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Factors affecting the Quality of Financial Reports: A Value Relevance Based Analysis

Nasrullah Djamil
Universitas Islam Negeri Sultan Syarif Kasim Riau, Pekanbaru
*Email : nasrullah.djamil@uin-suska.ac.id

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ABSTRACT

This study aims to examine the effect of company size, financial leverage, liquidity, and corporate governance practices on the quality of financial reporting within the context of value relevance. The research focuses on publicly-listed state-owned enterprises (BUMN) from 2017 to 2019. The sample consists of 20 BUMN companies, selected using a purposive sampling method, resulting in a total of 60 observations based on specific criteria. This study utilizes a quantitative descriptive research approach and secondary data for analysis. The primary analytical tool is panel data regression analysis. The findings indicate that the quality of financial reports in the value relevance context is significantly influenced by firm size, financial leverage, liquidity, and corporate governance. The coefficient of determination test shows an adjusted value of 77.5%, indicating that these variables collectively account for 77.5% of the variation in financial report quality in the value relevance approach. The remaining 22.5% is attributed to unexamined variables.

INTRODUCTION

On the contrary, the presentation of financial information comes with several inherent limitations, including its historical nature, generality, susceptibility to erroneous estimations, conservative nature, and the fact that it doesn't consistently align with real-world conditions. Accounting was established with a specific purpose: to provide essential services to customers and users of financial information required in the decision-making process (Harahap, 2011). The outcome of various accounting activities is the creation of financial reports. These reports serve as a medium to convey information to parties interested in a company's financial affairs (Kieso, 2017).

Within the framework of financial reporting concepts, the primary aim of financial statements is to furnish financial information about reporting entities that proves valuable for current and prospective investors, creditors extending loans, and other stakeholders when making decisions concerning resource allocation to the entity (KKPK, 2015). Therefore, it's imperative to provide comprehensive, lucid, and precise financial information regarding the company's financial health, ensuring the company's ongoing operations. Financial reports also serve as a tool employed by management to demonstrate corporate responsibility in the utilization of resources entrusted to the company (IAI, 2018). This is because the information contained in these reports can be utilized as a means to gauge the company's performance.

Furthermore, financial reports play a crucial role in determining aspects of future business planning. Consequently, the information contained in financial reports plays a pivotal role in decision-making. In essence, the information presented in financial reports must possess high value and quality. Companies that prepare financial reports diligently enhance transparency for users of financial statements, as noted by Komalasari and Permana (2015 in Purba 2018).

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To date, there exist diverse definitions of the quality of financial reports. Essentially, the quality of financial statements can be understood from two perspectives (Susanti, 2017). The first perspective suggests that financial statements are considered high quality if the current year's profit is a strong indicator of future profitability or closely linked to current cash flows in the upcoming period (Pagalung, 2012). The second perspective posits that the quality of financial reporting is related to a company's performance in the market capitalization, as manifested through share price movements (Fanani 2009 in Susanti 2017). This perspective aligns with the growing demand for companies to operate their management systems transparently and accountably, as fraudulent reporting attempts become more widespread in the corporate world (Prena, 2012).

In terms of the characteristics of financial statements, the International Accounting Standards Board (IASB) underscores that financial information can be more useful for decision-making (quality) if it fulfills qualitative characteristics, which can be categorized as fundamental characteristics (relevance and faithful representation) and enhancing characteristics (comparability, verifiability, timeliness, and understandability) (Kieso, 2017). Financial reports serve as a pivotal decision-making tool for company owners, investors, and various stakeholders (Rohmah, 2017). The quality of financial reports is indispensable, as it directly influences the quality of decisions made by the company and its stakeholders. This aligns with the concept of assessing financial report quality within the relevance framework. The relevance framework in accounting information describes how investors respond to accounting information disclosures. Information is considered relevant if it has the capacity to impact economic decisions by assisting in the evaluation of past, present, and future decisions.

