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CORPORATE GOVERNANCE, FINANCIAL REPORTING QUALITY, AND FIRM PERFORMANCE: EVIDENCE FROM INDONESIA

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Abstract
The aim of this research is to examine the connection between corporate governance, the dependability of financial statements, and the functioning of non-financial corporations listed on the Indonesia Stock Exchange during the years 2019 to 2021. This research draws on the findings of Khatib & Nour (2021), which indicated that an increase in board size significantly improves firm performance. Moreover, it cites the research conducted by Sohail & Aziz (2019), demonstrating that quality of financial reporting affects corporate performance. Utilizing the ASEAN CG Scorecard as a benchmark for corporate governance sets this research apart from earlier studies, as do the selected sample and the time frame of the research. This research contributes to the current literature on corporate governance criteria by employing the ASEAN CG Scorecard. Instead of concentrating on a limited range of indicators, this approach aims to deliver a comprehensive overview of corporate governance practices. Furthermore, since it is based on OECD standards, the ASEAN CG Scorecard is expected to enhance investor trust in publicly traded firms. The goals of this research are to assess whether effective governance influences corporate performance and to evaluate if the quality of financial reporting impacts overall corporate success.

Keywords: Corporate Governance, Firm Performance, Financial Reporting Quality

1. Introduction

Providing crucial insights regarding a company's strategy, background, and current condition through corporate financial reports, referred to as financial reporting, stands as a primary duty of any organization. Jonas and Blanchet (2000) mentioned that the quality of each element within a financial statement, including disclosures, details on business dealings, management choices, and specifics about the selection and application of accounting principles, significantly affects the effectiveness of financial reporting. This information is essential for decision-makers as they evaluate the likelihood of extending credit to a company or making an investment. Nowadays, due to geographical expansion, technological progress, and global business trends, the public, stakeholders, and companies all demand high-quality information.

Simply preparing financial statements in accordance with established accounting principles does not ensure superior quality of financial data. Thus, the traits of an organization's financial reports determine the benchmarks for financial disclosure. According to Martinez-Ferrero (2014), the reliability of these reports can impact share prices, influence the choices made by stakeholders, and also have implications for profitability, cash flow, operational effectiveness, and the general performance of the business. Corporations need to evaluate how these factors affect the standard of their financial disclosures. Moreover, transparent, high-quality financial statements contribute to reducing information asymmetry.

Conversely, unpredictable actions and decisions from management can lead to lower quality in financial statements. This refers to the alteration of financial records for various purposes. Such practices can undermine accurate representation, which is a fundamental aspect of high-quality reporting, ultimately affecting the company's financial outcomes. Consequently, the numerical values and qualitative information in financial statements should be prioritized.

During the COVID-19 pandemic in 2020, many publicly listed non-financial companies in Indonesia faced severe pressure, particularly within the property, transportation, and manufacturing sectors. A well-documented case was PT Garuda Indonesia (Persero) Tbk, which was reported to have presented financial statements inconsistent with prevailing accounting standards. The Financial Services Authority of Indonesia (OJK) revealed that the company declared a net profit of USD 809.85 thousand, whereas in reality it had incurred a loss of approximately USD 244.95 million (Kompas, 2019a; Kompas, 2019b). This case underscores the pivotal role of financial reporting quality in shaping investor and creditor decisions, as misleading disclosures may result in misguided judgments and a loss of market confidence once irregularities come to light. Moreover, the inability of the board of commissioners and the audit committee to detect such misstatements highlights weaknesses in corporate oversight mechanisms and reaffirms the importance of strong governance in safeguarding reporting integrity (Meiryani & Primado, 2023). The repercussions were evident in the form of declining public trust, a steep fall in share prices, and deteriorating financial conditions, which align with prior empirical evidence indicating that poor financial reporting quality has adverse long-term performance implications (Asiyanti & Trisnaningsih, 2024).

In contrast, PT Unilever Indonesia Tbk provides an example of effective governance in practice. With the support of an engaged board of directors and independent commissioners, the company consistently delivered transparent financial statements in compliance with IFRS (Wati, 2020). Such transparency not only reinforced the firm’s reputation but also sustained investor confidence and maintained relative stability in corporate performance despite weakened consumer purchasing power during the pandemic (Bisnis.com, 2020; Kontan, 2021). A comparison of these two cases offers compelling evidence that the effectiveness of corporate governance is instrumental in ensuring the quality of financial reporting while simultaneously supporting sustainable firm performance.

In addition to financial reporting quality, corporate governance frameworks play a pivotal role in shaping a firm’s overall performance. Prior studies (Sami et al., 2011; Guney et al., 2020; Khatib et al., 2020) demonstrate that effective governance enhances business growth, a finding consistent with agency theory, which emphasizes the role of governance in monitoring managerial actions and reducing agency costs (Jensen & Meckling, 1976). Boards of directors and commissioners are tasked with mitigating risks, upholding independence, and ensuring oversight, responsibilities that became even more critical during the COVID-19 pandemic (Croci et al., 2020; Khatib et al., 2020). When management faces challenges, boards must be prepared to assume direct supervisory roles.

