

# **Financial Statement Integrity: Intellectual Capital, Leverage, and Audit Quality of Consumer Goods Sector in Indonesia**

**AnnisaNurbaiti**

Faculty of Economics and Business  
Telkom University, Bandung, West Java, Indonesia  
[annisanurbaiti@telkomuniversity.ac.id](mailto:annisanurbaiti@telkomuniversity.ac.id)

**I Putu Diva Arimbawa Putra**

Faculty of Economics and Business  
Telkom University, Bandung, West Java, Indonesia  
[divaarimbawa@student.telkomuniversity.ac.id](mailto:divaarimbawa@student.telkomuniversity.ac.id)

## **Abstract**

This study finds out the simultaneous and partial effect intellectual capital, leverage, and audit quality on the financial statements' integrity of companies in the consumer goods industry listed on the Indonesia Stock Exchange (IDX) in 2016-2020. Purposive sampling produced 32 samples which data of five years were observed hence 160 data sets were observed. Panel data regression was used in the analysis assisted by the EViews 12 software. The results showed that the simultaneously, the independent variables of intellectual capital, leverage, and audit quality affected the financial statements' integrity. Intellectual capital had a partial positive effect on the financial statements' integrity, while leverage and audit quality did not affect the financial statements' integrity. The results of this study can be helpful for further researchers as they add information, insight, and knowledge. Furthermore, companies can consider their intellectual capital in improving the financial statement's integrity.

## **Keywords**

audit quality, financial statement integrity, intellectual capital, leverage

## **1. Introduction**

The consumer goods industry sector can produce or provide anything the community needs. The sector has six categories, namely food and beverages, cigarettes, pharmaceuticals, cosmetics and household goods, household appliances, and other consumer goods industries. Correction of the stock price index is a term that indicates a movement, namely a decrease in stock prices or all stock market indexes by 10% or more (Ash-Shidiq and Setiawan 2015). Dewi (2020) revealed that there are sector indexes that have been able to survive since early 2020, one of which is the consumer goods index, in which the consumption goods index has the lowest correction rate than other sector indexes. The company's good performance is how they present the financial statement with quality and integrity. Presenting quality financial statements by paying attention to the code of ethics in will produce financial statements with integrity.

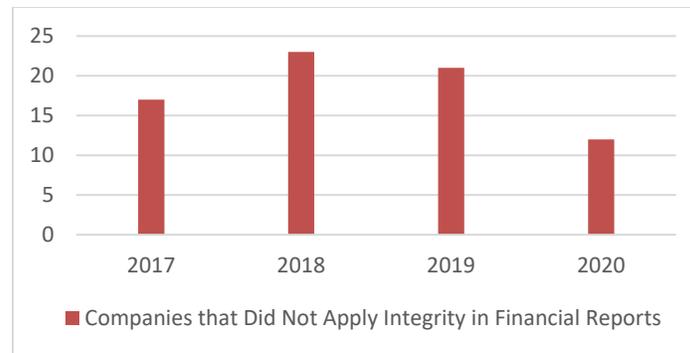


Figure 1. Companies in the consumer goods industry that did not apply integrity in their 2017-2020 financial statements

Source: Processed Data (2021)

Figure 1 shows that a number of consumer goods industrial sector companies in 2017-2020 presented financial statements that had no integrity based on the financial statement integrity measurement using the conservatism principle in the Givolyn and Hayn (2002) model. This will be detrimental to internal and external parties as the statement does not describe the company's real financial conditions. Such a phenomenon had happened, namely PT Tiga Pilar Sejahtera which manipulated its financial statements in terms of overstatements in the accounts receivable, sales, and flow of funds (Widhiyanto 2021). The company did this allegedly because of the company's optimism in attracting investors to invest in the company.

Intellectual capital is a presentation of resources with skills and abilities to behave in accordance with the knowledge possessed (Meramveliotakis and Manioudis 2021). Zhang and Wang (2022) stated that Human Capital, Structural Capital, and Customer Capital are the components of Intellectual Capital. Effective existing intellectual capital will positively affect the financial statement of the company. Leverage is a ratio measuring the amount of assets borne by debt. Leverage describes the amount of company assets that are financed by debt by using a comparison of total debt and total assets (Kasmir 2015). Companies that have high debt levels will reduce the principle of conservatism because if the company has a high debt value, it will cause losses. Audit quality acts as a measure to increase the credibility of financial statement information and can minimize incorrect information for users of financial statements (De Angelo 1981).

