

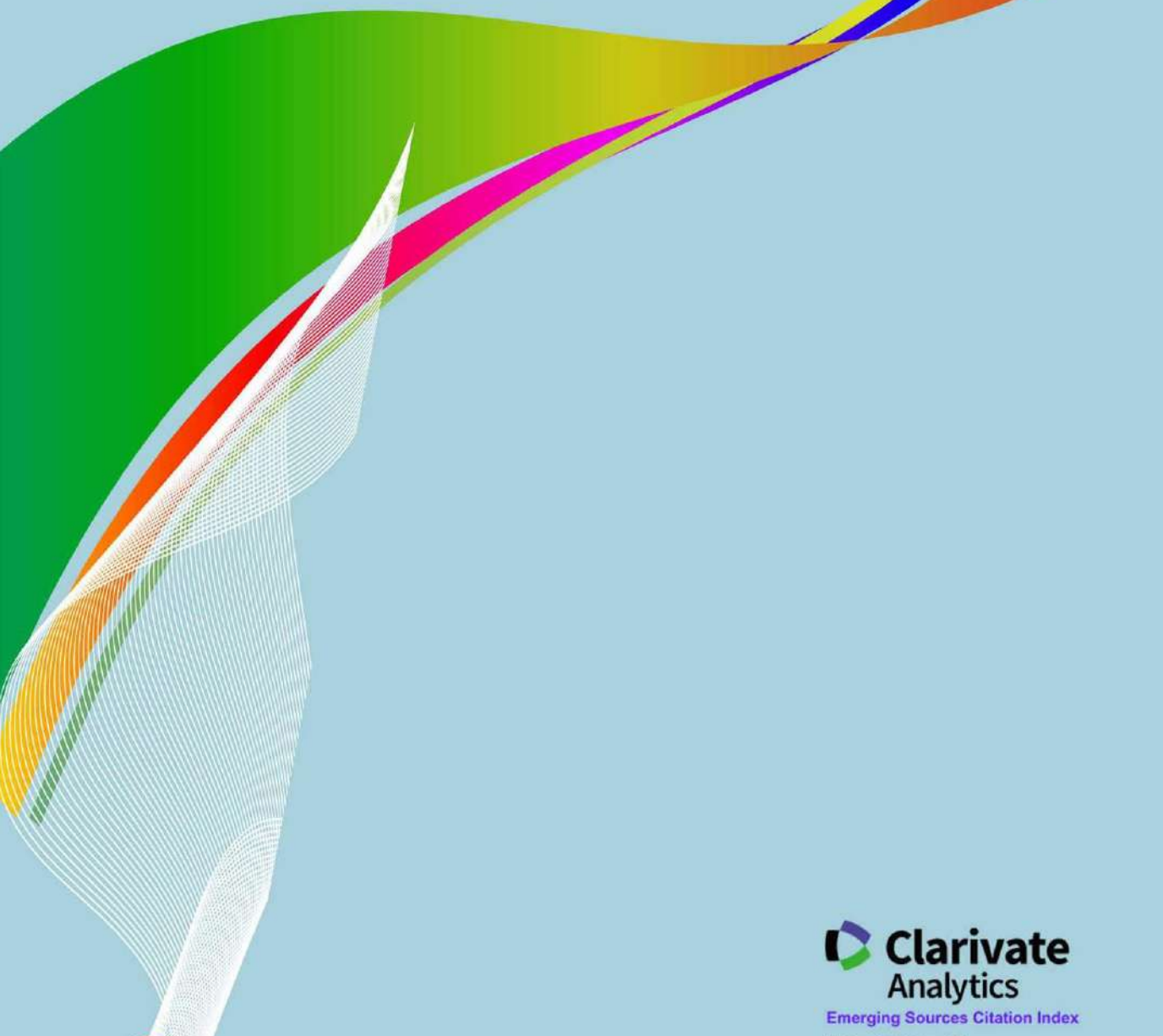
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**The Role of Company Characteristics in the Quality
of Financial Reporting in Indonesian**

