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FINANCIAL STATEMENT INTEGRITY IN THE CONSUMER NON CYCLICALS SECTOR: THE IMPACT OF FINANCIAL DISTRESS, EARNINGS MANAGEMENT, INSTITUTIONAL OWNERSHIP, AND BOARD INDEPENDENCE

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Abstract
This study examines the determinants of financial statement integrity in Indonesian consumer non-cyclicals companies, focusing on the effects of financial distress, earnings management, institutional ownership, and independent commissioners. The research employs quantitative panel data regression analysis using secondary data from 32 companies listed on the Indonesia Stock Exchange during the 2019-2023 period, resulting in 160 firm-year observations. Data were analyzed using EViews 12.0 with Random Effects Model estimation based on hypothesis testing results. The results indicate that earnings management significantly reduces financial statement integrity, while independent commissioners significantly enhance it. Surprisingly, institutional ownership shows a significant negative relationship with financial statement integrity, suggesting potential short-termism among institutional investors. Financial distress demonstrates no significant effect on financial statement integrity, indicating companies maintain reporting quality despite financial challenges. The findings highlight the critical role of independent commissioners in ensuring financial reporting quality and suggest regulatory attention toward institutional investor behavior and earnings management practices. Companies should strengthen board independence and monitoring mechanisms to improve financial statement reliability. This research provides novel insights into the contradictory role of institutional ownership in emerging markets and demonstrates the resilience of financial reporting quality during financial distress in Indonesian consumer non-cyclicals companies, contributing to both agency theory and corporate governance literature in emerging market contexts.

Keywords: Financial Statement Integrity, Earnings Management, Institutional Ownership, Independent Commissioners, Financial Distress

1. Introduction

Financial statements serve as crucial financial information that describes a company's performance within an accounting period (Kasmir, 2018). According to PSAK No. 201, the primary objective of financial statements is to present information about a company's financial position, performance, and changes in financial position over a specific period, providing valuable insights for users in their decision-making processes (Awara & Fauziati, 2024). Financial statements presented with integrity safeguard shareholders' rights by ensuring they receive an accurate representation of the company's actual condition, free from falsification and manipulation (Fitrianingsih et al., 2023).

Integrity in financial statements necessitates adherence to fundamental qualitative characteristics, particularly relevance and faithful representation, supported by enhancing qualities including understandability, reliability, and comparability (Andini et al., 2024).

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However, the persistent reality of financial statement manipulation in various companies indicates prevalent fraudulent practices. Numerous cases involving large corporations demonstrate continued failures in reporting financial information with complete integrity (Fairuzzaman & Damayanty, 2024).

The integrity of financial statements can be quantitatively assessed through the level of accounting conservatism. The conservatism principle promotes prudence in financial reporting by minimizing cumulative profit reporting, delaying revenue recognition, promptly acknowledging expenses, reducing asset valuations, and enhancing liability measurement (Priyono & Suhartini, 2022). Financial statements employing understatement approaches are generally considered to possess higher integrity due to their lower risk profile compared to overstatement practices (Desi, 2022). Higher accounting conservatism, as measured by CONACC (accounting conservatism with accrual size), correlates with greater financial statement integrity (Andani & Nurhayati, 2021).

Multiple factors influence financial statement integrity, particularly financial distress, earnings management, institutional ownership, and independent commissioners. Financial distress represents a declining financial condition stage preceding bankruptcy or liquidation (Mahendra & Syofyan, 2023), typically initiating with difficulties in meeting short-term obligations (Nurbaiti et al., 2021). Companies experiencing financial distress often demonstrate negative net profit and equity book values in their financial statements. Such distressed conditions frequently correlate with financial statement manipulation or fraud, consequently diminishing financial statement integrity (Andini et al., 2024).

