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FINANCIAL REPORTING INTEGRITY MODEL IN MANUFACTURING COMPANY

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Abstract

The purpose of this research is to analyze the influence of the variables Institutional Ownership (IO), Leverage (DER), Management Ownership (MO) on Earnings Management (EM) and on Financial Report Integrity (FRI). This is based on the phenomenon of inconsistency in various previous studies from what happened as a reality, thus encouraging researchers to carry out research again. This research is a type of quantitative descriptive research with a panel data multiple regression analysis method that uses 18 cross section samples and 5 years as a time series. This research formula is to maximize the value of FRI through EM as an intervening variable which is built into two research models and integrated into one research model using research objects in manufacturing sector companies listed on the Indonesia Stock Exchange. The results of the first research model; that MO can significantly explain the impact on EM with a positive correlation, which results confirm the current theory. Another result in the second research model is that DER and EM can each explain significantly their influence on FRI with a positive correlation in DER and negative in EM, which is a result that is in accordance with the applicable theory. The other variables cannot explain their influence on the endogenous variable EM in the first model and FRI in the second model. It is hoped that the results of this research can provide guidance for management practitioners and capital market players in Indonesia so that they can maximize the value of FRI.

Keywords: Institutional Ownership, Leverage, Managerial Ownership, Earnings Management, Financial Report Integrity.

INTRODUCTION

Financial Report Integrity is the objectivity of financial reports that present the true financial condition of a company, without any form of engineering. The presentation of financial reports is honest so that it is information that is not misleading for those who need it. The integrity of financial reports in this research uses an accounting conservatism approach. In Savitri (2016), reporting that is based on a level of prudence will provide the best benefits for those who need financial reports. In Dewi & Putra (2016), conservatism is the preparation of understated financial reports so that the risk is smaller than overstated financial reports. The explanation above emphasizes that conservatism is a careful action regarding existing uncertainties so that the uncertainties and risks related to business situations can be considered in a sufficiently measurable manner. These uncertainties and risks must be reflected in the financial statements so that their predictive value and neutrality are accurate.

It is important in efforts to use the principle of conservatism so that the potential for profit engineering in financial reporting can be controlled, it can be reduced by adopting an attitude

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of pessimism to offset excessive optimism from managers. What is meant by conservatism in this description uses the Givoly and Hayn (2000) model using negative accrual measurements and focusing on non-operating accruals as a measure of conservatism, Bressler (2014). Operating and non-operating accruals are measured over the sample period. During the sample period, while total operating accruals increase. The increase in operating accruals was not large enough to offset the decrease in non-operating accruals. They attribute this trend of increasing negative accruals to conservatism over the sample period (Givoly and Hayn 2000). The advantages of Givoly and Hayn's negative accruals are that they are company specific, easy to implement and do not require too many data items (Hogartaigh, et al. 2008). The results of the study carried out by the researcher were that there were various research results that were inconsistent among previous researchers, as in the study below where the underlying results needed to be researched again.

Atik Fajaryani (2015), N.P Yani Wulandari and I Ketut Budiartha (2014), Dewanti Oktadella (2011), Jama'an (2008), Istiantoro1, et.,al., (2017), Wulandari (2014), Fajaryani (2015), Verya (2017), that institutional ownership has a significant effect and is positively correlated with the integrity of financial statements. Different results in Laila Arvida (2013), Tia Astria (2011), that institutional ownership has a significant and negative correlation with Financial Report Integrity. Very different results are found in Hardiningsih (2010), Herawaty (2007), that institutional ownership has an insignificant effect on Financial Report Integrity. Institutional Ownership in its influence on Earnings Management has been carried out by various previous researchers, but the results obtained are very different or inconsistent. In the research results of Ujiyanto and Pramuka (2007), Sumanto B., and Kiswanto A., (2014), Wahyuningsih P., (2009), that Institutional Ownership has a significant and negative correlation with Profit Management. However, the research results are different in Kesuma A.I., et.,al., (2019), that Institutional Ownership has a significant influence with a positive correlation on Earnings Management. There are very different results in the research of Subhan (2011), Mahariana D.G.P., and Wayan Ramantha W., (2014), that Institutional Ownership has an insignificant effect on Earnings Management.

