

# The Effect of Good Corporate Governance and Financial Distress on the Integrity of Financial Statements with Audit Quality as a Mediation Variable

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## Abstract

*The information in the financial statements must be presented fairly, honestly, and fairly disclose facts to users in order to produce financial statements with integrity. The purpose of this study was to examine the effect of good corporate governance and financial distress on the integrity of financial statements through audit quality. The population in this study are consumer goods sector companies listed on the Indonesia Stock Exchange (IDX) for the 2018-2020 period. The number of samples obtained as many as 66 companies with purposive sampling method. The data analysis technique used is multiple linear regression and the selection of good corporate governance proxies using factor analysis. Based on the results of the analysis, it was found that good corporate governance has an effect on the integrity of financial statements. Financial distress affects the integrity of financial statements. Audit quality affects the integrity of financial statements. Good corporate governance affects the integrity of financial statements through audit quality. Financial distress affects the integrity of financial statements through audit quality. This shows that the increasing audit quality allows a reduction in financial distress that occurs in the company so as to produce financial statements with integrity.*

## Keywords

integrity, corporate governance,  
financial distress, audit



## I. Introduction

Financial reports function as a medium of communication between the parties involved in the company (Kurniawan & Khafid, 2016). Financial reports are a company mechanism to maintain relationships with stakeholders. Financial reports need to be prepared properly so that they can produce quality reports. Information in financial statements must be presented correctly and honestly so as not to mislead users of financial statements. This is because the results of these financial statements are used as the basis for making economic decisions. Therefore, the integrity of financial statements is very important for the company.

The phenomenon that occurs today is that there are still many cases of manipulation of financial data by companies. This is proof that realizing the integrity of financial statements is a difficult thing to do. The background of the research is based on a phenomenon that occurred in one of the consumer goods sector companies related to the weak integrity of financial reports with high audit quality, namely the case of manipulation of the financial statements of PT Tiga Pilar Sejahtera Food Tbk (AISA) in 2017. Based on information from the CNBC Indonesia website on In 2019, this case began with investors

who rejected the 2017 audited financial statements because there were allegations of misappropriation of funds by management.

PT. Indonesian Securities Rating Agency (PEFINDO) has assigned PT Tiga Pilar Sejahtera Food, Tbk (AISA) the rating of "Credit Watch with Negative Implications". An obligor with this rating is vulnerable, and is dependent on favorable business and financial conditions to meet its financial commitments. The rating reflects the company's weak liquidity and cash flow protection measures, its aggressive capital structure, its exposure to fluctuations in raw material costs, and intense competition in the industry.(PEFINDO, 2018). Viewed from the side of the financial statements Profit/Loss of PT Tiga Pilar Sejahtera Food, Tbk (TPSF). In 2015-2017, the company's revenue experienced extreme fluctuations. From 2015 to 2016, the company experienced an increase in revenue. However, the company also suffered losses in 2017 reaching 100% of its profits in 2016.

Various cases that show the weak integrity of the reportThe financial statements presented by the company involve many parties, ranging from internal parties to external parties, namely public accountants. The integrity of financial statements is a signalthat can affect the perceptions of investors and creditors or interested parties. Integrity of financial statements is affectedby several other factors outside the principles and requirements of the quality of a financial report that causes the financial statements to have integrity or not, depending on the factors themselves. These factors include good corporate governance, financial distress and audit quality.

The company's efforts to obtain quality financial reports require good corporate governance. Companies that have implemented good corporate governance should have complied with the principles of GCG, including fairness, transparency, accountability, and responsibility. Parties such as the board of commissioners also play an important role. Research conductedHadi (2014)who found that the greater the number of independent commissioners, the less likely the company was to experience financial distress. The board of commissioners can form a committee that will help carry out its duties. Generally, companies listed on the Indonesia Stock Exchange (IDX) must form an audit committee, and this committee is one component of Good Corporate Governance that plays an important role in the financial reporting system, namely by supervising the participation of management and independent auditors in the financial reporting process.

