

## Analysis Of The Effect Of Corporate Governance Structure And Financial Distress

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**Abstract.** The purpose of this study is to see the influence of corporate governance structure (independent commissioner, audit committee, institutional ownership, managerial ownership) and financial distress on the integrity of financial statements of studies on manufacturing companies listed on the IDX for the 2017-2021 period. In this study, quantitative methods were used with secondary data obtained by collecting financial statement data for all manufacturing companies listed on the IDX for the 2017-2021 period, with the use of purposive sampling techniques, sample selection with predetermined criteria so that samples of 40 companies with 5 years of period were obtained with 200 samples. The study used SPSS data processing applications with analytical methods multiple linear regression. The results of the hypothesis test in this study found that independent commissioners, audit committees have no influence on the integrity of financial statements. On the contrary, institutional ownership, managerial ownership and financial distress have an influence on the integrity of financial statements. The results of the F test prove simultaneously that the variables of independent commissioner, audit committee, institutional ownership, managerial ownership, and financial distress affect the integrity of financial statements.

**Keyword** Corporate governance structure, financial distress, financial statement integrity.

### INTRODUCTION

Based on the results of the global fraud survey report by ACFE in 2020 in Indonesia there were 36 fraud cases, in this case Indonesia is ranked first country with the most fraud cases in the Asia-Pacific region, we can see from the following table data.

**Figure 1.** Data on the Number of Fraud Cases in the Asia-Pacific Region Based on the 2020 ACFE Survey

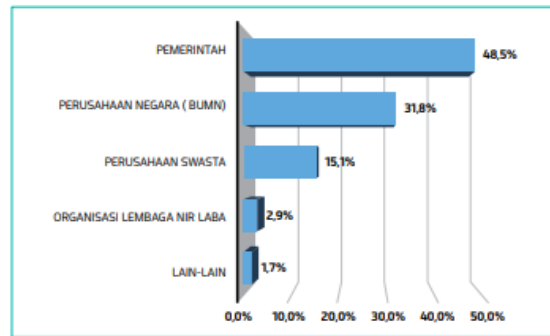
FIG. 56 Cases by country in the Asia-Pacific region

Country	Number of cases
Australia	29
China	33
Hong Kong	11
Indonesia	36
Japan	8
Laos	1
Macau	1
Malaysia	19
Myanmar (Burma)	1
New Zealand	3
Philippines	24
Singapore	17
South Korea	5
Taiwan	2
Thailand	6
Vietnam	2
<b>Total cases:</b>	<b>198</b>

The results of the fraud survey in Indonesia alone in 2019 there were 239 cases, where the most fraud disclosure media used media reports with a proportion of 38.9%. Based on the results of the fraud survey, government organizations showed results of 48.5% where these results were considered the most disadvantaged, and were consistent with the findings of fraud surveys in 2016, then state-owned company organizations amounted to 31.8%, private

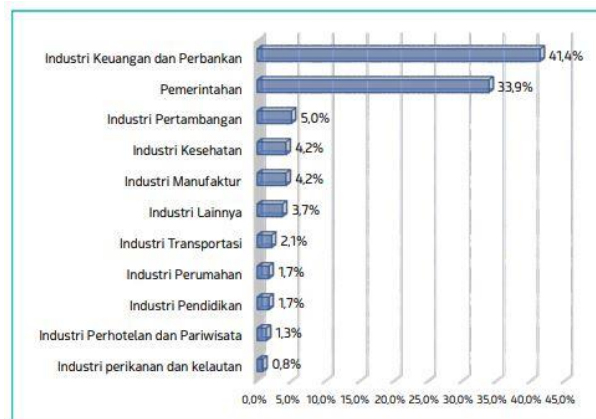
company organizations amounted to 15.1%, non-profit organizations amounted to 2.9% and the remaining 1.7% other organizations.

**Figure 2. Data on Types of Organizations Harmed by *Fraud***



The survey results also show the types of organizations that are very disadvantaged due to fraud, namely the financial and banking industry with a figure of 41.4%, this is the same as the results of the ACFE survey in 2018, while in the results of research in 2016 the financial and banking industry occupied the number two organizations that were very disadvantaged due to *fraud*.

