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THE EFFECT OF THE PUBLIC ACCOUNTANT FIRM SIZE, ISSUER SIZE, COMPANY OWNERSHIP, AND CORPORATE GOVERNANCE IMPLEMENTATION ON FINANCIAL STATEMENTS INTEGRITY

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Abstract: *This study aimed to formulate the effect of the public accountant firm size, issuer size, company ownership, and corporate governance implementation on financial statements integrity. The data of this study are secondary data of 176 audited financial statements of public companies in Indonesia. Variable of Corporate Governance Implementation is measured by primary data of 176 management of public companies in Indonesia. Hypothesis testing using multiple regression analysis and logistic regression. The result shows that (1) public accountant firm size, issuer size, and company ownership partially or simultaneously positively affect GCG implementation and (2) Public Accountant Firm Size, Issuer Size, Company Ownership and Implementation of Corporate Governance affects both simultaneously and partially on the integrity offinancial statements.*

Keywords: *Public Accountant Firm Size, Issuer Size, Company Ownership, Corporate Governance Implementation, Financial Statements Integrity.*

1. INTRODUCTION

Background

The financial statements provide the information that is necessary as a mean of decision-making both by internal and external parties. According to FASB, the two most important characteristics that must be present in the financial statements are relevant and reliable. The financial statements with good quality also face challenges related to the economic consequences in their preparation. Economic consequences is a concept which states that the choice of accounting policies may affect the value of a company. This means that the accounting policies and changes in accounting policies may lead the manager to change the actual results of the company operations. This practice is often referred to as the earnings management.

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The practice of earnings management may cause problems of agency (agency cost) that is triggered from the separation of the role or the difference of interest between the shareholders (principals) with the company management (agent). This agency conflict will erode the quality of reported earnings, thus reducing the financial statements integrity in the future.

Corporate governance implementation is implemented in agency theory that provides a view that financial statements integrity issue can be enhanced through supervision that is through good corporate governance. Corporate governance implementation by management can be improved through a monitoring mechanism to align (alignment) differences in the interests of owners and management among others; (1) audit quality as seen from the role of the auditors who have sufficient competence and are independent so they become a party that can provide assurance of the integrity of accounting figures reported by the management (Mayangsari 2003) in the form of public accountant firm size, (2) increase the company's share ownership by management (managerial ownership) (Jensen Meckling 1976) such as issuer size; and (3) institutional share ownership because they are regarded as a sophisticated investor with ownership of a significant amount who is able to monitor the management whose impact can reduce the manager motivation to perform the earnings management. (Midiastuty, Pratana and Mas'ud 2003) in the form of company ownership.

Research Objectives

This research aims to find the model on financial statements integrity in good corporate governance integrity on go public companies in Indonesia, namely: (1) Formulate the effect of public accountant firm size, issuer size, and company ownership on corporate governance implementation and (2) Formulate the effect of the public accountant firm size, issuer size, company ownership, and corporate governance implementation on financial statements integrity.

Research Contributions

The resulting research model in this research is expected to contribute to the development and application of accounting knowledge and can be used as a reference for future research.

2. CONCEPTUAL FRAMEWORK

A. The Relationship between Public Accountant Size with Good Corporate Governance Implementation and Financial Statements Integrity

Choi et. al., (2010) explains that there are two perspectives related to how public accounting firm size factor can affect the audit quality. The first perspective is called the economic dependence perspective. Small public accountant firms are more concerned about the economic interests of their clients compared to the risk of audit failure and tend to compromise on audit quality because of the economic dependence on the client. In other words, loss of reputation as a result of audit failure has a greater influence for large public accountant firms than smaller public accountant firms. Large public accountant firs do not depend on a particular client because of the level of economic dependence which is smaller than small public accountant firms. Large public accountant firms tend to not want to compromise on the audit quality so as to provide a better audit quality compared to smaller public accountant firms.

The second perspective is called the uniform quality perspective. This perspective argues that the large public accountant firms such as the Big 4 have responsibility for providing audit services with the same quality between local offices (affiliates) with different sizes and located in different regions and countries. Internal factors that encourage large public accountant firms in providing uniform audit quality at local offices namely the large public accountant firms are more concerned with the training of staffs and conduct periodic evaluations, and tend to use standardized techniques and procedures in auditing. It then facilitates the transfer of knowledge between local offices owned by large public accountant firms so as to create a uniform audit quality both at the central and branch. The opinions of Choi et. al., (2010) are also supported by Supriyati and Rolinda (2007),that large public accountant firms namely the big four tend to present better audit than non big four public accountant firms because they have a reputation that is at stake. Large public accountant firms have greater resources that can perform audits faster and produce better and more efficient audit quality.

