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ANALYSIS OF FACTORS THAT AFFECTING THE INTEGRITY OF FINANCIAL STATEMENTS

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ABSTRACT

This study aims to empirically prove the effect of Good Corporate Governance (GCG), leverage and KAP size on the integrity of financial statements. The dependent variable in this study is the integrity of financial statements as measured by the Pennman conservatism index. The independent variable in this study is Good Corporate Governance as measured by managerial ownership, institutional ownership, audit committees, independent commissioners, and other independent variables, namely leverage and KAP size. The population in this study were manufacturing industrial companies listed on the IDX. Based on the purposive sampling method, 102 samples were obtained that met the criteria. Research data was obtained from the annual report for the 2019-2021 period. The analytical method used is multiple linear regression with SPSS software. The results of the study show that ownership, managerial ownership and audit committee have an effect on the integrity of financial statements, while independent commissioners, leverage, KAP size have no effect on the integrity of financial statements.

1. INTRODUCTION

Management uses financial reports to communicate the state of the company to relevant parties. Financial reports provide crucial duties and services both within and outside. The goal of financial reports is to give information regarding financial statements, financial performance, and cash flows of companies that can be used by users of financial statements to make economic decisions. Financial statement information can be used if it meets the criteria [1]. Statement of Financial Accounting Concepts (SFAC) No.2 explains the characteristics of accounting information used in decision making, including that financial reports contain information that is relevant and reliable, so that users of financial statements can understand these financial statements [2].

Several occurrences, including the case of PT Garuda Indonesia, showed problems in the integrity of financial statements. PT Garuda Indonesia made a net profit in 2018 before suffering consecutive losses due to receivables being reported as revenue. The public's trust in PT Garuda Indonesia has begun to deteriorate, impacting the company's stock price. According to information received in 2018, GIAA made a net profit of US$ 809.85 thousand, or Rp. 11.33 billion (at a Rp. 14,000 exchange rate). The profit was driven by an increase in other operating revenues of $306.88 million. As a result, the commissioners refuse to certify the financial accounts since it burdens income reporting from cooperation agreement activities. This acknowledgement is likewise not in conformity with PSAK number 23 [3]. Due to financial reporting violations, Garuda Indonesia was sanctioned by government and non-government financial institutions. Other issues also had an impact on PT Garuda Indonesia's financial statement auditors, directors, and commissioners.

Findings from several studies on the integrity of financial statements conducted by [2], [4]–[7] demonstrated that good corporate governance affects the integrity of financial reports. The research demonstrates that various characteristics, including managerial ownership, independent commissioners, KAP size, audit committee, firm size, and audit tenure, might affect the integrity of financial statements. According to [8] research, excellent corporate governance as evaluated by institutional ownership, managerial ownership, independent commissioners, and audit committees has an effect on financial report veracity.

The implementation of effective corporate governance within the corporation is thought to be capable of supervising and controlling the organization by applying high-integrity financial reports. This has an impact not only on the implementation of good corporate governance, but also on other aspects like leverage. This element is supported by studies [9]–[11] that shows how leverage affects financial statement integrity. According to [12], the leverage ratio measures the amount to which a company's assets are financed with debt. According to [13], the manager is motivated to present financial reports with low integrity when a company's debt grows or it gets closer to a breach. Companies with more leverage will manage corporate earnings to avoid breaches of loan agreements or contracts, so high leverage can reduce financial statement integrity because managers will be incentivized to minimize company profits, which can undermine financial statement integrity.

