



Determinants of Integrity of Financial Statements in Indonesia

Alfina Maharani¹, Fransisco Pandapotan^{2*}

¹Accounting Department, Universitas Mercu Buana, Indonesia

^{2*}Accounting Department, Independent Researcher, Indonesia

*Corresponding Author: fransiscopandapotan17@gmail.com²⁾

Keywords : *Integrity of Financial Statements, Independent Commissioner, Internal Control, Audit Quality, Firm Size.*

Abstract: *The importance of integrity of financial statements is to assist the stakeholders and investors make improved assessments and decisions. Financial statements are presented according to the standards of accounting. Therefore, this research aims to investigate the influence of corporate governance, internal control system and company size on integrity of financial statements, as well as to prove the inconsistently findings from the prior studies. In this research, the corporate governance is proxied by independent commissioners and audit quality. The population used in this research is all state-owned enterprises listed on Indonesia Stock Exchange period 2019-2021. Purposive sampling technique was used, resulting a grand total of 108 observations. Using the multiple linear regression by SPSS 25 version, the results of this research reveal that internal control system and firm size have positive and significant influences on the integrity of financial statements while independent commissioners and audit quality do not have any significant influences on the integrity of financial statements.*



Introduction

Financial statements are tools to give a review about the value and profitability of the company to the management and stakeholders over a certain period of time (Raharjo, 2022). Financial Accounting Standard (SAK) stated that financial statements are a systematic presentation about the financial condition and the company's business results. Financial Accounting Standard No. 1 also explains that the aim of the financial statements is to give information about the net wealth of a company, financial position and business results for the users of financial statements when they are making economic decision (IAI, 2022).

Financial statements can be said integrated when the information in the financial statements can give an overview of the actual company's transaction. The integrated of financial statements' information will be trusted by the internal and external users because financial statements are presented correctly and in accordance with the accounting policies.

In Indonesia, there were many issues related to the unintegrated financial statements. One of them was from PT Asuransi Jiwa Adisarana Wanaarta or Wanaartha Life. In the financial statements period 2019, Financial Service Authority found the manipulation of insurance contract with a value of IDR12.1 trillion. This value was not recorded in the composition of company's liability. Because of that, Public Accounting Firm Nunu Nurdiyaman is banned to give the audit and non-audit services according to the Article 3 Law Number 5 of the Republic of Indonesia concerning Auditors. This phenomenon concludes that there are still state-owned companies that practice financial statements manipulation which can indicate low integrity of financial statements.

Research about the integrity of financial statements have previously been conducted. On the other hand, the researches revealed differed or inconsistent results, so further researches are needed. The novelty of this research is the usage of the variable of internal control which is still minimum to be used in previous researches, as well as the usage of sample date since 2019 to 2021.

Jensen & Meckling (1976) in their research, stated that agency theory is a relationship between an agent and a principal. In this agency relationship, there is a contract where one party or more parties will choose a party to conduct the duties on behalf of the principal and delegates authority to the agent to decide what is in the principal's best interests. Agency conflict is described as a situation where the agent and principal have competing interests (Sormin, 2021).

Agency theory has a relationship with the integrity of financial statements. The existence of this relationship between the principal and agent makes the financial statements as a form of agent accountability to the principal. Financial statements with a high integrity can help the stakeholders in making decisions. Each party will take several actions that benefit their respective interests, such as management, which is the party who best understands the condition of the company, trying to inform the owner about the company's performance through accurate financial statements information, so that the owner or investor can have a confidence in the management to carry out the operational of the company. One of the factors that motivates the management to implement any procedures so that the company

remains in existence is the desire to produce positive company performance results (Sormin, 2021).

Factors that are allegedly to have an influence on the integrity of financial statements are internal control system, independent commissioner, audit quality and firm size. The effective and impartial supervision from independent commissioners can produce a higher level of the integrity of financial statements which has an impact on the transparency of financial statements. The results of the research conducted by Maihartati et al. (2019) and Putri (2023) state that independent commissioners have a positive influence on the integrity of financial statements. This indicates that the higher the percentage of independent commissioners, the higher the trust rating in financial statements, considering that independent commissioners in a company are parties who have no affiliation with the main shareholders, members of the board of directors or other members of the board of commissioners. This will make the independent board of commissioners can supervise the company activities and protect the rights outside the company effectively.

