
THE EFFECT OF LEVERAGE AND PROFITABILITY ON THE INTEGRITY OF FINANCIAL STATEMENTS WITH MODERATION OF AUDIT QUALITY

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ABSTRACT

KEYWORDS

Profitability, Leverage, Integrity Financial Report, Audit Quality

Today's industrial revolution 4.0 requires companies to interact directly with the global market. The intense global competition that we face includes the rapidly growing economy accompanied by technological developments. The purpose of this research is to examine several aspects that affect the integrity of financial statements. The data analysis technique used is multiple linear regression analysis. The population is companies registered on the IDX. The data was collected using a purposive sampling method, with a sample size of 75 samples. The independent variables of this research are Profitability and Leverage. the dependent variable of this research is the integrity of financial reporting. The research findings prove that the variables of Profitability, and Leverage do not have an impact on Financial Statement Integrity in all categories of this research, while Profitability is able to moderate the influence on Financial Statement Integrity.

INTRODUCTION

The current industrial revolution 4.0 requires companies to interact directly with the global market. The intense global competition we are facing includes the rapidly growing economy accompanied by technological developments (Yuliaty et al., 2020). It is known that currently the number of companies registered on the IDX is increasing, one example of the latest public company is PT Garuda Indonesia with the stock code (GIAA), PT Garuda Indonesia (Persero) Tbk. in 2018 because he was considered to have violated OJK regulation Number 29/POJK.004/2016 regarding the annual reporting of issuers or public companies. The sanctions imposed by the Ministry of Finance. Integrity financial reports present the true financial condition of a company, without anything being deliberately concealed. Thus, when an auditor conducts an audit of financial reporting that does not have integrity (does not reflect the company's actual financial condition) (Hardiningsih, 2010). Fundamentally, financial reports are the output of an accounting mechanism that can be utilized as an instrument in communicating between management and external elements of the company regarding financial data or the company's activities in a period (SAK-PSAK 1, 2016: 3). The purpose of financial reporting is to present information regarding the financial condition, performance and transformation of a company's financial position in a certain period that has utility for all users in making economic decisions. The study aims to examine several aspects that affect the integrity of financial statements.

RESEARCH METHOD

Signaling Theory

Signaling theory was originally initiated by Spence (1973) who described that the sender (owner of the information) sends signals or signs in the form of information that reflects the position of a company that brings benefits to the investor (Riva'i, 2016). For Brigham and Houston (2006) the signal in question is an action carried out by the management of a company that instructs investors on

how management assesses the company's prospects. This theory also explains the company's motives in presenting financial and non-financial reporting data to outsiders, including holders with the aim of reducing asymmetry.

Leverage

The leverage ratio is the ratio used to measure how much a company's assets are funded by debt. The use of debt that is too high can bring losses to the company because the company will fall into the extreme leverage group and will have difficulty paying off the debt burden (Wardhani & Samrotun, 2020).

H1: Leverage has a positive effect on the Integrity of Financial Statements

Profitability

Profitability reflects the level of effectiveness achieved by the company's production activities (Trisnadewi, 2017). This ratio measures how much a company is able to earn profits according to the level of an asset. The greater the profitability ratio, the better the company will earn profits. Companies that create profits tend to do their financial reporting faster than companies with a low level of profitability (Himawan, 2019).

H2: Profitability has a positive impact on the Integrity of Financial Statements

Audit Quality Moderates Leverage

The company's high leverage reflects a high financial risk because it encounters financial difficulties triggered by the excessively high debt burden used to fund its assets (Sulistiyowati, 2021). The high financial risk will increase the time needed by management to provide information related to company performance and can increase the potential for fraud in manipulating financial reporting (Rafika, 2018). This will suppress the integrity of the company's financial statements. The high leverage that becomes a burden on a company will trigger a low level of integrity of the financial statements of that company. On the contrary, when the leverage that is a burden on a company is low, the integrity of its financial reports will be higher.