The size of a public accounting firm (KAP) can influence the integrity of financial statements in addition to effective corporate governance and leverage. Because the size of a public accounting firm (KAP) is related to the quality of the audit done [14], it is considered that the size of a KAP can influence the integrity of financial statements. Contribution to the presenting of financial statements with integrity as evidenced by the independence and competence of public accountants. In making judgments, users of financial accounts view opinions offered by public accountants as an indication of the financial statements' integrity [15]. The KAP size is a service quality standard connected to the auditor's involvement in determining the financial accounts provided. The community trusts KAP's size as an independent party, which is thought to strengthen the integrity of financial reporting [16]. The effect of the auditor in determining the financial accounts presented influences KAP size as a measure of service quality. The community believes that the size of KAP as an independent party increases the credibility of financial reports [16]. The research of [17]–[19] demonstrates the effect of the size of a public accounting firm on the integrity of financial reports.

Based on the foregoing, the authors are inspired to do research on the integrity of financial reports because there are several situations involving effective corporate governance, each with a unique set of findings. This study also seeks to determine the impact of debt and KAP size on the financial report accuracy of manufacturing enterprises between 2019 and 2021.

2. LITERATURE REVIEW

Agency Theory

Agency theory as interactions between two types of people: principals and agents [20]. According to agency theory, this connection develops when one party collaborates with another to perform services requiring an authorized agent for decision making. According to [21], firm shareholders operate as principles, and management acts as agents, managing the company by prioritizing the interests of the principals.

Good Corporate Governance

Good corporate governance is defined as the relationship between management, directors, boards of commissioners, shareholders, and interested stakeholders in providing rules and guiding actions [22]. The National Committee on Governance Policy (2006) created general principles for good corporate governance implementation. Companies that practice strong corporate governance must guarantee that the principles of good corporate governance are followed in all aspects of business and at all levels of the organization. The following are the principles of excellent corporate governance:

1. Transparency, the company's information must be material and relevant so that users may readily
3. understand and access it.
4. 2. Accountability means that the organization must be able to hold itself accountable for its performance in a transparent and fair manner.
5. 3. Accountability, businesses must comply with laws and regulations while also fulfilling societal and environmental duties.
6. 4. Independence (Independence), the administration of the company in such a way that no section of the company is dominant over the others and is not influenced by other parties.
7. 5. Equality and Fairness (Fairness), enterprises must consider the interests of shareholders and other stakeholders.

This is related to the stakeholders as well as the company's management objectives. The components of strong corporate governance in a corporation can be split into four categories: independent commissioners, audit committees, institutional ownership, and managerial ownership.

Institutional Ownership

Institutional ownership is defined as the percentage of a company's shares owned by other companies, both inside and outside the country, including shares controlled by local or foreign governments [23]. According to [20], institutional ownership can reduce agency issues between managers and shareholders.

Managerial Ownership

Managerial ownership is defined as a circumstance in which a manager handles a dual function, meaning being part of the company's management as well as a shareholder [24]. Share ownership management is capable of balancing internal and external interests [20]. When there is managerial ownership, the interests of shareholders and managers will be aligned due to the advantages of actions made and the danger of loss due to consequences likewise felt by managers [2].

Audit Committee

The audit committee is a body established by the board of directors to carry out the process of auditing operations and circumstances [24]. According to [25], [26], the purpose of audit committees in organizations is to oversee management behavior connected to financial statement presentation. This reduces the opportunity for managers to distort financial data throughout the accounting process. Forming an audit committee is one of the auditors' initiatives to achieve independence. The presence of an audit committee can improve the integrity of a company's financial statements [27].

Leverage

Leverage is a measure of the amount of money spent on debt assets [28]. According to [29], leverage is a corporation with fixed costs that uses assets and sources of funding to maximize the profit potential for shareholders. The use of assets that create fixed expenses is known as operating leverage, whereas the use of cash with fixed costs is known as financial leverage [10].

KAP Size

Regulation of the Minister of Finance Number: 20 of 2015 concerning Public Accountant Services Chapter 1 Article 1 specifies that a Public Accounting Firm is a commercial entity that has secured a license as a forum for Public Accountants to conduct their services. According to [19], Indonesian law has approved various types of accounting firms, namely accounting firms that exist in their own form of business using the names of the accountants concerned, and accounting firms that exist in this form of business using a maximum of three names of related public accountants.