Companies that use the services of large public accounting firms must be very interested in the results of the audit that can be used for decision-making for the investors, so with the awareness that the independence and audit quality is the key to large public accountant firms, therefore the companies are believed to be running good corporate governance and good corporate governance is believed will certainly result in financial statements integrity.

B. The relationship between Issuer Size with Good Corporate Governance implementation and Financial Statements Integrity

In addition to the public accountant firm size, the audit quality can also be affected by Issuer size. Larger companies will have greater complexity of the operation and there is a separation between the management and ownership, thus require larger public accountant firms to reduce agency costs (Watts and Zimmerman, 1986 in

Nasser et. al., 2006). Based on these arguments, large companies will certainly prefer to use the services of large independent and professional auditors to create a quality audit causing a positive relationship. Larger companies have an internal control system that is better than small companies (Fernando et. al., 2010).

This evidence is shown by Aryati and Maria (2005) who states that the company size as measured by the total assets have a significant impact on audit delay. This effect is indicated by the greater value of the assets of a company then the shorter the audit delay will be and vice versa. Larger companies are expected to complete the audit process more quickly than small companies. This is because the management of large companies tends to have incentives to reduce the audit delay due to the companies are strictly monitored by the investors, capital regulator and government. In other words, large companies tend to have a higher public demand for information than the smaller companies, and the high public demand for information will enable the growth of the investors' trust and the trust is believed will improve good corporate governance and good corporate governance is believed will certainly result in financial statements integrity.

This research criteria for the category of issuer size is the criteria issued by the Capital Market Supervisory Agency No. Kep. 11/PM/1997 which states that small and medium companies based on the assets (wealth) are legal entities that have total assets of not more than one hundred billion, while large companies are legal entities whose total assets are above one hundred billion.

C. The Relationship between Company Ownership with Good Corporate Governance and Financial Statements Integrity

Agency theory explains that the separation between ownership and management in a company would create a conflict of interest between the owners/shareholders and the managers/managers of the company. Zulhawati (2004) explains that the management tends to prefer its interests that are generally contrary to the company's main goal. Sartono (2001) concludes that this conflict of interest can be controlled by means of increasing managerial ownership (insider ownership). With the increase in managerial ownership, the management will certainly put the interests of shareholders because they are also shareholders. The managers will be motivated to increase the shareholders' wealth which will also affect the value of the company (Mahadwarta and Hartono, 2002). Suranta and Machfoedz (2003) states that the value of the company will be higher when the director has the greater shares.

Thus, the company's managers who have managerial ownership percentage will manage the company better (good corporate governance). They tend to have a greater responsibility in running the company, making the best decision for the welfare of the company, and reporting the financial statements with information that is true and honest so that the financial statements have high integrity. Based on these explanations, then we expect that there is a relationship between the company ownership (managerial and institutional ownership) with good corporate governance and financial statements integrity.

D. The Relationship between Good Corporate Governance and Financial Statements Integrity

Signaling Theory is based on the assumption of the existence of information asymmetry between the company management that has the full information (well informed) and the investors/other stakeholders who have less information (poorly information) (Wondabio Sensi, 2007). The management that has bad information (bad news) tends to not disclose such information to the investors than if the information is good (good news) in order to maintain a high stock price (Wondabio Sensi, 2007). The lack of information to the outside parties or investors about the company causing the investors to protect them selves by providing low prices to the companies (Jama'an, 2008). To over come this information asymmetry, it needs transparency and good management of the company (corporate governance). Corporate governance is a concept that is done to improve corporate performance through supervision or management performance monitoring and ensure the accountability of management to the stakeholders based on the regulatory framework (Nasution Setiawan, 2007). The corporate governance practices will provide transparent management of a company. Bank Indonesia regulation, Number 8/14/PBI/2006 explains that the principles of good corporate governance are transparency, accountability, responsibility, independence and fairness. The corporate governance mechanism has the capability in terms of generating financial statements that contain earnings information (Rachmawati and Triatmoko, 2007). The corporate governance mechanism consists of the composition of the independent commissioners, board of commissioners size and audit committee.