Internal control is a control activity in information system management that aims to ensure the accuracy and completeness of information. If internal control is implemented well, the company system will run well and will generate the integrated financial statements. Internal control is very important because the accounting system of the company can provide financial information through an information system that includes intentional and unintentional errors, thus requiring the implementation of an adequate control system. Therefore, superior internal control is needed to convince stakeholders and the general public that the resulting financial reports are presented accurately (Anto & Yusran, 2023). Previous research conducted by Samosir & Setiyawati (2019), Kurniawati & Setiyawati (2019) stated that internal control has a positive effect on the integrity of financial statements.

The integrity of a financial statements will be guaranteed if the audit quality carried out by the auditor is good. Qonitin & Yudowati (2018) stated that audit quality is very important because the higher the quality of the auditor, the higher the integrity of the financial statements, so that it can be relied on as a basis for decision making. In addition, the large public accounting firms are thought to produce superior audit quality compared to the small or medium sized public accounting firms. The results of research by Dewi et al. (2022), Mahendra et al. (2022) and Qonitin & Yudowati (2018) conclude that there is a positive influence between audit quality and the integrity of financial statements.

Firm size shows how big or small the company is in carrying out economic activities. This can be seen from the total assets and sales. Firm size can influence the level of integrity of financial statements because the larger the firm size, the more parties have an interest in financial statements, so the companies must carry out financial reporting carefully to produce the integrated and transparent financial statements. Research conducted by Nurullah et al. (2022) and Abbas et al. (2021) conclude that firm size has a positive effect on the integrity of financial statements.

Based on the introduction, phenomenon and literature reviews above, the hypothesis proposed in this research are as follows:

H1: Independent commissioner has a positive effect on the integrity of financial statements.

H2: Internal control has a positive effect on the integrity of financial statements.

H3: Audit quality has a positive effect on the integrity of financial statements.

H4: Firm size has a positive effect on the integrity of financial statements.

Research Method

This is causal research with a quantitative approach which aims to test the hypothesis of the direct effect of independent commissioner, internal control, audit quality and firm size on the integrity of financial statements. The population used in this research is all Indonesian state-owned enterprises listed in Indonesia Stock Exchange period 2019-2021 with a purposive sampling technique to obtain the samples. After the sampling, it is obtained 108 samples. The researchers used a multiple linear regression to test the hypothesis. Presented below are the measurements of each variable used.

Table 1. Variable Operationalization

Variable	Measurement
Independent Commissioner	This is a ratio variable which is measured by dividing the independent commissioners by the grand total of the commissioners in the company.
Audit Quality	This is a dummy variable which is measured by giving 1 if the company is audited by Big Four Public Accounting Firm and 0 if the company is not audited by Big Four Public Accounting Firm.
Internal Control	This is a ratio variable which is measured by giving 1 if the company discloses the information related to the internal environment, risk evaluation, communication and information, internal supervision, internal control defects, internal and external valuation, and 0 if the company does not disclose the information criteria. Then, divide the total score of the company's disclosures by the maximum score of internal control disclosure.
Firm Size	This is a ratio variable by natural logarithm of total assets of the company
Integrity of Financial Statements	This is a ratio company with a formulation: $\frac{[(\text{Net income} - \text{Depreciation expense}) - \text{Operating Cash Flows}]}{\text{Total Asset}}$

Source : Previous Researches

In order to help the readers about the relationship among the concepts that are developed in this research, the conceptual framework is drawn as follows:

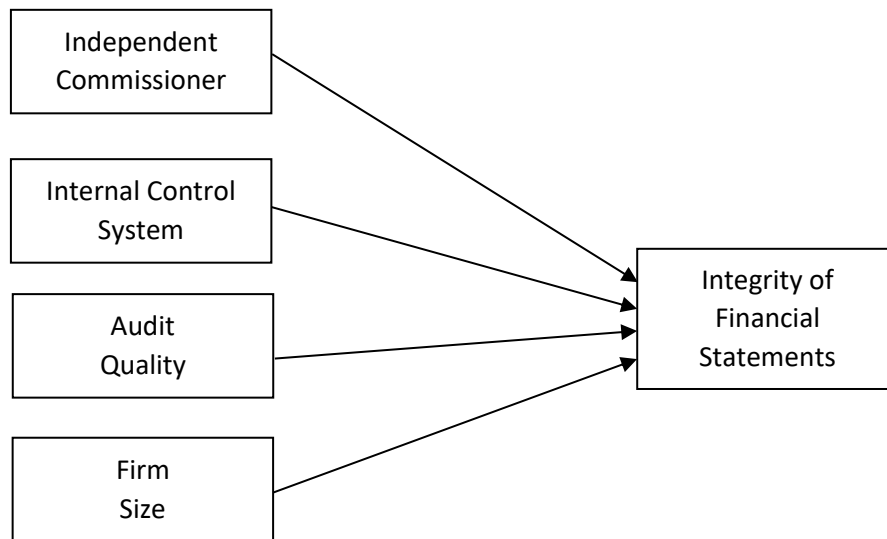


Figure 1. Conceptual Framework

Result and Discussion

Table 2. Multiple Linear Regression Test

Variable	Coefficient	T-Statistic	Prob.
Independent Commissioner	-0.162	-1.141	0.257
Internal Control System	0.423	2.653	0.009
Audit Quality	-0.023	-1.088	0.279
Firm Size	0.076	2.051	0.043
Adjusted R-Square		0.090	
F-Statistics		3.614	0.009
Total Samples		108	

Source : Processed by SPSS, 2024

The multiple linear regression in table 2 shows that the variable of independent commissioner does not affect the integrity of financial statements significantly. This is because the board of commissioners who are outside of the company have many experiences and different competencies. Therefore, independent commissioners in the company does not directly affect the integrity of financial statements. They cannot guarantee that independent commissioners have already conducted the good and effective management control to generate the integrated and high-valued financial statements. This result is in line with previous studies from Ulfa & Challen (2020) and Nazar & Arviana (2023) who stated that independent commissioner does not affect the integrity of financial statements significantly.

Previous studies from Samosir & Setiyawati (2019) and Kurniawati & Setiyawati (2019) support the result of this research that internal control system positively and significantly affect the integrity of financial statements. This indicates that if the company’s internal

control is superior and effective, then the integrity of financial statements will have integrated and valid information that will be useful of the investors, stakeholders, creditors, internal and external users.

The result of this research proves that audit quality does not have a significant effect on the integrity of financial statements. This indicates that the integrated financial statements are not affected by the selection of big four public accountants or non-big four public accountants as external parties. All the public accounting firms have the same standards in auditing the financial statements. Serly & Helmayunita (2019) and Safitri & Bahri (2021) support the result of this research that audit quality does not have any significant effect on the integrity of financial statements.

Multiple linear regression also reveals that firm size has a positive effect on the integrity of financial statements. The larger the size of the company, the higher the integrity of financial statements. Large companies tend to give the financial and non-financial information to the users transparently because they presume this abundance of information will increase the management's awareness of the importance of information for stakeholders, both external and internal. The result of this research is supported by the previous research by Nurullah et al. (2022), Sormin (2021) and Rivandi & Pramudia (2022) that firm size positively affects the integrity of the financial statements.

Furthermore, the adjusted r-square 0.090 meaning that the ability of independent commissioner, internal control system, audit quality and firm size to affect the integrity of financial statements is 9% while the remaining of 91% is affected by other independent variables that are not tested in this research. F-test shows the statistic of 3.614 with a probability of 0.009 lower than 5%. This means that the regression model in this research is fit.

Conclusion

Based on the results, analysis and discussion, the conclusions in this research are that internal control system and firm size have a positive and significant influence on the integrity of financial reports, while audit quality and independent commissioners do not have a significant effect on the integrity of financial reports. These results prove that independent commissioners and audit quality are not factors that can affect the integrity of financial reports, so that future researchers are expected to use other variables that may be able to affect the integrity of financial statements, choose the different proxies and use the samples from other company sectors. Moreover, the researchers also advise the investors to pay attention to internal control and firm size as a basis for investment and measurement whether the financial statements presented are integrated, valid and in line with the applicable financial accounting standards.