This study investigates the relationship between corporate governance, financial reporting quality, and firm performance among non-financial companies listed on the Indonesian Stock Exchange from 2019 to 2021. Building on prior findings that link board structure and reporting quality to improved performance (Khatib & Nour, 2021; Sohail & Aziz, 2019), it adopts the ASEAN CG Scorecard—aligned with OECD principles—as

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a more comprehensive governance measure compared to conventional indicators. While governance and reporting quality are widely recognized as drivers of firm performance, assessments in Indonesia remain fragmented and not fully aligned with international standards, and limited research has examined their combined effects during the COVID-19 crisis. By addressing these gaps, this study contributes both theoretically and empirically to the literature on governance in emerging markets, while offering practical insights for regulators, investors, and corporate managers.

2. Theoretical Background

2.1 Agency Theory

Agency theory, as formulated by Jensen and Meckling (1976), provides a foundational perspective for understanding the relationship between corporate governance and firm performance. The theory posits that conflicts of interest often arise between principals (shareholders) and agents (managers) due to divergent objectives and asymmetry of information. Managers may act opportunistically to maximize their personal benefits at the expense of shareholders' wealth, thereby generating agency costs. Effective corporate governance mechanisms—such as an independent board of directors, audit committees, and transparent reporting practices—are designed to reduce these costs by monitoring managerial behavior and ensuring that strategic decisions align with shareholders' interests. Within this context, high-quality financial reporting further mitigates agency problems by enhancing transparency and accountability, thus lowering information asymmetry and strengthening investor confidence.

2.2 Stakeholder Theory

While agency theory emphasizes the principal–agent relationship, stakeholder theory broadens the scope of corporate responsibility. Freeman (1984) argues that corporations operate within a complex network of relationships involving various stakeholders, including investors, creditors, employees, regulators, and society at large. From this perspective, both corporate governance and financial reporting quality are crucial mechanisms for balancing and fulfilling stakeholder interests. Transparent disclosures and reliable governance structures not only enhance credibility but also foster long-term sustainability by ensuring that stakeholder expectations are addressed. This theoretical lens is particularly relevant in emerging markets, where institutional frameworks are still developing and stakeholder trust plays a vital role in shaping firm performance.

2.3 Signaling Theory

Signaling theory, first introduced by Spence (1973), further explains the informational role of corporate governance and financial reporting. In the presence of information asymmetry between managers and external stakeholders, companies utilize governance structures and high-quality financial statements as credible signals of reliability, stability, and long-term viability. Accurate and transparent financial disclosures signal sound management practices, while robust governance frameworks reinforce the company's commitment to integrity and accountability. In turn, these signals reduce perceived risks, enhance market valuation, and attract investment, ultimately contributing to improved firm performance. Conversely, weak governance and low-quality reporting can generate negative signals, leading to declining investor confidence and adverse performance outcomes.

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2.4 Resource-Based View (RBV)

Complementing these perspectives, the resource-based view (Barney, 1991) highlights the strategic role of governance and financial reporting as intangible resources that contribute to sustainable competitive advantage. According to RBV, firms that develop unique, valuable, and difficult-to-imitate resources are more likely to achieve superior performance. Corporate governance structures, when effectively implemented, serve as organizational capabilities that enhance decision-making, risk management, and accountability. Similarly, the quality of financial reporting represents a strategic resource that facilitates informed decision-making by investors and other stakeholders. Together, these elements can enhance operational efficiency, reduce uncertainty, and strengthen a firm's market positioning.

2.5 Firm Performance

Firm performance represents a multidimensional construct that reflects a company's ability to generate value for shareholders and stakeholders through effective resource allocation, managerial decision-making, and governance practices. It is commonly assessed using financial indicators such as return on assets (ROA), return on equity (ROE), and Tobin's Q, which capture both accounting-based and market-based perspectives (Richard et al., 2009). From the standpoint of agency theory, firm performance serves as a benchmark to evaluate whether managers act in alignment with shareholder interests (Jensen & Meckling, 1976), while stakeholder theory emphasizes its broader role in meeting societal and institutional expectations (Freeman, 1984). In emerging economies such as Indonesia, high-quality financial reporting and strong corporate governance are essential to enhance firm performance, reduce information asymmetry, and foster sustainable growth.

2.6 Corporate Governance

Previous studies conducted by Sami et al. (2011), Guney et al. (2020), and Khatib et al. (2020) demonstrate that the way companies are governed has a significant impact on their overall success. This is consistent with the agency theory proposed by Jensen and Meckling (1976), which highlights the potential conflict of interest between managers (agents), who are responsible for running the firm, and shareholders (principals), who provide the capital.