The results of research conducted by Fajaryani (2015), Atiningsih S., Yohana Kus Suparwatithat Y. K., (2018), Leverage has a significant effect and has a negative correlation with Financial Report Integrity. Verya (2017) produced different results, namely that Leverage had an insignificant effect on Financial Report Integrity. The results of research conducted by Arifin and Destriana (2016), Astari (2017), Tala and Karamoy (2017), Agustia and Suryani (2018), Deviyanti (2018), Fandriani and Tunjung (2019), Cinthya M. T., et.,al ., (2022), shows the results that leverage has a positive effect on earnings management. However, different results were produced in the research of Susanti and Margareta (2019), Suyoto and Dwimulyani (2019), Aprillian and Hapsari (2020), Jao and Paroll (2011), Kesuma A.I., et.,al., (2019), that leverage has a significant and negative correlation with earnings management. There are very different research results, namely in Hermanto (2016), Astuti (2017), Pramudhita (2017), Purnama (2017), Farida and Kusumadewi (2020), that leverage has an insignificant effect on Earnings Management. Managerial ownership is share ownership owned by company management using a percentage measure of the number of shares outstanding, Istiantoro et al.

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(2017). This ownership shows that the company manager, apart from managing the company's business, is also the owner of the company concerned. With this ownership, management who owns shares actively participates in company decision making, Sari and Hapsari (2018). In Dewanti Oktadella (2011), Verya (2017), Managerial Ownership has a significant influence and has a positive correlation with Financial Report Integrity. Meanwhile, different results are found in Tia Astria (2011), that Managerial Ownership has a significant effect and is negatively correlated with the Integrity of Financial Reports. Very different results are found in Fikri M. & Suryani E. (2020), Atik Fajaryani (2015), N.P Yani Wulandari and I Ketut Budiartha (2014), Herawaty (2007), Istiantoro1, et.,al., (2017), Wulandari (2014), Managerial Ownership has an insignificant effect on Financial Report Integrity. Research produced in Mahariana D.G.P., and Wayan Ramantha W., (2014), Jao and Pagulung (2011), shows that Managerial Ownership has a significant and negative correlation with Profit Management. Different research results in Kesuma A.I., et.,al., (2019), show that Managerial Ownership has a significant and positive correlation with Earnings Management. The results of research in Putra and Muid (2012), show that Earnings Management has a significant effect on Financial Report Integrity with a negative correlation. Meanwhile, the results are very different in Latifah (2015), Lubis I., P., Fujianti L., Amyulianthy R., (2018), that Earnings Management has an insignificant effect on Financial Report Integrity.

LITERATURE REVIEW AND HYPOTHESIS

Researchers who have conducted research on the influence of Institutional Ownership on Profit Management are found in the research results of Ujiyanto and Pramuka (2007), Sumanto B., and Kiswanto A., (2014), Wahyuningsih P., (2009), Kesuma A.I. , et.,al., (2019), Subhan (2011), Mahariana D.G.P., and Wayan Ramantha W., (2014). Next, a hypothesis can be formulated:

H_1: There is an influence of Institutional Ownership (IO) on Earnings Management (EM).

Inconsistent research results also regarding the influence of Leverage (DER) on Earnings Management (EM). Those who have conducted research are Arifin and Destriana (2016), Astari (2017), Tala and Karamoy (2017), Agustia and Suryani (2018), Deviyanti (2018), Fandriani and Tunjung (2019), Cinthya M. T., et .,al., (2022), Susanti and Margareta (2019), Suyoto and Dwimulyani (2019), Aprillian and Hapsari (2020), Jao and Pagulung (2011), Kesuma A.I., et.,al., (2019), Hermanto (2016), Astuti (2017), Pramudhita (2017), Purnama (2017), Farida and Kusumadewi (2020). Various research results can be formulated so that a hypothesis can be formulated:

H_2: There is an influence of Leverage (DER) on Earnings Management (EM).

Those who have conducted research on the influence of Managerial Ownership (MO) on Earnings Management (EM) are Mahariana D.G.P., and Wayan Ramantha W., (2014), Jao and Pagulung (2011), Kesuma A.I., et.,al. , (2019). Their various research results show inconsistent results and can be formulated into hypotheses:

H_3: There is an influence of Managerial Ownership (MO) on Earnings Management (EM).

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In research on the influence of Institutional Ownership (IO) on Financial Report Integrity (FRI), many research results have been inconsistent among previous researchers. The researchers are Atik Fajaryani (2015), N.P Yani Wulandari and I Ketut Budiartha (2014), Dewanti Oktadella (2011), Jama'an (2008), Istiantoro1, et.,al., (2017), Wulandari (2014), Fajaryani (2015), Verya (2017), Laila Arvida (2013), Tia Astria (2011), Hardiningsih (2010), Herawaty (2007). The various results from their research are mentioned above so that research hypotheses can be formulated:

H_4: There is an influence of Institutional Ownership (IO) on Financial Report Integrity (FRI).