**Figure 3. Data on Types of Industries that are Severely Disadvantaged Due to *Fraud***



The number of *fraud cases* that occur in Indonesia indicates a lack of integrity in the company's financial statements that include internal or external parties. Financial statements include elements of business information that are needed and meaningful to its users. Financial statements contain information that reflects the financial state of the company, this information can be presented as an overview of the company's results. Information in the financial statements must meet reliable and quality criteria that are free from manipulation, there are no material errors and information provided based on reality, which is in the interest of many people, especially interested parties (IAI, 2004)

As a result of the global economic crisis, quite a lot of companies and public accounting services are starting to be questioned and doubted their trust due to the many manipulations of

accounting data, therefore many businesses are starting to challenge the integrity of their financial statements. The decline in integrity in the company's financial statements leads to controversies related to financial law case information that drags the company's internal team or external teams such as external auditors. This study uses several factors that are thought to have an influence on the integrity of financial statements, namely (Nicolin & Sabeni, 2013) *corporate governance structure* (independent commissioner, audit committee, managerial ownership, institutional ownership) and *financial distress*. Quoted from an independent commissioner is a component of the Board of Commissioners that meets the requirements to become an Independent Commissioner authorized by OJK Regulations and is not a member of the Issuer or Public Company Financial Services Authority (2014)

Quoted by Stekom University, the audit committee, namely an entity or institution formed by the composition of the board of commissioners to support the implementation of validation and important research on the implementation of the functions and responsibilities of the composition of directors in organizing in listed companies (Munifah, 2021)

According to managerial ownership, it can affect the integrity of financial statements, because the high percentage of managerial shareholders makes managerial as well as experiencing the influence of a decision taken, including the impact of making inappropriate choices on the part of managers. Thus, management has a tendency to be responsible for managing the company and providing honest and accurate financial statements that can provide financial statements with high integrity (Tamara & Kartika, 2021)

Fajaryani (2015) Stating institutional ownership affects the integrity of financial statements, because institutional investors are able to maximize supervision of management performance so as to minimize opportunistic management behavior that prioritizes the interests of management itself.

Research concludes Abdillah (2019), *financial distress* can affect financial statements, because increased financial difficulties result in an increased risk of bankruptcy of a company, this can encourage companies to apply fraud to numbers in financial statements because companies usually finance the company with debt, and investors usually avoid investing in companies that have a lot of debt because they are considered to have high danger, So that this will affect the integrity of the financial statements.

This study refers to research, there are differences between this study and the previous one, namely (1) using independent variables with differences, namely Nicolin & Sabeni (2013) *tenure audit variables* and auditor industry specialization, on the contrary, this study

uses independent variables (independent) *financial distress*. (2) using financial statement data for different years, namely 2017-2021.

The focus of this research is on all manufacturing companies listed on the IDX in 2017-2021. The formulation of the research problem is: how the influence of *corporate governance* structure and *financial distress* on the integrity of financial statements partially or simultaneously. The purpose of this study is: to determine the effect of *corporate governance* structure and *financial distress* on the integrity of financial reports partially or simultaneously.

Quoted from the Basic Book of Financial Management, agency theory is a theory presented by Jensen and Meckling (1976), this theory discusses the existence of agency relations, agency relations that are there are certain (Purnamasari & Djuniardi, 2021) *parties (principals)* who entrust work to other parties (*agents*) to carry out a job. This agency theory is focused on solving two issues that will arise in agency relations. Jensen & Meckling (1976) in saying that agency relations have two kinds of relationships, namely the manager's agency relationship with Saad & Abdillah (2019) *shareholders*, and the manager's relationship with *bondholders*. The issue that will arise from agency relations is the problem of information integrity, where all circumstances cannot be known by the parties concerned.

