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THE INFLUENCE OF BUSINESS ETHICS COMMITMENT ON FINANCIAL REPORTING QUALITY

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Abstract: *This study examines the influence of business ethics commitment toward financial reporting quality. This study uses explanatory research method and a multivariate regression test to conduct the statistic testing. Data are collected directly from companies and authoritative bodies, i.e., annual reports, official websites, and other publications. The result indicates a positive influence of the implicit business ethics commitment on the financial reporting quality. This finding reveals that top management support, culture, ethical leadership, open communication channels, and ethics training are considered essential to improve the quality of financial reporting.*

Keywords: *Business Ethics Commitment, Financial Reporting Quality*

1. INTRODUCTION

Financial reporting can be described as a two-party transaction, in which the issuers of a financial report who control its preparation, provide it to the users of the report, who use it in the hope that it will help improve their financial decisions about the reporting entity as a whole (Rosenfield, 2006). Traditionally, the purpose of financial reporting is to make possible outside parties to assess the stewardship of management, that is whether all resources are already operated well as they should be (Deegan & Unerman, 2008). Today, financial reporting must produce information to support present and potential investors and creditors in making rational investment and credit decisions(Anthony *et al*., 2011).Thus, the currently objective of financial reporting is decision usefulness, i.e., whether the generated information can help users to make better economic decision (Deegan & Unerman, 2008). To achieve this objective, financial reporting must meet the minimum requirement of quality level.

Financial reporting in Indonesia still has many problems,which indicates poor quality. For example, Hoesen (2014), Director Appraisal of Indonesia Stock

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Exchange stated that several listed companies' annual financial reports had qualified or even disclaimer opinion. Another problem is that an investigation aud it was already conducted to investigate substantial peculiar transactions in listed companies' financial performance as explained by Johanes Soetikno (2014), Chairman of Expert Board of Indonesia Security Investor Community/Masyarakat Investor Sekuritas Seluruh Indonesia (MISSI).

Ito Warsito (2012), President Director of Indonesia Stock Exchange and Andre Toelle (2012), Stock Trading Division Head of Indonesia Stock Exchange illustrated that there were some long delayed annual and interim financial reports delivery to the authoritative body. Besides, Yunus Husein (2011), Chairman of Financial Transaction Reports and Analysis Center/Pusat Pelapor and an Analisis Transaksi Keuangan (PPATK) said that PPATK had many findings on irregular financial reporting for some corporations and partnerships.

This study examines the influence of business ethics commitment on the financial reporting quality. A high business ethics commitment is expected to increase the financial reporting quality of a company. Ethical behavior is the responsibility of everyone in the company. The lack of commitment to business ethics has likely led to the rise in observed misconducts, such as wrongdoing in financial reporting. Eventually that wrongdoing makes the quality of financial reporting even worse. Various high profile scandals in financial reporting occurred due to the low business ethics commitment.

2. LITERATURE REVIEW

2.1. Business Ethics Commitment

Business ethics is a specialized study of moral right and wrong that concentrates on moral standards as they apply to business institutions and behavior (Velasquez, 2012). Business ethics refers to morality and fairness in behavior, actions, and practices that take place within a business context (Buchholtz & Carroll, 2012).

Business ethics always asks whether a particular practice is acceptable or not (Buchholtz & Carroll, 2012). In business ethics, personal moral norms of an agent are applied to the activities and goals of commercial enterprise (Weiss,2006). Agents comprised of those charged with acting on behalf of a business(Des Jardins, 2004). Thus, business ethics refers to the application of standards of moral behavior to business situations (Ghillyer, 2012).

Managers must act ethically by doing the right things (Boatright, 2012). They have to make sound business decision, from both ethical and business perspectives(Boatright, 2012). Companies' commitment to business ethics can be

described by disclosure of ethical behavior in their annual reports (Verschoor, 1998). Implicit and explicit methods are the two alternative methods for a company to implement its business ethics commitment (Choi & Jung, 2008).

2.2. Implicit Business Ethics Commitment

Implicit business ethics commitment is described as an informal cultural system related with values, norms, and behavior (Trevino & Nelson, 2007, Ferrer *et al.*, 2015). It is in ethical organization culture or climate that ethical behavior, values, and policies are displayed, promoted, and rewarded (Buchholtz & Carroll, 2012). This implicit business ethics commitment comprised of: 1) top management support, 2) culture, 3) ethical leadership, 4) open communication channels, and 5) ethics training (Choi & Jung, 2008).