Platt & Platt (2002)states that Financial Distress is a condition thatshows the stage of decline in the company's financial condition that occurred before the occurrence of bankruptcy or liquidation. Companies that are experiencing financial difficulties or decline tend to submit financial reports that are not timely(Narayana & Yadnyana, 2017). One of the reasons for the delay infinancial reporting in the form of financial distress (financial distress) in a company which is also bad news for the company.

Agency theory assumes that humans are always self-interested, so the presence of an independent third party as a mediator in the relationship between the principal and agent is necessary, in this case an independent auditor. Investors will be more inclined to accounting data resulting from high audit quality. Audit quality aims to improve the results of financial reporting audit performance that can be used by users of financial statements and submitted transparently along with the evidence obtained.

The research was conducted in the consumer goods sector registered inIndonesia stock exchange. The Consumer Goods industry is one of the most important and most effective sectors as an indicator to assess the economy of the community at a macro level. Sectors whose productivity/sales are relatively stable and also consumer goods are a staple element that cannot be separated from people's lives, it will be easier to influence stock prices without looking at other factors such as consumer tastes but to meet the needs of

consumers (Agriansyah, 2020). Stable demand for consumer goods industry products has an impact on the ability to generate optimal profits. The increasing number of people makes the needs increase, and this also affects the consumer goods sector. Companies that have good performance and performance are always encouraged to improve the quality of financial reporting (Karajeh & Ibrahim, 2017). The company will try to be able to publish its financial statements in a timely manner because information is a very important element for investors and business people because it provides information on past, present or future conditions. (Dewi & Ratnadi, 2016).

## **II. Review of Literature**

### **2.1 Agency Theory**

Agency Theory or agency theory explains the relationship between two parties, namely the principal and the agent. Agency theory was first proposed by Jensen and Meckling in 1976. According to Jensen & Meckling (1976), the agency relationship is a contract between the manager (agent) and the investor (principal).

### **2.2 Signal Theory**

Signaling theory indicates the existence of information asymmetry that occurs between the company's management and the parties with an interest in the information. This theory explains how companies should give signals to users of financial statements.

### **2.3 Financial Report Integrity**

Hardiningsih (2010) defines the integrity of financial statements are financial statements that present the actual condition of a company, without anything being covered up or hidden. Fajaryani (2015) explained that the integrity of financial statements as a measure of the extent to which the information in the financial statements presented can show true and honest information so that it will not mislead users when making a decision.

### **2.4 Good Corporate Governance**

Good Corporate Governance (GCG) is an extension of the concept that regulates the relationship between management and investors that allows agency problems to arise. Corporate Governance according to Forum for Corporate Governance in Indonesia (FCGI, 2013) defined as a set of rules governing the relationship between shareholders, company managers, creditors, government, employees and other internal and external stakeholders relating to their rights and obligations or in other words a system that regulates and controls the company.

### **2.5 Financial Distress**

Financial distress can be experienced by all companies, especially if the economic conditions in the country where the company operates experience an economic crisis (Paulalengan & Ratnadi, 2019). Platt & Platt (2002) states that financial distress is a decline in the company's financial condition before bankruptcy or liquidation.

## **III. Research Method**

This research was conducted on consumer goods sector companies listed on the Indonesia Stock Exchange that provide audited financial report data by accessing and downloading the official website of the Indonesia Stock Exchange through the

website. [www.idx.co.id](http://www.idx.co.id). The object of research used in this study is the integrity of financial statements, good corporate governance, financial distress, and audit quality in consumer goods sector companies listed on the Indonesia Stock Exchange for the 2018-2020 period. The population in this study are all companies in the consumer goods sector that listed on the Indonesia Stock Exchange which publishes financial statements for the financial year 2018 to 2020 amounted to 63 company. The sampling method used in this study is a purposive sampling method. Sample This research is a company in the consumer goods sector listed on the Indonesia Stock Exchange. In this study, the data analysis technique used Sobel test to test the intervening variables. Before doing path analysis, this method implies to test the classical assumptions in order to get good regression results. In addition, this study uses descriptive statistics.