Djamil, N. (2018) Hence, it is hoped that these issues can be mitigated to reduce the occurrence of irrelevant financial report presentations. The background of this concern is the prevalence of presenting financial statements that lack relevance due to information asymmetry issues in agency theory. Such modifications to financial reports, although intended to align with certain theories, can ultimately mislead users of financial reports. The repercussions of these actions extend to various parties, including CEOs, board members, audit committees, internal auditors, and external auditors, leading to questions arising from various quarters. According to Stice (2004, as cited in Rohmah 2017), internal company interests may pressure financial report creators to include information that could pique the interest of potential investors for external funding, potentially yielding future profits. This practice is often associated with information asymmetry in the form of modified financial reports. Therefore, external users must exercise caution and ensure that financial statements are presented objectively.

However, as of now, Indonesia still witnesses instances of compromised financial report quality, exemplified by the manipulation of financial reports coming into the public domain. A notable case is that of PT Insurance Jiwasraya. Beginning in 2017, this state-owned company received an unqualified opinion on its financial statements from the Badan Pemeriksa Keuangan (BPK), reporting a profit of 24 trillion. However, upon BPK's audit, net profit decreased by 360.3 billion, and a shortfall of 7.7 trillion in reserves was discovered. This led to concerns that the company should have actually reported significant losses. Further investigations by BPK spanning 2010-2019 revealed that Jiwasraya had manipulated financial statements since 2006, falsely portraying profits over several years. Jiwasraya had, in essence, distorted its financial records to present a more favorable image to stakeholders (source: www.kompas.com).

This case has consumed a significant amount of time and resources at the Ministry of State-Owned Enterprises. Negligent investment practices, such as concentrating investments in low-quality stocks and equity mutual funds, along with indications of price manipulation, have left Jiwasraya struggling to meet its claim payment obligations totaling Rp 16 trillion. As of December 2019, Jiwasraya's equity recorded a negative value of Rp 28 trillion. Funds collected from savings plans were invested in low-quality instruments, violating regulations. An investigation by BPK in 2018 revealed allegations of corporate misconduct (involving only one modification of financial reports) implicating the board of directors, management, and external parties, resulting in internal and national losses (source: www.kompas.com).

Based on this phenomenon, it is evident that state-owned companies have, for a significant period, presented low-quality financial reports due to manipulation or modifications. This has inflicted harm on various stakeholders. In essence, financial reporting integrity is a critical element for evaluating a company's

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overall performance. Empirical research on financial statement quality has been undertaken by previous researchers, but relatively limited work has been done in Indonesia. Nurul Fajri's research in 2013, titled "Effect of Company Size, Ownership Structure, and Market Concentration on Financial Report Quality," found a positive and significant influence of company size and market concentration on financial report quality, while ownership structure had no effect.

In another study by Yasmen & Hermawati in 2015, titled "The Impact of Corporate Governance on the Quality of Financial Reporting in Manufacturing Companies," it was found that leverage had an effect on financial reporting quality. However, board composition, institutional ownership, managerial ownership, and company age did not significantly influence financial reporting quality. Research conducted by Yunita Puji Astuti in the same year, titled "The Influence of Company Characteristics on the Quality of Financial Statements (Empirical Studies in Manufacturing Companies Registered on the IDX for the Period 2010-2013)," revealed that variables such as company size, age, liquidity, and profitability had significant positive effects on financial report quality, while company size and age had no significant influence.

Amalia Nur Rohmah's 2017 study, "The Impact of Company Size, Company Age, Financial Leverage, and Good Corporate Governance on the Quality of Financial Statements (A Study of Manufacturing Companies Registered on the IDX for the Years 2013-2015)," demonstrated that company size, company age, and good corporate governance had significant positive effects on financial statement quality. In contrast, financial leverage had a significant negative influence on financial report quality. Collectively, company size, company age, financial leverage, and good corporate governance had a significant impact on financial report quality.

Fitriana & Febrianto's 2019 research, titled "Influence of Company Size and Asymmetry Information on the Quality of Financial Reports Using the Value Relevance Approach," found that both company size and asymmetry information significantly influence the quality of financial statements.

Given that studies on financial report quality employ various approaches, researchers have expressed interest in investigating financial report quality within the value relevance approach. This research builds upon Fitriana & Febrianto's study (2019) by incorporating three additional variables that can impact financial report quality: financial leverage, liquidity, and good corporate governance. Furthermore, the research focus differs from the previous study. The value relevance approach to accounting information examines "how accounting information can be beneficial for market actors or investors." This concept explores how investors react to the disclosure of accounting information.