Within financial distress situations, management may become motivated to present misleading financial information to preserve corporate image. Accounting data manipulation tends to escalate when companies experience financial distress, as managers seek to avoid projecting poor performance to investors (Nurbaiti et al., 2021). Agency theory elucidates how conflicting interests between agents and principals intensify during financial distress, prompting managers to manipulate financial statements to enhance the appearance of financial health for creditors, shareholders, and other stakeholders. This behavior inevitably compromises financial statement integrity and signals poor agent performance under principal scrutiny (Andini et al., 2024).

Earnings management represents another significant factor affecting financial statement integrity. This practice involves management's selection of accounting techniques to report corporate earnings, utilizing their authority to enhance apparent company performance through reported profits (Fairuzzaman & Damayanty, 2024). Management motivations for earnings management practices include bonus incentives, debt considerations, and tax motivations. Common earnings management patterns encompass big bath accounting, income minimization, income maximization, and income smoothing (Sulistiawan et al., 2011). The income maximization pattern particularly conflicts with conservative principles by presenting artificially high profits, thereby establishing a negative relationship between earnings management and financial statement integrity (Sucitra et al., 2020).

Agency theory further explains earnings management as arising from information asymmetry, where agents (managers) possess more detailed and comprehensive information about the company's actual situation and future opportunities compared to principals (investors or shareholders). This information is crucial for stakeholders' decision-making and management performance evaluation (Oktaviyanti & Damayanty, 2021). As internal parties responsible for presenting financial information, agents must ensure high integrity in financial statements. This substantial responsibility, coupled with pressure to demonstrate strong performance, may incentivize agents to utilize their authority in manipulating accounting data (Sucitra et al., 2020), ultimately eroding trust and causing inappropriate decision-making among stakeholders (Fairuzzaman & Damayanty, 2024).

Institutional ownership significantly influences financial statement integrity through monitoring mechanisms. Defined as share ownership by institutions such as insurance companies, banks, investment firms, and other financial institutions (Nurbaiti et al., 2021), high institutional ownership encourages managerial compliance with regulations due to institutional shareholders' professional capacity to assess, analyze, and verify financial statement reliability (Azzah & Triani, 2021). Within agency theory framework, institutional ownership plays a vital role in overseeing management policies and corporate performance measurement (Dewi et al., 2019). Intensive monitoring by institutional shareholders enhances control over unethical managerial behavior, consequently improving financial statement quality and reducing manipulation risks (Novianti & Isynuwardhana, 2021).

Independent commissioners constitute another crucial factor affecting financial statement integrity. These board members originate externally without company affiliation in financial, management, ownership, or familial relationships with directors or other commissioners (Kurniawan & Fahrunniza, 2022). Companies with higher proportions of independent commissioners demonstrate improved audit quality, as increased commissioner numbers enhance supervision effectiveness (Azzah & Triani, 2021). In agency theory context, independent commissioners ensure managers avoid self-interest in decision-making, safeguarding shareholder interests. Their effective supervision of company management substantially contributes to enhanced financial statement integrity (Yendrawati & Hidayat, 2021).

This study aims to comprehensively examine the influence of financial distress, earnings management, institutional ownership, and independent commissioners on financial statement integrity within the Indonesian context. The research contributes to both theoretical understanding and practical applications by identifying key factors affecting financial reporting quality and providing insights for regulators, investors, and corporate governance practitioners.

2. Theoretical Background

2.1 Agency Theory

Agency theory, as developed by Jensen and Meckling (1976), examines the contractual relationship between principals (owners) and agents (managers) who are delegated authority and decision-making responsibilities. This relationship inherently creates potential conflicts of interest, as managers may prioritize personal gains over owner objectives (Nicolin, 2013). In financial reporting contexts, managers responsible for performance reporting may manipulate financial statements to present favorable results, particularly during challenging financial periods (Yendrawati & Hidayat, 2021).