Research on Leverage on Financial Report Integrity also has inconsistent results, as in Fajaryani (2015), Atiningsih S., Yohana Kus Suparwaticepat Y. K., (2018), Verya (2017). Next, the research hypothesis can be formulated as follows:

H_5: There is an influence of Leverage (DER) on Financial Report Integrity (FRI).

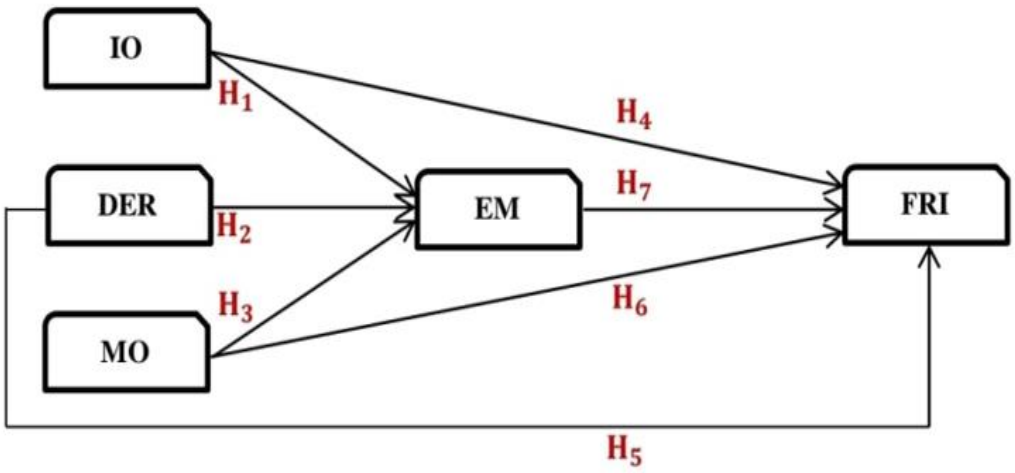
Research on Managerial Ownership on Financial Report Integrity has been conducted by Dewanti Oktadella (2011), Verya (2017), Tia Astria (2011), Fikri M. & Suryani E. (2020), Atik Fajaryani (2015), N.P Yani Wulandari and I Ketut Budiartha (2014), Herawaty (2007), Istiantoro1, et.,al., (2017), Wulandari (2014). Their research results showed inconsistent results between them. Next, the research hypothesis can be formulated as follows:

H_6: There is an influence of Managerial Ownership (MO) on Financial Report Integrity (FRI).

Research conducted by Putra and Muid (2012), Latifah (2015), Lubis I., P., Fujianti L., Amyulianthy R., (2018), regarding Earnings Management (EM) on Financial Report Integrity (FRI), resulted in inconsistent among their research results. The research hypothesis that can be formulated is as follows:

H_7: There is an influence of Earnings Management (EM) on Financial Report Integrity (FRI).

Figure 1: Research Framework Model



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RESEARCH METHODS

This research uses a qualitative and quantitative descriptive approach using multiple regression analysis methods for panel data, which is a combination of 5 year time series data or the 2015 or 2019 year period and cross section. The objects used in this research are manufacturing companies listed on the Indonesia Stock Exchange. By using purposive sampling as a research sampling technique, the total research sample was 18 companies.

Operational Variables:

Table 1: Operational Variables

No	Variables	Notation	Formulas
1	Institutional Ownership	IO it	$\frac{\text{Number of shares owned by institutions}_{it}}{\text{Number of shares outstanding}_{it}}$
2	Leverage	DER $_{it}$	$\frac{\text{Total Debit}_{it}}{\text{Total Assets}_{it}}$
3	Managerial Ownership	MO $_{it}$	$\frac{\text{Number of Shares Owned by Management}_{it}}{\text{Number of shares outstanding}_{it}}$
4	Earnings Management (discretionary accrual)	EM it	(1) $TA_{it} = NI_{it} - CFO_{it}$
	Where: TA_{it}= Accrual Amount NI_{it} = Net Profit CFO_{it} = Operating Cash Flow $A_{i(t-1)}$= Total Assets		(2) $\frac{TA_{it}}{A_{i(t-1)}} = \alpha_1(\frac{1}{A_{i(t-1)}}) + \alpha_2\left(\frac{\Delta Rev_{it}}{A_{i(t-1)}}\right) + \alpha_3\left(\frac{PPE_{it}}{A_{i(t-1)}}\right) + \varepsilon_{it}$
	ΔRev_{it} = Sales changes ΔRec_{it} = Receivables Changes PPE_{it}= Company property, plant and equipment α_1 α_2 α_3 =Regression Parameters		(3) $\frac{TA_{it}}{A_{i(t-1)}} = \alpha_1(\frac{1}{A_{i(t-1)}}) + \alpha_2\left(\frac{\Delta Rev_{it}}{A_{i(t-1)}} - \frac{\Delta Rec_{it}}{A_{i(t-1)}}\right) + \alpha_3(\frac{PPE_{it}}{A_{i(t-1)}}) + \varepsilon_{it}$
	ε_{it} = Error Term NDA_{it}= Nondiscretionary Accruals DA_{it} = Discretionary Accrual		(4) $DA_{it}=\frac{TA_{it}}{A_{i(t-1)}}-NDA_{it}$ *) Jones Model (1991)
5	Financial Report Integrity	FRI it	$\frac{BV_{it}}{MV_{it}}$

Panel Data Multiple Regression Estimation

The approach that can be taken in conducting analysis between time series data and cross section data can be used:

1. Common Effect Model (CEM)
2. Fixed Effect Model (FEM)
3. Random Effect Model (REM)

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Model Suitability Selection Test

There are three model suitability testing procedures to determine the best panel data multiple regression model as follows:

Chow Test:

(Common Effect Model / CEM versus Fixed Effect Model / FEM)

The test criteria are based on the α level = 5%:

- F count < F table rejects the null hypothesis (H_0) and accepts the alternative hypothesis (H_a) so that the selected model is the Fixed Effect Model (FEM).
- F count > F table accepts the null hypothesis (H_0) and rejects the alternative hypothesis (H_a) so that the selected model is the Common Effect Model (CEM).

***Hausman Test*:**

(Fixed Effect Model / FEM versus Random Effect Model / REM)

The test criteria are based on the α level = 5%:

- Prob. Chi-Sq. Statistic, Cross-section random < 5%, is to reject the null hypothesis (H_0) and accept the alternative hypothesis (H_a) so that the selected model is the Fixed Effect Model (FEM).
- Prob. Chi-Sq. Statistic, Cross-section random > 5%, is to accept the null hypothesis (H_0) and reject the alternative hypothesis (H_a) so that the selected model is the Random Effect Model (REM).

Uji Lagrange Multiplier (LM)

(Common Effect Model / CEM versus Random Effect Model / REM)

The test criteria are based on the α level = 5%:

- Test Hypothesis, Cross-section, Breusch-Pagan < 5%, is to reject the null hypothesis (H_0) and accept the alternative hypothesis (H_a) so that the selected model is the Random Effect Model (REM).
- Prob. Chi-Sq. Statistic, Cross-section random > 5%, is to accept the null hypothesis (H_0) and reject the alternative hypothesis (H_a) so that the selected model is the Common Effect Model (CEM)

Panel Data Regression Model

Structural Equation Research Model I,

$EM_{it} = \alpha + \beta_1 IO_{it} + \beta_2 DER_{it} + \beta_3 MO_{it} + \varepsilon_{it}$; ……(1)

i = 1,2,.,.,., N ; t = 1,2,.,.,.,T

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Structural Equations Research Model II,

$FRI_{it} = \alpha + \beta_1 IO_{it} + \beta_2 DER_{it} + \beta_3 MO_{it} + EM_{it} + \varepsilon_{it}$; .....(2)

i = 1,2,.,.,., N ; t = 1,2,.,.,.,T

Where:

EM	=	Earnings Management	β	=	Slope
IO	=	Institutional Ownership	α	=	Intercept
DER	=	Leverage	N	=	Number of Observations
MO	=	Management Ownership	T	=	Lots of time
FRI	=	Financial Report Integrity	NxT	=	Number of Panel Data
ε	=	Error component			

RESEARCH RESULTS

Table 2: Statistics Descriptive

	FRI	IO	DER	MO	EM
Mean	0.062759	0.775677	0.228676	0.835012	0.012559
Median	0.054750	0.813250	0.210900	0.869050	0.010750
Maximum	0.803000	1.437600	0.664300	1.135000	0.031000
Minimum	0.011000	0.189000	0.126700	0.242000	0.000800
Std. Dev.	0.080831	0.182566	0.081864	0.154229	0.007489
Observations	90	90	90	90	90