H3 : The Size of Companies moderate leverage has a positive impact on the Integrity of Financial Statements

Audit Quality Moderates Profitability

Profitability reflects the level of effectiveness achieved by the company's production activities. This ratio measures how much a company is able to earn profits according to the level of an asset. The greater the profitability ratio, the better the company will earn profits (Chasana, 2018). Companies that create profits tend to do their financial reporting faster than companies with a low level of profitability. H4: Moderate Profitability Company size has a positive influence on the Integrity of Financial Statements.

The more assets a company has, the bigger the company and the better its image. Of course, in order to have an attractive appearance, managers try to portray that they can manage their assets well in order to form a stable corporate structure (Oktamawati, 2017). The framework of thinking applied to this research is as follows.

This research is intended to identify the impact of Leverage and Profitability on the Integrity of Financial Statements. This type of research is descriptive qualitative which is intended to test hypotheses through theory validation or testing the application of theory and explaining the characteristics of the variables studied.

Financial Report Integrity

Financial Report Integrity Measurement:

$$MBV = \frac{\text{Market Capitalization}}{\text{Book Value}}$$

Leverage

Leverage Measurement :

$$DAR = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

Profitability

Profitability Measurement:

$$\frac{\text{Earning After Tax}}{\text{Total Assets}}$$

Audit Quality

Measurement of Audit Quality:

"Measured using a dummy, 1 is a company audited by the Big Four KAP and 0 are companies audited by non-Big Four"

The population used in this research is Logistics Transportation Companies which are registered on the IDX from 31 December 2016 to 31 December 2020, namely 15 companies. These companies are utilized in this research because besides having an obligation to carry out financial reports or annual reports for external parties, especially policy makers.

RESULTS

Descriptive Statistics

There are 15 sample companies using secondary data, so the total sample data for the period 2016 – 2020 is 75. Table 1 displays the findings of a descriptive statistical study of manufacturing companies for 2016 – 2020.

Table 1. Descriptive Statistics

| | Y | X1 | X2 | Z |
|-------------------------|-----------|----------|-----------|----------|
| Means | 2.180742 | 0.680081 | -0.016889 | 0.306667 |
| Median | 0.692967 | 0.578902 | -0.004042 | 0.000000 |
| Maximum | 72.05100 | 4.431081 | 2.192030 | 1.000000 |
| Minimum | -4.699878 | 0.074970 | -0.654912 | 0.000000 |
| std. Dev. | 8.631850 | 0.648030 | 0.290567 | 0.464215 |
| Skewness | 7.251627 | 3.489230 | 5.702987 | 0.838557 |
| kurtosis | 58.86294 | 18.71249 | 46.27653 | 1.703177 |
| Jarque-Bera probability | 10409.42 | 923.6913 | 6259,232 | 14.04518 |
| | 0.000000 | 0.000000 | 0.000000 | 0.000892 |
| sum | 163.5557 | 51.00609 | -1.266647 | 23.00000 |
| Sum Sq. Dev. | 5513654 | 31.07576 | 6.247753 | 15.94667 |
| Observations | 75 | 75 | 75 | 75 |

Financial Report Integrity (Y) in table 1 descriptive statistics have a minimum value of -4.699878 held by PT. AirAsia Indonesia Tbk in 2017, while the maximum value is 72.05100 owned by PT. Steady Safe Tbk in 2017, with an average value of 1.984878, and a standard deviation of 7.244816.

Leverage (X1) in table 1 descriptive statistics have a minimum value of -0.074970 held by PT. Pelayaran Nelly Dwi Putri Tbk in 2017, while the maximum value is 4.431081 owned by PT. Steady Safe Tbk in 2016, with an average value of 0.621917, and a standard deviation of 0.553479.

Profitability (X2) in table 1 descriptive statistics have a minimum value of -0.654912 owned by PT. Express Transindo Utama Tbk in 2018, while the maximum value is 2.192030 owned by PT. Steady Safe Tbk in 2016, with an average value of -0.002391, and a standard deviation of 0.244018.