2.2.1. Top Management Support

Top managements of the firm must promote ethical practice by setting code of ethics as the standard for employees at all levels and giving any ethical consideration apparently at lower levels (Banks, 2004). The ethical behavior of top level executives, senior level managers, and executives will be a signal to employees, that they believe ethics should receive high priority in all business decision (Ferrell *et al.*, 2015). Chief executive officers, boards of directors, and senior managers should be involved in any ethics and compliance program to show a real commitment to strong ethical culture consistently (Lawrence & Weber, 2011).

There are some reasons why directors need to support every ethical obligation, ie., 1) recent corporate scandals involved serious ethical failures at the board level; 2) the nature of boards requires observance of ethical obligations; 3) boards, charged with the ultimate responsibility of ensuring the ethics of their organizations, are thereby obligated to act as ethical role models themselves; and 4) it is simply good for corporate business success for directors to be ethical (Schwartz *et al.*, 2005).

Top management can emphasize the importance of business ethics by demonstrating the firm's commitment to ethics as an example for empowering every member of the organization to take ethical personal actions (Sauser, 2005). The commitments of senior management and the employees' immediate supervisor and their involvement in ethics as a daily influence on employee behavior are the most essential safeguards for creating an ethical workplace (Lawrence & Weber, 2011).

2.2.2. Culture

Ethical culture is a culture in which individuals are encouraged and supported in making ethically responsible decisions (Hartman *et al.*, 2015). Management of a

corporate culture is very important in creating, enhancing, and preserving culture that supports ethical behavior (Hartman *et al.*, 2015). A culture is fashioned by a shared pattern of beliefs, expectations, and meanings that influence and guide the thinking and behaviors of the member of an organization (Hartman *et al.*, 2015). Strong ethical cultures produce substantially better outcomes (less pressure, less misconduct, higher reporting, and less retaliation) than in a weaker ethical environment (Hartman *et al.*, 2015).

In a company's formal mission and vision statement, there are some insights in to organizations' compliance and ethics values and commitments (Hartman *et al.*, 2015). Top leader's periodical or continuous communication on the values, mission, and vision is a must (Hartman *et al.*, 2015). There must be a strong committment to follow through and support organization's value in an ethical culture (Hartman *et al.*, 2015). Corporate culture is often expressed informally through statements, both directly and indirectly, that communicate the wishes of management (Ferrell*et al.*, 2015). Shared beliefs and values are also expressed by instituting informal dress codes, working late, and participating in extracurricular activities (Ferrell*et al.*, 2015). Corporate culture can be expressed through gestures, looks, labels, promotions, programs, and legends (Ferrell*et al.*, 2015). Every corporate culture is expected to encourage ethical conduct (Ferrell*et al.*, 2015).

2.2.3. Ethical Leadership

Ethical business commitment relates to the nature and quality of a firm leadership (Banks, 2004). A company's board of directors and executives are responsible for making an ethics framework effectiveness, by defining and institutionalizing the firm's ethical norms, monitoring and reporting adherence to standards that have been defined as important, and penalizing those who violate them (Banks, 2004).

Ethical leaders will create reward and disciplinary system for encouraging employees to act in an ethical manner in their day to day activities (Ferrell *et al.*, 2015). Everyday ethical employee behavior pattern will create an ethical organization with higher employee satisfaction and commitment (Ferrell *et al.*, 2015). This reward and disciplinary system will provide cultural motivation for ethical behavior (Ferrell *et al.*, 2015).

Ethical leadership also creates a strong relationship with external stakeholders. Through the favorable relationships with employees, customers, investors, and regulators, ethical leader develops the ethical reputation of the company which is very important for sustainability (Ferrell *et al.*, 2015). Effective ethical leadership influences the organization culture, then it will directly impact throughout the firm's ethical behavior (Ferrell *et al.*, 2015).

Ethical business leaders not only talk about ethics and act ethically on their personal level, but they also allocate corporate resources to support any ethical behavior (Hartman *et al.,* 2015). For example, they decide that the company regularly dedicates a significant portion of its profit toward philanthrophy (Choi & Jung, 2008). It is very important for leaders to engage in a visible ethical action as a regular agenda (Hartman *et al.,* 2015).

2.2.4. Open Communication Channels

Communication is one of the most determinative elements of integrating ethical culture into the organization (Hartman *et al.,* 2015). Communication patterns are important mechanisms that allow everyone to come forward with questions, concerns, and information about unethical behavior (Hartman *et al.,* 2015).

