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The effect of corporate governance on the quality of financial report with the capital structure as moderating variable

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ABSTRACT

MARYAM P. The effect of corporate governance on the quality of financial report with the capital structure as moderating variable. (Guided by **Mr. Gagaring Pagalung** and **Mrs. Andi Kusumawati**)

This study aims to find out the effect of corporate governance on the quality of financial report with the capital structure as moderating variable.

The subject of this study were listed manufacturing company in Indonesia Stock Exchange (IDX). The population of this study were 132 companies that amount listed manufacturing company in Indonesia Stock Exchange (IDX) since 2015-2019. The sampling method used Nonprobability sampling technique. Samples taken amounted 47 companies. The data collection method using documentation technique. The analysis method used descriptive statistical analysis, clasic assumption tested, hypothesis tested consists of multiple linear regression analysis, moderated regression analysis, F tested, T tested and determination coeficient tested.

The results showed that (1) The independent board of commissioners has positive effect on the quality of financial report (2) The board of directors has positive effect on the quality of financial report (3) The managerial ownership has positive effect on the quality of financial report (4) The institutional ownership has positive effect on the quality of financial report (5) The capital structure moderating the effect of the independent board of commisioners, the board of directors, managerial ownership, institutional ownership on the quality of financial report.

Keyword: the independent board of commisioners, the board of directors, managerial ownership, institutional ownership, the capital structure, the quality of financial report.

I. INTRODUCTION

According to Belkaoui (2006), one of the main sources of information for economic decision making is financial report. Financial report should be presented in an unbiased manner, with integrity and showed the true condition of the company. But in the fact current era of globalization, there are still many companies in presenting financial information, some are good and some are not good at presenting their company financial statements such as lack of integrity, where the information submitted is not true and fair to some users of financial statements (Badewin , 2019). The act of financial statements is a form of fraud or fraud law. Australian Auditing Standard (AUS) defines financial statement fraud as the intentional omission including the amount of presentation or disclosure in financial statements to deceive users of financial statements (Brennan & McGrath, 2007).

In 2019, PT Garuda Indonesia (Persero) Tbk was in the public spotlight because of last April two commissioners, Chairal Tanjung and Dony Oskaria, rejected the airline's financial report due to there was a misleading element. The rejection occurred even though Garuda reported net profit, but the company had a loss in 2017. The investigation was also carried out by the Supreme Audit Agency (BPK), the Financial Services Authority (OJK) and the Indonesia Stock Exchange (BEI). The decision was that Garuda was guilty and had to correct their financial statements which resulted in losses of Rp 2.4 trillion through 2018 (www.Liputan6.com). It is known that in the 2018 financial statements, Garuda recorded a net profit of US $ 809.85 thousand, or the equivalent of Rp.11.33 billion (exchange rate of Rp.14,000). This profit was supported by the cooperation between Garuda and PT Mahata Aero Teknologi. The cooperation is valued at US $ 239.94 million or around Rp 2.98 trillion. The funds are still receivable but have been recognized as income. As a result, the company previously made a loss and then made a profit (www.finance.detik.com).

From the several cases of manipulation or manipulation of financial statements above, of course it is very detrimental to investors, the public, and all other parties who have an interest and impact on the company that commits the fraud, which is causes the company's value to fall.

One of the elements of corporate governance is the independent board of commissioners. An independent board of commissioners is a member of the board of commissioners who is not affiliated with management, other members of the board of commissioners, and controlling shareholders, and also free from business or other relationships that may affect their ability to act independently or act solely for the interest of the company (National Policy Committee). Governance, 2006). So it can be stated that the supervision of the independent board of commissioners can encourage managers to act for the interest of shareholders, instead of the managers interest. Research of Yulinda N (2016) showed that the independent commissioners are proven to have significant effect on the integrity of financial statements, indicating that there is a tendency for the existence of the independent commissioners to be effective in supervising corporate governance, so that increasing the integrity of financial statements. However, different from research of Hezadeen, A.H. (2016) , Rosyida (2018) and N.P Yani Wulandari (2014) the independent commissioners has no effect on the integrity of financial statements that are presented to parties who need company financial statements.

In corporate governance, the board of directors has a very vital role in a company, which is one of the most important corporate governance mechanisms in determining company performance. As in line with research from Miko, N.U., Kamardin, H. (2015) and N.P Yani Wulandari et al (2014), states that the Board of Directors has no effect on financial reporting.