References

Abbas, D. S., Siregar, I. G., & Basuki. (2021). Integrity Of Financial Statements And The Factors. *Journal of Accounting Science*, 5(1), 17–28. <https://doi.org/10.21070/jas.v5i1.1108>

- Anto, L. O., & Yusran, I. N. (2023). Determinants Of The Quality Of Financial Reports. *International Journal Of Professional Business Review*, 8(3), 1–40.
- Dewi, A. S., Rustiarini, N. W., & Dewi, N. P. S. (2022). Pengaruh Kepemilikan Institusional, Komisaris Independen, Komite Audit, Kepemilikan Manajerial, Dan Kualitas Audit Terhadap Integritas Laporan Keuangan. *Jurnal Publikasi Sistem Informasi Dan Manajemen Bisnis*, 4(1), 353–362. <https://doi.org/10.55606/jupsim.v2i1.789>
- IAI. (2022). *Standar Akuntansi Keuangan*. DSAK-IAI.
- Jensen, M. C., & Meckling, W. H. (1976). Theory Of The Firm: Managerial Behavior, Agency Costs And Ownership Structure. In *Journal of Financial Economics* (Vol. 3, Issue 4, pp. 305–360). <https://doi.org/10.1177/0018726718812602>
- Kurniawati, M., & Setiyawati, H. (2019). The Effect of Internal Controlling System , Government Accounting Standard and the Accomplishment of Audit Findings on the Quality of Financial Statement. *International Journal of Science and Research*, 8(5), 123–129.
- Mahendra, I. G. A. M. N., Rustiarini, N. W., & Dewi, N. P. S. (2022). Pengaruh Mekanisme Corporate Governance, Kualitas Audit Dan Financial Distress Terhadap Integritas Laporan Keuangan. *Jurnal Kharisma*, 4(3), 147–158.
- Maihartati, A., Makhdalena, & Riadi, R. (2019). The Influence Of Corporate Governance On Integrity Of Financial Statement At Manufacturing Companies Which Is Listing In Indonesia Stock Exchanh. *JOM FKIP*, 6(2), 1–14.
- Nazar, M. R., & Arviana, N. (2023). Pengaruh Corporate Governance dan Ukuran Perusahaan Terhadap Integritas Laporan Keuangan Pada Perusahaan BUMN Non-Keuangan yang Terdaftar di Bursa Efek Indonesia Periode 2018-2021. *SEIKO : Journal of Management & Business*, 6(2), 409–417.
- Nurullah, A., Khamisah, N., & Kesuma, N. (2022). Determinants of Integrity of Finansial Statements and The Role of Whistleblowing System. *Akuntabilitas*, 16(1), 83–104.
- Putri, K. J. (2023). Implications of Good Corporate Governance (GCG) on Financial Statement Integrity. *International Journal of Asian Business and Management (IJABM)*, 2(3), 179–192.
- Qonitin, R. A., & Yudowati, S. P. (2018). Pengaruh Mekanisme Corporate Governance Dan Kualitas Audit Terhadap Integritas Laporan Keuangan Pada Perusahaan Pertambangan Di Bursa Efek Indonesia. *Jurnal Ekonomi, Manajemen Dan Akuntansi*, 8(1), 1–14.
- Raharjo, B. (2022). *Analisa Laporan Keuangan*. Yayasan Prima Agus Teknik.
- Rivandi, M., & Pramudia, M. H. (2022). Pengaruh Kepemilikan Institusional Dan Ukuran Perusahaan Terhadap Integritas Laporan Keuangan Pada Perusahaan Property Dan Real Estate. *Jurnal Inovasi Bisnis Dan Manajemen Indonesia*, 5(2), 255–269. <https://doi.org/10.31842/jurnalinobis.v5i2.228>
- Safitri, A., & Bahri, S. (2021). The Effect Of Leverage, Audit Quality, And Earnings Management On The Integrity Of Financial Statements. *International Journal of Educational Research & Social Sciences*, 2(6), 1294–1301. <https://ijersc.org>
- Samosir, M., & Setiyawati, H. (2019). The Effect of Competence of Human Resources, Application Internal Control System, Utilization of Information Technology on the Quality of Financial Statements. *International Journal of Business and Management Invention (IJBMI)*, 8(3), 31–38.
- Serly, V., & Helmayunita, N. (2019). The Correlation of Audit Fee, Audit Quality and Integrity of Financial Statement. *Advances in Economics, Business and Management Research*, 64(4), 67–72. <https://doi.org/10.2991/piceeba2-18.2019.9>

- Sormin, F. (2021). The Effect of Managerial Ownership, Profitability, Company Size on the Integrity of Financial Statements at Plantation Companies. *Saudi Journal of Economics and Finance*, 5(4), 160–163. <https://doi.org/10.36348/sjef.2021.v05i04.004>
- Ulfa, A. M., & Challen, A. E. (2020). Good Corporate Governance on Integrity of Financial Statements. *Atlantis Press*, 439, 40–46. <https://doi.org/10.2991/assehr.k.200515.008>.