Mayangsari (2003) in saying that agency theory is difficult to believe management to act based on the interests of shareholders, so it needs an implementation system that is able to equalize the misalignment of interests between the two parties involved. The Rozania et al., (2013) *corporate governance* system has skills related to creating reliable financial statements. *Corporate governance* is expected to be a solution in minimizing conflicts arising from agency relations. With good governance, companies are expected to be able to create financial statements with integrity.

Based on SAK (2004) in financial statements become a communication medium to describe the financial condition of a company by management to investors, so that during the process of presenting financial statements must be provided appropriately and honestly for users of financial statement information. High-integrity information has the power to influence its users to make decisions. The integrity of financial statements here is represented by the principle of conservatism because accounting is parallel to the presentation of financial statements that are quite thorough, resulting in less risk than the provision that is too optimistic. Prudent financial statements are considered more reliable and meet the priority characteristics of information on financial statements, ultimately contributing to a higher perception of integrity. (Nicolin & Sabeni, 2013; Selviana & Wenny, 2021; and Arista et al., 2019).

A mechanism is a process of operating that fits the system to a certain condition. Corporate *governance* mechanism is a procedure and real relationship between decision makers and parties who carry out supervision and control over decisions. The implementation of corporate governance in Indonesia has an important role in supporting the improvement of development and sustainable economic balance, because its implementation is seen to affect the results of financial reporting (Dewi et al., 2019) .

**a) Independent Commissioner**

Quoted from the book *Independent Commissioner & Audit Committee*, an independent Commissioner is a commissioner who is not a component of the managerial team, majority shareholder, officer or someone who has a direct or indirect relationship with the majority shareholder in a company that observes the company's operations. Independent commissioners play a role in forming a more objective, independent climate, maintaining *fairness and* presenting harmony between the interests of majority shareholders and safeguarding the interests of minority shareholders, as well as the interests of *other stakeholders* (Hasnati (2014) .

**b) Audit Committee**

The role of the audit committee *in good corporate governance* in the company is very important. The effectiveness of the audit committee in monitoring financial control and observing the financial reporting process is very crucial to encourage the creation of credible financial statements. With the existence of an audit committee, it is expected to grow the level of investor confidence in a company. The audit committee is required to be independent, the independence of the audit committee cannot be separated from the ethics underlying its integration, it must be realized because the audit committee is the part that connects the external auditor with the company, as well as linking the control function of the board of commissioners with the internal auditor. The audit committee is formed by the board of commissioners, which is solely responsible for the board of commissioners.

**c) Managerial Ownership**

Managerial ownership is equity ownership by managers who also have duties as company managers. The important role of managerial ownership includes executing planning, organizing, directing and making decisions. The involvement of managers as controllers of the company, the risk of decision making taken has a direct impact on oneself. So, managers will be careful about all decisions so as not to have a self-defeating impact. (Nurbaiti et al., 2021)

**d) Institutional Ownership**

Institutional ownership is shares held by institutions such as insurance institutions, investment companies, banks, and other institutions. The existence of institutional ownership encourages control over management performance, because institutional ownership has the ability and expertise in reviewing financial statements (Nurbaiti et al., 2021).

Quoted from the book *Analysis of Company Financial Performance*, a situation where the company is in financial difficulty and cannot meet various obligations to other parties, such as creditors, obligations to bond shareholders and so on which can lead to insolvency. Hutabarat (2020) state that *financial distress* is not the same as bankruptcy. *Financial distress* can also be referred to as a period where there is a shrinkage in financial conditions that can occur before the stage of bankruptcy or liquidation.

**a) Various kinds of *financial distress***

In financial management, financial difficulties are divided into:

- 1) Economic *failure*
- 2) Business failure
- 3) Technical insolvency or technical insolvency
- 4) Insolvency in bankruptcy
- 5) Legal *bankruptcy*

**b) Causes of *Financial Distress***

Possible causes of *financial distress* are:

- 1) *Neoclasical model*
- 2) *Financial model*
- 3) *Corporate governance model*

**c) Classification of *financial distress predictions***

Some categories of *financial distress* prediction groups are as follows:

- 1) Group A or very high (very dangerous)
- 2) Group B or high (considered dangerous)
- 3) Group C or medium
- 4) Group D or low.