There are two types of communication, formal and informal (Banks, 2004). Proper formal channels of communication should exist and accessible that every serious ethical issues can be elevated immediately without fear of reprisal, and there should be independent ombudsman or ethics officer that can confidentially verify the nature of the claim (Banks, 2004). This type of communication is apparent on a company's organization chart (Ferrell *et al.,* 2015). Everyone knows whom to contact to for guidance when they encounter gray areas in the organization's values, rules, policies, and training that do not provide adequate direction (Ferrell *et al.,* 2015).

Informal channels of communication are called the grapevine (Ferrell *et al.,* 2015). This type of communication flow up, down, diagonally, and horizontally, beyond the organization chart (Ferrell *et al.,* 2015). Information passed along the grapevine is various including any ethical issue, but it is not always accurate (Ferrell *et al.,* 2015). However, it can act as an early warning system for employees to learn informally whether an action is unethical or ethical one (Ferrell *et al.,* 2015). It becomes an important source of information for individuals to assess ethical behavior within their organization (Ferrell *et al.,* 2015). An employee can determine acceptable behavior by asking friends and peers informally about consequences of certain actions (Ferrell *et al.,* 2015).

An open communication is necessary for feedback mechanisms within the organization (Ferrell *et al.,* 2015). The right open channels of communication act as eyes and ears to ensure the company is functioning as it should be (particularly at the operating level, where information can often get overlooked), and serve as a means to greater demonstration of the ethical principles of the company (makes the employees feel that they are working in an ethical environment) (Banks, 2004).

2.2.5. Ethics Training

Ethics training program can educate employees about the firm's policies and expectations, relevant laws and regulations, and general social standards (Ferrell *et al.,* 2015). Training programs can also make employee aware of available resources, support systems, and designated personnel who assist them with ethical and legal advice (Ferrell *et al.,* 2015). Training can empower employees to ask tough questions and make ethical decisions (Ferrell *et al.,* 2015). It heightens ethical awareness and helps employees integrate ethical considerations into their decision processes (Hartman *et al.,* 2015).

Ethics training must be designed adequately and thoughfully (Ferrell *et al.,* 2015). It must start with a theoretical foundation based on values, a code of ethics, procedures for arising ethical concerns, line and staff involvements, and clear executive priorities on ethics, all of which must be communicated to employees (Ferrell *et al.,* 2015). It must involve any level in every department (Ferrell *et al.,* 2015). Web based on-line training combined with in-person one is usual method used in ethics training (Lawrence & Weber, 2011). It may be led by experts in business ethics, or they may be informal in nature and led by the manager and/or employees themselves (Sauser, 2005). Behavior simulation is also approriate for the training (Ferrell *et al.,* 2015). Thus, a bank of "what if" cases must be developed (Sauser, 2005).

Small firms often ignore ethics training, whereas larger firms usually conduct ethics training regularly (Lawrence & Weber, 2011). At the end, the effectiveness of ethics training can be measured by two ways, such as employees surveys and the incorporation of ethics measurements in performance appraisal systems (Ferrell *et al.,* 2015).These two ways of measurement are conducted periodically to give feedbacks about ethics training of a company.

2.3. Explicit Business Ethics Commitment

Explicit business ethics commitment is described as a formal cultural system related with artifacs in a company (Trevino & Nelson, 2007; Ferrer *et al.*, 2015). This explicit business ethics commitment comprises of: 1) codes of ethics, 2) ethics hotlines, 3) ethics officer, and 4) ethics committee (Choi & Jung, 2008).

2.3.1. Codes of Ethics

A code of ethics consists of general statements and serves as principles and as the basis for rules of conduct (Ferrell *et al.*, 2015). It is a guide for individuals who face novel ethical situations and served as a general statement of company expectations for individuals who face situations with ethical dimensions (Gaumnitz &Lere, 2004). It is a governance mechanism that projects broad ethical values regarding the treatment of various stakeholders groups (Stevens *et al.*, 2005).

Code of conduct is intended to establish the ethical and moral norms of the company (Banks, 2004). It aims to ensure a clear understanding of basic ethical principles in dealing with those inside and outside of the firm (Banks, 2004).It helps employees and managers deal with ethical dilemmas (Ferrell *et al.,* 2015). It provides guidelines and principles capable of helping employees achieve organizational ethical objectives and address risks in an accepted way (Ferrell *et al.,* 2015).