## IV. Result and Discussion

### 4.1 Normality Test Results

**Table 1.** Normality Test Results

Structural Equation	<i>Kolmogorov-Smirnov Z</i>	<i>Unstandardized Residual</i>
1 structure	N	66
	<i>asympt. Sig</i>	0.166
2 structures	N	66
	<i>asympt. Sig</i>	0.190

Source: Data processed, 2022

Based on Table 1, it can be seen that the structure model 1 and structure 2 show that the variables of financial statement integrity, GCG, financial distress, audit quality and the residual model created have a norm distribution. This is indicated by the Asymp value. Sig. 0.166 and 0.190 which are greater than the 0.05 alpha. Thus, the model made is suitable for further analysis.

### 4.2 Multicollinearity Test Results

**Table 2.** Multicollinearity Test Results

Structural Equation	Variable	<i>Tolerance</i>	VIF
1 structure	GCG	0.951	1.051
	<i>Financial Distress</i>	0.951	1.051
2. structure	GCG	0.602	1,661
	<i>Financial Distress</i>	0.736	1.360
	Audit Quality	0.474	2,109

Source: Data processed, 2022

Based on Table 2, it can be seen that the tolerance and VIF values of the variable *good corporate governance*, *financial distress* and *audit quality* shows the tolerance value for each variable is greater than 10% and the VIF value is less than 10, which means the regression equation model is free from multicollinearity.

### 4.3 Heteroscedasticity Test Results

**Table 3.** Heteroscedasticity Test Results

Structural Equation	Variable	Sig.
1 structure	GCG	0.071
	<i>Financial Distress</i>	0.883
2. structure	GCG	0.087
	<i>Financial Distress</i>	0.057
	Audit Quality	0.056

Source: Data processed, 2022

In Table 3 it can be seen that the significance value for each variable is above 0.05. Thus, the model made does not contain symptoms of heteroscedasticity, so it is feasible to use it to predict

### 4.4 Autocorrelation Test Results

**Table 4.** Autocorrelation Test Results

Structural Equation	R	R Square	Adjust R Square	Std. Error of the Estimate	Durbin-Watson
1 structure	0.725	0.526	0.511	0.34436	2,129
2. structure	0.882	0.778	0.767	0.93876	2,083

Source: Data processed, 2022

In Table 4 it can be seen in the structural equation 1, the Durbin Watson value (d-count) is 2.129. With a significant of 0.05,  $N = 66$  and the number of independent variables  $k = 2$ , then the upper limit value ( $du$ ) is 1.631 and the value  $(4 - du)$  is  $4 - 1.631 = 2.369$ . Because the Durbin Watson value (d-count) of 2.129 is between 1.631 and 2.369, it can be concluded that there is no autocorrelation. Based on structural equation 2, the Durbin Watson value (d-count) is 2.083, the significant value is 0.05,  $N = 66$  and the number of independent variables is  $k = 3$ , then the upper limit value ( $du$ ) is 1.664 and the value  $(4 - du)$  of  $4 - 1.664 = 2.336$ . Because the Durbin Watson value (d-count) of 2.083 is between 1.664 and 2.336, it can be concluded that there is no autocorrelation.

### 4.5 Multiple Linear Regression Analysis Results

**Table 5.** Multiple Linear Regression Analysis Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.727	0.199		3,659	0.001
GCG	0.018	0.003	0.538	6,043	0.000
Financial Distress	0.022	0.005	0.382	4,298	0.000
F	34,940				0.000
R2	0.526				

Source: Processed data, 2022

Based on the results of multiple linear regression analysis as presented in Table 5., the structural equations can be made as follows:

$$Y = 0.727 + 0.018 X_1 + 0.022 X_2$$

The results of these equations indicate the magnitude and direction of the influence of the independent variable on the dependent variable. Regression coefficient that is positive means that it has a direct effect on audit quality.