Research by Nurdiniah and Pradika (2017) showed that leverage, audit committees and institutional ownership did not affect financial statement integrity, while independent commissioners and company size had an effect. In contrast to the research by Priharto and Rahayu (2019), which showed that leverage, audit quality, company size, and corporate governance perception index (CGPI) partially affected the integrity of financial statements. Hasanuddin's research (2018) which examined corporate governance and audit quality showed that corporate governance and audit quality did not have an effect on financial statement integrity. Based on the results of previous studies, there are still inconsistencies in the studies regarding the integrity of financial statements. Therefore, the author conducted a study entitled "Financial Statement Integrity: Intellectual Capital, Leverage, and Audit Quality of Consumer Goods Sector in Indonesia".

## 1.1 Objectives

This study has the following objectives:

1. To find out intellectual capital, leverage, audit quality, and financial statement integrity of companies in the consumer goods industry listed on the Indonesia Stock Exchange (IDX) for the 2016-2020 period
2. To find out the simultaneous influence of intellectual capital, leverage, and audit quality on the financial statement integrity of companies in the consumer goods industry listed on the IDX in 2016-2020.
3. To find out the partial effect of intellectual capital on the financial statement integrity of companies in the consumer goods industry listed on the IDX in 2016-2020.
4. To find out the partial effect of leverage on the financial statement integrity of companies in the consumer goods industry listed on the IDX in 2016-2020.

5. To find out the partial effect of audit quality on the financial statement integrity of companies in the consumer goods industry listed on the IDX in 2016-2020.

## 2. Literature Review

### 2.1 Agency Theory

The agency theory describes the relationship between the principal and the agent related to a contract in which there are one or more people who are the principal and give orders to other people who are the agents (Jensen and Meckling 1976). Wikartika and Akbar (2019) stated that the agency relationship has two forms, first, between managers and bond holders and second, between managers and shareholders. The agency theory emerges when there are two different responsibilities, and the purpose of the agency theory is to determine solutions related to the problems contained in the relationship between the agent and the principal.

### 2.2 Integrity of Financial Statement

Kieso, et al. (2011) stated that financial statements have integrity if the financial statements have met the quality of reliability that is relevant to accounting principles and can be accepted by the public. Reliability measures how far accounting information can provide consistency and provide correct information to its users. The measurement of the integrity of financial statements can use the conservatism concept. Savitri (2016) defined conservatism as the principle of accounting which will obtain lower income and asset values, as well as higher costs and debt values. Companies that implement conservatism aim to limit managers in opportunistic behavior, increase company value and minimize lawsuits (Fajar and Nurbaiti 2020). This study tends to discuss conservatism in terms of the company's profit and loss, thus the Givolyn and Hayn (2002) model in measuring the integrity of financial statements was used. This model was also used in a research conducted by (Inayanti and Azizah 2021).

$$CONACCit = NIit - CFOit$$

Information:

- CONACCit : The company's level of conservatism in i year t.  
NIit : Profit before extraordinary items plus depreciation of the company in i year t.  
CFOit : Cash Flow from operating activities of company in i year t.

### 2.3 Intellectual Capital

Intellectual capital, as an intangible company asset in the form of knowledge, becomes the company's wealth in carrying out new innovations for the progress of the company (Khan and Yang 2018). Meramveliotakis and Manioudis (2021) stated that intellectual capital is important, because if it continues to be developed, it will increase the company's and the employees' productivity. Intellectual capital has three components, namely Human Capital (related to the employees), Structural Capital (knowledge about company), and Capital Employed (knowledge about employees) (Zhang and Wang 2022). Therefore, if the intellectual capital of the company continues to be developed, it will be the company's added value. In the research by Febrilyantri (2020) and Palebangan and Majidah (2021), intellectual capital positively affected the financial statement integrity. Quality intellectual capital such as adequate and qualified knowledge, skills, and expertise will have an impact on the good performance of the company's human resources, so that they can convey company information through financial statements with integrity. This study uses the Value Added Intellectual Capital (VAIC) indicator, because it presents a consistent and standardized measure, and standardized financial values are usually presented in financial statements, so that analysis is possible. This measurement was also used by Febrilyantri (2020).