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THE ROLE OF COMPANY CHARACTERISTICS IN THE QUALITY OF FINANCIAL REPORTING IN INDONESIAN

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Abstract

This study aimed to explain the role of company characteristics in shaping the quality of financial reporting in Indonesia, either simultaneously or partially, analyzed using Structural Equation Modeling. This study found that simultaneously structural characteristics, monitoring characteristics, and performance characteristics had a significant influence on the quality of financial reporting. While partially the characteristics of the structure and characteristics of monitoring had a significant influence on the quality of financial reporting. Meanwhile, performance characteristics did not influence the quality of financial reporting. It can be concluded that quality financial reporting can form good company characteristics and increase company performance, and can increase market response or market confidence in the current pandemic situation. The paper provides insight for the company to more concentrate on monitoring, structural, and performance to gain a good quality of financial reporting.

Keywords: *Structure and Monitoring; Performance; Financial Report.*



A. Introduction

Financial reports are means of communication between internal parties and external parties in the company because financial statement information is an important element for investors and business people as a decision-making tool. In addition, financial reports can be used as a tool to assess the company's financial performance, with financial reports, internal and external parties can determine the company's financial position. Jensen and Meckling (1976) in agency theory explain that agents as company managers know more about the company's information and prospects in the future than the owners of capital. Company managers such as managers who know more about the company's financial condition than the owners of capital will have more opportunities to commit fraud on the company's financial statements so that sometimes there are differences in interests between them. Based on this, a conflict of interest often occurs because the maximum utility does not meet between shareholders and managers, provided it is assumed that all individuals act on interests. Based on this phenomenon, quality financial reporting is needed. Hasibuan, A. N, et.al., (2017) The quality of financial information creates the need for the company to shape the characteristics of the company structure, as well as strengthen the monitoring characteristics of managers and improve good performance within the company.

In Indonesia, the quality of the company's financial statements can be seen from the results of the audit opinion on the company's financial statements. In the Indonesia Stock Exchange, audit opinions, apart from being unqualified, are still often encountered, which indicates that many financial reports of companies on the Indonesia Stock Exchange do not meet reporting standards. The following is the opinion result of the company's financial statements on the Indonesia Stock Exchange based on the processing results:

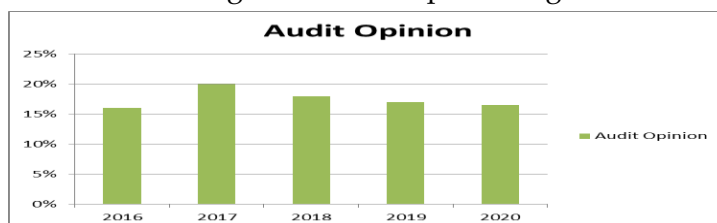


Figure 1: Unqualified Fluctuation in Audit Opinion

Figure 1 shows that the audit opinion apart from being unqualified from 141 issuers of manufacturing companies listed on the Indonesia Stock Exchange in 2016 was 16 percent of companies whose audit opinion was unqualified and increased by 4 percent in 2017, and in 2018 the audit opinion In addition to being unqualified, it decreased by 2 percent, in 2019 it decreased by 1 percent and in 2020 the fluctuation of audit opinion other than unqualified decreased by 0,5 percent. From this figure, it can be concluded that the quality of financial reporting on the Indonesia Stock Exchange is still low so that it is not suitable as a basis for making investment decisions by investors, therefore researchers are interested in researching the role of company characteristics in determining the quality of financial reports.

Many previous studies (Hirasawa & Kuratani, 2013) (Chen et al., 2012) discuss the quality of financial reporting but do not focus on structural, monitoring, and performance. This study provides new insight for a company to more concentrate on monitoring, structural, and performance to gain a good quality of financial reporting.