#### 4.6 Results of Multiple Linear Regression Analysis Structure Model 2

**Table 6.** Results of Multiple Linear Regression Analysis Structure Model 2

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2,569	0.596		4,309	0.000
GCG	0.044	0.01	0.333	4.32	0.000
Financial Distress	0.094	0.016	0.417	5,972	0.000
Audit Quality	1,429	0.343	0.362	4.16	0.000
F	72,386				0.000
R <sup>2</sup>	0.778				

Source: Processed data, 2022

Based on the results of multiple linear regression analysis as presented in Table 6, the following structural equations can be made:

$$Y = 2.569 + 0.044 X_1 + 0.094 X_2 + 1,429 X_3$$

The results of these equations indicate the magnitude and direction of the influence of the independent variable on the dependent variable. Regression coefficient that is positive means that it has a direct effect on audit quality.

#### 4.7 Hypothesis Test Results

##### a. Coefficient of Determination Test Results

Based on Table 5 in the structural equation 1, the magnitude of the influence of the independent variable on the dependent variable is shown by the value of the coefficient of determination or R Square of 0.526 means that 52.6% variation *good corporate governance* and financial distress effect on audit quality while the remaining 47.4% is explained by other factors that are not included in the model.

Based on Table 6 in structural equation 2, the magnitude of the influence of the independent variable on the dependent variable is shown by the value of the coefficient of determination or R Square of 0.778 means that the variation is 77.8% *good corporate governance*, financial distress and audit quality affect the integrity of financial statements while the remaining 22.2% is explained by other factors that are not included in the model.



### b. Results of the F Statistical Test (F-test)

The results of Table 5 in the structural equation 1 obtained the Fcount value of 34.940 with a significance of 0.000 and Ftable is  $F(0.05; 2, 64) = 3.14$ . Based on the overall test results obtained a value of  $34.940 > 3.14$  where Fcount is greater than Ftable and with a sig value,  $0.000 < 0.05$ . This result means that *good corporate governance* and financial distress have a positive and significant effect together on audit quality.

The results of Table 6 in the structural equation 2 obtained the Fcount value of 72,386 with a significance of 0.000 and Ftable is  $F(0.05; 3, 63) = 2.75$ . Based on the overall test results obtained a value of  $72,386 > 2.75$  where Fcount is greater than Ftable and with a sig value,  $0.000 < 0.05$ . This result means that *good corporate governance* and financial distress and audit quality have a positive and significant effect together on the integrity of financial statements.

### c. Results of t-test statistics (t-test)

In Table 5 the structural equation 1 shows the results of the t-statistical test as follows:

#### a) The Effect of Good Corporate Governance on Audit Quality

The results in Table 5 obtained the tcount value of 6.043 with a significance of 0.000, and t table is  $t(0.05; 63) = 1.669$ . Based on the overall test results obtained a value of  $6.043 > 1.669$  where tcount is greater than ttable and with the value of sig.  $0.000 < 0.05$  and the value of the regression coefficient is 0.538. This result means that *good corporate governance* positive effect on audit quality.

#### b) Effect of Financial Distress on Audit Quality

The results in Table 5 obtained the tcount value of 4.298 with a significance of 0.000, and t table is  $t(0.05; 63) = 1.669$ . Based on the overall test results obtained a value of  $4.298 > 1.669$  where tcount is greater than ttable and with the value of sig.  $0.000 < 0.05$  and the regression coefficient value is 0.382. This result means that *financial distress* positive effect on audit quality.

In Table 6 structural equation 2, the results of the t statistic test are as follows:

#### a) The Effect of Good Corporate Governance on the Integrity of Financial Statements

The results in Table 6 obtained the tcount value of 4.320 with a significance of 0.000 and t table is  $t(0.05; 62) = 1.660$ . Based on the overall test results obtained a value of  $4.320 > 1.660$  where tcount is greater than ttable and with the value of sig.  $0.000 < 0.05$  and the regression coefficient value is 0.333. This result means that *good corporate governance* positive effect on the integrity of financial statements.

#### b) The Effect of Financial Distress on the Integrity of Financial Statements

The results in Table 6 obtained the tcount value of 5.972 with a significance of 0.000 and t table is  $t(0.05; 62) = 1.660$ . Based on the overall test results obtained a value of  $5.972 > 1.660$  where tcount is greater than ttable and with the value of sig.  $0.000 < 0.05$  and the value of the regression coefficient is 0.417. This result means that *financial distress* positive effect on the integrity of financial statements.