**H1: Intellectual capital has a positive effect on financial statement integrity.**

$$VAIC = HCE + SCE + CEE$$

1. Calculating Value Added (VA)

$$VA = OUT - IN$$

Information:

- OUT = output, the company's total sales revenue

IN = input, operating expenses (except employee expenses)

2. Calculating Human Capital Efficiency (HCE)

$$HCE = \frac{VA}{HC}$$

Information:

VA = Value Added

HC = Cost of Employee Salaries and Wages

3. Calculating Structural Capital Efficiency (SCE)

$$SCE = \frac{(VA - HC)}{VA}$$

Information:

VA = Value Added

HC = Cost of Employee Salaries and Wages

4. Calculating Capital Employed Efficiency (CEE)

$$CEE = \frac{VA}{CE}$$

Information:

VA = Value Added

CE = Total Company Equity

## 2.4 Leverage

Debt is part of the company's source of funding and most companies develop their business through debt (Horne and Wachowicz 2009). Companies that have high leverage ratios (have high debt) will lead to high financial ratios, and have a great opportunity to earn high profits (Nurdiniah and Pradika 2017). In addition, high debt will cause financial problems in the company if it has difficulty paying the debts (Fahmi 2014). Therefore, the existence of a high level of leverage in the company will result in low financial statements. A'yunin et al.'s (2019) study showed that leverage has a negative effect on financial statement integrity. In this study, the proxy for leverage is the Debt to Asset Ratio. This measurement was also used by Nurdiniah and Pradika (2017).

**H<sub>2</sub>: Leverage has a negative effect on financial statement integrity.**

$$LEV = \frac{\text{Total Debt}}{\text{Total Asset}}$$

Information:

LEV = Leverage

## 2.5 Audit Quality

Nwanyanwu (2017) wrote that standards in conducting audits include professional quality standards, independent auditors, judgment that plays a role in audit activities and in compiling audit statements. These standards can be used by auditors as a measure in financial statement audits. Audit quality is how probable an auditor in finding indications of violations when auditing an accounting system and reporting the violations (Joshi et al. 2011). Audit quality in financial statements is important because it is a reflection of decision making on these financial statements. The higher the audit quality obtained, the more trusted the financial statements as decision makers. Mulyadi et al. (2022) showed that audit quality affected on financial statement integrity. In this current study, audit quality was measured using the auditor specialization proxy, which was calculated from the percentage of clients who have been audited in one industry. An auditor/KAP is declared a specialist if the auditor/KAP has audited 15% of the number of companies in a particular industry (Craswell et al., 1995).

**H<sub>3</sub>: Audit quality has a positive effect on financial statement integrity**

$$SPCLIND = \frac{\text{The Number of Auditor's or KAP's clients in the Industry}}{\text{The Number of All Issuers in the Industry}} \times 100\%$$

Information:

SPCLIND = Auditor Industry Specialization

### 3. Methods

This is a descriptive quantitative study that uses a case study. The unit in this study is a group of companies listed on the Indonesia Stock Exchange (IDX) in 2016-2020 operating in the consumer goods industry. The sample was selected based on purposive sampling, hence the total sample was 160 consisting of 32 companies with a five-year observation period. The criteria are as follows:

1. Consumer goods companies that were listed on the IDX in 2016-2020
2. Companies that have consistently issued their audited financial statements in 2016-2020

The research background used is the non-contrived setting. The analysis technique in this study uses panel data which combines time series with cross sectional data. The equation of the panel data regression analysis used in this study is as follows:

$$Y = \alpha + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + e$$

Furthermore, the study conducted classical and hypothesis tests, namely the simultaneous test (F-Test), the Determinant Coefficient Test (R<sup>2</sup>), and the Partial Test (T-Test).