Boediono (2005) states that the composition of the board of commissioners is one of the characteristics associated with the content of earnings information. Through its role in oversight, board composition may affect the management in preparing the financial statements in order to obtain a qualified profit.

E. Financial Statements Integrity Measurement

Financial statements integrity is the financial statements presented correctly and honestly. According to Statement of Financial Accounting Concepts (SFAC) No. 2 quality financial information is financial information that assures that information is reasonably free from error and bias and honestly presents what is intended to be expressed. Financial statements integrity size intuitively can be divided into two, which is measured by the conservatism and existence of manipulation of financial statements that are usually measured by the earnings management (Mayangsari, 2003). Conservatism means that the accountants must record the lowest alternative value for the assets and the highest alternative value for the liabilities (Watts and Zimmerman, 1986).Characteristics of the information in this conservatism principle can be one factor to improve the financial statements integrity. The implications of the conservatism concept to the accounting principles are accounting recognizes expenses or losses that might occur, but do not immediately recognizes revenues or profits that would come despite of the high possibility (Suwardjono, 1989). From the explanations, it can besummarized that the reasons for the use of conservatism as a proxy of the financial statements integrity, namely the conservatism itself is identical to the understated financial statements whose risk is smaller than the overstated financial statements. The financial statements that meet these characteristics will be more reliable that qualify the quality of information in SFAC No. 2. The financial statements integrity in this researchis measured with the principle of conservatism by using the assumption that the company's methods used among others the methods of depreciation, methods of depreciation and amortization, as well as recognition of the cost of research methods.

Each accounting method has a different level of conservatism. Jama'an (2008) argues that differences in the selection of accounting methods affect the figures presented, either in the statement of financial position and income statement. The first assumption is that the company that uses the average inventory method will be more conservative than the one that uses the FIFO method, because the average method produces smaller cost of ending inventory so the price of cost of goods sold become greater and the resulting profit becomes smaller. The second assumption is that the company that uses the declining balance depreciation method is relatively more conservative than the company that uses the straight-line method, because it produces greater depreciation costs and smaller profit. The third assumption is that the company that uses the declining balance method of amortization is relatively more conservative than the company that uses the straight-line method, because it produces a greater amortization cost resulting in a smaller profit. The fourth assumption is that the company that recognizes research and development costs as expenses in the current year will tend to be more conservative than the company that recognizes the research and development costs as assets. The research and development costs that are recognized as expenseswill lead to the profit generated be comes smaller.

Research Model

Model 1

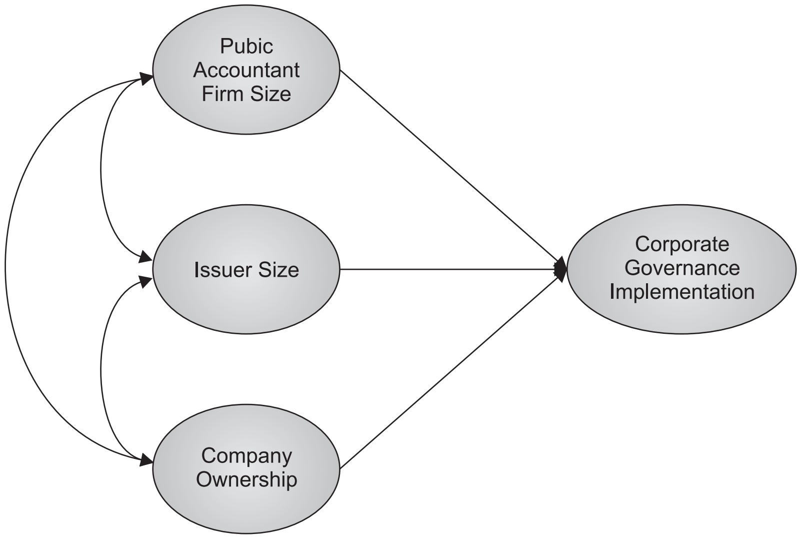

Figure 2.1: The Effect Model of Public Accountant Firm Size, Issuer Size and Company Ownership on Corporate Governance Implementation

Research Hypothesis

H1 : Public Accountant Firm Size, Issuer Size and Company Ownership affect either simultaneously or partially Corporate Governance Implementation

H2 : Public Accountant Firm Size, Issuer Size, Company Ownership and Corporate Governance Implementation affect either simultaneously or partially Financial Statements Integrity

3. RESEARCH METHODS

A. Data Type, Data Source and Data Collection Method

The data of this research are secondary data and primary data. Variables Public Accountant Firm Size, Issuer Size, Company Ownership and financial statement integrity are measured by data of 176 audited financial statements of public companies in 2010-2012 that is obtained from the Indonesian Capital Market Directory (ICMD) available in the Indonesian Stock Exchange.