#### c) The Effect of Audit Quality on the Integrity of Financial Statements

The results in Table 6 obtained the tcount value of 4.160 with a significance of 0.000 and t table is  $t(0.05; 62) = 1.660$ . Based on the overall test results obtained a value of  $4.160 > 1.660$  where tcount is greater than ttable and with the value of sig.  $0.000 < 0.05$  and the regression coefficient value is 0.362. This result means that audit quality positive effect on the integrity of financial statements.

#### d. Sobel Test Results

##### a. Good Corporate Governance Sobel Test Results On Financial Report Integrity through Quality Audit

With a significance of 5%, the t table value is 1.96. If the t-count value is greater than the t-table value, it can be concluded that there is a mediation effect. To test the significance of the indirect effect, the t value of the coefficient ab is used where the following formula is used:

$$S_{ab} = \sqrt{b^2 Sa^2 + a^2 Sb^2 + Sa^2 Sb^2}$$

$$S_{ab} = \sqrt{(0,362)^2(0,003)^2 + (0,538)^2(0,343)^2 + (0,003)^2(0,343)^2}$$

$$S_{ab} = 0,034$$

Then calculate the value of t count with the following formula:

$$t \text{ hitung} = \frac{ab}{Sab}$$

$$t \text{ hitung} = \frac{(0,538)(0,362)}{0.034}$$

$$t \text{ hitung} = 5,728$$

Therefore, t count is  $5.728 > 1.96$ . This means that good corporate governance affects the integrity of financial statements through quality audits.

##### e. Sobel test results Financial distress On Financial Report Integrity through Quality Audit

With a significance of 5%, the t table value is 1.96. If the t-count value is greater than the t-table value, it can be concluded that there is a mediation effect. To test the significance of the indirect effect, the t value of the coefficient ab is used where the following formula is used:

$$S_{ab} = \sqrt{b^2 Sa^2 + a^2 Sb^2 + Sa^2 Sb^2}$$

$$S_{ab} = \sqrt{(0,362)^2(0,005)^2 + (0,382)^2(0,343)^2 + (0,005)^2(0,343)^2}$$

$$S_{ab} = 0,0172$$

Then calculate the value of t count with the following formula:

$$t \text{ hitung} = \frac{ab}{Sab}$$

$$t \text{ hitung} = \frac{(0,382)(0,362)}{0,0172}$$

$$t \text{ hitung} = 8,039$$



Therefore, t count is  $8.039 > 1.96$ . This means that financial distress affects the integrity of financial statements through quality audits.

#### f. VAF Test Results

- a. VAF Good Corporate Governance Test On Financial Report Integrity through Quality Audit

$$VAF = \frac{b \times c}{a + b \times c}$$

$$VAF = \frac{(0,538)(0,333)}{(0,538 + 0,362 \times 0,333)}$$

$$VAF = 0,272$$

Because the VAF value is 27.2 percent more than 20 percent, it can be explained that there is a mediation effect or in other words audit quality as partial mediation.

- b. VAF Financial Distress Test On Financial Report Integrity through Quality Audit

$$VAF = \frac{b \times c}{a + b \times c}$$

$$VAF = \frac{(0,382)(0,417)}{(0,382 + 0,362 \times 0,417)}$$

$$VAF = 0,299$$

Because the VAF value is 29.9 percent more than 20 percent, it can be explained that there is a mediation effect or in other words audit quality as partial mediation.

#### g. Discussion of Research Results

##### 1 Effect of Good Corporate Governance on Audit Quality

The results of testing the first hypothesis are obtained that good corporate governance has a positive effect on the audit quality of consumer goods companies on the Indonesia Stock Exchange for the 2018-2020 period. This shows that the better good corporate governance will improve the quality of the company's audit, otherwise if the good corporate governance is getting worse, the audit quality will decrease.

