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ANALYSIS OF THE EFFECT OF MANAGERIAL OWNERSHIP AND FINANCIAL DISTRESS ON THE INTEGRITY OF FINANCIAL STATEMENTS

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ABSTRACT

This study aims to analyze the effect of managerial ownership and financial distress on the integrity of financial statements. The data used is secondary data from the financial reports of infrastructure, utilities, and transportation companies listed on the Indonesia Stock Exchange in 2021 of 80 companies with 37 samples. The results of the study show that managerial ownership has no effect on the integrity of financial statements. Conversely, financial distress has a negative and significant effect on the integrity of financial reports. Managerial ownership that is too high can also create conflicts of interest and reduce the transparency of financial reports. Therefore, companies need to regulate the level of managerial ownership in a balanced way to maintain the integrity of financial reports.

ABSTRAK

Penelitian ini bertujuan untuk menganalisis pengaruh kepemilikan manajerial dan financial distress terhadap integritas laporan keuangan. Data yang digunakan adalah data sekunder dari laporan keuangan Perusahaan infrastruktur, utilitas dan transportasi yang terdaftar di Bursa Efek Indonesia tahun 2021 sebanyak 80 perusahaan dengan 37 sampel. Hasil penelitian menunjukkan bahwa kepemilikan manajerial tidak berpengaruh terhadap integritas laporan keuangan. Sebaliknya, financial distress memiliki pengaruh negatif dan signifikan terhadap integritas laporan keuangan. Kepemilikan manajerial yang terlalu tinggi juga dapat menyebabkan konflik kepentingan dan menurunkan transparansi laporan keuangan. Oleh karena itu, Perusahaan perlu mengatur tingkat kepemilikan manajerial secara seimbang untuk menjaga integritas laporan keuangan.

INTRODUCTION

The phenomenon that is currently taking place is that there are a lot of instances of financial data manipulation in business entities and companies in Indonesia, which shows that financial reports lack integrity in how they present information to users of financial statements and do not accurately reflect the financial health of companies. Financial statements are a structured display of the financial status and financial performance of a company, according to Statement of Financial Accounting Standards (PSAK) No. 1 (2014) regarding the presentation of financial statements. Information on assets, liabilities, equity, income, expenses, including profits and losses, contributions from and payments to owners in their capacity as owners, and cash flows are all included in the financial statements. The information contained in financial reports is beneficial to users due to their qualitative features. There are four primary categories of quality: intelligible, relevant, trustworthy, and comparable.

The financial statements of the Garuda Indonesia Group for that year showed a bigger net profit than the previous year. This was a case of financial statement manipulation by Garuda Indonesia for the 2018 fiscal year. Due to disagreements about whether the financial accounts for 2018 were consistent with the Statement of Financial Accounting Standards, the two commissioners of Garuda Indonesia balked at signing them (PSAK). The financial performance of enterprises in Indonesia is said to be significantly impacted by the fiercer competition and uncertain domestic economic conditions brought on by the influence of the global economy. Due to this, the prospect of financial distress can actually materialize. Listed below are several corporations' net profits for the infrastructure, utilities, and transportation industries in 2021.

According to the Table 1, some businesses in the infrastructure, utilities, and transportation sectors may be in financial trouble because they have posted negative EPS in recent years. The use of negative EPS as an indicator of financial distress itself refers to previous research conducted by Kartika and Hasanudin (2019) and Radifan and Yuyetta (2015). The findings of Savero and Safitri's (2017) study on "The Influence of Independent Commissioners, Audit Committees, Institutional Ownership, and Managerial Ownership on the Integrity of Financial Statements" indicate that these factors have been shown to have a significant impact on the integrity of financial reports. The factors employed in this study differ from those used in earlier studies because they are managerial ownership and financial distress. The analytical approach employed in this research and earlier studies is the same.

Table 1. Net Profit (Loss) Per Share (EPS) Of The IUT Sector For The 2021 Period

No	Company	Net Profit and Loss per Share (Rp)
		2021
1	PT Jasa Marga (Persero) Tbk	222,56
2	PT Smartfren Telecom Tbk	-1,39
3	PT Garuda Indonesia (Persero) Tbk	-0,16
4	PT Armada Berjaya Trans Tbk	13,47
5	PT Bakrie Telecom Tbk	-2,57
6	PT Express Transindo Utama Tbk	18,45

(Source: IDX, 2022)

The results of a different study by Wardhani and Samrotun (2020) on "The Influence of Institutional Ownership, Managerial Ownership, Company Size and Leverage on the Integrity of Financial Statements" revealed that Managerial Ownership, Firm Size, and Leverage have no effect on the integrity of financial statements but Institutional Ownership does. The factors employed in this study differ from those used in earlier studies because they are Managerial Ownership and Financial Distress. The analytical approach employed in this research and earlier studies is the same.