Source: Data processed

B. Earnings Management and Financial Report Integrity as Endogenous Variables in Testing the Suitability of Research Models

Table 3: Chow Test

Research Model 1 Chow Test: Common Effect Vs Fixed Effect Endogenous Variable: EM				Research Model 2 Chow Test: Common Effect Vs Fixed Effect Endogenous Variable: FRI			
Effects Test	**Statistic**	**d.f.**	**Prob.**	**Effects Test**	**Statistic**	**d.f.**	**Prob.**
Cross-section F	2.897646	(17,69)	0.0009	Cross-section F	3.932776	(17,68)	0.0000
Cross-section Chi-square	48.490108	17	0.0001	Cross-section Chi-square	61.623777	17	0.0000

Source: Data processed

Chow-test testing in Research Model 1 and Research Model 2 produces statistical hypotheses: rejecting the null hypothesis (H_0) and accepting the alternative hypothesis (H_a) at the level of α = 5%. This can be interpreted as saying that the **Fixed Effect Model** will be better used than the Common Effect Model. (Table-3).

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Table 4: Hausman Test

Research Model 1 Hausman Test: Fixed Effect Vs Random Effect Endogenous Variable: EM				**Research Model 2** Hausman Test: Fixed Effect Vs Random Effect Endogenous Variable: FRI			
Test Summary	**Chi-Sq. Statistic**	**Chi-Sq. d.f.**	**Prob.**	**Test Summary**	**Chi-Sq. Statistic**	**Chi-Sq. d.f.**	**Prob.**
Cross-section random	3.761657	3	0.2884	Cross-section random	2.824000	4	0.5877

Source: Data processed

Hausman-test testing in Model Research-1 and Model Research-2 produces statistical hypotheses: accepting null hypotheses (H_0) and rejecting alternative hypotheses (H_a) at the level of $\alpha = 5\%$. This can be interpreted as saying that **the Random Effect Model** will be better used than the Fixed Effect Model, (Table-4). The results are different between the Chow Test and the Hausman Test so it is necessary to continue testing the Lagrange Multiplier Tests (LM-Test).

Table 5: Lagrange Multiplier Tests (LM-Test)

Research Model 1 LM Test: Common Effect Vs Random Effect Endogenous Variable: EM				**Research Model 2** LM Test: Common Effect Vs Random Effect Endogenous Variable: FRI			
	Test Hypothesis				**Test Hypothesis**		
	Cross-section	**Time**	**Both**		**Cross-section**	**Time**	**Both**
Breusch-Pagan	10.09968 (0.0015)	0.991027 (0.3195)	11.09070 (0.0009)	Breusch-Pagan	20.56328 (0.0000)	0.005441 (0.9412)	20.56872 (0.0000)

Source: Data processed

Testing the Lagrange Multiplier Tests in Model Research-1 and Model Research-2 produces statistical hypotheses: rejecting the null hypothesis (H_0) and accepting the alternative hypothesis (H_a) at the level of $\alpha = 5\%$. This can be interpreted as saying that **the Random Effect Model** will be better used than the Common Effect Model. (Table-5)

Table 6: Endogenous Variable: EM

Total pool (balanced) observations: 90

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	0.003255	0.009252	0.351851	0.7260
IO	-0.005034	0.006994	-0.719671	0.4742
DER	0.009803	0.007717	1.270194	0.2083
MO	**0.025795**	**0.010733**	**2.403402**	**0.0189**
Adjusted R-squared	0.277849			
F-statistic	2.712149			
Prob(F-statistic)	0.001149			

Source: Data processed

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Table 7: Endogenous Variable: FRI

Total pool (balanced) observations: 90

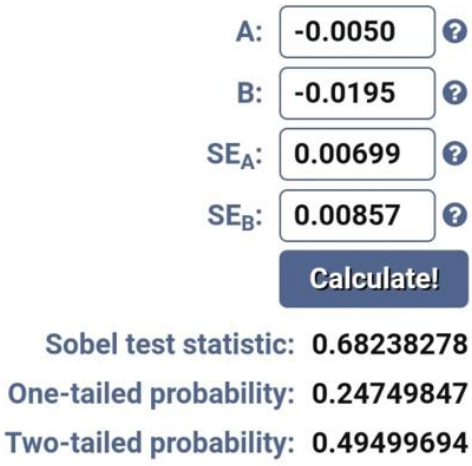
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.002750	0.007417	0.370743	0.7118
IO	0.002497	0.005434	0.459481	0.6471
DER	**0.023940**	**0.009324**	**2.567569**	**0.0120**
MO	0.004027	0.005664	0.711038	0.4790
EM	**-0.019536**	**0.008578**	**-2.277439**	**0.0253**
Adjusted R-squared	0.086188			
F-statistic	3.098558			
Prob(F-statistic)	0.019697			