##### 2 Effect of Financial Distress on Audit Quality

The results of testing the second hypothesis are obtained that financial distress has a positive effect on the audit quality of consumer goods companies on the Indonesia Stock Exchange for the 2018-2020 period. This shows that the better the company in dealing with financial distress, the better the audit quality of the company, on the other hand, if the company is worse in handling financial distress, the audit quality will decrease.

##### 3. The Effect of Good Corporate Governance on the Integrity of Financial Statements

The results of testing the third hypothesis are obtained that good corporate governance has a positive effect on the integrity of the financial statements of consumer goods companies on the Indonesia Stock Exchange for the 2018-2020 period. This shows that the better good corporate governance will increase the integrity of financial statements, whereas if good corporate governance gets worse, the integrity of financial statements will decrease. The results of this study are in accordance with agency theory.

This agency theory explains that there will be a conflict between the owner of the company (principal) and management (agent). Meanwhile, to mediate the conflict, a third party is needed, namely an auditor whose task is to audit the client company. For companies that go public, entrust the company's financial statements to be audited by a competent auditor in order to provide good audit quality and make the basis for making a decision for the company. The results of this study are in line with research conducted by Jayanti & Widhiyanti (2014) and Subianto (2018) which states that financial distress has an effect on audit quality.

#### **4 The Effect of Financial Distress on the Integrity of Financial Statements**

The results of testing the third hypothesis are obtained that financial distress has a positive effect on the integrity of the financial statements of consumer goods companies on the Indonesia Stock Exchange for the 2018-2020 period. This shows that the better the company in dealing with financial distress, the integrity of the company's financial statements will increase. The results of this study are in accordance with agency theory. The agency theory proposed by Jensen & Meckling (1976) explains that there are differences in interests between the principal and the agent. A good control and corporate governance is expected to enable the management to publish its financial reports quickly in order to avoid conflicts between the principal and the agent. Good Corporate Governance is defined as the structure, system, and process used by the company's organs as an effort to provide added value to the company on an ongoing basis in the long term, while taking into account the interests of other stakeholders, based on the prevailing laws and norms. The mechanism of good corporate governance as measured by the principles of good corporate governance when applied will produce several benefits for the company. Citra (2013); Octadella (2011); and Siahaan (2017) which states that Good Corporate Governance affects the integrity of financial statements.

#### **5. The Effect of Audit Quality on the Integrity of Financial Statements**

The results of testing the fifth hypothesis are obtained that audit quality has a positive effect on the integrity of the financial statements of consumer goods companies on the Indonesia Stock Exchange for the 2018-2020 period. This shows that the better the audit quality will increase the integrity of the company's financial statements, on the contrary if the audit quality is getting worse, the integrity of the financial statements will decrease. The results of this study support the signal theory. Differences in interests between agents and principals that can cause agency conflicts are needed by a third party in this case is a public accountant to provide assurance to investors that they will receive a return on the funds they have invested. (Susiana & Herawaty, 2007). Audit quality is very important because high audit quality will produce reliable financial reports as a basis for decision making. Signal theory explains that management tries to provide relevant information. This is realized through the roles and responsibilities of the part of GCG, namely the audit committee to monitor and supervise the audit of financial statements, as well as to assess the quality of service and the reasonableness of fees submitted by external auditors. Companies that have an audit committee tend to have high audit quality, because it can be an effort to minimize fraud, compared to companies that do not have an audit committee. The existence of an audit committee can be a signal to outsiders that by having a high audit quality, the company can provide promising benefits. Sulthon & Cahyonowati (2015), Pristiawan (2016), Syofyan & Herawaty (2019) which states that good corporate governance has a positive effect on audit quality.

## **6. Good Corporate Governance On the Integrity of Financial Statements Through Quality Audit**

The results of testing the sixth hypothesis are obtained that good corporate governance has a positive effect on the integrity of financial statements through audit quality on consumer goods companies on the Indonesia Stock Exchange for the 2018-2020 period. This shows that increasing audit quality will increase the influence of good corporate governance on the integrity of financial statements. The results of this study are in accordance with agency theory. Differences in interests between agents and principals that can cause agency conflicts are needed by a third party in this case is a public accountant to provide assurance to investors that they will receive a return on the funds they have invested.(Susiana & Herawaty, 2007).