Code of conducts can capture what the organization understands about ethical behavior, establish a detailed guideline to acceptable behavior, state policies for behavior in specific situations, and document punishments for violations of those policies (Ghillyer, 2012). It hastwo significant strategic benefits, ie., positive internal consequences (dettering inappropriate decisions and behavior)and positive external consequences (enhancing the reputation and image of the firm with respect to its stakeholders) (Stevens *et al.,* 2005).

2.3.2. Ethics Hotlines

Ethics hotlines are the most determinative elements of communication (Hartman *et al.,* 2015). Hotlines are the most frequent way to blow the whistle on fraud or related infraction (Buchholtz & Carroll, 2012). Such hotlines may be in the form of telephone, web, or e-mail based (Buchholtz & Carroll, 2012).They are also perceived as an early warning system for the need to develop a new ethics training program for the firm's supervisors (Lawrence & Weber, 2011).

There are external and internal ethics hotlines (Hartman *et al.,* 2015). External ethics hotlines are mechanisms that allow employees or other stakeholders to report wrongdoings to legal authorities and mass media (Hartman *et al.,* 2015). Internal ethics hotlines have a limited scope that occur internally (Hartman *et al.,* 2015). Both of them are mechanisms for follow-up and enforcement of unethical activities (Hartman *et al.,* 2015). However, because external ethics hotlines can be so harmful to the firm itself, internal ethics hotlines are preferable for all concerned (Hartman *et al.,* 2015).

For an ethics hotline to work, trust must be established between employees and their employer – trust that the information can be given anonymously and without fear of retaliation, even if the identity of the employee is ultimately revealed during the investigation (Ghillyer, 2012). This ethics reporting mechanisms are also called as company's ethics assist line, ethics helpline or ethics crisis line (Lawrence & Weber, 2011).

There are some benefits of ethics hotlines, such as: (1) providing interpretations of proper ethical behavior involving conflicts of interest and the appropriateness of gift giving, (2) creating an avenue to make known to the proper authorities

allegations of unethical conduct, and (3) giving employees and other corporate stakeholders a way to discover general ethics information about a wide range of work-related topics (Lawrence & Weber, 2011).

2.3.3. Ethics Officer

Organization ethics programs must have an oversight conducted by high-ranking persons known to respect legal and ethical standards, called as ethics officer; ethics and compliance officer (Ferrell *et al.,* 2015); corporate responsibility officer; or head of ethics and compliance (Hartman *et al.,* 2015). Ethics officer is a senior executive responsible for monitoring the ethical performance of the organization both internally and externally (Ghillyer, 2012). Ethics officers are responsible for managing their organizations' ethics and legal compliance programs (Ferrell *et al.,* 2015).

Ethics officers have backgrounds in law, finance, and human resource management (Ferrell *et al.,* 2015). Ethics officers must know various relevant regulations as well as communicating and reinforcing values that build an ethical corporate culture (Ferrell *et al.,* 2015). Ethics officers can be promoted from within the organization (selecting a familiar face who can be trusted) or hired from outside (selecting an independent face who is new to company history and office politics) (Ghillyer, 2012). However, ethics officers' positions are still relatively new and somewhat ill-defined (Ferrell *et al.,* 2015).

Detailed responsibilities of ethics officers are: 1) assessing the needs and risks of an organization – wide ethics program must address, 2) developing and distributing a code of conduct or ethics, 3) conducting training programs for employees, 4) establishing and maintaining a confidential service to answer employees' questions about ethical issues, 5) making sure the company is in compliance with government regulation, 6) monitoring and auditing ethical conduct, 7) taking action on possible violations of the company's code, and 8) reviewing and updating the code (Ferrell *et al.,* 2015).

Creation of the position of ethics officer becomes significant in a larger organization than smaller one (Ghillyer, 2012). The best recommended practice is that ethics officers report directly to the board of directors (Ferrell *et al.,* 2015). But, it is more common that ethics officers report directly to the chief executive officer and may have some access to the board of directors (Ferrell *et al.,* 2015). However, there is a major downside danger in the existence of ethics officer (Buchholtz & Carroll, 2012). By holding individuals and organizational units responsible for the company's "ethics," there is a possibility that managers may come to "delegate" to these persons/units the responsibility for the firm's ethics (Buchholtz & Carroll, 2012). This is not aligned with the idea that ethics is everyone's responsibility (Buchholtz& Carroll, 2012).