The research's subject comprises state-owned companies (BUMN) listed on the Indonesia Stock Exchange during the years 2017-2019. State-owned companies were selected as the study's sample due to a notable case of financial report manipulation in one of these entities that garnered significant public attention. Considering the aforementioned context, the research is titled: "The Impact of Company Size, Financial Leverage, Liquidity, and Good Corporate Governance on the Quality of Financial Reporting in the Value Relevance Approach (Empirical Study on State-Owned Companies) Listed on the Indonesia Stock Exchange for the Years 2017-2019."

LITERATURE RESEARCH

A. Agency Theory

The agency theory describes the relationship between management as agents and shareholders as principals. The agent-principal relationship occurs when the principal employs someone else as an agent to provide a service and delegates authority in decision-making to the agent (Jensen and Meckling, 1976, as cited in Utomo, 2019).

In practice, the agency theory can give rise to conflicts of interest between the agent and the principal. The assumption that each party tends to be motivated by their self-interest arises because of the separation of ownership between the principal (shareholders) and the agent (management) in company management (Novianti, 2012). Additionally, agents and principals have distinct objectives in their contractual working relationship. According to Fitriana and Febrianto (2019), conflicts of interest can lead agents to exhibit behavior that is not in line with their responsibilities (dysfunctional behavior). One manifestation of such

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dysfunctional behavior is the manipulation or modification of financial reports to make them appear favorable to the principal, even if these reports do not accurately depict the true state of the company

B. Reporting Quality (In the Value Relevance Approach)

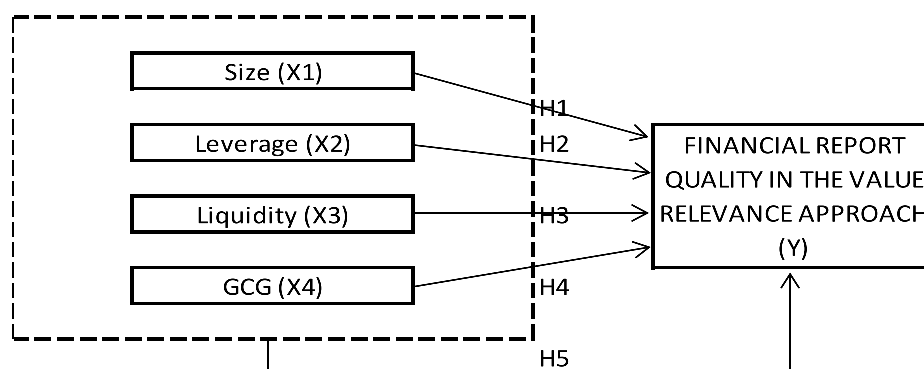
According to the International Financial Accounting Standards Board (IASB), financial information can be more useful (of higher quality) when it possesses qualitative characteristics, which are categorized into fundamental characteristics and enhancing characteristics in financial reporting information (Kieso, 2017:55). Fundamental characteristics consist of relevance and faithful representation, while enhancing characteristics include comparability, verifiability, timeliness, and understandability.

Accounting information constitutes the content that can be extracted from a company's financial statements through fundamental analysis techniques (Fitriana and Febrianto, 2019). The concept of the value relevance of accounting information and the concept of faithful representation are interrelated. The value relevance concept emphasizes "how accounting information has value relevant for market participants (investors)?" The consequence of this concept is that accounting information contained in financial statements should provide value (usefulness) to users in their decision-making processes. The value relevance concept explains how investors react to the disclosure of accounting information.

Relevant financial information should be capable of making a difference in decisions. This difference can be in terms of having predictive value, confirmatory value, or both. It is considered predictive when the information has value as an input for the prediction process used by investors to form future expectations. Relevant information also assists users in confirming or adjusting their prior expectations (Kieso, 2017). For example, when a company releases its year-end financial statements, it either confirms or revises the latest expectations based on the evaluation of the previous period. Therefore, predictive value and confirmatory value are interrelated.