Referring to agency theory can be understood that there are agency problems due to differences in interest and asymmetric information between agents and owners. With the managerial ownership mechanism in the company, agents will be more careful in making decisions. Agents as the determinants of accounting policies and procedures used by the company will also bear the risk of unqualified financial information. Research of Adebiyi (2016) proves that the managerial ownership has positive effect on the quality financial statement, it is explained that the presence of managerial ownership can improve the quality of financial reports and reduce the level of manipulation of financial statements. But the research from Affan M.W (2017) showed that has no effect on the quality financial statement.

Besides of the managerial ownership, there is institutional ownership. The institutional ownership is condition where the institution owns shares in a company. The institutional ownership has the ability to control management through an effective monitoring process so as to improve company performance. A certain percentage of shares owned by an institution can affect the process of depreciation of financial statements, which is one of the company's performance measures. According to research of N.P. Yani Wulandari dkk (2014) and Affan M.W (2017), the institutional ownership has significant effect on the quality of financial statements. It is the opposite of research from Iswara, U.S (2016), Badewin (2019) and Yasmeen D (2015) showed that the institutional ownership has no significant effect on the quality of financial statements.

Besides of the *Corporate Governance*, another factor that must be considered is the capital structure. The capital structure is arranged to reduce conflicts between various interest shareholders and managers. The decision taken by the company in choosing a source of capital must be carefully considered and cost because each source of capital has different financial effects to produce the capital structure. Determining an incorrect capital structure can increase financial risks such as large expenses, inability to pay interest expenses and debt installments. So that in strategic decision making, such as debt, good report quality is needed (Budiman, 2017).

Eisenhardt (1989) states that agents have more information about the whole company. Meanwhile, the principal does not have enough information about the agent's performance. When not all circumstances and consequences are are not considered by the parties, as a result, there is imbalanced of information happen between the principal and agent. The interest difference between the principal and the agent is called agency problems, where agency problems can reduce the quality of financial reports.

II. LITERATURE REVIEW

Agency Theory

Agency theory is a theory that explain the working relationship between the authorized party (the principal) and the party receiving the authority (the agent). According to Jensen & Meckling (1976), explains the agency relationship as a contract between management (agent) and owner (principal) occurs when one or more people (principal) employ other people (agent) to provide a service then delegates authority for decision making. Principals are shareholders or investors, while agents are management who manage the company. Principals expect management to act according to their interest. Meanwhile, managers are motivated to maximize themselves in terms of obtaining investment, loans and compensation contracts.

The Quality of Financial Report

Financial reports are a means of communicating financial information to interested parties between internal and external parties of the company. Financial reporting is intended to provide information that is useful in making economic decisions and business decisions. The financial statements must show the financial condition of a company in a certain period (Kasmir, 2014).

The Independent Board Of Commisioners

According to the Financial Services Authority Regulation No. 33 / POJK.04 / 2014, concerning the Board of Directors and Board of Commissioners of Issuers or Public Companies, the Board of Commissioners is responsible of supervising management policies, the way of running management in general , whether issuer or public companies and giving advise to the board of directors. An independent commissioner is a has no financial, management, shareholding, family relationship with other members of the board of commissioners, directors, controlling shareholder or other relationship that affects their ability to act independently.

The Board of Directors

The Board of Directors is a part of company entity who charged as operation and management of the company. The board of directors is fully responsible for all forms of operations and management of the company in order to

carry out interests in achieving company goals. With such a big role in the management of their company, the directors basically have significant control rights in managing company resources and funds from investors.

The Managerial Ownership

The management ownership is share ownership by management or internal company parties. Jensen, (1976) the size number of managerial shareholdings can indicate similarity interest between management and shareholders. Managers who have share ownership in the company will tend to act accordingly with the interests of the shareholders because there is similarity interest between them and a sense of belonging of the company. This can minimize the occurrence of agency problems.

The Institutional Ownership

According to Juniarti and Sentosa (2009) in Rebecca (2012), institutional ownership is: Ownership of company shares owned by institutional investors, such as governments, investment companies, banks, insurance companies, foreign institutions, trust funds and other institutions.