2.3.4. Ethics Committee

A committee is a formal group of individuals assigned to a specific task (Ferrell *et al.,* 2015). Committees may meet regulary to review performance, develop plans, or make decisions (Ferrell *et al.,* 2015). Most formal committees in organizations operate on an ongoing basis, but their membership may change over time (Ferrell *et al.,* 2015). A committee is staffed by board members and specialist (Ghillyer, 2012). Committee decisions are legitimized in part by agreement or majority rule (Ferrell *et al.,* 2015). Although many organizations have various board level committee for financial, diversity, personnel, or social responsibility, only few organizations have a committee devoted exclusively to ethics (Ferrell *et al.,* 2015; Hartman *et al.,* 2015).

An ethics committee might raise ethical concerns, resolve ethical dilemmas in the organization, and create or update the company's code of ethics (Ferrell *et al.,* 2015). He/she can gather information on functional areas of the business and examine manufacturing practices, personnel policies, dealings with suppliers, financial reporting, and sales techniques to determine if the company's practices are ethical (Ferrell *et al.,* 2015). Sometimes this committee is called as corporate governance committee (Ghillyer, 2012).

2.4. Financial Reporting Quality

The objective of financial reporting is to support interested parties in evaluating a company's past performance and in forecasting its future performance (Stice & Stice, 2012). In order to achieve this objective, the quality of financial reporting must be at high level.

There are two approaches related to financial reporting quality, ie., users need approach and shareholder/investors approach (Jonas & Blanchet, 2000). The first approach, users need approach, tends to focus on valuation-related issues (Jonas & Blanchet, 2000). Under this category, the quality of financial reporting is determined in relation to the usefulness of the financial information to the user (broadly defined as investors and creditors) of that information (Jonas & Blanchet, 2000). The second approach, shareholders/investors protection approach, tends to focus more on corporate governance and stewardship-related issues (Jonas & Blanchet, 2000). Under this category, the quality of financial reporting is defined primarily in relation to providing shareholders with full and transparent financial information that is not designed to obfuscate or mislead users (Jonas & Blanchet, 2000). The two approaches are not necessarily mutually exclusive, in many respects, they reinforce each other (Jonas & Blanchet, 2000).

The notion of financial reporting quality still remains a vague concept (Cohen *et al*., 2004). Financial reporting is another term for financial accounting (Anthony *et al*, 2011). In financial accounting quality, there are five quality approaches, i.e.,1)

GAAP quality, 2) audit quality, 3) GAAP application quality, 4) transaction quality, and 5) disclosure quality (Penman, 2007). This study uses the last approach by operationalizing qualitative characteristics both fundamental and enhancing ones (van Beest*et al*., 2009).

The fundamental qualitative characteristics (i.e. relevance and faithful representation) are most important and determine the content of financial reporting information(van Beest*et al*., 2009). The enhancing qualitative characteristics (i.e. understandability, comparability, verifiability, and timeliness) can improve decision usefulness (van Beest*et al*., 2009).

In order to achieve a high quality of financial reporting, the acceptable accounting methods, the amount and types of information to disclose, and the format in which to present it are chosen based on which alternative provides the most useful information for decision-making purposes (decision-usefulness) (Kieso*et al*., 2014). Regardless of the classification, each qualitative characteristic contributes to the decision-usefulness of financial reporting information (Kieso*et al*., 2014). Characteristics that make information useful are relevance, reliability, completeness, timeliness, understandability, and verifiability (Azmi Fitriati & Sri Mulyani, 2015).

Qualitative characteristics consist of fundamental and enhancing characteristics, where fundamental qualities encompass relevance and faithful representation, while enhancing qualities encompass comparability, verifiability, timeliness, and understandability (Mackenzie *et al*., 2012). These fundamental and enhancing qualities are the most valuable information for capital providers (Beyersdoff *et al*., 2013). The qualities that make accounting information useful have been designated its "qualitative characteristics" (Carmichael *et al*., 2007). These characteristics are the attributes that make information useful to users (Gaffikin, 2008). These characteristics are called as desirable qualities of accounting information (Subramanyam & Wild, 2009).

Information with criteria such as relevant, reliable, complete, timelines, understandable, verifiable, and accessible is classified as a high quality information (Sri Mulyani, 2009). The usefulness of this high quality information depends on the user (Sri Mulyani, 2009). Users of accounting information are classified into two categories, internal and external users (Azhar Susanto, 2013). Generally, accounting information has four dimensions of quality, ie., accurate, relevance, timelines, and complete (Azhar Susanto, 2013). These dimensions can be broaded into seven dimensions, ie., effectivity, efficiency, confidentiality, integrity, availability, compliance, and truthfulness (Azhar Susanto, 2013).