Audit quality (Z) in table 1 descriptive statistics has a minimum value of 0.000000 which is owned by a total of 52 samples of 75 data, while the maximum value is 1.000000 owned by a total of 23 samples of 75 data, with an average value of 0.300000, and the standard deviation has a value of 0.464215.

Observations in table 4.1 descriptive statistics have a value of 800 for the amount of data utilized in this research a total of 75 sample companies.

Chow test

Table 2. Chow test

| Redundant Fixed Effects Tests | | | |
|----------------------------------|-----------|---------|--------|
| Equation: Untitled | | | |
| Test cross-section fixed effects | | | |
| Effects Test | Statistic | d.f. | Prob. |
| Cross-section F | 1.381683 | (14,57) | 0.1922 |
| Cross-section Chi-square | 21.914432 | 14 | 0.0804 |

Based on the picture above, the Chow test results above can be concluded that the Probability Cross-section F value is 0.1922 so that H1 is accepted and H0 is rejected with the Probability Cross-section F > 0.05, so in this Chow test the model chosen is using Random Effects Model.

Hausman test

Table 3. Hausman test

| Correlated Random Effects - Hausman Test | | | |
|--|-------------------|--------------|--------|
| Equation: Untitled | | | |
| Test cross-section random effects | | | |
| Test Summary | Chi-Sq. Statistic | Chi-Sq. d.f. | Prob. |
| Cross-section random | 2.498601 | 3 | 0.4755 |

From the figure above the results of the Hausman Test show that the value of the Random Cross-section Probability is 0.4755 so that it can be concluded that H0 is accepted and H1 is not accepted with a Random Cross-section Probability number exceeding 0.05, so in this test the Random Effect Model is determined as model.

Lagrange Multiplier Test

Based on this research, it cannot be used using the Lagrange Multiplier Test, which means that it shows the value of the Breusch-Pagan Both Probability, a number of 0.0000. Thus, it can be concluded that H0 is accepted with the Breusch-Pagan Both Probability of <0.05 and H1 is accepted, so in the test, the Random Effect Model is determined as the model used.

Inferential Statistics Results

Table 4. Inferential Statistics Results

| Test | Test Criteria | Significance | Results |
|---------------------|---------------------------------|--------------|----------------|
| Chow | <i>Cross-section Chi square</i> | 0.1922 | Random Effects |
| Hausman | <i>Cross-section Random</i> | 0.4755 | Random Effects |
| Lagrange Multiplier | <i>Breush-Pagan</i> | 0.0000 | Random Effects |

Based on table 4, the best panel model test shows that the random effect is the best model, because the probability of the cross-section chi-square is lower than 0.05, so we choose the random effect. It can be concluded that the results of testing the influence of Leverage and Profitability on the Integrity of Financial Statements, utilize the random effect approach.

F test

Table 5. F test

| | | | |
|--------------------|----------|--------------------|----------|
| R-squared | 0.021896 | Mean dependent var | 1.786735 |
| Adjusted R-squared | 0.019432 | S.D. dependent var | 8.286187 |
| S.E. of regression | 8.366310 | Sum squared resid | 4969.655 |
| F-statistic | 0.529803 | Durbin-Watson stat | 2.707718 |
| Prob(F-statistic) | 0.663282 | | |

The F test was carried out in order to identify whether the regression model in this research was appropriate or not. The results of the F test as shown in table 5 show that the Prob value (F-Statistics) for table 4.5 is $0.663282 > 0.05$ which means that simultaneously the Leverage and Profitability variables have no impact on the Integrity of Financial Statements.