Research "The effect of *corporate governance* structure, audit tenure and auditor industry specialization on the integrity of financial statements in manufacturing companies for the period 2008-2011", with the results of influential variables, namely independent commissioners and audit committees, for variables that do not affect managerial ownership, auditor industry specialization, institutional ownership, and *audit tenure* Nicolin & Sabeni (2013).

The study, entitled "The effect of audit tenure and Dewi et al., (2019) *corporate governance* structure on the integrity of financial statements in LQ45 companies for the 2014-2017 period", shows the results that do not affect are managerial ownership, *audit tenure*, audit committee, on the contrary, influential variables are independent commissioners and institutional ownership.

The study, entitled "The effect of Nurbaiti et al., (2021) *corporate governance*, financial distress, and company size on the integrity of financial statements in property, real estate, and *building construction sector companies listed on IDX companies for the 2014-2018*

*period", showed the results that did not affect the variables were managerial ownership, institutional ownership, independent commissioners, audit committees, and Financial distress, on the other hand, the variable that negatively affects the size of the company.*

Abdillah (2019) entitled "The effect of company size, leverage, audit tenure, and financial distress on financial statements in property and real estate companies for the period 2014-2017", shows the results that *leverage, company size, and audit tenure have a significant negative effect, while financial distress has a positive effect.*

Tamara & Kartika (2021) with the title "The influence of institutional ownership, managerial ownership and audit committee on the integrity of financial statements in all manufacturing companies listed on the IDX for the period 2015-2019", shows that the variables that have a significant positive effect are managerial ownership and institutional ownership, while the variable that does not affect is the audit committee.

Indrasari et al., (2017) entitled "The influence of independent commissioners, audit committees, and financial distress on the integrity of financial statements in property and real estate sector companies for the period 2005-2014", shows the results that the variables that influence are only independent commissioners, while the variables that do not affect are audit committees *and financial distress.*

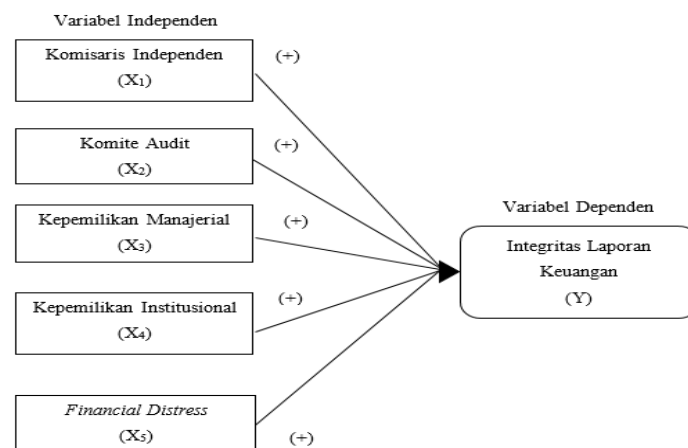
Fajaryani (2015) "Analysis of factors affecting the integrity of financial statements in mining companies for the period 2008-2013" shows the following influential variables, namely company size, institutional ownership, *leverage*, and auditor industry specialization, while the variable that does not affect is managerial ownership.

Saad & Abdillah (2019) "Analysis of the effect of company size, leverage, audit tenure, and financial distress on the integrity of financial statements in property *and real estate companies"*, shows the results of variables that have a positive effect, *namely financial distress and company size, while there are variables that have a negative influence, namely audit tenure and leverage.*

There are similarities between previous research and this study, which is the same as having a dependent variable on the integrity of financial statements but different on the independent variable.

## **FRAME OF MIND**

This research has a frame of mind that is described as follows:

**Figure 4. Thinking Framework**

### Research Hypothesis

The hypothesis of this study is formulated as follows:

1. Independent commissioners positively affect the integrity of financial statements.
2. The audit committee has a positive effect on the integrity of financial statements.
3. Managerial ownership has a positive effect on the integrity of financial statements.
4. Institutional ownership positively affects the integrity of financial statements.
5. *Financial distress* has a positive effect on the integrity of financial statements.