2.5. THE INFLUENCE OF BUSINESS ETHICS COMMITMENT ON FINANCIAL REPORTING QUALITY

Ethics determines the financial reporting process, because the ethics behavior will ensure financial reporting produces a reliable accounting information (Ingram *et al.*, 2004). Transparent publication on business activities of a corporate is a good ethical practice and will encourage financial reporting process to obtain information for users' assessment on organization performance (Ingram *et al.*, 2004). Ethics is very important in financial reporting in order to achieve its objective, ie., supplying information which is reliable and relevant for users' decision making (Wild & Kwok, 2011). Ethics rules assigned as guidelines in deciding an ethical choice for financial reporting process (Wild & Kwok, 2011).

If business ethics commitment is conducted well, practices of creative accounting will decrease significantly (Dellaportas et al., 2005). Every participants' compliance on code of conduct in financial reporting process will be monitored continuously to get a high quality financial reporting (Dellaportas et al., 2005). Ethical concern will affect the financial reporting process (Horngren & Harrison, 2007). Ethical standard is designed in such a way that the financial reporting can generate relevant and reliable information to support decision making (Horngren & Harrison, 2007). Effective financial reporting depends on ethics (Weygandt*et al*., 2015).

A study conducted by Mahdavikhou & Khotanlou (2011) finds that ethics has a high influence on increasing the qualitative characteristics of financial reporting. This study is carried on companies listed in Tehran Stock Exchange for 2010 (Mahdavikhou & Khotanlou, 2011).Based on their research, Arel*et al.* (2012) have an empirical evidence that ethics is an important determinant factor on accountant's tendency to journal a transaction. Respondents of their research are executive, manager, or accounting staff in United States back in 2010 (Arel*et al.*, 2012).

Choi & Pae (2011) have a research result that company's commitment on business ethics has a continuous impact on financial reporting quality in the future. Their research is based on a survey to managers who work at Korean companies. listed in Korea Composite Stock Price Index (KOSPI) or Korean Securities Dealers Automated Quotations (KOSDAQ) for 2004 (Choi &Pae, 2011).

Thus, research hypotheses are formulated as follows:

H_1: Implicit business ethics commitment has a positive effect on financial reporting quality.

H_2: Explicit business ethics commitment has a positive effect on financial reporting quality.

3. METHOD

The research object at the center of attention in this study is business ethics commitment and financial reporting quality. The research method is explanatory one, which is done to obtain a description, picture or depicting systematically, factual information about the nature of and the relationship between variables studied (Sekaran & Bougie, 2013). The main reason of using this method is to find empirical facts about business ethics commitment(implicit and explicit) as the factors that can cause a particular phenomenon related to the low quality of financial reporting.

3.1. Sample And Data Collection

Population is the entire group of people, events, or things that the researcher desires to investigate (Sekaran & Bougie, 2013). The population of this study is comprised of 511 listed corporations in Indonesia Stock Exchange for 2014.

Sampling is the process of selecting items from the population so that sample characteristics can be generalized to population(Sekaran & Bougie, 2013). Sampling consists of decision in design choice and sample size (Sekaran & Bougie, 2013).

Sampling technique design used in this research is probability sampling - simple random sampling. The sample is chosen randomly without any group level concerns and every item has the same probability to be chosen (Sekaran & Bougie, 2013).

The minimum sample size is 84, calculated based on Slovin equation as follows (Husein Umar, 2003):

$$n = \frac{N}{1 + N e^2}$$

Where:

n = sample size

N = population size

E = tolerable error term (10%)

87 companies are already chosen randomly for the actual sample in this research. Data are collected directly from 87 companies and also from the authoritative bodies (Indonesia Stock Exchange and Financial Service Authority). In order to maintain the data validity, the measurement is conducted by three raters and only the same result of measurement is used.