T test

Table 6. T test

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|----------|-------------|------------|-------------|--------|
| C | 0.903776 | 1.908083 | 0.473657 | 0.6372 |
| X1 | 0.577315 | 1.887076 | 0.305931 | 0.7606 |
| X2 | -2.172482 | 3.964851 | -0.547935 | 0.5855 |
| Z | 2.764092 | 2.508380 | 1.101943 | 0.2742 |

The impact of the Profitability variable on the Integrity of Financial Statements has a significant value of 0.7606, where the value exceeds 0.05. In other words, the Leverage variable has no impact on the Integrity of Financial Statements. The impact of the Profitability variable on the Integrity of Financial Statements has a significance value of 0.5855, where this value exceeds 0.05. In other words, the Leverage variable has no impact on the integrity of financial reporting. The impact of the Audit Quality variable on the integrity of financial reporting has a significance value of 0.2742, where the value exceeds 0.05. In other words, the Audit Quality variable does not have an impact on the Integrity of Financial Statements.

X1 moderation**Table 7. X1 moderation**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|----------|-------------|------------|-------------|--------|
| C | 1.837356 | 1.716238 | 1.070572 | 0.2880 |
| X1 | -0.692348 | 1.640283 | -0.422091 | 0.6742 |
| M1 | 16.96845 | 7.892467 | 2.149956 | 0.0350 |
| Z | -9.264278 | 6.046341 | -1.532212 | 0.1299 |

X2 moderation**Table 8. X2 moderation**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|----------|-------------|------------|-------------|--------|
| C | 1.405625 | 1.167337 | 1.204129 | 0.2325 |
| X2 | -1.105952 | 3.419798 | -0.323397 | 0.7473 |
| M2 | -35.65260 | 19.54081 | -1.824520 | 0.0723 |
| Z | 1.441535 | 2.178517 | 0.661705 | 0.5103 |

- 1) The influence of the Leverage variable is moderated by Audit Quality on Disclosure of the Integrity of Financial Statements which has a significance value of 0.0350, where the value is below 0.05. In other words, the Leverage variable is moderated by Audit Quality having an impact on Disclosure of Financial Reporting Integrity.
- 2) The impact of the variable Profitability moderated by Audit Quality on Disclosure of the Integrity of financial reporting has a significance value of 0.0723, where this value exceeds 0.05. In other words, the variable Profitability is moderated Audit Quality has no impact on Disclosure of Financial Reporting Integrity.

The test results for the moderating variable, namely audit quality, have an impact on leverage on the integrity of financial reporting. It can be concluded that the results in this research fall into pure moderation or predictive moderation.

Test R²**Table 9. Test R²**

| | | | |
|--------------------|----------|--------------------|----------|
| R-squared | 0.021896 | Mean dependent var | 1.786735 |
| Adjusted R-squared | 0.019432 | S.D. dependent var | 8.286187 |
| S.E. of regression | 8.366310 | Sum squared resid | 4969.655 |
| F-statistic | 0.529803 | Durbin-Watson stat | 2.707718 |
| Prob(F-statistic) | 0.663282 | | |

Adjusted R-square value is 0.019432 or 1.95%. This value can be explained that the variation of the Financial Statement Integrity variable can be described by the variables of the variables leverage, profitability, Audit Quality, while the overall factor result value minus R (1 – 0, 019432) obtained 0.980568 or 98.05% can be described by other factors that are not included in this research model. The impact of leverage, profitability, and audit quality is due to other factors related to the integrity of financial statements, such as the quality of financial reports, liquidity and other independent variables that are not included in this research.

CONCLUSIONS

The findings of this research prove that the Leverage and Profitability variables do not affect the Integrity of Financial Statements in all categories of this research, while Audit Quality is able to moderate the effect of the Integrity of Financial Statements. The findings of this research show that Leverage and Profitability do not have a substantial effect on the Integrity of Financial Statements. For future research, you should include other variables or look for independent variables outside of this study because in this study "Leverage, Profitability, and Audit Quality" contributed to an adjusted R Square value of only 0.018319 or 1.83% which had an impact on the dependent variable "Integrity of Financial Statements", while the remaining 0.981681 or 98.17% is found in other independent variables.

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