### 4. Data Collection

The data were audited annual reports issued by companies in the consumer goods industry in 2016-2020 which were retrieved from the IDX website (www.idx.id) and the companies' official websites.

### 5. Results and Discussion

#### 5.1 Numerical Results

##### 5.1.1 Descriptive Statistics

1. Intellectual capital had a mean of 2.856236 which was smaller than the standard deviation of 2.8845405. This indicated that the Intellectual capital data of the companies in the consumer goods industry in 2016-2020 were not clustered. The maximum value was 21.9363 and the minimum value was -9.8160.
2. Leverage had a mean of 0.522266 which was smaller than the standard deviation of 0.8295937. This indicated that the leverage data were not clustered. The maximum value was 7.2637 and the minimum value was 0.0003.
3. Audit quality had a mean of 0.337500 which was smaller than the standard deviation of 0.4743416. This indicated that the data on the audit quality variable were not clustered. The maximum value was 1.0000 and the minimum value was 0.0000.
4. The financial statement integrity had a mean of -249,361,520,207.11 which was smaller than the standard deviation of 1,166,598,474,062,201. This indicated that the data on the financial statement integrity were not clustered. The maximum value was 1,937,920,162,000 and the minimum value was -9,284,900,000,000.

Table 1. Results of Descriptive Statistical Tests

	Variable			
	Intellectual Capital (X1)	Leverage (X2)	Audit Quality (X3)	Financial Statement Integrity (Y)
Max	21.9363	7.2637	1.0000	1,937,920,162,000
Min	-98.160	0.0003	0.0000	9,284,900,000,000
Mean	2.856236	0.522266	0.3375	- 249,361,520,207.11
Std. Dev.	2.8845405	0.8295937	0.4743416	1,166,598,474,062.20
Observation	160	160	160	160

Source: Processed data (2022)

### 5.1.2 Classical Assumption Tests

#### 1. Multicollinearity Test

Table 2. Multicollinearity Test Results

	X1	X2	X3
X1	1	0.03380642	0.04785753
X2	0.03380642	1	-0.1368275
X3	0.04785753	-0.1368275	1

Source: Processed data by EViews12 (2022)

The results of the multicollinearity test (Table 2) of intellectual capital (X1), leverage (X2), and audit quality (X3) showed values smaller than 0.8 (<0.8) and therefore no multicollinearity was found between the independent variables.

#### 2. Heteroscedasticity Test

Table 3. Heteroscedasticity Test

Heteroskedasticity Test: White  
Null hypothesis: Homoskedasticity

F-statistic	1.558909	Prob. F(8,151)	0.1417
Obs*R-squared	12.20645	Prob. Chi-Square(8)	0.1422
Scaled explained SS	174.4295	Prob. Chi-Square(8)	0.0000

Processed data by EViews12 (2022)

In this study, the heteroscedasticity test used the white test method and the Prob. Chi-square (Obs\*R-Squared) value obtained was 0.1422, where  $0.1422 > 0.05$  (Table 3). It can be concluded that there was no heteroscedasticity problem or that this study was free from heteroscedasticity problems.

### 5.1.3 Data Panel Regression Model Selection

#### 1. Chow Test

Table 4. Chow Test Results

Redundant Fixed Effects Tests  
Equation: FEM\_MODEL  
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	2.311098	(31,125)	0.0006
Cross-section Chi-square	72.493022	31	0.0000

Source: Processed data by EViews 12 (2022)

The value of Prob. Cross-section Chi-square was 0.0000 in Table 4. The value was smaller than the significant level 0.05 (<0.05), meaning that the best model for this study was the fixed effect model. The next step was the Hausman test.

2. Hausman Test

Table 5. Hausman Test Results

Correlated Random Effects - Hausman Test			
Equation: REM MODEL			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	10.565060	3	0.0143

Source: Processed data by EViews 12 (2022)

The value of Prob. Random cross-section was 0.0143 (Table 5). This value was smaller than the significant level 0.05 (<0.05), which meant the best model for this study was the fixed effect model. From the results of the two tests, the most appropriate model in the study was the fixed effect model.