B. Data Analysis

The method of analysis of this research is inferential analysis or verificative, with multiple regression and logistic regression. This analysis uses the Statistical

Model 2

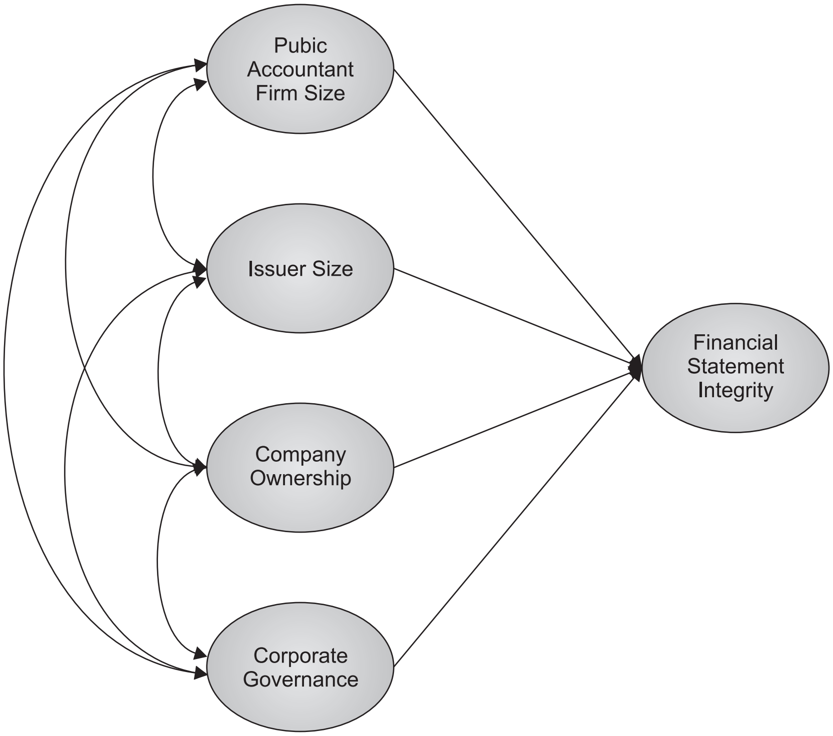

Figure 2.2: The Effect Model of Public Accountant Firm Size, Issuer Size and Company Ownership on Corporate Governance Implementation and Its Implications for the Financial Statements Integrity

Program for Social Sciences version 22, which the hypothesis test or significance test is conducted by comparing the significance (sig., Or p-Value) with α. If sig. or p-value is smaller than α, it means significant. The coefficient of determination (Cox and Snell's R Square) is used to measure the ability of the independent variables in explaining the dependent variable. The feasibility of the model is also seen from the initial-2 Log likelihood and signficance value Hosmer dan Lemeshow Test.

C. Operationalization of Research Variables

Operationalization of research variable scan be explained as follows:

1. **Public Accountant Firm Size (X_1):** The public accountant firm size who performs company audit based on the number of the auditors, number of affiliates, number of clients, and total area of the public accountant firm work
2. **Issuer Size (X_2):** An operational volatility proxy and inventory controlability that in the economies of scale the company size should indicate the current operation achievements and inventory control (Mukhlasin, 2002).

3. **Company Ownership (X_3):** Share ownership percentage in a company owned by the institution as a monitoring agent due to the size of their investment in the capital market (Braisford, Oliver and Pua, 2002)
4. **Corporate Governance Implementation (Y):** Transparency, Accountability, Responsibility, Independence, Fairness
5. **Financial Statements Integrity (Z):** Extent of the financial statements presented shows a true and honest information to the selection of methods and accounting estimates that keep the book value of net assets relatively low (Penman and Zhang, 2002).