Integrity of Financial Reports

Financial reports are valuable and required commodities because they supply the information that the user need. The needs of financial statement users, specifically, [30]:

1. Investors require information to help them decide whether to acquire, hold, or sell an investment.
2. Employees and the organizations that represent them are interested in learning about the company's stability and profitability.
3. Lending, interested in financial information that will allow them to choose a loan and pay the interest at maturity.
4. Suppliers and other business creditors are interested in financial information that will allow them to determine whether or not amounts owed will be paid on time.
5. Customers are interested in information about the company's survival.
6. The government and the institutions under its power have an interest in resource allocation, and that arena has an interest in company activities.
7. Communities and businesses influence community members in many ways to contribute.

3. METHOD

This study takes a quantitative method. The integrity of financial records serves as the dependent variable in this study. This study's independent factors are effective corporate governance, leverage, and KAP size. The secondary data source in this study is firm financial records received from the Indonesia Stock Exchange (IDX) between 2019 - 2021. Purposive sampling was utilized in this investigation, with the following criteria:

1) Companies listed on the Indonesia Stock Exchange that are engaged in manufacturing for the 2019-2021 period.
2) The corporation discloses the data required for the comprehensive research for the 2019-2021 period.

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Operational Definition and Variable Measurement

1). Good Corporate Governance

Good Corporate Governance is a structure, method, and set of rules used to oversee the interactions of interested parties (stakeholders). The implementation of good corporate governance has a positive impact on the company, namely the ability to increase the company's value, improve the company's performance, reduce the risk of the board of commissioners making decisions for their own benefit, and increase investor confidence [31]. Good corporate governance includes various components that can have an impact on the integrity of the company's financial statements, such as:

Institutional Ownership

Shares owned by external companies such as insurance companies, banks, and others are referred to as institutional ownership. Institutional ownership is defined by [24] as the percentage of corporate shares owned by other companies or the government both at home and abroad. The percentage of shares owned by firms or other institutions is used to calculate institutional ownership using the formula:

$$\text{IO} = \frac{Number\ of\ shares\ owned\ by\ the\ institution}{Number\ of\ outstanding\ shares}$$

Managerial Ownership

Managerial ownership refers to corporate shares reserved for management who engage in decision-making processes, such as directors and commissioners [8]. The formula for calculating management ownership is as follows:

$$\text{MO} = \frac{number\ of\ shares\ owned\ by\ management}{number\ of\ outstanding\ shares}$$

Audit Committee

The audit committee is a group comprised of the board of commissioners and external parties that are asked to assist in the process of accomplishing organizational goals through their expertise, experience, and quality [8]. The composition of the audit committee of the company included in the financial statements is used to determine the audit committee based on the sample.

$$\text{AC} = \sum Audit\ Committee$$

Independent Commissioner

Independent commissioners are members of the board of commissioners who are not affiliated with the board of directors, other members of the board of commissioners, or controlling shareholders, and are free of relationships that cause commissioners to do unreasonable things to fulfill company interests [8]. The findings of the comparison between the total board of independent commissioners and the total board of commissioners based on the company sample are used to compute the percentage of independent commissioners; the formula is:

$$\text{INDC} = \frac{Number\ of\ independent\ commissioners}{number\ of\ all\ independent\ commissioners}$$

2. Leverage

The leverage ratio is calculated by dividing total debt by total equity. The debt equity ratio is calculated by comparing the company's debt and equity capital and demonstrates the company's capacity to meet its obligations [32]. The equation is used to compute leverage [31].

$$\text{LEVit} = \frac{Dit}{Ait}$$

LEVit : Leverage of company i in year t.
Dit : Total debt of company i in year t.
Ait : total assets of company i in year t.