Strong corporate governance serves as a regulatory, monitoring, and advisory mechanism for management, thereby minimizing conflicts of interest and reducing agency costs. In practice, the role of boards of directors and commissioners is crucial, as effective oversight can mitigate risks associated with uncertainty, preserve independence, and ensure the continuity of optimal strategic decision-making, particularly during periods of crisis such as the pandemic (Croci et al., 2020; Khatib et al., 2020). Prior research further emphasizes that the stronger the governance practices, the greater the firm's ability to manage risks and sustain performance stability (Sami et al., 2011; Guney et al., 2020; Khatib et al., 2020). Therefore, both theoretical reasoning and empirical evidence suggest that:

H1: Corporate governance has an effect on firm performance

2.7 Financial Reporting Quality

Several scholars (García-Lara et al., 2010; Ahmed & Duellman, 2011) have emphasized that providing high-quality financial information aligned with established

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standards enhances organizational effectiveness. Transparent and reliable reporting not only supports informed decision-making by shareholders and stakeholders but also strengthens the firm's market credibility.

In line with this, Ouma (2017) identified a positive and significant relationship between the quality of financial reporting and corporate performance, showing that firms with higher reporting quality tend to achieve stronger profitability margins. Similarly, King'wara (2015) found that the effectiveness of financial reporting significantly influences firm performance, based on an analysis of companies listed between 1994 and 2003, comparing the pre- and post-IFRS adoption periods. These findings reinforce the notion that accurate, transparent, and reliable reporting reduces information asymmetry, improves investor confidence, and ultimately contributes to superior business outcomes. Therefore, both theoretical and empirical evidence support the following hypothesis:

H2: Financial reporting quality has an effect on firm performance

3. Methods

3.1 Data and Samples

This study employs a quantitative research design using secondary data obtained from annual reports of non-financial companies listed on the Indonesia Stock Exchange (IDX) during the period 2019–2021. The financial sector is excluded because it is subject to specific regulations that provide exemptions from certain disclosure and governance requirements, which may lead to inconsistencies in comparison with other industries. The sample selection follows a purposive sampling approach, where firms are included if they (1) were consistently listed on the IDX during the observation period, (2) published complete annual reports, and (3) disclosed corporate governance information in line with the ASEAN CG Scorecard indicators. Data on financial performance and control variables were obtained from audited financial statements, while governance data were manually collected from corporate annual reports.

3.2 Operational Definition of Variables

The dependent variable in this study is firm performance, measured using Return on Assets (ROA) and Return on Equity (ROE), following Khatib & Nour (2021). Two independent variables are employed. The first is corporate governance, measured using the ASEAN Corporate Governance Scorecard (ACGS), which comprises five dimensions aligned with OECD principles: (1) rights of shareholders, (2) equitable treatment of shareholders, (3) role of stakeholders, (4) disclosure and transparency, and (5) responsibilities of the board, consisting of 185 checklist items. The second independent variable is financial reporting quality, proxied by the level of earnings management, consistent with prior literature. To account for firm heterogeneity, several control variables are incorporated, including firm size (log of total assets), firm age (years since establishment), and leverage (debt-to-equity ratio).

3.3 Data Analysis Technique

This research applies panel data regression analysis to examine the relationships among corporate governance, financial reporting quality, and firm performance. Prior to hypothesis testing, classical assumption tests are conducted, including normality, multicollinearity, autocorrelation, and heteroscedasticity tests, to ensure model validity. Both individual regression and multiple linear regression models are employed to capture

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direct and combined effects of the independent variables on firm performance. The model specification is expressed as follows:

$$FP_{it}=\alpha+\beta_1 CG_{it}+\beta_2 FRQ_{it}+\beta_3 Size_{it}+\beta_4 Age_{it}+\beta_5 Lev_{it}+\varepsilon_{it}$$

Where:
FP_{it} = Firm performance of company *i* in year *t*
CG_{it} = Corporate governance
FRQ_{it} = Financial reporting quality
$Size_{it}$ = Firm size
Age_{it} = Firm age
Lev_{it} = Leverage
ε_{it} = Error term

Data were processed using SPSS to ensure robustness. To further validate the findings, robustness checks were performed by comparing results across different model specifications.

4. Results and Discussion

This research examines every firm listed on the Indonesia Stock Exchange (IDX) from 2019 to 2021, excluding the financial sector, as it is not subject to specific regulations. The sample selected for this study was determined through purposive sampling. The data collected for this assessment follows a normal distribution and does not show signs of autocorrelation or heteroscedasticity.

