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CONSEQUENCES OF THE QUALITY OF FINANCIAL REPORTING

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Abstract

This study investigates the economic consequences of the quality of financial reporting in the manufacturing industry of the Indonesian Stock Exchange (Bursa Efek Indonesia). The sample comprises 100 manufacturing companies listed on the Indonesian Stock Exchange, observed over a period of 5 years. The analysis employs Structural Equation Modeling (SEM). The findings indicate that the financial performance characteristics do not significantly affect the quality of market-based financial reporting. However, these characteristics do have a significant impact on the quality of accounting-based financial reporting. Moreover, the intervening variables, represented by the influence of the company's performance on market-based and accounting-based financial reporting, exhibit a significant effect, which is notably larger than the direct impact. These results highlight the intricate relationship between financial performance, the quality of financial reporting, and their economic consequences within the manufacturing sector of the Indonesian Stock Exchange. They underscore the importance of accounting practices and reporting quality in shaping investors' perceptions and decision-making processes, thereby impacting the overall economic outcomes of the companies involved.

Keywords : ***Quality of Financial Report; Economic Consequences; Asymmetric Information***

1. INTRODUCTION

Financial statements are the end result of the accounting process containing information about a company's financial performance over an accounting period. This information is used by investors as a basis for decision-making. Financial statements also serve as a management accountability to the company's owners, providing an overview of the company's economic performance and business conditions. The quality of financial statements is an interesting issue because financial statements are a means of communication to external users, such as investors, creditors, and government, who require accurate and relevant information to make decisions. The quality of financial statements is a cornerstone of transparent and accountable financial reporting within organizations. It serves as a vital communication tool, providing stakeholders with essential information to evaluate the financial health and performance of a company. Several factors contribute to ensuring the quality of financial statements.The implementation of an effective accounting information system plays a pivotal role. An efficient system not only streamlines the process of data collection and recording but also facilitates accurate financial reporting. By automating routine tasks and minimizing manual errors, an advanced accounting information system enhances the reliability and integrity of financial data.

The expertise and integrity of individuals involved in preparing financial statements are paramount. Qualified accountants with a deep understanding of accounting principles and regulations ensure compliance with reporting standards. Their diligence and attention to detail safeguard against errors and misstatements, thereby upholding the credibility of financial statements. The utilization of information technology is indispensable in modern financial reporting practices. Advanced software and tools enable organizations to analyze vast amounts of financial data efficiently, identify trends, and generate comprehensive reports. Moreover, cloud-based solutions enhance accessibility and collaboration, facilitating real-time updates and ensuring data security. Quality financial statements exhibit several characteristics that instill confidence and trust among users. Relevance ensures that information is pertinent and useful for decision-making, while materiality focuses on highlighting significant transactions and events.

Reliability emphasizes the accuracy and consistency of information, underpinned by robust internal controls and audit procedures. Financial statements should be presented in a clear and understandable manner, catering to users with varying levels of financial literacy. Fair presentation requires impartiality and transparency in depicting the company's financial position and performance, free from bias or manipulation. Neutrality ensures objectivity, while sound judgment guides accounting estimates and assumptions. Completeness entails disclosing all relevant information, while comparability enables users to benchmark performance over time and against peers. Timeliness ensures that financial information is available promptly, enabling timely decision-making. Lastly, striking a balance between costs and benefits ensures that the resources expended in preparing financial statements are justified by the value they provide to users.

The need for financial statements by management to shareholders is explained through agency theory. Jensen and Meckling (1976) explain the contractual relationship between managers and owners of the company, where decision-making authority is given to the manager. This creates a conflict between the economic consequences of owners and agents. Agents as company managers have a moral obligation to optimize the benefits of owners, but other agents also have interests in maximizing the benefits and welfare of their staff. Conflict arises due to opportunistic behavior of agents who do not always act as expected and violate agreed contracts. Based on this background, this study analyzes financial performance for the quality of financial statements and its impact on economic consequences in the manufacturing industry of the Indonesian Stock Exchange. The object of this research is manufacturing companies listed on the Indonesian Stock Exchange. Based on the background of the problem, the researcher wants to see the influence of financial performance on the quality of financial statements and market-based. This paper is related to Easley and O'hara (2004), who found that the quality of information affects asset pricing, so how information is provided to the market is clearly important.