### RESEARCH METHODS

In this study using quantitative methods that apply purposive sampling techniques, there is a sample of 40 companies selected from a population of 239 manufacturing companies listed on the IDX in 2017-2021 with selection criteria focusing on the company's published financial statements.

This research adopts a quantitative data analysis approach, where the method involves explaining quantitative data analysis using numerical values and performing calculations through statistical techniques using SPSS software for data processing. With descriptive statistical testing, classical assumptions, goodness of fit, hypothesis testing and multiple regression analysis.

Multiple regression analysis is used in order to assess the accuracy of the relationship between the integrity of financial statements (dependent variable) with the structure of corporate governance and financial distress which acts as influence factors (independent variables), by utilizing the following equation:



$$\text{CONSR}_{it} = a + \beta_1(X1) + \beta_2(X2) + \beta_3(X3) + \beta_4(X4) + \beta_5(X5) + \epsilon$$

Where: KONSAR = Proxy for the integrity of financial statements; a = Constant;  $\beta$  = Regression coefficient of each variable; X1 = Independent commissioner; X2 = Audit committee; X3 = Institutional ownership; X4 = Management ownership; X5 = Financial Distress;  $\epsilon$  = *Error term*.

### Multiple Analysis Test

The following are the results of the study of multiple regression analysis results:

**Table 1. Multiple Regression Test Results**

		Coefficients <sup>a</sup>					Collinearity Statistics	
Model		Unstandardized Coefficients	Std. Error	Standardized Coefficients	t	Sig.	Tolerance	VIF
1	(Constant)	-.250	.076		-3.314	.001		
	KOMISARIS INDEPENDEN	.007	.078	.006	.086	.932	.886	1.129
	KOMITE AUDIT	.039	.023	.118	1.706	.090	.882	1.134
	KEPEMILIKAN INSTITUSIONAL	.170	.040	.378	4.214	<.001	.527	1.899
	KEPEMILIKAN MANAJERIAL	.119	.044	.249	2.721	.007	.505	1.982
	FINANCIAL DISTRESS	.013	.003	.273	3.837	<.001	.834	1.199

a. Dependent Variable: INTEGRITAS LAPORAN KEUANGAN

From the test results above, a regression equation is obtained as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$$

Where: Y = Measure of financial statement integrity; a = Constant;  $\beta$  = Regression coefficient of each variable; X1 = Independent commissioner; X2 = Audit committee; X3 = Institutional ownership; X4 = Management ownership; X5 = Financial Distress;  $\epsilon$  = Standard error

The above equation can be presented:

1. The coefficient  $\beta_1 = 0.007$  which indicates that an independent commissioner has a positive effect on the integrity of financial statements
2. Coefficient  $\beta_2 = 0.039$  which indicates that the audit committee has a positive effect on the integrity of financial statements
3. Coefficient  $\beta_3 = 0.170$  which indicates Institutional Ownership has a positive effect on the integrity of financial statements
4. Coefficient  $\beta_4 = 0.119$  which shows Managerial Ownership has a positive effect on the integrity of financial statements
5. The coefficient  $\beta_5 = 0.012$  which indicates financial *distress* has a positive effect on the integrity of financial statements.

### Discussion of Research Results

Based on the exam, the first hypothesis shows that the independent commissioner has no influence on the integrity of the financial statements with a significant value of  $0.932 > 0.05$  or a t-count  $< t$ -table value of  $0.086 < 1.97220$  so that H1 is rejected. It can be concluded that independent commissioners do not have a significant effect on the integrity of financial statements. This is similar to research indicating that the proportion of independent commissioners in the company does not affect the integrity of the financial statements held for users of financial statements. The positive but insignificant direction of coefficient shows that

the commissioner is independent of several factors that may not have a direct influence on the part that makes the financial statements. Qonitin & Yudowati (2018)

