulation can still occur. The approach that can control individual behavior is with a spiritual approach" (Informant B). Informant B noted that religious symbols or affiliations alone do not guarantee ethical behavior. Instead, it is the internalization of spirituality—beyond formal religiosity—that fosters self-awareness and moral restraint. A spiritually grounded individual is more likely to engage in empathetic reflection, considering the broader consequences of their decisions not only for the organization but also for stakeholders, including employees, customers, and the community.

This statement reflects a deeper understanding that spirituality involves a sense of accountability beyond institutional rules—toward a higher moral order that emphasizes empathy, honesty, and fairness. When spiritual values are internalized, they enhance one's ethical sensitivity, making individuals more attuned to the social and emotional impact of financial decisions. In the context of earnings management, such individuals are less likely to justify manipulative practices as mere strategy, and more likely to perceive them as moral transgressions with real human consequences.

Informant D reinforced this view by highlighting the moral disparity between different levels of manipulation and stressing that integrity—not just technical competence—is essential for leadership in financial decision-making: "Usually those who dare to manipulate it to become a fraud are in the field such as the Account Officer but the value is small, if the one who manipulates top management, the value can be billions. Therefore, the integrity of BPR managers must be strong, not only have competence in managing but integrity is the main thing" (Informant D).

This perspective aligns with theories of ethical decision-making (Rest, 1986; Jones, 1991), which suggest that moral character and empathy enhance ethical judgment. In situations involving earnings management, decision-makers with strong moral and spiritual grounding are more likely to consider not only whether a financial adjustment is technically permissible, but whether it aligns with their moral values and the well-being of others.

Moreover, informants described regulatory compliance (e.g., OJK and BI rules) not merely as external obligations but as expressions of their internal moral compass. Informant A explicitly

connected obedience to financial regulations with spiritual peace and ethical clarity, stating: "Obey the rules of the OJK and BI, live safely and peacefully. The rule is part of a guideline that is in harmony with spiritual values" (Informant A).

This suggests that for spiritually oriented individuals, compliance is not driven by fear of punishment, but by a desire to act in harmony with higher ethical standards. Such alignment between spiritual purpose and professional conduct reflects a holistic ethical identity, wherein decisions about earnings management are filtered through both regulatory and moral lenses.

In summary, the internalization of spiritual values—when coupled with empathy and moral reflection—enables managers to develop stronger ethical judgments in situations where manipulation might be legally permissible but morally questionable. It is through this lens that earnings management is not simply evaluated based on regulatory frameworks, but on its alignment with deeper values such as honesty, fairness, and responsibility toward others.

4. Conclusion

This study reveals that earnings management in Indonesia's banking sector is often exercised not only as a financial reporting tool but as a strategic response to regulatory, institutional, and organizational pressures. However, when earnings management is approached merely as a means to achieve compliance or short-term objectives, it risks becoming ethically ambiguous.

The findings demonstrate that spirituality—when deeply internalized—can act as a moral compass that shapes ethical judgments in situations of discretion. Empathy, personal integrity, and adherence to spiritual purpose empower banking leaders to reflect on the broader consequences of their decisions, fostering resistance to ethically questionable practices even when they are legally acceptable.

Thus, while earnings management may be a common strategy in financial governance, its ethical acceptability depends on the interplay between organizational norms, regulatory constraints, and the decision-maker's spiritual and moral convictions. Spirituality does not function as a superficial deterrent, but as a deeper internal framework that promotes ethical resilience in financial decision-making. It is essential to consider Indonesia's socio-cultural context as a high-context society, where communication is indirect, relationships are hierarchical, and decisions are deeply influenced by collective norms, religiosity, and social harmony. Within this cultural framework, ethical decision-making in the banking sector does not occur in isolation but is shaped by an intricate interplay of spiritual beliefs, interpersonal obligations, and institutional expectations. The strong presence of religious values in everyday professional life often reinforces moral boundaries, making compliance with regulations not only a legal requirement but also a spiritual imperative.

Moreover, the collectivist nature of Indonesian society encourages consensus and loyalty to organizational norms, which may sometimes lead to rationalization of ethically ambiguous practices such as earnings management, particularly when such practices are seen as serving the collective interest of the organization. However, for spiritually grounded individuals, this collectivism is counterbalanced by an internalized sense of moral responsibility and empathy toward broader stakeholders—including employees, customers, and the public.

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