Financial distress situations exacerbate agency conflicts, as managers face increased pressure to maintain corporate image and avoid negative perceptions from investors (Wulandari et al., 2021). According to agency theory, managers may resort to accounting manipulation during financial distress to enhance the appearance of financial health for creditors, shareholders, and other stakeholders, ultimately compromising financial statement integrity (Andini et al., 2024).

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Earnings management practices emerge from information asymmetry, where managers possess superior knowledge about the company's actual conditions and future prospects compared to shareholders (Oktaviyanti & Damayanty, 2021). This information advantage, coupled with performance pressures, may incentivize managers to utilize their authority in manipulating accounting data, thereby reducing financial statement reliability and stakeholder trust (Sucitra et al., 2020; Fairuzzaman & Damayanty, 2024).

2.3 Variable and Hypothesis Development

2.3.1 Effect of Financial Distress on Financial Statement Integrity

Financial distress represents a declining financial condition stage preceding bankruptcy or liquidation, typically characterized by difficulties in meeting short-term obligations (Mahendra & Syofyan, 2023; Fitrianingsih et al., 2023). Companies experiencing financial distress often engage in financial statement manipulation or fraud to improve apparent financial health, consequently reducing financial statement integrity (Andini et al., 2024).

Agency theory suggests that financial distress intensifies conflicts between agents and principals, prompting managers to manipulate financial statements to protect corporate image and avoid negative perceptions (Andini et al., 2024). Empirical evidence supports this relationship, with Wulandari et al. (2021) and Fairuzzaman & Damayanty (2024) demonstrating that higher financial distress levels correlate with reduced financial statement integrity. Therefore, we hypothesize:

H1: Financial distress negatively affects financial statement integrity.

2.3.2 Effect of Earnings Management on Financial Statement Integrity

Earnings management involves management's strategic selection of accounting techniques to influence reported earnings and enhance apparent performance (Fairuzzaman & Damayanty, 2024). Practices such as income maximization contradict conservative accounting principles and negatively impact financial statement reliability (Sucitra et al., 2020).

Information asymmetry in agency relationships enables managers to manipulate accounting data to meet performance expectations, ultimately compromising financial statement integrity and stakeholder trust (Oktaviyanti & Damayanty, 2021; Fairuzzaman & Damayanty, 2024). Research by Hapiansyah et al. (2024), Sangaji (2023), and Sucitra et al. (2020) consistently demonstrates that earnings management reduces financial statement integrity. Thus, we propose:

H2: Earnings management negatively affects financial statement integrity.

2.3.3 Effect of Institutional Ownership on Financial Statement Integrity

Institutional ownership, representing shareholding by banks, investment companies, insurance firms, and other financial institutions, enhances monitoring mechanisms that reduce agency problems (Azzah & Triani, 2021). Institutional investors' professional oversight improves control over unethical managerial behavior, thereby enhancing financial statement quality and reducing manipulation risks (Novianti & Isynuwardhana, 2021).

Through their analytical capabilities and monitoring functions, institutional investors can better detect management manipulation, consequently improving financial statement integrity (Lesmono & Setiyawati, 2023). Empirical studies by Sudarmadi (2024) and

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Azzah & Triani (2021) confirm that higher institutional ownership levels positively influence financial statement integrity. Accordingly, we hypothesize:
H3: Institutional ownership positively affects financial statement integrity.

2.3.4 Effect of Independent Commissioners on Financial Statement Integrity

Independent commissioners, as external board members without company affiliations, serve crucial balancing and oversight functions in corporate governance (Azzah & Triani, 2021). Their independent supervision ensures management decisions align with shareholder interests rather than personal gain, thereby enhancing financial statement integrity (Yendrawati & Hidayat, 2021).

Within agency theory framework, independent commissioners effectively monitor management actions, promoting transparency and accountability in financial reporting (Yendrawati & Hidayat, 2021). Research by Azzah & Triani (2021) and Kurnia & Lastanti (2024) demonstrates that companies with independent commissioners exhibit higher financial statement integrity. Therefore, we propose:
H4: Independent commissioners positively affect financial statement integrity.