This study looks at the impact of managerial ownership and financial distress on the accuracy of financial statements in the infrastructure, utilities, and transportation industries. Research issues can be identified based on the aforementioned phenomena and descriptions in this work. “Analysis of the Influence of Managerial Ownership and Financial Distress on the Integrity of Financial Statements in Infrastructure, Utilities and Transportation Companies Listed on the Indonesia Stock Exchange”.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Literature Review

Agency Theory

According to agency theory, the obligations of the principal and the agent should be kept separate. The principal is the one who delegated power to the agent. An agent is a management party or a party that the principal has given permission to run the business. The foundation of agency theory is a contractual arrangement between shareholders, or owners, and management, or managers. Because of the two parties' competing interests, it is basically impossible to establish a bond between them. The agency relationship is described by Jensen and Meckling (1976) in terms of a nexus of contracts between the owners of economic resources (the principal) and managers (the agents) who manage the use and management of those resources. According to the accounting principle, management should operate as an agent to advance the interests of the principal, but it is also permitted to act simply to further its own interests.

Financial Report Integrity

Integrity, according to Hardiningsih (2010), is being honest and being what one is. Financial reports with integrity are those that accurately depict a company's state without any obfuscation or concealment. The level of information quality that guarantees that the information is fairly free from bias and inaccuracy and honestly displays what it purports to state is known as the integrity of financial reports. Schroeder in Saputri (2010) identified the following characteristics of reliability: Verifiability, representational accuracy, and neutrality are the first three criteria. Financial report information must be focused on the needs of users as a whole rather than on the wants and needs of particular groups of people. Information that favors certain parties while harming those with competing interests shouldn't be attempted to be presented.

Managerial Ownership

Managerial ownership, which includes commissioners and directors, is defined by Linata & Sugiarto (2012) as the proportion of shares owned by management that actively participates in corporate decision-making. Theoretically, management with a large percentage of stock ownership will behave as though they have an interest in the company, claim Mahariana and Ramantha (2014). Share ownership by management can help bring together the interests of internal companies and investors, according to Jensen and Meckling (1976). The percentage of management share ownership will rise if the company performs better.

Financial Distress

When present obligations cannot be met by cash flows, financial distress results. The liabilities in consideration may include debts owed to raw material suppliers, taxes, outstanding bank loans, and other debts (Wurck in Manurung) (2012: 96). When a business is unable to make payments on time or when cash flow forecasts show that they will soon be unable to meet their obligations, financial distress sets in (Brigham and Daves in Nugroho, 2012). In general, increased loan usage raises the likelihood of financial difficulty. According to this reasoning, the likelihood that financial trouble will result from a loss in income increases as debt use and interest payments increase (Sjahrial, 2010:202).

Managerial Ownership of the Integrity of Financial Statements

Shares owned by the company's directors and management are known as managerial ownership. Managerial ownership refers to the ownership of shareholders who hold a position in the management of the company, either as creditors or as members of the board of commissioners. The integrity of financial accounts is unaffected by managerial ownership, according to earlier research by Wardhani and Samrotun (2020).

According to Savero and Safitri's (2017) research, managerial ownership has an impact on the accuracy of financial reports. Because people are naturally self-interested, a management will try to give the finest financial reports possible to stakeholders in order to make the company's performance appear better than it actually is. A control system is required from both inside and outside the organization, such as effective corporate governance and auditors, to be able to create a financial report with integrity.

H_1: Managerial Ownership affects the Integrity of Financial Statements

Financial Distress on the Integrity of Financial Statements

When present obligations cannot be met by cash flows, financial distress results. The responsibilities in question may include debts owed to raw material suppliers, taxes that must be paid, loans from banks, and other debts. Financial strain has an impact on the credibility of financial reporting, according to prior research by Saad and Adillah (2019).

Financial strain has a favorable and significant impact on the integrity of financial reporting, according to research by Saad and Abdillah (2019). This occurs because a company's financial issues will make investors more risk averse and drive up their expectations for returns. The integrity of a company's financial statements increases with the degree of financial crisis it experiences. Ideally, the integrity of a company's financial accounts should decrease the less financial crisis it has.