The Capital Structure

There are some severals definitions of capital structure. In general, the capital structure is defined as the composition of the company's capital in terms of its source, especially showing the portion of the company's capital that comes from debt sources (creditors) and also the portion of capital that comes from the owner. Capital structure is a comparison between the amount of long-term debt and equity (Robert, 1997).

The Research Hypothesis

H1 : The independent board of commissionners has positive effect on the quality of financial reports

H2 : The board of directors has positive effect on the quality of financial reports

H3 : The managerial ownership has positive effect on the quality of financial reports

H4 : The Institutional ownership has positive effect on the quality of financial reports

H5 : The capital structure able to moderating the relationship the independent board of commissioners, the board of directors, the managerial ownership, the institutional ownership on the quality of financial reports.

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III. Research Methodology

Types of Research

The design of this study is to find at the relations between independent variables consisting of the independent board of commissioners, the board of directors, managerial ownership and institutional ownership with the quality of financial report as the dependent variable and firm size as a moderating variable.

Types of and Sources of Data

This study used secondary data. The secondary data is finished data that has been collecting and processing by other parties. Secondary data used in this study is the company's annual financial report data. The secondary data were obtained from www.idx.co.id, the company's website and the Indonesian Capital Market Directory (ICMD).

Method of Collecting Data

This study used the method of collecting documentation and literature study. The documentation method is a way of collecting data by taking notes and studying documents or archives in accordance with the research problems.

Population and Sample
The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange with an observation period from 2015 to 2019. The sampling technique was carried out by purposive sampling in order to obtain samples that match the predetermined criteria.

Data Analysis Technique
Data analysis in this study using the IBM SPSS Statistics 23 application. Data analysis in this study began with descriptive analysis, data quality testing, classical assumption testing and hypothesis testing using regression analysis.

Normality Test
The normality test aims to test whether in the regression model, the residual variables have a normal distribution. The normality test in this study used normal probability plot test (n-p plot). The data can be stated as normal distributed if data distribution criteria follow a diagonal line. Meanwhile, if the data spreads from the diagonal line or does not follow the diagonal direction, the regression model does not meet the assumptions.

Multicolonierity Test
The multicollinearity test aims to test whether the regression model found a correlation between independent variables (independent). A good regression model should not have a correlation between the independent variables. Multicollinearity can be seen with the Variance Inflation Factor (VIF), if the VIF value is <10 and the tolerance value> 0.10 then, there are no symptoms of multicollinearity (Ghozali, 2013).

Heteroscedasticity Test
The heteroscedasticity test aims to test whether in the regression model there is an inequality of variance from the residuals of one observation to another. If there is a certain pattern, such as the dots forming a certain regular pattern (widened then narrowed, wavy), it indicates heteroscedasticity (Ghozali, 2013).

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Hypothesis Test
The analysis model used to test the hypothesis using Moderated Regression Analysis (MRA). This regression analysis was carried out in two steps of testing. The first step is multiple regression which is carried out without any moderating variables. The second step is regression which is carried out by the interaction between the variables and the independent variables. The equations in hypothesis testing are as follows:

The First Equation:
$Y = \alpha + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + e$

The second equation:
$Y = \alpha + \beta 5X1.X2.X3.X4.Z + e$

IV. RESULTS

Normality Test
The normality test in this study uses the distribution on the P-P plot graph. Based on it can be seen that the data spreads around the diagonal line and follows the direction of the diagonal line on the histogram graph, it shows that the distribution pattern is normal. So it can be concluded that based on the P-P plot graph, the regression model fulfills the normality assumption.

Multicolonierity Test
Based on the results, it is known that tolerance on the variables of the Independent Commissioners and Board of Directors shows the values of 0.997 and 0.940. Then for Managerial Ownership and Institutional Ownership, the values are 0.896 and 0.941 which are above the value of 0.01 (tolerance> 0.01), so it can be stated that there is no multicollinearity of data on the variables of the Independent Commissioner, Board of Directors, Managerial

Ownership and Institutional Ownership. Furthermore, the value of Variance Inflation Factor (VIF) on the Board of Independent Commissioners and Board of Directors shows the numbers 1.003 and 1.064, then Managerial Ownership and Institutional Ownership show the numbers 1.116 and 1.062 which are below the value of 10 (VIF <10), so it can be stated that data multicolonierity does not occur on the variables of the Independent Commissioner, Board of Directors, Managerial Ownership and Institutional Ownership.