2.3 Research Model

Based on the theoretical framework, the following research model illustrates the relationships between independent variables and financial statement integrity:

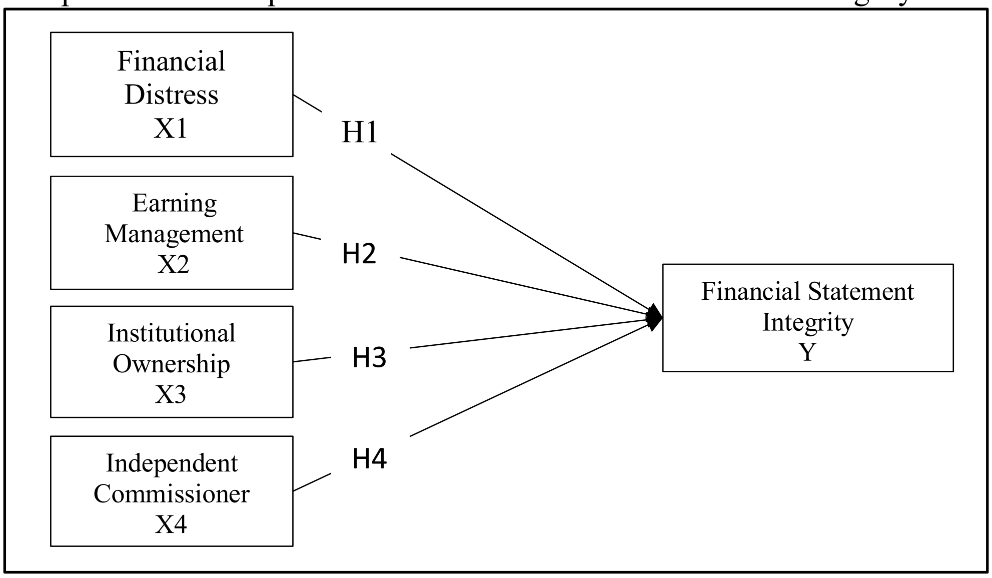

Figure 1. Research Model
Source: Developed for this research, 2025

Where:
Y : Dependent Variable (Financial Statement Integrity)
X1-X4 : Independent Variables
H1 : Effect of Financial Distress on Financial Statement Integrity
H2 : Effect of Earnings Management on Financial Statement Integrity
H3 : Effect of Institutional Ownership on Financial Statement Integrity
H4 : Effect of Independent Commissioners on Financial Statement Integrity

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3. Methods

3.1 Research Design

This study employs a quantitative research approach using panel data regression analysis to examine the influence of financial distress, earnings management, institutional ownership, and independent commissioners on financial statement integrity. The research follows a positivist philosophy, utilizing statistical data analysis to test predetermined hypotheses through empirical evidence from financial reports.

3.2 Population and Sample

This study utilizes secondary data from annual financial statements of Non-Cyclicals Consumer Sector companies listed on the Indonesia Stock Exchange during the 2019-2023 period. From an initial population of 78 companies, the sampling process using purposive sampling method yielded 32 companies that met all established criteria, resulting in 160 firm-year observations.

Table 1. Sample Selection Criteria

No.	Criteria	Companies Eliminated	Remaining Companies
1	Companies consistently listed on IDX 2019-2023	1	77
2	Companies publishing complete financial statements	10	67
3	Companies reporting in Indonesian Rupiah	2	65
4	Companies with complete research variable data	33	32
Final Sample Companies			32
Total Observations (5 years)			160

Source: Processed data, 2025

3.3 Data Collection Methods

This study utilizes secondary data obtained from the official Indonesia Stock Exchange website (www.idx.co.id). The data includes annual financial reports of Consumer Non-Cyclicals sector companies for the 2019-2023 period.