Research resultSaksakotama & Cahyonowati (2014)and Siahaan (2017) stated that the corporate governance mechanism has a positive effect on the integrity of financial statements. Research resultSolikhah & Hamid (2017)states that the corporate governance mechanism has a negative effect on the integrity of financial statements. Another factor that affects the integrity of financial statements is audit quality.De Angelo (1981)defines audit quality as the joint probability of detecting and reporting material errors in the financial statements.

Audit quality is a possibility that an auditor will find and report violations contained in the client's accounting system. Audit quality is very important because high audit quality will assist management in producing company financial reports with integrity so that they can be trusted as the basis for making decisions by investors. This is in accordance with researchSyofyan & Herawaty (2019)where good corporate governance affects audit quality. Then the research resultsTussiana & Lastanti (2016),Qonitin & Yudowati (2018), andBadewin (2019)prove that audit quality affects the integrity of financial statements. The results of this study are in line with research conducted byAlrsham (2014)prove that audit quality mediates the influence of corporate governance on the integrity of financial statements.

## **7 Financial Distress on the Integrity of Financial Statements through Quality Audit**

The results of testing the seventh hypothesis are obtained that financial distress has a positive effect on the integrity of financial statements through audit quality on consumer goods companies on the Indonesia Stock Exchange for the 2018-2020 period. This shows that increasing audit quality will increase the effect of financial distress on the integrity of financial statements. The results of this study are in accordance with agency theory. Agency conflict causes differences in the interests of managers and principals so that it will create financial distress. Managers will tend to reduce the level of accounting conservatism if the company experiences a high level of financial distress because if financial distress occurs, it indicates poor management performance and will result in management changes.(Haq et al., 2017). Accounting conservatism indicates the integrity of financial statements because companies that experience failure tend to manipulate accounting data by applying non-conservative practices, so that conservatism is considered more appropriate to be a proxy for the integrity of financial statements than other proxies such as earnings management.(Saksakotama & Cahyonowati, 2014). Agency theory assumes that humans are always self-interested, so the presence of an independent third party as a mediator in the relationship between the principal and agent is necessary, in this case an independent auditor. Audit quality provides assurance to users about the reliability of financial reporting. Audit quality as a procedure established by the auditor to ensure the relevance and reliability of financial reports to members of the organization and the public(Serly & Helmayunita, 2019). Investors will be more inclined to accounting data

resulting from high audit quality. Some literature shows that a good level of audit quality is found in companies audited by large KAPs than those audited by small KAPs (Kimeli, 2016). Financial reports with integrity, assisted by an audit process by a good KAP can produce satisfactory results and allow for a reduction in the risk of financial distress. The results of this study are in line with research conducted by Jayanti & Widhiyani (2014) where financial distress affects audit quality. Then the research results Tussiana & Lastanti (2016), Qonitin & Yudowati (2018), and Badewin (2019) prove that audit quality affects the integrity of financial statements.

## V. Conclusion

Based on the results of the study, it can be concluded that:

- a) Good corporate governance effect on audit quality in consumer goods sector companies listed on the Indonesia Stock Exchange.
- b) Financial distress effect on audit quality in consumer goods sector companies listed on the Indonesia Stock Exchange.
- c) Good corporate governance effect on integrity of financial reports in consumer goods sector companies listed on the Indonesia Stock Exchange.
- d) Financial distress effect on integrity of financial reports in consumer goods sector companies listed on the Indonesia Stock Exchange.
- e) Audit quality affects the integrity of financial statements in consumer goods sector companies listed on the Indonesia Stock Exchange.
- f) Good corporate governance affect the integrity of financial statements in consumer goods sector companies listed on the Indonesia Stock Exchange through quality audits.
- g) Financial distress affect the integrity of financial statements in consumer goods sector companies listed on the Indonesia Stock Exchange through quality audits.

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