5.1.4 Results of Panel Data Regression Analysis

$$Y = -3.91E+11 + 1.68E+11X_1 + 1.26E+10X_2 - 1.02E+12X_3 + e$$

Information:

- Y = Integrity of Financial Statements
- X1 = Intellectual Capital
- X2 = Leverage
- X = Audit Quality
- e = Error term

Table 6. Fixed Effect Model Test Results

Dependent Variable: Y				
Method: Panel Least Squares				
Date: 05/16/22 Time: 20:21				
Sample: 2016 2020				
Periods included: 5				
Cross-sections included: 32				
Total panel (balanced) observations: 160				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-3.91E+11	4.07E+11	-0.961012	0.3384
X1	1.68E+11	3.79E+10	4.447331	0.0000
X2	1.26E+10	1.39E+11	0.090754	0.9278
X3	-1.02E+12	1.17E+12	-0.875552	0.3830
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.385949	Mean dependent var	-2.49E+11	
Adjusted R-squared	0.218927	S.D. dependent var	1.17E+12	
S.E. of regression	1.03E+12	Akaike info criterion	58.35166	
Sum squared resid	1.33E+26	Schwarz criterion	59.02435	
Log likelihood	-4633.133	Hannan-Quinn criter.	58.62481	
F-statistic	2.310771	Durbin-Watson stat	2.288376	
Prob(F-statistic)	0.000438			

Source: Processed data by EViews 12 (2022)

### 5.1.5 Coefficient of Determination Test

Table 7. Coefficient of Determination Test (R2) Results

R-squared	0.385949	Mean dependent var	-2.49E+11
Adjusted R-squared	0.218927	S.D. dependent var	1.17E+12
S.E. of regression	1.03E+12	Akaike info criterion	58.35166
Sum squared resid	1.33E+26	Schwarz criterion	59.02435
Log likelihood	-4633.133	Hannan-Quinn criter.	58.62481
F-statistic	2.310771	Durbin-Watson stat	2.288376
Prob(F-statistic)	0.000438		

Source: Processed data by EViews 12 (2022)

The adjusted R-squared was 0.218927, which meant that the independent variables, namely intellectual capital, leverage, and audit quality were able to explain the financial statement integrity by 21.89% and the remaining 78.11% was explained by factors outside the study.

### 5.1.6 Simultaneous Hypothesis Testing (F Test)

The probability value (F-statistic) was Table 7 is 0.000438. The probability value (F-statistic) showed that it was smaller than the significant level 0.05 ( $<0.05$ ), meaning that the independent variables, namely intellectual capital, leverage, and audit quality together (simultaneously) affected the dependent variable, namely the integrity of financial statement.

### 5.1.7 Partial Hypothesis Testing

Table 8. Partial Hypothesis Testing (T Test) Results

Dependent Variable: Y				
Method: Panel Least Squares				
Date: 05/16/22 Time: 20:21				
Sample: 2016 2020				
Periods included: 5				
Cross-sections included: 32				
Total panel (balanced) observations: 160				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-3.91E+11	4.07E+11	-0.961012	0.3384
X1	1.68E+11	3.79E+10	4.447331	0.0000
X2	1.26E+10	1.39E+11	0.090754	0.9278
X3	-1.02E+12	1.17E+12	-0.875552	0.3830

Source: Processed data by EViews 12 (2022)

Table 8 shows the results of partial hypothesis testing (T test).

1. Intellectual capital obtained a probability value (t-statistic) of 0.0000, which was smaller than the significant level 0.05 ( $0.0000 < 0.05$ ). The Intellectual capital coefficient was  $1.68E+11$ , therefore  $H_1$  was accepted. In other words, the Intellectual capital variable affected the financial statement integrity in a positive direction.
2. Leverage obtained a probability value (t-statistic) of 0.9278, which was greater than the significant level 0.05 ( $0.9278 > 0.05$ ). The leverage coefficient was  $1.26E + 10$ , therefore  $H_2$  was rejected. In other words, the leverage variable had no effect on financial statement integrity.
3. Audit quality had a probability value (t-statistic) of 0.3830, which was greater than the significant level 0.05 ( $0.3830 > 0.05$ ). The audit quality coefficient was  $-1.02E+12$ , therefore  $H_3$  was rejected. In other words, the audit quality variable had no effect on financial statement integrity.