C. Conceptual Framework

Picture 1. Conceptual Framework



Source : Research Data (2020)

METHOD

A. Population and Sampling Method

The research was conducted using a population consisting of companies listed on the Indonesia Stock Exchange between 2017 and 2019. The sampling approach employed in this study involved the deliberate selection of samples based on specific criteria. These criteria included:

1. State-owned companies (BUMN) that maintained continuous listings on the Indonesia Stock Exchange (IDX) throughout the period from 2017 to 2019;

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2. State-owned companies that did not publish annual financial reports consecutively during the 2017-2019 timeframe on the IDX;
3. State-owned companies (BUMN) that utilized the US Dollar as their currency during the study period. Applying these criteria resulted in the selection of 20 companies as the research sample

B. Research Variables And Measurement

The research methodology employed in this study is quantitative in nature. Quantitative data, by definition, consist of numerical values. The objective of quantitative research methods is to investigate the connections between two or more variables under examination. In terms of the level of explanation, this research falls into the category of associative research, which seeks to understand the relationships between multiple variables (Sugiyono, 2012). This approach is concerned with identifying causal relationships, specifically examining how independent variables influence the dependent variable. The measurement of each research variable is outlined as follows:

Table 1. Measurement of Variables

Numb	Variables		Measurement	Scale
1	Quality of Financial Reporting	Y	Book Value per Share	Ratio
2	Firm Size	X1	Ln Fixed Asset	Ratio
3	Financial Leverage	X2	Debt Ratio	Ratio
4	Liquidity	X2	Current Ratio	Ratio
3	Good Corporate Governance	X4	Board of Commissioners	Ratio

Source : Research Data, 2020

For testing in this research, used:

1. Descriptive Statistical Test

Descriptive statistics offer an overview or portrayal of a subject based on various criteria, including measures such as the mean (average), standard deviation, variance, maximum, minimum, sum, range, kurtosis, and skewness (Sugiyono, 2012).

2. Classic Assumption Test

a. Data Normality Test

According to Ghozali (2018), the initial step in any multivariate analysis, particularly when aiming for inference, is to conduct a normality test. When data exhibit normality, it implies that the residuals will also follow a normal and independent distribution. In this research, the Kolmogorov-Smirnov test was employed to assess the normality of the data. The criterion for assessment was that if each variable yielded a K-S-Z value with $P > 0.05$, it could be inferred that the data pertaining to the variables under investigation exhibited a normal distribution.

b. Multicollinearity Test

The purpose of conducting a multicollinearity test is to determine whether there exists a correlation among the independent variables in the regression model. An ideal regression model should be devoid of multicollinearity. To ascertain the presence or absence of multicollinearity, an analysis of the intercorrelation between independent variables is performed. If such intercorrelation among the independent variables is observed, indicated by a VIF (Variance Inflation Factor) value exceeding 10, it suggests the existence of multicollinearity within the regression model. Conversely, if the VIF value is less than 10, it indicates the absence of multicollinearity among the independent variables in the regression model (Ghozali, 2018).

c. Autocorrelation Test

To identify autocorrelation, the Durbin-Watson test (DW test) is employed, with the requirement that the regression model includes an intercept (constant) and lacks lag variables among the independent variables.

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d. Heteroscedasticity Test

The heteroscedasticity test is conducted to examine whether there is a disparity in variance among residual observations within the multiple regression model under examination. The Glejser test is the method employed in this study to determine the presence or absence of heteroscedasticity. An ideal regression model exhibits homoscedasticity, where variances are uniform across observations. This study employed the Glejser test to assess the presence or absence of heteroscedasticity. In the Glejser test, if an independent variable significantly affects the dependent variable, it may indicate the presence of heteroscedasticity (Ghozali, 2018).