B. Method

This research was conducted on the Indonesia Stock Exchange in the period January 2016 to December 2020. The population of this study was a manufacturing company that provides data on company characteristics and financial reporting quality with a proportionate stratified random sampling technique, totaling 132 companies. Independent variables are the factors that affect the quality of financial reporting, namely the characteristics of the company used in this study are the characteristics of the company structure (company age, company size, leverage), company monitoring characteristics (board composition, institutional ownership), company performance characteristics (profitability, liquidity and company growth). The dependent variable is financial reporting quality as measured by relevance, timeliness, and conservatism.

Analysis of the data used in this study was carried out by conducting a relationship test, which was analyzed using structural equation modeling tools with the alternative method of partial least square using SmartPLS software.



In this study, researchers used SEM (Structural Equation Model) analysis, with the stages of developing a model based on theory, compiling path diagrams, compiling structural equations and measurements, and drawing conclusions.

C. Result and Discussion

1. Result

a. Analysis SEM (Structural Equation Modeling)

The results of the calculation of the path diagram are carried out in two stages, this is because the timeliness indicator has a loading factor below 0.5, so it is invalid in reflecting their respective latent variables so that they are reduced from the model. Following are the results of the full model path diagram calculation after invalid indicators are reduced from the model.

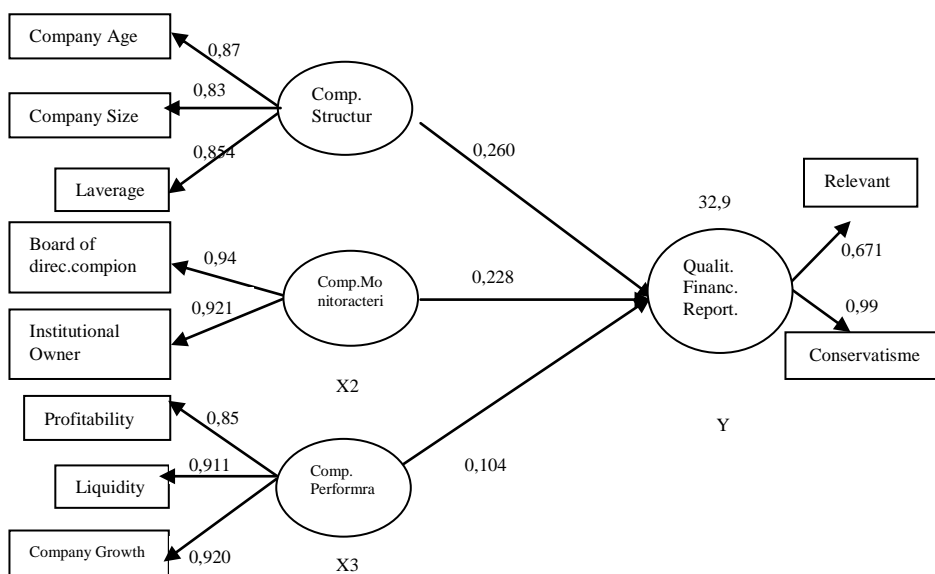


Figure 2: Structural Model

Furthermore, to answer the research hypothesis, structural model analysis is carried out so that the causal relationship between latent variables can be identified. The structural model is a model that connects exogenous latent variables with endogenous latent variables or the relationship of endogenous variables with other endogenous variables. Based on the research paradigm, the structural model to be tested in this study is formulated as follows.



$$Y = 0,260 X_1 + 0,228 X_2 + 0,104 X_3 + e$$

Based on the results of data processing, it is found that the path coefficient is known to have a loading factor above 0.5, so it is valid in reflecting the latent variables of each. The results of data processing obtained path coefficients and test statistical values of each exogenous variable on the quality of financial reporting as summarized in the results of hypothesis testing.

b. Hypothesis Test Results

1) Direct Effect of Structural Characteristics, Monitoring Characteristics, and Performance Characteristics on the Quality of Financial Reporting

For the direct effect of structural characteristics, monitoring characteristics, and performance characteristics on the quality of financial reporting. It can be seen through the path coefficient values and the results of hypothesis testing through the coefficient of determination (R^2) on the model, it is known that the structural characteristics, monitoring characteristics, and performance characteristics simultaneously influence the quality of financial reporting by 32.9%.