3. KAP size

The size of a Public Accounting Firm (KAP) distinguishes between large and small public accounting firms based on the number of clients managed and professional personnel [25]. The amount of KAPs is separated into two groups: those linked with bigfour and those that are not [11]. A dummy variable is used to measure KAP size. Companies audited by KAP and linked with bigfour will be assigned the value 1 (one). Companies not linked with bigfour will be assigned a value of 0 (zero) [26].

4. Integrity of Financial Statements

The extent to which a financial report is given with genuine and honest facts is referred to as its integrity. The data provided depicts a company's current state [27]. In this study, the integrity of financial

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reports is examined using the conservatism index, which is based on the [33] model. The following formula is used to assess the financial statement integrity: [6], [17]

$$C = \frac{RP + DEPR}{NOA}$$

C : Conservatism Index
RP :Total research and development costs in the financial statements
DEPR :Depreciation expense contained in the company's financial statements
NOA : *Net Operating Assets are calculated using the formula, namely: {(total debt + total shares + total dividends) – (cash + total investment)} in the company*

Data Analysis Technique

Quantitative analysis approaches are used to analyze a problem that has been solved using quantitative methods. In this study, the hypothesis is tested using multiple regression analysis techniques using the Statistical Package for Social Sciences (SPSS) version 21. The stages of testing are as follows:

1. Descriptive Statistics

According to [34], descriptive statistics are the use of statistical tools to gather, process, present, and analyze quantitative data in a descriptive manner. Descriptive statistics provide an overview or description of data based on the average value, standard deviation (standard deviation), minimum and maximum.

2. Classical Assumption Test

The classical assumption test must be performed to see whether the hypothesis utilizing the multiple linear regression model satisfies the classical assumptions required for the results obtained to be accurate estimates. This researcher used traditional assumption tests such as normality testing, multicollinearity tests, and heteroscedasticity tests.

Normality test

The normality test is used to determine if the confounding or residual variables in the regression model have a normal distribution or not. The purpose of the normality test is to determine whether or not the data on the dependent variable, independent variable, or both have a normal distribution. There are two approaches to determining if the residuals are normally distributed or not in the normality test, namely graphical analysis and statistical tests [35]. The Kolmogrov-Smirnov (K-S) statistical test can be used to evaluate this test. The following is the rationale for deciding on the Kolmogorov-Smirnov test (K-S):
- If the significant value or probability value is greater than 0.05 or 5%, the data is regularly distributed.
- If the significant value or probability value is less than 0.05 or 5%, the data is not normally distributed.

Multicollinearity Test

The multicollinearity test determines whether there is a correlation between the independent variables in the regression model. To determine whether or not multicollinearity occurs, examine the tolerance value and the Variance Inflation Factor (VIF). Tolerance measures the variability of the independent variable that is not explained by other independent variables. Because VIF = 1/tolerance, a low tolerance value is equivalent to a high VIF number. The Tolerance value 0.10, or the same as the VIF value 10, is widely used to indicate the presence of multicollinearity [36].

Heteroscedasticity Test

A good regression model is one that has no heteroscedasticity. The heteroscedasticity test determines whether there is an imbalance of variance from one residual observation to another in the regression model. If the variance between the residuals of one observation and another remains constant, this is referred to as homoscedasticity. If the independent variable has a statistically significant effect on the dependent variable, this indicates heteroscedasticity [36].

This test can be combined with the Glejser test by making the following decisions:
- Heteroscedasticity occurs if the significance value of the independent variable is 0.05.
- There is no heteroscedasticity if the independent variable's significance value is greater than 0.05.

3. Hypothesis Test

This study will employ hypothesis testing to determine the impact of Institutional Ownership, Managerial Ownership, Audit Committee, Independent Commissioners, Leverage, and KAP Size on the Integrity of Financial Statements.