3. Hypothesis Test

In statistical analysis, there are two main types of data: time series data and cross-section data. Panel data, as described by Ghozali (2017: 267), represents a combination of both time series and cross-section data. Panel data is commonly known by various names, such as pooled data (resulting from the pooling of time series and cross-sectional data), micro panel data, longitudinal data, event history analysis, and cohort analysis. These terms all imply the examination of units across different time periods. The pooled data regression model is defined by the following equation:

$$Y_{i,t} = \beta + \beta_1 \, UP_{it} + \beta_2 \, LEV_{it} + \beta_3 \, LKD_{it} + \beta_4 \, GCG_{it} + \mu_{it}$$

RESULTS AND DISCUSSION

1. Descriptive Statistical Test

Table1. Descriptive Statistical Test

	N	Minimum	Maximum	Mean	Std. Deviation
Firm Size	60	27,96	34,89	31,5380	1,78537
Financial Leverage	60	,29	,87	,6392	,16938
Liquidity	60	,28	2,53	1,3297	,43422
GCG	60	2,00	11,00	6,0000	1,74667
Quality of FR	60	,75	45344,03	2972,1232	7921,34961
Valid N (listwise)	60				

Source: Research Data, 2020

Based on the provided data, there are a total of 60 observations in the dataset. Among these 60 observations, the firm size variable ranges from a minimum of 27.96 to a maximum of 34.89, with an average value of 31.54 and a standard deviation of 1.79. The financial leverage variable ranges from a minimum of 0.29 to a maximum of 0.87, with an average value of 0.64 and a standard deviation of 0.17. For liquidity, the lowest value is 0.28, while the highest is 2.53, with an average of 1.33 and a standard deviation of 0.43. Regarding the Good Corporate Governance (GCG) variable, the smallest value is 2.00, and the largest is 11.00, with an average of 6.00 and a standard deviation of 1.75. Lastly, the Quality of Financial Reports (Quality of FR) ranges from a minimum of 0.75 to a maximum of 45344.03, with an average value of 2972.12 and a standard deviation of 7921.35.

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2. Classic Assumption Test

a. Data Normality Test

Table 2. Data Normality Test

		FS	FL	Lq	GCG	QoFR
N		60	60	60	60	60
Normal Parameters[a,b]	Mean	31,5380	,6392	1,3297	6,0000	2972,1232
Std. Deviation		1,78537	,16938	,43422	1,74667	7921,350
Most Extreme	Absolute	,084	,113	,110	,150	,354
Differences	Positive	,084	,086	,110	,150	,326
Negative		-,082	-,113	-,084	-,100	-,354
Kolmogorov-Smirnov Z		,650	,878	,852	1,162	2,740
Asymp. Sig. (2-tailed)		,793	,423	,463	,134	,078

a. Test distribution is Normal.

Source: Research Data, 2020

The table provides results indicating that the significance value of the Kolmogorov-Smirnov test for all the research variables exceeds 0.05. This suggests that the data for the variables under investigation follows a normal distribution, making it suitable for subsequent data analysis and processing.

b. Multicollinearity Test

Table 3. Multicolinearity Test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B		Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Tolerance	VIF
1	(Constant)	-345,294	103,513		-3,336	,002	-552,740	-137,849		
	Firm Size	11,163	4,020	,512	2,777	,007	3,106	19,219	,362	2,765
	Financial Lvrg	3,294	36,601	,014	,090	,929	-70,056	76,644	,485	2,063
	Liquidity	10,247	12,766	,114	,803	,426	-15,337	35,832	,606	1,650
	GCG	2,667	3,762	,120	,709	,481	-4,871	10,206	,432	2,317

a. Dependent Variable: Quality of FR

Source: Research Data, 2020

Upon examination of the tolerance values in the provided table, it is evident that none of the variables have a tolerance value less than 0.10, and there are no VIF (Variance Inflation Factor) values exceeding 10. Therefore, it can be inferred that there is no presence of multicollinearity among the independent variables in the regression model for all the study variables.

c. Autocorrelation Test

Table 4. Autocorrelation Test

Model	Std. Error of the Estimate	Durbin- Watson
1	33,15307	1,048

a. Predictors: (Constant), Firm Size, Financial Leverage, Liqudity, GCG

b. Dependent Variable: Quality of FR

Source: Research Data, 2020

As the DW (Durbin-Watson) value falls within the range greater than the upper limit (du) but less than 4 – du, it can be inferred that there is an absence of autocorrelation among the research variables.

d. Heteroscedasticity Test

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Table 5. Heteroscedasticity Test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-345,294	103,513		-3,336	,002		
	Fim Size	11,163	4,020	,512	2,777	,007	,362	2,765
	Financial Lvrg	3,294	36,601	,014	,090	,929	,485	2,063
	Liqudity	10,247	12,766	,114	,803	,426	,606	1,650
	GCG	2,667	3,762	,120	,709	,481	,432	2,317

a. Dependent Variable: AbsUt

Source: Research Data, 2020

Based on the significance values presented in the table above, it is apparent that the significance value for all research variables exceeds 5%. Therefore, it can be deduced that the regression model is not influenced by heteroscedasticity.