2) Indirect Influence of Structural Characteristics, Monitoring Characteristics, and Performance Characteristics on the Quality of Financial Reporting

In this study partially, the variable of corporate structure characteristics affected the quality of financial reporting with a t count of 3.055 and a variable of monitoring characteristics had an effect on the quality of financial reporting at a rate of 2.487. This result can be concluded that it has a greater influence because it is greater with a critical value of 1.96. While the results of the study partially the variable performance characteristics did not affect the quality of financial reporting where the tcount was 0.949 smaller than the critical level of 1.96. The results of this study show that the company's performance is not responded to by investors but is used as a prediction.



2. Discussion

The quality of financial reporting can be seen from two accounting-based perspectives, namely the current year's profit can explain the profit of the coming year, while the quality of market-based financial reporting is how far the profit can explain stock prices. Determining the quality of financial reporting is influenced by factors from within the company, namely the company's characteristics and factors from outside the company, namely external auditors who validate the information submitted by the company. For the direct effect of structural characteristics, monitoring characteristics, and performance characteristics on the quality of financial reporting. It can be seen through the path coefficient values contained in Figure 1, it is known that the structural characteristics, monitoring characteristics, and performance characteristics can be known to simultaneously influence the quality of financial reporting by 32.9%.

These results support research conducted by (Chen et al., 2012) (Cohen, 2005) (Fanani, 2009) with the results of a comprehensive assessment of the characteristics of the company will improve the quality of financial statements that affect users of information in economic decision making and improve overall market efficiency, thereby reducing the cost of capital. for the company. This is also due to the success of the Indonesia Stock Exchange (IDX) in enforcing the submission of corporate financial reports after being audited for issuers of the Indonesia Stock Exchange (IDX). This policy has a positive impact on investors in the Indonesia Stock Exchange (IDX) who feel so confident in the presentation of the company's financial statements as a means of communication and accountability between management and investors. This is evidenced by the growth of investors and the market response on the Indonesia Stock Exchange (IDX) which is increasing from 2017-2020 as follows:



Source: [www.http.idx.go.id](http://www.idx.go.id)

From this data, it is known that the presentation of quality financial reporting by the private sector can increase market response or market confidence in the current pandemic situation. This result is in line with the research results of (Chaudhary, 2021) which states that the role of the government and the private sector is to realize a solid recovery of economic stability in increasing market confidence.

In contrast to the research of (Easley & O'Hara, 2004) Hidayat and Elisabet (2008) shows that institutional ownership, management ownership, and the composition of the board of commissioners all show an insignificant effect on the quality of the company's financial reporting. This happens because of differences in variables in limiting opportunistic behavior of company management in financial reporting, by limiting opportunistic behavior of management in the form of independent auditors in the company will improve the quality of financial reporting. It is proven in this research with structure, monitoring, good company performance will provide quality financial reporting. This result is also because different measurements of financial reporting quality can lead to high-quality financial reporting, and in this study the sampled companies have fully implemented IFRS financial reporting disclosure guidelines, causing the information submitted to be more effective and efficient in influencing investors and potential investors.



a. Effect of Structural Characteristics on Reporting Quality

A company structure is a relationship or part of the company, where the company structure can explain the company's position and structure can also introduce the form, class, duties, and activities of a company formally as well as the company's prospects in the future. Because the company structure will describe what activities exist in an organization, with the structure investors feel close to the company.

In this study, the manifest variables of the characteristics of the company structure are the age of the company, the size of the company, and the leverage, with the age of the company and the size of the company, can be seen that the level of experience in carrying out the company's operational activities will increase the level of confidence of investors in the company, marked by increased leverage.