Multiple Linear Regression

Multiple linear regression analysis is used to identify the effect of more than one independent variable on the dependent variable [37]. Multiple linear regression analysis is utilized in this study to examine the sixth hypothesis, which asserts that institutional ownership, managerial ownership, audit committees, independent commissioners, leverage, and KAP size all affect the integrity of financial statements at the same time. The equation for multiple linear regression is as follows:

$$ILK_{it} = \beta_0 + \beta_1 IO + \beta_2 MO + \beta_3 AC + \beta_4 INDC + \beta_5 LEV + \beta_6 KAPs + \epsilon$$

Information :
ILKit : Financial Report Integrity
β_0 : Constant
β_1 - β_6 : Regression Coefficient
IO : Institutional Ownership
MO : Managerial Ownership
AC : Audit Committee
INDC : Independent Commissioner
LEV : *Leverage*
KAPs : KAP size
ε : Error

This hypothesis test consists of the following steps:

1. Test the hypothesis with a statistical test t

The t statistical test determines whether or not the influence of each dependent variable is examined at a significance level of 0.05 and reveals how far the influence of one explanatory or independent variable independently explains the dependent variable. If the significance of t > 0.05, Ha is rejected; otherwise, Ha is accepted and there is a substantial influence between the independent factors and the dependent variable [36].

4. RESULT AND DISCUSSION

1. Descriptive Statistics

The following is table 1. The results of the statistical description of variables with a sample of manufacturing industry companies

Table 1. Descriptive Statistics

	N	Minimum	Maksimum	Mean	Std. Deviation
IO	102	0.31724507	1.00	0.9593754	0.1173506
MO	102	0.0000000	0.682754	0.1057423	0.1241809
AC	102	0	4.00	2.90	0.436
INDC	102	0.300	1	0.41124	0.151862
LEV	102	0.07689380	2.8998737	0.4347788	0.310215704
KAPs	102	0	1	0.41	0.495
IFS	102	0.00065184	5.6001788	1.2451777	1.05063587
Valid N (listwise)	102				

Table 2 Description of Public Accounting Firm Size Variable

	Big4	N0n-Big4	Total
Frequency	42	60	102
Percentage	41.2	58.8	100

2. Classical Assumption Test

a. Normality test

The normality test is used to determine whether or not the dependent variable and independent variable have a normal distribution. The Kolmogrov-Smirnov test was employed in this investigation to determine normalcy. Figure 4.3 shows the results of the normalcy test:

Table 3 Normality Test Results (*One-Sample Kolmogorov-Smirnov Test*)

One-Sample Kolmogorov-Smirnov Test

	Unstandardized Residual
N	102

Normal Parameters[a,b]	Mean	.0000000
	Std. Deviation	.96356987
Most Extreme Differences	Absolute	.092
	Positive	.092
	Negative	-.073
Test Statistics		.092
Asymp. Sig. (2-tailed)		.035[c,]

a. Test distribution is Normal.
b. Calculated from data.
c. Lilliefors Significance Correction.

In table 3, the results of processing the test data with Kolmogrov-Smirnov (K-S) obtained Asymp data. Sig. (2-tailed) of 0.035 is smaller than 0.05, so the data is not normally distributed.

Table 4. Normality Test Results (*One-Sample Kolmogorov-Smirnov Test*)

One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		98
Normal Parameters[a,b]	Mean	.0000000
	Std. Deviation	.76850038
Most Extreme Differences	Absolute	.057
	Positive	.057
	Negative	-.052
Test Statistics		.057
Asymp. Sig. (2-tailed)		.0200[c,d]

a. Test distribution is Normal.
b. Calculated from data.
c. Lilliefors Significance Correction.
d. This is a lower bound of the true significance.

Table 4 shows that the data tested after transforming the data has a total of 102 data and an Asym value. Sig. (2-tailed) 0.200 is higher than the probability used, which is 0.05. It can be concluded that the data used after data transformation can be normally distributed.

b. Multicollinearity Test

The multicollinearity test can be used to determine whether or not there is a relationship between the independent variables in a regression model. To determine if there is or not, look at the Tolerance value > 0.10 and the VIF value 10, which indicate that the data is free of multicollinearity symptoms. Table 4.5 shows the results of the multicollinearity test.