Heteroscedasticity Test
Based on results, it is known that the data (dots) spread out on the zero line and without forming a certain pattern, it can be said to be free of heteroscedasticity.

Regression Analysis of Research Data

a. **The Effect of the Independent Board of Commissioners (X1) on the Quality of Financial Reports (Y)**
The probability value of the independent board of commissioners is 0.000 , since the probability value is less than 5% (0.000 <0.050), partially the independent board of commissioners variable (X1) has a significant effect on the variable quality of financial reports (Y). Based on the coefficient value 0.146 it means has a positive effect. The meaning is the more the independent board of commissioners (X1), the more the quality of the financial reports (Y) will increase.

b. **The Effect Of The Board Of Directors (X2) On The Quality Of Financial Reports (Y)**
The probability value of the The Board Of Directors is 0.000 , since the probability value is less than 5% (0.000 <0.050), partially the independent board of directors variable (X2) has a significant effect on the variable quality of financial reports (Y). Based on the coefficient value 0.010 it means has a positive effect. The meaning is the more the independent board of directors (X2), the more the quality of the financial reports (Y) will increase.

c. **The Effect of The Managerial Ownership (X3) on The Quality of Financial Reports (Y)**
The probability value of the managerial ownership is 0.000 , since the probability value is less than 5% (0.000 <0.050), partially the managerial ownership variable (X3) has a significant effect on the variable quality of financial reports (Y). Based on the coefficient value 0.143 it means has a positive effect. The meaning is the more the managerial ownership (X3), the more the quality of the financial reports (Y) will increase.

d. **The Effect of The Institutional Ownership (X4) on The Quality of Financial Reports (Y)**
The probability value of the institutional ownership is 0.000 , since the probability value is less than 5% (0.000 <0.050), partially the institutional ownership variable (X4) has a significant effect on the variable quality of financial reports (Y). Based on the coefficient value 0.039 it means has a positive effect. The meaning is the more the institutional ownership (X4), the more the quality of the financial reports (Y) will increase.

e. **The Effect Of The Independent Board Of Commissioners (X1), The Board Of Directors (X2), The Managerial Ownership (X3), The Institutional Ownership (X4) On The Quality Of Financial Reports moderating by The Capital Structure (Z)**
Based on the results of the moderated regression test, the probability value of The Independent Board Of Commissioners (X1), The Board Of Directors (X2), The Managerial Ownership (X3), the institutional ownership (x4) after interacting with the capital structure variable (z) is 0,000 below the standard significance value of 0,05. it showed that the intention moderates the effect of the independent board of commissioners, the board of directors, the managerial ownership , the institutional ownership on the quality of financial reports. The coefficient value of of The Independent Board Of Commissioners (X1), The Board Of Directors (X2), The Managerial Ownership (X3), the institutional ownership (x4) and the capital structure variable (z) is -,0,004 , it showed it has negative effect which means the capital structure variable weakens the effect of the independent board of commissioners, the board of directors, the managerial ownership , the institutional ownership on the quality of financial reports.

V. DISCUSSION

The Independent Board of Commissioners has positive effect on The Quality of Financial Report
The first hypothesis based on result testing is accepted. It means the higher level of the independent board of commissioners, the higher the quality of a company's financial reports.

According to National Committee for Governance Policy (KNKG), one of the principles that companies must have to called as good corporate governance or a form of good corporate management is the principle of independence. Better quality information will be produced if the company management have a good supervision. It can be stated that by increasing the number of independent boards of commissioners, the higher the level of supervision and can encourage managers not to act in their own interests and in the interests of shareholders. With an increase in the proportion of the independent board of commissioners, it will limit the level of earnings management through the monitoring function of financial reporting so as to improve the quality of financial reports.

The results of this study are in line with Akeju & Babatunde (2017) and Onourah et al. (2016) showed that there was a significant positive relationship to the quality of financial reporting, also research from Purnamasari (2019) where independent commissioners had a positive effect on the integrity of financial statements. It is stated that the existence of independent commissioners is able to create control over management actions, or the better supervision of the board of commissioners, the quality of a financial report will be better.

The Board of Directors has positive effect on The Quality of Financial Report

The second hypothesis based on result testing is accepted. It means the more increasing of the board of directors, the higher the quality of a company's financial reports.