## 5.2 Validation

### 5.2.1 The Effect of Intellectual Capital on Financial Statement Integrity

The probability value (t-statistic) Intellectual capital was 0.0000, smaller than the significant level 0.05 ( $0.0000 < 0.05$ ). It was found that  $H_1$  was accepted and the intellectual capital variable affected the integrity of financial

statements in a positive direction. These results agree with the hypotheses built by previous researchers. The results also support previous studies conducted by Febrilyantri (2020) and Palebangan and Majidah (2021) which stated that intellectual capital affected financial statement integrity in a positive direction. It can be concluded that properly managed Intellectual capital, which is adequate and qualified knowledge, skills, and expertise, will have an impact on the good performance of the company's human resources, so that it can convey company information through financial statements that have integrity.

### **5.2.2 The Effect of Leverage on Financial Statement Integrity**

Leverage had a probability value (t-statistic) of 0.9278. This was greater than the significant level 0.05 ( $0.9278 < 0.05$ ). It was found that  $H_2$  was rejected and that the leverage variable had no effect on financial statement integrity. These results are not in line with the hypotheses built by previous researchers. However, they are in line with Safitri and Bahri (2021) and Wahyuni (2021) who stated that leverage did not have an effect on financial statement integrity. It can be said that the companies' leverage and whether the leverage is large or small would not influence the financial statement's integrity because the company would do better and would develop if the company had debt, as the company's initial capital (Wahyuni 2021).

### **5.2.3 The Effect of Audit Quality on Financial Statement Integrity**

Audit quality had a probability value (t-statistic) of 0.3830. This value was larger than the significant level 0.05 ( $0.3830 > 0.05$ ). It was found that  $H_3$  was rejected and that the audit quality variable did not have an effect on financial statement integrity. These results were not in line with the hypotheses built by previous researchers. However, the results were in line previous studies conducted by Safitri and Bahri (2021) and Serly and Helmayunita (2019) which stated that audit quality did not have an effect on financial statement integrity. According to De Angelo (1981), the audit quality proxy, namely the specialization of the auditor could not influence financial statement integrity. This is because the auditors' ability to find or report indications of violations in the financial statements depends on their abilities, knowledge, skills, and techniques.

## **6. Conclusion and Recommendations**

### **6.1 Conclusion**

The results and discussion of this study, lead to the following conclusion.

1. The independent variables, namely intellectual capital, leverage, and audit quality simultaneously affected on the financial statement integrity of companies in the consumer goods industry listed on the Indonesia Stock Exchange (IDX) in 2016-2020.
2. Intellectual capital, in a positive direction, partially affected financial statement integrity of companies in the consumer goods industry listed on IDX in 2016-2020.
3. Leverage did not partially affect the financial statement integrity of companies in the consumer goods industry listed on IDX in 2016-2020.
4. Audit quality did not partially affect the financial statement integrity of companies in the consumer goods industry listed on IDX in 2016-2020.

### **6.2 Recommendations**

This study is expected to add information in accounting, especially on financial statement integrity. Furthermore, companies can consider making use of their intellectual capital to improve their financial statement integrity.

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## **Biographies**

**Annisa Nurbaiti** obtained her bachelor's degree in accounting, from the Faculty of Economics, Universitas Widyatama Bandung, Indonesia. She continued her graduate studies in Master of Economics in Accounting, at Universitas Padjadjaran, Bandung, Indonesia. She received a scholarship from the Ministry of Education and Culture, Republic of Indonesia when she continued her study. She has been a Lecturer at the Faculty of Economics and Business, Telkom University, Indonesia since 2015. Her research interests are auditing and risk management.

**I Putu Diva Arimbawa Putra** is a student at Telkom University. He has participated in several competitions of scientific writing. He won second place in a scientific writing competition at the Jakarta Economic Forum in 2019. He received a scholarship from the Amazon Web Service (AWS) in 2021 and is active as tax volunteers in West Java, Indonesia. He has also conducted research related to financial statement integrity and is active in journal writing as a graduation requirement for the undergraduate Accounting program at Telkom University.