Source: Data processed

C. EM Intervening Variable Function Testing

- At the α = 5% level, the Intervening Variable EM cannot function to mediate the influence of Institutional Ownership (IO) on Financial Report Integrity (FRI), which is 0.49499694 > 0.05. (Table 8)

Table 8: Indirect Effect of IO on FRI



Where:

A: Regression Coefficient of IO against EM

B: Regression Coefficient of EM against FRI

SE_A : Std. Error of IO againt EM

SE_B : Std. Error of EM againt FRI

- At the α = 5% level, the EM Intervening Variable cannot function to mediate the effect of Leverage (DER) on Financial Report Integrity (FRI), which is 0.26713985< 0.05. (Table 9)

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Table 9: Indirect Effect of DER on FRI

A:	0.00980
B:	-0.0195
SE_A:	0.00771
SE_B:	0.00857
	Calculate!
Sobel test statistic:	-1.10967326
One-tailed probability:	0.13356992
Two-tailed probability:	0.26713985

Where:

A: Regression Coefficient of DER against EM

B: Regression Coefficient of EM against FRI

SE_A : Std. Error of DER against EM

SE_B : Std. Error of EM against FRI

- At the $\alpha = 5\%$ level, the Intervening Variable EM cannot function to mediate the influence of Managerial Ownership (MO) on Financial Report Integrity (FRI), which is $0.09845561 < 0.05$. (Table 10)

Table 10: Indirect Effect of MO on FRI

A:	0.02579
B:	-0.0195
SE_A:	0.01073
SE_B:	0.00857
	Calculate!
Sobel test statistic:	-1.65238735
One-tailed probability:	0.04922781
Two-tailed probability:	0.09845561

Where:

A: Regression Coefficient of MO against EM

B: Regression Coefficient of EM against FRI

SE_A : Std. Error of MO against EM

SE_B : Std. Error of EM against FRI

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1. Institutional Ownership (IO) has an insignificant effect on Earnings Management (EM). (Table-6)
2. Leverage (DER) has an insignificant effect on Earnings Management (EM). (Table-6)
3. Managerial Ownership (MO) has a significant effect on Earnings Management (EM) with a positive correlation. (Table-6)
4. 4 Institutional Ownership (IO) has an insignificant effect on Financial Report Integrity (FRI). (Table-7)
5. Leverage (DER) has a significant effect on Financial Report Integrity (FRI). With positive correlation. (table-7)
6. Managerial Ownership (MO) has an insignificant effect on Financial Report Integrity (FRI). (table-7)
7. Earnings Management (EM) has a significant effect on Financial Report Integrity (FRI). With negative correlation. (table-7)
8. Earnings Management (EM) as an intervening variable does not partially function to mediate the indirect influence between IO (table-8), DER (table- 9), and MO (table-10) against FRI.

DISCUSSION

The greater the managerial ownership, the greater the potential to open up opportunities for earnings management. Basically, earnings management will have a negative impact on market appreciation considering that it is seen as providing information that deviates from reality. The results of this research support the results in Kesuma A.I., et.,al., (2019). The results of research on capital structure provide an illustration that the greater the level of debt a corporation has, the more it will be appreciated by the market. In the context of the object of this research, it is a manufacturing company, so the large level of debt will have a positive impact on the market, which means that the object of this research provides prospective information on its growth. This research also produces results, as explained in the paragraph above, that an increase in the amount of earnings management has an impact on the market because information from earnings management does not provide anything that is realistic but is more for management's interests. The greater the level of financial management, the lower the level of market appreciation, so this result supports the results in Putra and Muid (2012).

CONCLUTIONS

Findings: This research succeeded in concluding that intervening variables do not function to mediate their influence on Financial Report Integrity (FRI), so that all exogenous variables cannot explain their indirect influence on FRI. The exogenous variables DER and EM can only directly explain their influence on FRI. As an implication, Managerial Ownership is the dominant variable with the highest level of sensitivity. This is a suggestion for future researchers and especially for business practitioners in the manufacturing sector regarding the importance of Managerial Ownership as a key variable.

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