3.4 Operational Definitions of Research Variables

Table 2. Variable Operationalization and Measurement

Variable	Symbol	Measurement	Scale	Source
Financial Statement Integrity	ILK	Measured using accounting conservatism index (CONACC) = (Change in operating profit + Depreciation expense - Cash flow from operations) / Total Assets. Higher values indicate greater conservatism and integrity.	Ratio	Givoly and Hayn (2000); Andani & Nurhayati (2021)
Financial Distress	FD	Measured using Altman Z-Score = 1.2(Working Capital/Total Assets) + 1.4(Retained Earnings/Total Assets) + 3.3(EBIT/Total Assets) + 0.6(Market Value Equity/Total Liabilities) + 1.0(Sales/Total	Ratio	Altman (1968); Hermuningsih et al. (2022)

		Assets). Companies classified as: Z > 2.99 (Healthy), 1.81 < Z < 2.99 (Grey Area), Z < 1.81 (Distressed).		
Earnings Management	ML	Measured using Modified Jones Model through Discretionary Accruals (DAC). Calculated through multiple steps involving total accruals, non-discretionary accruals, and discretionary accruals. Higher absolute values indicate greater earnings management.	Ratio	Novitasari & Martani (2022); Sucitra et al. (2020)
Institutional Ownership	KPI	Calculated as (Number of Institutional Shares / Total Outstanding Shares) × 100%	Ratio	Azzah & Triani (2021)
Independent Commissioners	KI	Calculated as (Number of Independent Commissioners / Total Board of Commissioners) × 100%	Ratio	Azzah & Triani (2021)

Source: Processed by researcher, 2025

3.5 Data Analysis Techniques

Data analysis in this study employs panel data regression analysis, which combines cross-sectional and time-series data. The analysis begins with estimating three alternative panel data regression models: the Common Effect Model (CEM), which assumes no individual or time-specific effects; the Fixed Effect Model (FEM), which captures individual-specific effects using dummy variables; and the Random Effect Model (REM), which treats individual effects as random variables. The general regression equation takes the form of $Y\_it = \alpha + \beta_1 X1\_it + \beta_2 X2\_it + \beta_3 X3\_it + \beta_4 X4\_it + \varepsilon\_it$, where Y represents financial statement integrity, X1 through X4 denote the independent variables, α is the constant, β represents regression coefficients, and ε is the error term.

Model selection follows a sequential testing procedure using statistical tests with a significance level of $\alpha = 0.05$. The Chow Test determines whether CEM or FEM is more appropriate, the Hausman Test selects between FEM and REM, and the Lagrange Multiplier Test compares CEM and REM. To ensure the validity of regression results, classical assumption tests are conducted, including multicollinearity testing using Variance Inflation Factor (VIF) with a threshold of VIF < 10, and heteroscedasticity testing using the Breusch-Pagan test.

Hypothesis testing employs multiple statistical approaches. The F-test examines the simultaneous effect of all independent variables on financial statement integrity, while t-tests assess the partial effect of each independent variable. The coefficient of determination (R^2) measures the model's explanatory power by indicating the proportion of variance in the dependent variable explained by the independent variables. All analyses are performed using EViews 12 software, which provides comprehensive tools for panel data regression processing and hypothesis testing.

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4. Results and Discussion

4.1 Descriptive Statistics

Table 3 presents the descriptive statistics for all research variables, providing an overview of data characteristics including mean, standard deviation, minimum, and maximum values.

Table 3. Descriptive Statistics

Variable	Mean	Median	Maximum	Minimum	Std. Deviation
Financial Distress	2.775041	2.654457	6.625387	0.857887	1.047407
Earnings Management	0.000422	0.000402	0.015283	-0.015826	0.003573
Institutional Ownership	0.701695	0.743292	0.979055	0.133333	0.176675
Independent Commissioners	0.423876	0.400000	0.833333	0.250000	0.121435
Financial Statement Integrity	0.045621	0.038492	0.152833	-0.038291	0.028743

Source: Processed data from EViews 12, 2025

The descriptive analysis reveals that the average Altman Z-Score of 2.78 places sample companies in the "grey zone," indicating financial vulnerability without critical distress. Earnings management shows minimal aggregate practice with balanced positive and negative discretionary accruals. Institutional ownership averages 70.17%, demonstrating dominant institutional influence, while independent commissioners exceed regulatory requirements at 42.39%.