H_2: Financial Distress affects the Integrity of Financial Statements

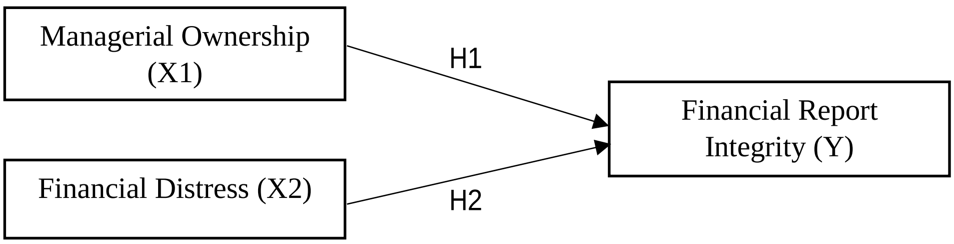

Figure 1. Conceptual Framework

RESEARCH METHOD

This study used a quantitative research methodology. The financial reports of the Infrastructure, Utilities and Transportation companies listed on the Indonesia Stock Exchange for the 2021 period were downloaded via the Indonesia Stock Exchange's official website, www.idx.co.id, which served as the data source. The population of this study consists of 80 firms that are listed in the infrastructure, utilities, and transportation sectors on the Indonesia Stock Exchange for the year 2021. Purposive sampling is the approach utilized, and the following standards were used: 1) Companies in the infrastructure, utilities, and transportation sectors that are listed on the Indonesia Stock Exchange for the year 2021; 2) Companies in the same sector that are constantly listed on the Indonesia Stock Exchange in 2021; Infrastructure, Utilities, and Transportation Companies registered on the Indonesia Stock Exchange with comprehensive variable data used for 2021; 3) Infrastructure, Utilities, and Transportation Companies that consistently produce financial reports and have been audited in 2021. With a one-year research period, observation data for 37 companies were thus collected. Descriptive analysis and regression analysis are the analysis methods employed in this study. Regression analysis is the analytical technique employed in this study, and the equation is as follows

$$Y = a + b_1X_1 + b_2X_2 + e \qquad (1)$$

Y is integrity of financial statements, a is constanta, b1 and b2 is regression coefficient of each independent variable, X1 is managerial ownership, x2 is financial distress, and e is standard error.

Operational Definition and Variable Measurement

Operational definitions and measurements of each variable used in this study are presented in the following Table 2.

Table 2. Operational Variable

Variable	Definition	Variable Measurement
Managerial Ownership (X1)	Managerial ownership ratios, which compute the proportion of shares owned by the company's management, including the board of directors and commissioners, divided by the total number of outstanding shares, can be used to calculate managerial ownership.	( ) x 100% (Source: Haq, Suzan dan Muslih, 2017)
Financial Distress (X2)	the company's declining financial health, as shown by its declining earnings per share value.	This variable will be expressed in the form of a dummy variable, namely 1 for companies with financial distress and 0 for companies with non-financial distress. (Source: Kartika dan Hasanudin, 2019)
Financial Report Integrity (Y)	The degree to which a financial report's information is truthful and honest.	(Source: Wardhani dan Samrotun, 2020)

Table 3. Results of Descriptive Statistics

	Financial Report Integrity (Y)	Managerial Ownership (X1)	Financial Distress (X2)
Mean	2,352	0,142	0,189
Maximum	9,735	0,756	1
Minimum	-0,940	2,364	0
Std. Dev	2,537	0,218	0,397
Observation	37	37	37

RESULT AND DISCUSSIONS

Descriptive Statistical Analysis

Based on the following descriptive analysis are the results of descriptive statistics for each operational variable. There were 37 corporations according to the results of gathering secondary data on the infrastructure, utilities, and transportation companies listed on the IDX in 2021 in terms of the integrity of financial statements, managerial ownership, and financial distress. Included in the descriptive data are the means, maximums, minimums, and standard deviations. The values for the minimum, maximum, mean, and standard deviation are described in the sections that follow. The financial report integrity variable (Y) has a mean value of 2.352, a range of values from -0.940 to 9.735, a standard deviation of 2.537, and a maximum value of 9.735. Additionally, the managerial ownership variable (X1) has a standard deviation of 0.218, a mean value of 0.142, a range of 0.756 to 2.364, a maximum value of 0.756, and a minimum value of 2.364. The average value of the financial distress variable (X2) is 0.189, while the maximum value is 1, the minimum value is 0, and the standard deviation is 0.397.

Multiple Linear Regression Analysis

Based on the Table 4, the regression equation is obtained as follows.

$$Y = a + b_1X_1 + b_2X_2 + e \quad (2)$$

$$FRI = 2{,}533 – 0{,}112\ MO – 0{,}873\ FD \quad (3)$$

Y is integrity of financial statements, a is constanta, b1 and b2 is regression coefficient of each independent variable, X1 is managerial ownership, x2 is financial distress, and e is standard error.

Based on table 4, the constant value is 2.533, which means that the financial statement integrity variable (Y) will have a value of 2.533 if all the independent variables are zero. According to the managerial ownership coefficient (X1), which is -0.112, managerial ownership has no appreciable impact on the accuracy of financial statements. Financial distress has a considerable impact on the accuracy of financial accounts, according to the financial distress coefficient (X2), which is -0.873.