2. IMPLEMENTATION METHOD

This research was conducted in the Indonesia Stock Exchange from January 2019 to December 2023. The population of this study consisted of manufacturing companies that provided data on company characteristics and the quality of financial reporting using the proportional stratified random sampling technique, totaling 100 companies. The independent variables are determinants of the quality of market-based financial reporting (relevance, timeliness, conservatism) and accounting-based reporting quality (persistence, predictability, earnings smoothing). The dependent variables are decision-making (asymmetric information, cost of capital). The data analysis method used in this study involves testing relationships, which will be analyzed using Structural Equation Modeling (SEM) with the alternative method of Partial Least Square (PLS) using SmartPLS software. In this research, the researcher utilizes SEM (Structural Equation Model). SEM is a statistical technique capable of analyzing the pattern of relationships between latent constructs and their indicators, latent constructs with each other, as well as direct measurement errors. SEM enables analysis among multiple dependent and independent variables directly.

3. RESULTS AND DISCUSSION

1) Results of Research Model Testing

The estimation model used in this study is :

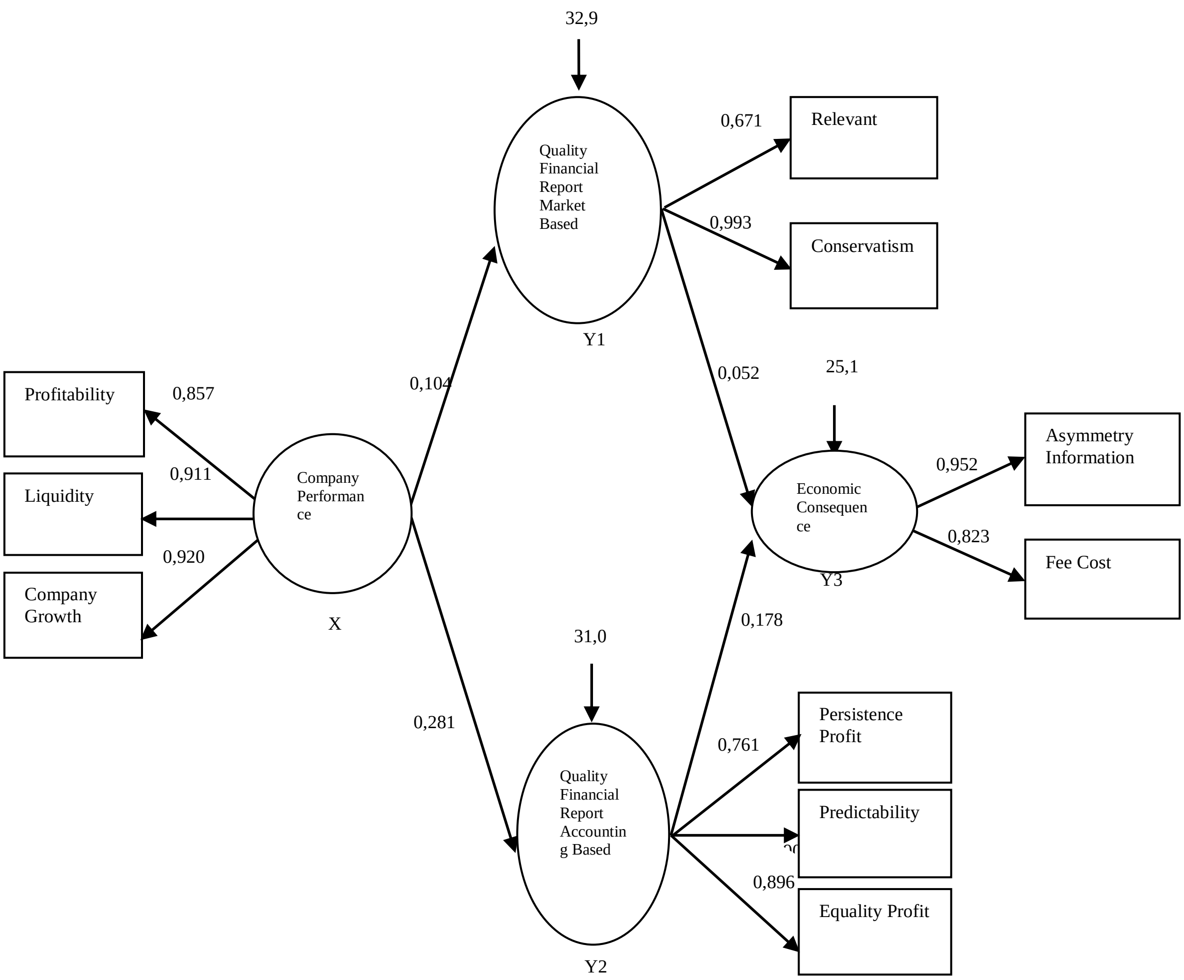

Figure 1. Influence the Company's Performance to the Quality of Market-Based Financial Report and Accounting.