4.3 Panel Data Regression Model Selection

The model selection process involved sequential testing to determine the most appropriate estimation technique.

Table 4. Model Selection Test Results

Test	Comparison	Probability Value	Selected Model
Chow Test	CEM vs FEM	0.0000	FEM
Hausman Test	FEM vs REM	0.2462	REM
Lagrange Multiplier	CEM vs REM	0.0000	REM

Source: Processed data from EViews 12, 2025

Based on the testing hierarchy, the **Random Effects Model (REM)** was selected as the most appropriate estimator, with the Hausman test ($p = 0.2462 > 0.05$) confirming REM as consistent and efficient.

4.4 Hypothesis Testing Results

Table 5 presents the complete Random Effects Model estimation results, including coefficient estimates and hypothesis test outcomes.

Table 5. Random Effects Model Estimation Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Hypothesis
Constant	0.048571	0.012384	3.922047	0.0001	
Financial Distress	0.000428	0.006405	0.066787	0.9468	H1: Rejected
Earnings Management	-11.62220	1.051342	-11.05527	0.0000	H2: Accepted
Institutional Ownership	-0.084259	0.037559	-2.243215	0.0263	H3: Accepted

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Hypothesis
Independent Commissioners	0.112065	0.046777	2.395265	0.0178	H4: Accepted

Source: Processed data from EViews 12, 2025

The regression equation derived from the analysis is:

Financial Statement Integrity = 0.048571 + 0.000428(FD) - 11.62220(EM) - 0.084259(IO) + 0.112065(IC)

Table 6 shows the model goodness-of-fit tests, indicating strong explanatory power and statistical significance.

Table 6. Model Goodness-of-Fit Tests

Test	Value	Conclusion
F-statistic	32.14453	Significant ($p = 0.0000$)
Adjusted R^2	0.439308	43.93% variance explained

Source: Processed data from EViews 12, 2025

The F-test confirms the model's overall significance ($p < 0.05$), while the Adjusted R^2 of 0.4393 indicates that 43.93% of financial statement integrity variation is explained by the independent variables.

4.5 Discussion of Findings

4.5.1 Effect of Financial Distress on Financial Statement Integrity

Hypothesis 1 (H1) proposed that financial distress affects financial statement integrity. However, the results show an insignificant relationship ($\beta = 0.000428$, $p = 0.9468 > 0.05$), leading to H1 rejection. This finding suggests that financial distress alone may not directly drive financial statement manipulation in Indonesian Non-Cyclicals Consumer companies.

The non-significant relationship may be attributed to several factors. First, the sample's average Z-Score of 2.78 indicates that most companies are in the "grey zone" rather than critical distress, reducing incentives for high-risk manipulation. Second, regulatory compliance pressures and the serious consequences of financial statement fraud may deter manipulation even in distressed conditions. Third, companies may prefer fundamental operational improvements over risky accounting manipulations.

This finding aligns with research by Nurbaiti et al. (2021) and Andini et al. (2024), supporting the notion that financial reporting quality may be maintained despite financial challenges due to strong regulatory frameworks and corporate governance mechanisms.

4.5.2 Effect of Earnings Management on Financial Statement Integrity

Hypothesis 2 (H2) examining earnings management's effect on financial statement integrity is strongly supported ($\beta = -11.62220$, $p = 0.0000 < 0.05$). The significant negative coefficient indicates that earnings management practices substantially reduce financial statement integrity.