Table 4. Results of Multiple Linear Regression Analysis

Variable	*Coefficient*	*t-Statistic*	*P-Value*
Constant	2,533	4,481	8,002
Managerial Ownership	-0,112	-0,056	0,955
Financial Distress	-0,873	-0,790	0,434
	R-squared		0,018
	Adjusted R-squared		-0,039

Partial Test (t Test)

The t-value for management ownership, which is based on the calculation results in Table 4, is -0.056 with a significance level of 0.955. The significance value is more than 0.05 and the estimated t value is smaller than the t table. The integrity of financial accounts is thus unaffected by managerial ownership. Therefore, it can be said that hypothesis 1 is false. Financial hardship is measured by a variable with a t value of -0.790 and a significance value of 0.434. The significance value is less than 0.05 and the estimated t value is smaller than the t table. This indicates that financial hardship affects the accuracy of financial records. Therefore, it can be said that hypothesis 2 is true.

The Effect of Managerial Ownership on the Integrity of Financial Statements

According to the findings of the hypothesis testing (t test) carried out, managerial ownership has no impact on the accuracy of financial accounts. This study supports research by Arvida (2013), which found that managerial ownership had no bearing on the accuracy of financial accounts. However, it is inversely related to the findings of Savero (2017) and Rizkiyah (2020) research, which indicate that managerial ownership has an impact on the accuracy of financial reports.

Because the accuracy of the financial statements will also be worse in companies with a smaller percentage of managerial ownership, management tends to pay less attention to the interests of shareholders, including himself. The veracity of financial reports will be compromised by minimal managerial share ownership. In order for management to prioritize its own interests. Consequently, it generates issues with or conflicts with agencies between the two parties.

The Effect of Financial Distress on the Integrity of Financial Statements

The results of the hypothesis testing (t-test) indicate that financial difficulty has an impact on the accuracy of the financial statements. Financial strain has a favorable and significant impact on the integrity of financial reporting, according to research by Saad and Abdillah (2019). These findings concur with recent research by Haq, Suzan, and Muslih (2017), which demonstrates that the financial distress variable significantly affects the accuracy of financial statements.

The findings of this study suggest that financial hardship has an impact on the accuracy of financial reports. This demonstrates that a company's financial statements have greater integrity the more financial crisis it experiences. On the other hand, a company's financial statements have less integrity the less financial crisis it experiences.

CONCLUSION

A quality that demonstrates that a company's financial reports are prepared in an honest, reliable, and accurate manner is called the integrity of financial reports. As it may affect investors' investment choices, this is a crucial component of financial reporting. Companies must adhere to applicable accounting standards and disclose financial information in a clear and open manner in order to guarantee the integrity of financial reports. A manager's financial or share ownership interest in a business is referred to as managerial ownership. Managerial ownership is regarded as crucial since it can foster alignment between managers and the company's objectives and help managers perform better. The degree of managerial ownership can have an impact on the integrity of financial statements since managers with a significant financial stake in the business are typically more focused on maximizing performance, which includes providing accurate and trustworthy financial reports. However, excessive managerial ownership can also lead to conflicts of interest and diminish the transparency of financial reporting, impairing the integrity of those reports. To preserve the accuracy of financial accounts, it is crucial to govern the level of managerial ownership in a balanced manner. When a business is in financial hardship, it is having significant problems. Numerous things, like a lack of liquidity, a high debt load, or an inability to generate enough income to

cover obligations, might contribute to this. A corporation in financial difficulties may default on its bills, file for bankruptcy, or even sell assets to pay off its outstanding debts. Financial distress can have an impact on the integrity of financial reports because, in a bad financial state, businesses may struggle to adhere to appropriate accounting rules and accurately provide financial reports. Additionally, in an effort to hide their dire financial circumstances, organizations in financial trouble may be compelled to engage in odd financial transactions or disregard basic accounting norms. This can hurt investors who rely on financial reports for investing decisions as well as diminish the quality of those reports.
The use of a very brief research year resulted in less-than-ideal outcomes, which is a limitation of this study. The results of this study have led to several recommendations for more research, including using the subject and time period of the study to observe how the integrity of the financial statements of other Indonesian enterprises has developed. This study refutes the findings of several earlier studies that managerial ownership factors have an impact on the accuracy of financial statements. If managerial ownership has little impact on the accuracy of financial statements, managers may not be highly motivated to boost business performance and match their goals with those of the company. Without this shared objective, managers can be more focused on making choices that will benefit them personally rather than the organization. This could compromise the integrity of financial reports by causing them to be erroneous and untrustworthy.

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