The results of the hypothesis test show that the audit committee does not have a significant effect on the integrity of financial statements. This study shows a number of 0.090 where the sig value is more than 0.05 or the t-count number is less than the t-table number which is  $1.706 < 1.97220$  which means H2 is rejected. It can be concluded that the audit committee does not affect the integrity of financial statements. This is in line with research that shows that audit committee variables have no influence on the integrity of financial statements, this can happen because the audit committee's ability to encourage information exchange between financial statement makers and ensure compliance with financial reporting provisions is considered inadequate. In another sense, the function of the audit committee function in supervising, reviewing and facilitating auditing and interaction with the Board of Directors is not carried out effectively. As a result, the audit committee's capacity to reduce financial statement fraud and strengthen the reliability of financial statements is impaired Indrasari et al., (2017)

This study shows that institutional ownership variables affect the integrity of financial statements with evidence that the sig number is less than  $0.001 < 0.05$  or t-count value  $4.214 > 1.97220$  which means that institutional ownership variables affect the integrity of financial statements so that H3 is accepted, it supports research that institutional ownership affects the integrity of financial statements, because of potential institutional ownership Increase the role of control over management performance, so as to reduce opportunistic management behavior by management that prioritizes their personal interests Fajaryani (2015)

This study shows the results that managerial ownership affects the integrity of financial statements where the sig value is  $0.007 < 0.05$  or t-count value  $2.721 > 1.97220$  which means managerial ownership affects the integrity of financial statements so that H4 is accepted, it supports research that shows managerial ownership affects the integrity of financial statements where a large level of managerial ownership is considered to result in integrity Financial statements because management is responsible for the company and makes decisions that can have a direct impact on itself so that management is careful about a decision taken so that the tendency to manipulate data is lower (Nurbaiti et al., 2021)

The results showed that financial distress affects the integrity of financial statements *because it has a sig number of less than  $0.001 < 0.05$  or a t-count value of  $3.837 > 1.9720$  which means that financial distress affects the integrity of financial statements which means H5 is*

accepted, it is the same as research showing financial distress. Affect the integrity of financial statements, due to the company's financial limitations can result in unfavorable projections, which can be considered as negative signals, as a result, the company will try to convey a more positive message in order to regain public confidence in the company (Saad & Abdillah, 2019).

The Effect of *Corporate Governance Structure* (Independent Commission, Audit Committee, Managerial Ownership, Institutional Ownership) and *Financial Distress* on Financial Statement Integrity. The results of the F test found that the variables of independent commissioner, audit committee, managerial ownership, institutional ownership, and *financial distress* simultaneously affect the integrity of financial statements. The results can be seen in the ANNOVA test where the F value shows  $8.427 > 2.42$  and the signya number is less than  $0.001 < 0.05$ .

### **Conclusion**

The results of the study can be concluded that:

1. The influence of the *Corporate Governance Structure* on the integrity of financial statements is as follows:
  - a) Independent commissioners do not have a significant effect on the integrity of financial statements because the amount of GIS  $> 0.05$
  - b) The audit committee has no significant effect on the integrity of the financial statements because of the amount of  $> 0.05$
  - c) Institutional ownership has a significant effect on the integrity of financial statements because the amount of sig  $< 0.05$
  - d) Managerial ownership has a significant effect on the integrity of financial statements because the amount of GIS  $< 0.05$
2. *Financial distress* has a significant effect on the integrity of financial statements because the amount of GIS  $< 0.05$
3. Corporate Governance and Financial distress structures simultaneously affect the integrity of financial statements because of the amount of GIS  $< 0.05$

### **Suggestion**

The researcher gave several suggestions as material for improvement for the next researcher, namely: the research data used should be normally distributed so that the data obtained from the population distribution is normal, it is recommended to the next researcher to use different samples and more in order to represent various types of companies, adding the variables used because this study only 15.7% of variables affect the integrity of financial statements in This research, so it has not been able to describe variations in the integrity of financial statements so that it requires developments in further research.

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