This study's findings underscore the intricate relationship between company performance and the quality of financial reporting, shedding light on its multifaceted implications for stakeholders. Firstly, the distinction between market-based and accounting-based financial reporting quality highlights the nuanced nature of information dissemination within the financial landscape. While market-based reporting reflects the dynamics of investor sentiment and market perceptions, accounting-based reporting adheres to standardized principles and regulatory requirements. These results are consistent with Fanani (2008) and Fanani et al. (2009), who did not find a significant influence between liquidity and financial reporting. Both market-based and accounting-based financial reporting quality significantly impact company performance and its economic consequences. Companies with higher-quality financial reporting tend to have better performance and more positive economic consequences. This is because companies with higher-quality financial reporting are more capable of disclosing accurate and relevant information to investors and owners, enabling them to make more informed decisions. Market-based and accounting-based financial reporting quality also affect economic consequences through their influence on the cost of capital. Better-informed investors can adjust their portfolios to include new information, disadvantaging uninformed investors. In balance, the quantity and quality of information affect asset prices. This differs from the results of this paper, as their findings raise interesting questions about security market design and the cost of capital. Market-based and accounting-based financial reporting quality also affect company performance through their influence on performance accountability. Company performance accountability can be enhanced by presenting high-quality financial statements.

High-quality financial statements enable investors and owners to make more accurate decisions and better monitor company performance. Therefore, companies should focus on improving the quality of financial reporting to enhance performance accountability. The observed lack of significant influence of company performance characteristics on market-based financial reporting quality suggests that market perceptions may be driven by factors beyond traditional financial metrics. This could include qualitative aspects such as industry reputation, strategic positioning, or market sentiment, which may not be fully captured by conventional performance indicators. Understanding these non-financial drivers of market-based reporting quality is crucial for companies seeking to effectively communicate their value proposition to investors and stakeholders. Conversely, the significant impact of company performance characteristics on accounting-based financial reporting quality underscores the importance of robust financial management practices and governance structures. Companies that prioritize transparency, accuracy, and compliance with accounting standards are better positioned to produce high-quality financial statements that reflect their true financial health.

This enhances trust and credibility among investors, reducing information asymmetry and mitigating agency costs. Furthermore, the linkage between financial reporting quality and company performance extends beyond mere disclosure practices. It encompasses the broader concept of performance accountability, wherein transparent and reliable financial reporting serves as a mechanism for monitoring and evaluating managerial decisions and actions. By providing stakeholders with accurate and timely information, companies can foster greater trust and confidence, leading to improved performance outcomes and shareholder value creation. The implications of financial reporting quality on economic consequences are manifold, particularly concerning the cost of capital and asset pricing dynamics. High-quality financial reporting enhances market efficiency by facilitating informed investment decisions and reducing uncertainty. This, in turn, contributes to lower capital costs for companies with transparent and reliable financial reporting practices, ultimately bolstering their competitiveness and financial sustainability. This research demonstrates that the quality of financial reporting plays a crucial role in influencing company performance and its economic consequences. Both market-based and accounting-based financial reporting quality significantly impact company performance and its economic consequences. Therefore, companies should focus on improving the quality of financial reporting to enhance both performance and economic consequences.

4. CONCLUSION

1. Performance Characteristics Do Not Influence the Quality of Market-Based Financial Reporting, indicating that company performance characteristics do not have a significant impact on the quality of financial reporting used in the market. This means that company performance does not directly affect the quality of information presented in market-based financial reports.
2. Performance Characteristics Impact the Quality of Accounting-Based Financial Reporting, indicating that company performance characteristics have a significant effect on the quality of

financial reporting used in accounting. This means that company performance directly influences the quality of information presented in accounting-based financial reports.

3. Intervening Variables Influence Company Performance on Economic Consequences with Intervening Variables Quality of Market-Based and Accounting-Based Financial Reporting, indicating that intervening variables, quality of market-based and accounting-based financial reporting, have a significant effect on company performance and its economic consequences. This means that the quality of market-based and accounting-based financial reporting has a larger impact than the direct impact on company performance and its economic consequences.

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