In this study partially the characteristics of the company structure variables affect the quality of financial reporting. This result is because the information presented by the company is more effective so that the information is more responded to by investors than as a prediction tool for the underlying data.

These findings support the research of (Scott, 2015), which states that structural characteristics affect the quality of financial reporting. Research conducted by (Smulowitz et al., 2019) and (Hidayat and Elisabet, 2008) states that company age has a significant effect on the quality of corporate financial reporting. This happens because investors and potential investors pay more attention to the characteristics of corporate structures in Indonesia in making decisions related to finance. The longer the life of the company causes the company to be assessed historically as showing fairness in its financial statement submission and having stability in its performance. In line with the increasing size, the company will have stability and predictable operations that are better than small companies.

b. The Effect of Monitoring Characteristics on the Quality of Financial Reporting

The characteristic of company monitoring is supervision carried out by internal parties or parties with an interest in managerial opportunistic behavior. Supervision is to improve the performance and survival of the company. Monitoring that is carried out can limit the opportunistic behavior of managers on financial reporting, as well as information conveyed by managers of good quality.

In this study, the manifest variables are composition with directors and institutional ownership. This happens because the composition of the board of directors is often used to identify the presence of collusion and domination of directors in the company. Share ownership by a larger institution or institution can limit the opportunistic behavior of managers related to better company performance as shown in the financial statements.

The results of this study, the variable of monitoring characteristics affects the quality of financial reporting. These results can be concluded that monitoring conducted on the opportunistic behavior of managers related to financial reporting can increase investor response or the level of investor confidence in the information presented, but cannot increase the predicted value of the underlying items.

These findings support the research of (Chen et al., 2012) (Klein, 2002) which found that monitoring characteristics have a significant effect on the quality of financial reporting. Fanani (2009) found that institutional ownership affects the quality of financial reporting. This occurs because the large percentage of institutional investors has a function as a monitoring tool to prevent managers from opportunistic behavior in managing company earnings. As well as large institutional investor ownership can represent controlling shareholder votes or higher voting rights if decision-making is based on the majority vote. Institutional ownership can increase more optimal supervision of financial reports and minimize agency conflicts that occur between shareholders and managers (Easley & O'Hara, 2004).



c. The Effect of Performance Characteristics on the Quality of Financial Reporting

Company performance is an achievement or result at the level obtained by the company, these achievements and results can describe the level of success of a company and the company's prospects. In this study, the manifest variables of company performance are profitability, liquidity, and company growth which will help convince investors about the prospects of the company, so it is not uncommon for managers to influence this manifest variable. Because managers always think positively about their performance and try to look better.

In this study partially the performance characteristics variable does not affect the quality of financial reporting. The results of this study show that the company's performance is not responded to by investors but is used as a prediction. These findings are in line with the research of Fanani, et al., (2009), who found an insignificant influence between liquidity and financial reporting quality. This is because companies are more concerned with higher company performance to be good in front of investors and ignore the quality of financial reporting.

The liquidity of the company is used as an internal factor of the company which shows the ability of a company in the short term to meet its obligations when the company goes bankrupt. This condition will carefully affect creditors, which companies will provide credit so as not to experience losses. Because liquidity is closely related to creditors, if the condition of the company is not liquid, it means there will be a delay in paying the interest and principal of the company loan (Lambert et al, 2007; Li and Wang, 2010).

D. Conclusion

Quality financial reporting can shape the characteristics of a good company and improve company performance and can increase market response or market confidence in the current pandemic situation. Simultaneously the structural characteristics, monitoring characteristics, and performance characteristics have a significant influence on the quality of financial reporting.



The structural characteristics have a significant effect on the quality of financial reporting. Monitoring characteristics have a significant effect on the quality of financial reporting. Performance characteristics do not influence the quality of financial reporting.

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