3. Hypothesis Test

a. Determination Coefficient Test

Table 6. Determination Coefficient Test

Model	R	R Square	AdjustedR Square	Std. Error of the Estimate
1	,769[a]	,724	,775	33,15307

a. Predictors: (Constant), Firm Size, Financial Leverage, Liqudity, GCG

b. Dependent Variable: Quality of FR

Source: Research Data, 2020

The provided table indicates that the adjusted R2 value is 0.775. This signifies that 77.5% of the variation in the learning motivation variable can be elucidated and influenced by the two independent variables. The remaining 22.5% is attributed to the influence of other unexamined variables.

b. F Test

Table 7. F Test

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	29006,331	4	7251,583	76,598	,000[a]
	Residual	60451,927	55	1099,126		
	Total	89458,258	59			

a. Predictors: (Constant), Firm Size, Financial Leverage, Liqudity, GCG

b. Dependent Variable: Quality of FR

Source: Research Data, 2020

The table above displays a calculated F value of 76.598 with a probability of 0.00. Given that the probability is significantly less than 0.05, it can be inferred that all independent variables collectively have a substantial impact on the quality of financial reports.

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c. t Test

Table 8. t Test

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	345,294	103,513		3,336	,002
Firm Size	11,163	4,020	,512	2,777	,007
Financial Lvrg	3,294	36,601	,014	,090	,029
Liquidity	10,247	12,766	,114	,803	,016
GCG	2,667	3,762	,120	,709	,001

a. Dependent Variable: Quality of FR

Source: Research Data, 2020

The table above reveals that the significance values of all independent variables are less than 0.05. Given that the probability is significantly below 0.05, it can be affirmed that the entire research hypothesis is accepted, as demonstrated by the following mathematical equation:

Quality of FR = 345,294 + 11,163 Firm Size + 3,294 Financial Leverage + 10,247 Liquidity + 2,667 GCG

Firm size significantly impacts the quality of financial reports within the value relevance framework. This implies that larger companies tend to have higher-quality financial statements. The study underscores that company size plays a pivotal role in shaping the quality of financial reporting. Larger corporations exhibit superior financial reporting practices compared to their smaller counterparts. The reason lies in the fact that larger companies typically enjoy more predictable stability and operational efficiency, resulting in fewer errors in financial reporting. Error-free reports, in turn, contribute to the preservation of report integrity.

Moreover, larger companies are inherently associated with lower risk profiles compared to smaller firms. This reduced risk stems from their enhanced predictability in operational stability and decreased likelihood of errors in financial reporting. Consequently, the integrity of their financial reports is more reliable. Larger companies, due to their size, tend to produce higher-quality financial reports, fostering trust among investors (Fitriana and Febrianto, 2019).

According to Prasetyorini (2013), leverage serves as a crucial metric for gauging the effectiveness of utilizing company debt. It represents a company's capacity to manage fixed costs while employing assets and funding sources with the aim of enhancing returns for shareholders (Novianti, 2012).

Liquidity, as defined by Chasanah (2017), pertains to a company's resource availability and its ability to fulfill short-term obligations promptly. A liquid company can be identified when it successfully meets all impending short-term obligations. Such companies typically exhibit a commitment to enhancing the quality of their financial reports (Susanti, 2017).

Good corporate governance is a well-defined system that regulates and oversees companies, aiming to create additional value for all stakeholders (Manossoh, 2016). It involves corporate governance practices that prioritize not only the interests of management but also those of company owners. Good corporate governance is governed by shareholders or institutional ownership, the board of commissioners, audit committees, and other relevant parties involved in the company's development within a specific context (Goenawan, 2012).

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Corresponding Author : Nasrullah Djamil

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