Management as a party running the company activities need to keep stakeholder's interest , in this case the board of directors has the authority and responsibility in managing the company by setting strategic directions, establishing operational policies and being responsible for ensuring the management company health level to improve the quality of financial reports.

The results of this study are in line with Miko, N.U., Kamardin, H. (2015), Dewi (2019) and N. P. Yani (2014) the board of directors has effect on the integrity of the financial reports. a large board of directors shows great resources and will make it easier to detect and resolve potential problems in financial reporting. The board of directors has very important role for the sustainability of the company, with a capable and professional board of directors will be able to improve the integrity of the report.

The Managerial ownership has positive effect on The Quality of Financial Report

The third hypothesis based on result testing is accepted. It means the more increasing of the managerial ownership, the higher the quality of a company's financial reports.

Through the applied agency theory, there are agency problems caused by difference interest and asymmetry information between agents and owners. The agent will be more careful for decision making with the managerial ownership in company. Agent as a determinants of accounting policies and procedures used by company will also bear the risk of unqualified financial information. With managerial ownership, agent will be motivated to work better in improving the company performance and eliminating opportunistic behavior, since agents have a part of the profits generated by the company.

The results of this study are in line with Fratini and Tettamansi (2015) and Adebiyi (2016), showed that the managerial ownership has positive effect on the quality of financial reports, the managerial ownership could improve the quality of financial reports and decreasing the manipulation level of financial reports.

The institutional ownership has positive effect on The Quality of Financial Report

The fourth hypothesis based on result testing is accepted. It means the more increasing of the institutional ownership, the higher the quality of a company's financial reports.

Based on agency theory Jensen and Meckling (1976), which states one of the ways to minimize agency incidents through supervising using ownership structures (managerial ownership and institutional ownership). The institutional ownership in this study have ability to control management through the monitoring process effectively so can reduce management actions to make earnings management. The decreasing of agency problem will have positive impact for the company, since the supervising from external parties, it can be ensured that financial reports can be used for all stakeholders and no one party will be harmed. The financial reports like that will increase the quality of the company and the quality of the reports obtained for investors and can describe the actual condition of the company.

The results of this study are in line with research from Affan M.W (2017), Rafika M (2018) and N. P. Yani (2014), the proportion of institutional ownership has positive effect on the financial reports. The institutional ownership has higher resources and professionalism to supervising the use of company assets and could test the reliability in analyzing information.

The capital structure able to moderating the relationship of the independent board of commissioners, the board of directors, the managerial ownership, the institutional ownership on the quality of financial reports.

The fifth hypothesis based on result testing is accepted. It means the more increasing of the capital structure, the lower the effect of independent board of commissioners, the board of directors, the managerial ownership, the institutional ownership on the quality of financial reports.

According to the Agency theory approach, the capital structure is structured to reduce conflicts between various interest groups. The conflict between shareholders and managers is the concept of free cash flow. There is a tendency for managers to hold resources so they have control over these resources. Debt can be seen as a way to reduce free cash flow agency conflicts. If the company uses debt, then the manager will be forced to remove cash from the company to pay interest. With Agency theory, the capital structure is structured to reduce conflict from interested groups. Corporate governance, in this case capital structure management, is needed so that the company's financial condition remains in good and safe condition. And so there are no losses that could cause the company to run into problems. Good management of capital structure indicates that the company is in good financial management as well. However, in this study it is contradictory, the results show that with a high capital structure, which means that the debt ratio is bigger than equity, it will affect corporate governance in making strategic decisions due to high risks which will certainly have an impact on the quality of financial reports.

The results of this study are in line with research from Faisal et al. (2019) which shows that capital structure is significant in moderating the effect of institutional ownership on financial performance where a company has a high level of leverage, so managers tend to take bigger earnings management actions to maket the resulting earnings quality is low.

VI. CONCLUSION

1. The independent board of commissionners has positive effect on the quality of financial reports
2. The board of directors has positive effect on the quality of financial reports
3. The managerial ownership has positive effect on the quality of financial reports
4. The Institutional ownership has positive effect on the quality of financial reports
5. The capital structure able to moderating the relationship of the independent board of commissioners, the board of directors, the managerial ownership, the institutional ownership on the quality of financial reports.

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