Table 5 Multicollinearity Test Results

Variable	***Tolerance***	**VIF**
IO	.308	3.246
MO	.299	3.339
AC	.951	1.051
INDC	.945	1.059
LEV	.955	1.047
KAPs	.845	1.183

Table 5 shows that the VIF value is less than ten and the tolerance value is more than 0.1, implying that there is no multicollinearity or significant correlation between the independent variables.

c. Heteroscedasticity Test

Table 6. Glejser Test Results

Model	**Unstandardized**	**Standardized**	**Sig.**

	Coefficient		Coefficient	
	B	std. Error	Betas	
(Constant)	.582	1.076		.590
IO	-.075	.980	-.014	.939
MO	-.647	.935	-.125	.491
AC	.151	.150	.102	.319
INDC	-.645	.432	-.152	.139
LEV	.265	.210	.128	.209
KAPs	-.127	.140	-.098	.367

Based on the data in table 6 above, it can be concluded that the Sig (2-tailed) value of the good corporate governance variable, which is proxied by managerial ownership, institutional ownership, audit committee, independent commissioners, leverage, and KAP size, is greater than 0.05.
The results of the classical assumption tests presented in tables 4.4, 4.5, and 4.6 can demonstrate that the hypothesis utilizing the multiple linear regression model met the classical assumptions required to generate the correct estimate.

3. Hypothesis Test

In this study, multiple linear regression analysis was utilized to investigate the effect of independent factors with more than one dependent variable. In table 4.7, the following are the findings of the multiple linear regression test:

Table 4.7. Multiple Linear Regression Test Results

Model	Unstandardized Coefficient		Standardized Coefficient	Sig.
	B	std. Error	Betas	
(Constant)	-2.040	1.374		.141
IO	2.170	1.260	.255	.028
MO	3.975	1.175	.509	.001
AC	.344	.192	.176	.036
INDC	-.312	.541	-.056	.565
LEV	.191	.262	.071	.468
KAPs	-0.91	.177	-.053	.610

1. The Coefficient of Determination

The coefficient of determination measures the model's ability to apply the variance of the dependent variable. The coefficient of determination results are scaled to the degree of freedom of the prediction equation. The coefficient of determination was tested to see how well the regression model explained the variation in the dependent variable. The R Square value is used to assess the regression line's goodness of fit. The coefficient of determination was tested, and the results are shown in Table 4.8. The chart shows that the R Square value is 0.278, implying that the dimensions responsible for 27.8% of the ILK can be explained. The remainder can be explained by variables not investigated in this study. This can also be seen in the company and time investigated, and it does not exclude other industries.

2. Statistical Test t

The purpose of the t statistical test is to assess the influence of independent variables that have a combined effect on the dependent variable. The test can be seen from the level of significance; if the p value is greater than 0.05, Ha is rejected; however, if the p value is less than 0.05, Ha is accepted and there is a substantial influence between the independent and dependent variables.

5. CONCLUSION

The integrity of financial statements is influenced by institutional ownership. The findings of this study support the specified agency theory [20] as well as the empirical findings of [17], [31], [38], [39]. The integrity of financial statements is affected by managerial ownership. This study's findings support the agency theory described by [20] as well as the empirical findings of [4], [31], [40], [41]. The audit committee has an impact on the accuracy of financial reports. The findings of this study support the agency theory described by [20] and the empirical findings [6], [31], [41]–[43]. The integrity of financial reports is unaffected by independent commissioners. The findings of this study contradict [20] agency theory and support the empirical findings of [8], [10], [27], [44], [45]. The integrity of financial statements is unaffected by leverage. The findings of this study contradict [20]agency theory and support the empirical findings of [18], [29], [46]–[48]. KAP size has no effect on financial statement integrity. The findings of this study contradict [20] agency theory and support the empirical findings of [18], [29], [46]–[48].

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