3.2. Variable Operationalization

Measurement for every variable is conducted based on the variable operationalization as follows:

Table 1
Variable, Proxy, and Measurement

Variables (Code)	*Proxies (Measurement)*	*Scale*	*Item*
Implicit Business Ethical Commitment (IBEC) (Choi & Jung, 2008; Choi &Pae, 2011)	Implicit Business Ethical Commitment Disclosure *Top management support* Top management of this company emphasize the importance of business ethics	Ratio	1
	Culture Ethical behavior based on a formal business philosophy is the norm of this company		2
	Ethical leadership • This company has a disciplinary system through which unethical behavior is strictly punished • This company regularly puts a significant portion of its profit towards philanthropy • This company has an ethics evaluation system measured by an independent party from outside the company		3-5
	Open communication channels In this company, employees can report unethical conduct through an anonymous channel		6
	Ethics training In this company, ethics education, training, or workshops are in place to enhance business ethics of employees		7
	Implicit Ethicals Commitment Index$_j$ = $\left(\sum_{i=1}^{n} i_i\right) / M$ Where: j = firm j i_i = implicit ethical commitment indicator i M = expected maximum score		
Explicit Business Ethical Commitment (EBEC) (Choi & Jung, 2008; Choi & Pae, 2011)	Explicit Business Ethical Commitment Disclosure *Codes of ethics* This company has a code of ethics	Ratio	8
	Ethics hotlines In this company, employees can get help regarding business ethics through an ethics hotline or open communication channel		9
	Ethics officer This company has an independent ethics department and officers		10
	Ethics committee This company has an ethics committee		11

Variables (Code)	*Proxies (Measurement)*	*Scale*	*Item*
	$\text{Explicit Ethicals Commitment Index}_j = \left(\sum_{i=1}^{n} e_i\right) / M$ Where: j = firm j e_i = explicit ethical commitment indicator i M = expected maximum score		
Financial Reporting Quality (FRQ) (Braam& van Beest, 2013; van Beest*et al.*, 2009)	Relevant 1. To what extent does the company use fair value instead of historical cost? 2. To what extent does the presence of non-financial information in terms of business opportunities and risks complement the financial information? 3. To what extent does the risk section provide good insights into the risk profile of the company? 4. To what extent does the annual report contain forward-looking information? 5. To what extent does the annual report contain information on CSR? 6. To what extent does the annual report contain a proper disclosure of the extraordinary gains and losses? 7. To what extent does the annual report contain information regarding personnel policies? 8. To what extent does the annual report contain information concerning divisions? 9. To what extent does the annual report contain an analysis concerning cash flows? 10. To what extent are the intangible assets disclosed? 11. To what extent are the "off-balance" activities disclosed? 12. To what extent is the financial structure disclosed? 13. To what extent does the annual report contain information concerning the companies' going concern?	Ordinal	1 - 13
	Representation Faithfulness 14. Which type of auditors' report is included in the annual report? 15. To what extent does the company provide information on corporate governance? 16. To what extent does the annual report contain disclosure concerning the "comply or explain" application? 17. To what extent does the annual report contain disclosure related to both positive and negative contingencies? 18. To what extent does the annual report contain information concerning bonuses of the board of directors?	Ordinal	14 - 18
	Comparability 19. To what extent are changes in accounting policies disclosed? 20. To what extent are changes in accounting estimates disclosed? 21. To what extent does the annual report contain information concerning comparison and effects of accounting policy changes? 22. To what extent does the company present financial index numbers and ratios in the annual report? 23. To what extent does the annual report contain information concerning companies' shares? 24. To what extent does the annual report contain benchmark information concerning competitors?	Ordinal	19 - 24

Variables (Code)	*Proxies (Measurement)*	*Scale*	*Item*
	Verifiability 25. To what extent are valid arguments provided to support the decision for certain assumptions and estimates in annual report? 26. To what extent does the company base its choice for certain accounting principles on valid arguments?	Ordinal	25 -26
	Timeliness 27. How many days did it take for the auditor to sign the auditors' report after book-year end?	Ordinal	27
	Understandability 28. To what extent is the annual report presented in a well organized manner? 29. To what extent does the presence of graphs and tables clarify the presented information? 30. To what extent does the annual report contain technical jargon in the perception of the researcher? 31. What is the size of the glossary? 32. To what extent does the annual report contain information concerning mission and strategy? 33. To what extent is the annual report understandable in the perception of the researcher?	Ordinal	28 - 33

3.3. Data Analysis

The purpose of this study is to examine whether business ethics commitment have an influence on financial reporting quality. The independent variable business ethics commitment (implicit and explicit) is measured in a ratio scale. The dependent variable financial reporting quality is measured in an ordinal scale. So it needs to be upgraded to an interval scale using the method of successive inverval (MSI). The following cross-sectional regression model with an ordinary least squares (OLS) technique is used to test the influence of business ethics commitment (implicit and explicit) toward financial reporting quality.

$$FRQ = \alpha + \beta_1 IBEC + \beta_2 EBEC + e$$

The proxy and measurement of each variable is defined in the variable operationalization (Table 1). STATA 12.0 is used as ananalys is tool to develop the cross-sectional regression model. A robust option is already used for estimating the standard errors and passing the classic assumption test.