Table 1. Results of Hypothesis Testing

Model		Unstandarized Coefficients		Standarized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-16.707	8.818	-	-1.895	0.058
	CG	0.130	0.075	0.059	1.744	0.008
a. Dependent Variable: ROA						
Description: This table aims to see whether the hypotheses in this research are fulfilled or not by testing the dependent and independent variables. The dependent variables is ROA. The independent variable is CG Scorecard. Based on the result, the significance value is below0.05 which indicates that the relationship is significant.						

Source: Author Own Source (2024)

The subsequent information demonstrates the formula obtained from the earlier linear regression:

$$ROA = -16.707 + 0.130CGS + 1$$

This equation indicates that a one-unit increase in corporate governance leads to an increase of 0.130 in firm performance (ROA).

Table 2. Result of the Coefficient of Determination Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.591	0.349	0.234	47.10977
a. Predictors: (Constant), CG				
Description: This table aims to see the result of the coefficient of determination test. The R Square result in 0.349 which indicate that the dependent variables can get influenced by 34.9% from independent variables.				

Source: Author Own Source (2024)

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The R2 value is recorded at 0.349, as indicated by the coefficient of determination analysis detailed in Tables 1 and 2 above. This suggests that corporate governance may influence 34.9% of a company's performance, reflected by ROA, while ROE shows a 21.8% impact. The study determines that the performance of 870 companies traded on the Indonesia Stock Exchange from 2019 to 2021 is influenced by corporate governance based on the statistical evaluations conducted. The results of this investigation align with previous research undertaken by Sami et al. (2011), Guney et al. (2020), and Khatib et al. (2020), which similarly found that corporate governance impacts business performance.

This connection can be understood through agency theory. An independent board of directors paired with transparency and accountability, which signify robust corporate governance practices, can alleviate moral hazard and adverse selection problems arising from clashing goals among executives and investors. As a result, this may result in more effective decision-making and enhanced outcomes, as indicated by the ROA and ROE figures. Moreover, stakeholder theory proposes that effective governance can strengthen connections with various stakeholders, since open and accountable management practices can boost the confidence of both outside stakeholders (such as investors and lenders) and those within the organization (like staff). This creates a supportive atmosphere for sustainable development and enhanced performance.

Table 3. Result of the Coefficient of Determination Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.224	0.050	0.043	0.033334
a. Predictors: (Constant), CG				
Description: This table aims to see the result of the coefficient of determination test. The R Square result of 0.050. This indicates that the standard of financial reporting influences merely 5% of a company's performance, evaluated by earnings management.				

Source: Author Own Source (2024)

Nonetheless, this research failed to adequately demonstrate the link between the quality of financial reports and the performance of the business, as evidenced by Table 3, which shows an R2 value of 0.050. This indicates that the standard of financial reporting influences merely 5% of a company's performance, evaluated by earnings management. These findings can be analyzed from the viewpoint of agency theory. When the quality of financial reports is poor, managers may conceal negative details or alter financial documents for their personal benefit. This perspective is further supported by research from Rathnayake et al. (2021), which demonstrates that a manager's discretionary choices can impact corporate performance; for instance, a manager's poor production decisions could result in lower firm performance. The presence of extra details for those who use financial statements could also affect how financial reporting quality correlates with a company's performance. To illustrate, when users have access to more pertinent information, they might depend less on the figures shown in financial reports. Stakeholder theory indicates that how transparent and accountable a business is to its stakeholders is indicative of the quality of its financial reporting. However, if the quality of financial reporting is poor, it may harm the trust with stakeholders who prioritize the honesty of the information shared. However, the results of this study indicate that the standard of financial reporting does not greatly impact a company's performance, implying that in Indonesia, stakeholders like investors might prioritize other elements that directly affect corporate performance, such as strategic choices and regulations, instead of solely the quality of financial reporting.

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5. Conclusion

The objectives of this research are to explore the impact of corporate governance and the precision of financial statements on the performance of companies listed on the Indonesian Stock Exchange, excluding those within the financial sector, for the period from 2019 to 2021. This research builds on the conclusions of Khatib & Nour (2021), which suggested that larger board sizes significantly benefit business outcomes. Furthermore, it utilizes insights from Sohail & Aziz (2019), who found a link between a firm's prosperity and the standard of its financial disclosures. This research stands apart from earlier studies due to its selection of samples, research duration, and the application of the ASEAN CG Scorecard for evaluating corporate governance standards. By employing the ASEAN CG Scorecard, the study seeks to offer a detailed perspective on the governance practices in place, rather than concentrating on a narrow set of measures, thereby supporting the implementation of the ASEAN CG Scorecard as a tool for assessing governance. It is also anticipated that the ASEAN CG Scorecard will boost investor confidence in publicly traded companies because it is grounded in OECD guidelines. The aim of the research is to evaluate the relationship between the quality of financial reports and the performance of businesses, as well as the effects of robust governance.

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