This finding confirms agency theory predictions that managers may exploit accounting discretion to influence reported earnings, compromising financial reporting quality. The substantial coefficient magnitude underscores the material impact of earnings management on financial statement reliability. This aligns with previous research by Sucitra et al. (2020) and demonstrates that earnings management remains a critical threat to financial reporting integrity in emerging markets.

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4.5.3 Effect of Institutional Ownership on Financial Statement Integrity

Hypothesis 3 (H3) regarding institutional ownership's effect is supported (β = -0.084259, $p = 0.0263 < 0.05$). However, the negative coefficient direction contradicts theoretical expectations, suggesting that higher institutional ownership may not necessarily enhance financial statement integrity in this context.

The unexpected negative relationship may indicate that institutional investors in Indonesian Non-Cyclicals Consumer companies prioritize short-term returns over rigorous monitoring, or that their presence creates additional pressure for performance manipulation. This finding contrasts with conventional agency theory predictions and warrants further investigation into the specific monitoring behaviors of institutional investors in emerging markets.

4.5.4 Effect of Independent Commissioners on Financial Statement Integrity

Hypothesis 4 (H4) concerning independent commissioners is strongly supported (β = 0.112065, $p = 0.0178 < 0.05$). The positive coefficient confirms that independent commissioners effectively enhance financial statement integrity through objective oversight and governance.

This finding aligns with agency theory and corporate governance literature, demonstrating that independent commissioners provide crucial monitoring that constrains managerial opportunism in financial reporting. Their independence from management influence enables them to challenge questionable accounting practices, thereby improving financial statement quality and reliability.

4.6 Theoretical and Practical Implications

The results offer nuanced insights into financial reporting determinants in emerging markets. While earnings management and board independence function as expected, the non-significant effect of financial distress and unexpected institutional ownership impact suggest contextual factors specific to Indonesian markets. Practically, regulators should focus on strengthening independent board oversight and constraining earnings management, while recognizing that conventional risk indicators like financial distress may not reliably predict reporting quality in this sector.

5. Conclusion

This study examined the influence of financial distress, earnings management, institutional ownership, and independent commissioners on financial statement integrity in Non-Cyclicals Consumer sector companies listed on the Indonesia Stock Exchange during the 2019-2023 period. Using purposive sampling, 32 companies meeting the research criteria were selected, resulting in 160 firm-year observations analyzed through panel data regression with EViews 12.0.

The findings reveal that financial distress does not significantly affect financial statement integrity, suggesting that companies may prioritize regulatory compliance and accurate financial reporting despite financial challenges, recognizing that the consequences of non-compliance outweigh the benefits of manipulation.

Earnings management demonstrates a significant negative effect on financial statement integrity, confirming agency theory predictions that managerial discretion in accounting practices fundamentally undermines financial reporting quality and reliability, potentially misleading stakeholders.

Institutional ownership exhibits a significant negative relationship with financial statement integrity, indicating potential short-termism or conflicting interests among institutional investors that may pressure management toward earnings manipulation rather than ensuring reporting quality.

Independent commissioners show a significant positive effect on financial statement integrity, validating their crucial role in providing objective oversight, constraining managerial opportunism, and ensuring compliance with accounting standards.

This study acknowledges several limitations that provide opportunities for future research. The research model incorporates only four explanatory variables, while other factors such as audit quality, company characteristics, board composition, and audit committee effectiveness may also influence financial statement integrity. Additionally, the exclusive focus on Non-Cyclicals Consumer sector companies limits the generalizability of findings to other industrial sectors with different business dynamics and market pressures.

Based on the findings and limitations, future research should incorporate additional explanatory variables such as audit quality, leverage, profitability, and corporate governance mechanisms to enhance model comprehensiveness. Expanding the research scope to include multiple industrial sectors would allow for comparative analysis and improve the generalizability of findings. Furthermore, extending the research period would enable examination of long-term trends and the evolution of financial reporting practices across different economic cycles.

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