4. RESULT AND DISCUSSION

The multivariate regression analysis gives the following result:

Table 2
Result of Multivariate Regression for Estimating FRQ N= 87

Item	*Parameter*	*Estimate*	*Standard Error*	*p>|t|*
Constanta	α	.920234	.0318426	0.000 ***
IBEC	β_1	.1915789	.0771954	0.015 **
EBEC	β_2	.0348561	.0743304	0.640
R-Squared		0.1019		
Probability F		0.0127**		

As shown in Table 2, the F-statistic of the model is significant (p < 0,05) indicating that a subset of the independent variables does explain the variation in Financial Reporting Quality (FRQ). The value of R^2 is 0.1019 indicating that about 10 percent of the financial reporting quality variance can be explained by independent variables in the model.

Implicit Business Ethics Commitment (IBEC) is a significant variable which influences financial reporting quality (at 5 percent level). The result suggests what implicit business ethics commitment is more likely to increase the financial reporting quality of the company. It supports implicit business ethics commitment is an important process to be considered for enhancing the financial reporting quality. This result is in accordance with prior research conducted by Adam & Rachman-Moore (2004) which found that a majority of managers agree that implicit business ethical commitment has the greatest influence on instilling ethical behavior. Implicit business ethical refers to shared values, beliefs, behaviors, and ways of doing things (Buchholtz & Carroll, 2012). It is very difficult to evaluate how good top management support, culture, ethical leadership, open communication channels, and ethics training are of a company. But, this implicit business ethics commitment is an important determinat factor on the process of financial reporting to generate high quality information.

The regression result also indicates that Explicit Business Ethical Commitment (EBRC) is not significant in influencing FRQ. On the other hand, the positive coefficient of explicit business ethical commitment is consistent with the prediction in the literature which implies that explicit business ethics commitment has a positive association with financial reporting quality. This result may be explained by the fact that explicit business ethics commitment focuses on short term strategy (to fulfill the minimum requirement of stakeholder expectation), whereas implicit business ethics commitment focuses on long term strategy (to develop real

ethical behavior for a long term). Implicit business ethics commitment is broader than explicit business ethics commitment. Implicit business ethics commitment emphasizes a wider of goals than just the rightness or wrongness of doing (Brenner, 1992). It is easy to see the explicit business ethics commitment, by questioning whether its components (codes of ethics, ethics hotlines, ethics officer, and ethics committee)exist in the company.

5. CONCLUSION

This study provides an empirical evidence on the important role of ethics, as one of the corporate governance mechanism, in ensuring the financial reporting quality. The finding shows that the implicit business ethics commitment may increase the quality of financial reporting. In Indonesia, implicit business ethics commitment is proven as a significant factor that can influence financial reporting quality. Thus, companies should perhaps evaluate how to further improve their implicit business commitment in order to enhance the quality of financial reporting. Improving implicit business ethics commitment is conducted by enhancing the top management leadership and moral management. The existence of explicit business ethics commitment equips the implicit business ethics commitment with various formal means such as codes of ethics, ethics hotlines, ethics officer, and ethics committee. Formal means need to be elaborated with various informal means which develop the implicit business ethics committee. The company must ensure that implicit business ethics commitment is applied continuously and explicit business ethics really exists to support it.

There are some limitations in this study that should be considered when interpreting the results. First, with regards to the design of this study, the data are collected from externally available information (annual reports and websites). There is a possibility that business ethics commitment disclosure presented in the annual reports and websites does not reflect the actual practices. Further research is suggested to use other measurements by in depth interview to depict this true fact from the company. Second limitation is the window period. This research is a cross section research that uses data from 2014 annual report and information published in website in 2015. Thus, further research may perform a longitudinal analysis to capture more complex factors that influence financial reporting quality. Another limitation is the measurement developed in this research. Probably, there are other aspects of business ethics commitment and financial reporting quality that have not been addressed by this study. Then, further research can explore other alternative measurements for business ethics commitment and financial reporting quality.

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