4. REASEARH RESULTS

A. Validity and Reliability Test

Validity test of Public Accountant Firm Size, Company Ownership, GCG Implementation, all items statement of KAP, the ownership of the company and GCG is valid because the value of r count > 0.148. Reliability test of Public Accountant Firm Size, Company Ownership, GCG Implementation, all items is reliability because value un bet win 0,61 – 0,80 (cronbach Alpha)

B. Normality Test, Multicollinearity Test and Test Heteroscedasticity

Npartest using a One-Sample Kolmogorov-Smirnov Test, found that all data has to be normally distributed. While the data is free from heteroscedasticity, Because It has asig > 0.05 is 0146; 0232; and 0443.

First Hypothesis Test

The results of first hypothesis test through multiple regression analysis shows that public accountant firm size, issuer size, and company ownership partially affect GCG implementation at the level of significant 90% ($\alpha = 0.10$). That public accountant firm size, issuer size, and company ownership partially affect GCG implementation on F count 4.837 with p-value (Sig.) = 0.003, and a level of significant 95% ($\alpha = 0.05$). Because p-value (0.003) < α (0.05), then H_1 is accepted, namely that public accountant firm size, issuer size, and company ownership partially or simultaneously positively affect GCG implementation.

Table 1
The Coefficient of Determination (R^2) with Model Summary[b]

Model	*R*	*R Square*	*Adjusted R Square*	*Std. Error of the Estimate*
1	.279[a]	.078	.062	.38144

Table shows that the effect of public accountant firm size, issuer size, and company ownership to GCG implementation reaches 6.2%, is significant at $\alpha = 0.05$ and p-value = 0.000. The remaining amount of 93.8% is affected by other factors.

The equation path shown is GCG = 0,131 KAP + 0,211 KEP + 0,127 Emiten + 0,938.

Second Hypothesis Test

Results of testing the second hypothesis by logistic regression analysis showed that H2 is accepted, namely that the Public Accountant Firm Size, Issuer Size, Company Ownership and Implementation of Corporate Governance affects both simultaneously and partially on the integrity of financial statements. Some assessment criteria model fit, indicated by:

1. Initial-2 log like lihood 169.867. decreased to 160.869.
2. Value Nagelkerke R square of 0.081; which means that the variable financial statements integrity can be explained by the variable Public Accountant Firm Size, Issuer Size, Company Ownership and Implementation of Corporate Governance.
3. The significance value of Hosmer and Lemeshow shows that the value 0.835>0.05; It means the model is able to predict the observed values.

While the results of logistic regression, shows model fit, indicated resources by Initial-2 log likelihood 169.867. Decreased to 160.869. Financial statements integrity variables can be explained by the variable of Public Accountant Firm Size, Issuer Size, Company Ownership and Implementation of Corporate Governance by 0081 or 8.1%. The models is Able to predict the observed values for the Hosmer & Lemeshow test, the table shows the value 0835> 0.05. Then obtained the following equation:

$$\text{ILK KAP} = 1{,}852 + 0{,}478 - 0{,}064 + 0{,}014\ \text{Issuer} - 1{,}350\ \text{GCG}$$

The results of this research are consistent with some previous researches, namely: (a) The research on the analysis of the factors that affect the auditor's job satisfaction and its relationship with the performance and auditor's work turnover intentions, with the result that public accountant firm size affects corporate governance implementation. (b) The research that examines differences in earnings management behaviour based on the differences in Life Cycle and company size which concludes that issuer size affects corporate governance implementation. (c) The research that examines management ownership, institutional ownership, leverage and corporate social reponsibility which concludes that company ownership affects corporate governance implementation.

The difference of this research with previous researches, namely: (1) differences in performance in the form of corporate governance implementation among large, medium and small public accountant firms; (2) issuer size affects earnings management as the corporate governance implementation; (3) company ownership status determines corporate governance implementation.

5. CONCLUSION

The conclusions of this research are:

1. Public accountant firm size, issuer size, and company ownership positively and significantly affect good corporate governance implementation on the companies in Indonesia that have go public.
2. The Public accountant firm size, issuer size, company ownership, and good corporate governance implementation positively and significantly affect financial statements integrity on the companies in Indonesia that have go public. The results also showed that the implementation of GCG affect negatively with financial statements integrity. This may be due to lack of proper corporate governance instruments, or the need for moderating variables to mediate the relationship between the implementation of GCG with the financial statements integrity.

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