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THE INFLUENCE OF IMPLEMENTATION AND QUALITY OF INTEGRATED REPORTING ON EARNINGS QUALITY WITH AGENCY COST AS THE MODERATING VARIABLE

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ABSTRACT

The objective of this study is to examine the effect of the implementation of integrated reporting and the quality of integrated reporting on earnings quality and the effectiveness of integrated reporting implementation on earnings quality, depends on agency cost. This study uses the dependent variable Earnings Quality; independent variable Integrated Reporting Implementation and Quality; Agency Cost moderating variable; and Corporate Governance control variable.

The population in this study consists of mining companies in Indonesia Stock Exchange for the period 2017-2020. The number of companies studied were 47 companies with a total of 188 data. This study used moderated regression analysis for hypotheses testing. The results of this study show that the implementation and quality of Integrated Reporting has a significant negative effect on earnings quality. Meanwhile, agency costs managed to moderate the relationship between the application of Integrated Reporting to earnings quality.

Keywords: Integrated Reporting, Earnings Quality, and Agency Cost.

INTRODUCTION

Various financial reporting systems for a company are increasingly innovative to improve the system that has been proposed. The function of the new ideas that emerge is to provide benefits for the company and also the employees who work for the company. Integrated Reporting (IR) is an integrated report that compact also comprehensive communication over how strategies, governance and remuneration, performance, also prospects build value in the short, medium, and long term (Integrated Reporting, n.d.).

IR was created because of the impetus for the company due to the development of dynamic business patterns. IR aims to provide more understanding to company stakeholders so that they are more sensitive and understand the managerial conditions of the company (Singh, Sadiq, & Kaur, 2019). Over the last few years, the meaning of accountability has evolved and reshaped what institutions are expected to be accountable for and how. Entering an era that is growing rapidly, it is hoped that company stakeholders will be more sensitive to the social business aspects and managerial conditions of the company and not only for the sake of financial performance.

It is certain that IR has many advantages in terms of delivering accounting information. The revolution that has been developing every day has new things that

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can be applied to make it better. What impact has this actually had as the world of accounting in reporting has created that retort for needed a mandatory reporting approach that reflects a rapidly changing business landscape in which intangible and non – financial assets that for most impact determinants of long-term value generation couple firms. As a result, requests for reform in the way firms disclose and convey their value creation stories have been made (CIMA Global, 2019).

IR was created to assist company management with useful information to make decisions by ensuring efficient resources. IR also assists firm stakeholders with management actions that improve their monitoring of profitability and managerial (social business) circumstances within the organization. The use of IR can provide detailed disclosure of various forms and aspects of capital used in the business operations of a company. This is the benefit of IR in the production of high-quality data.

Consequently, managerial incentives for reporting are of great value in shaping the financial reporting process. In recent years, there has been widespread agreement that combining financial and non – financial information under the financial reporting system is critical to achieving high-quality disclosures. The problem of each company's sustainability and transparency becomes less effective for company stakeholders and also for company management (Couldridge, 2015). Therefore, stakeholders the company is very interested in understanding about business continuity in the company it is managed. Stakeholders are indeed interested in the environmental impact from company's operations, as well as the corporation's economic situation.

In Indonesia, regarding disclosure of reporting, especially reporting on the performance of a business entity, there is Financial Services Authority Regulation Number 29 / POJK.04/2016 concerning the Annual Report of Issuers or Public Companies. The regulation states that the annual report (AR) must at least contain: an overview on important financial data; stock information; the report of the Board of Directors; the report of the Board of Commissioners; the profile of the Issuer or Public Company; management analysis and discussion; governance of Issuers or Public Companies; social and environmental responsibility of the Issuer or Public Company; audited annual financial report; also a statement from members of the Board of Directors and members of the Board of Commissioners regarding the responsibility for the annual report. From these regulations, although in Indonesia there is no specific regulation regarding the requirement for companies to issue integrated reporting, from these regulations, it can be seen that there is a common thread related to the minimum criteria of an entity's annual report with the guiding principle of integrated reporting from IIRC.

This research attempts to investigate the association between IR implementation and profits quality. The phrase "integrated thinking" refers to the relationship between integrated reporting and earnings quality, which to determine a short medium between short-term company priorities and long-term value generation (Churet & Eccles, 2014). One of the management activities which decreases of quality of accounting information in financial statements is the idea of earnings management (Kinney Jr, Palmrose, & Scholz, 2004). Managers alter accounting figures, which leads to earnings management (Fields, Lys, & Vincent, 2001). When managers think that consumers of accounting data can understand and forecast the impact of earnings management on the business, they use this technique to generate a profit, so that earnings management delivers poorer earnings quality. This improves the inaccuracy of profits and cash flow projections (Baruch & Zambon, 2003) and leads investors astray by engaging in immoral activities (Kaplan, 2001).

Earnings management is a phenomenon that academics, financial market regulators, operators, and investors have found as one of the key indicators of a financial performance of a company. There must be several issues in the firm, such as management manipulating accounting earnings. Making compensation contract, political cost reduction, loss avoidance, avoidance of debt covenant violations, and management purchases are the most common reasons for manipulating earnings (Erickson & Wang, 1999). When managers smooth accounting statistics, they are referred to as earning management (Fields, Lys, & Vincent, 2001).

Managers choose the technique when they accept users of accounting information may be incapable to comprehend and foresee the impact of earnings management. A more stable profits stream may afford to pay out more dividends than a more volatile earnings stream. Earnings variability is viewed as a key indicator of a company's overall riskiness, and it has a direct impact on investors' capitalization rates, lowering the value of a company's stock and lowering investors' subjective expectations for future earnings and dividends (Burgstahler & Eames, 2003). Earnings management results in lower earnings quality. As a result, predicted earnings and cash flows have a decreased predictive capacity, and investors are misled, leading to unethical behaviors (Kaplan, 2001). Furthermore, the theory of market equilibrium under uncertain conditions argues that smoothing is an overt attempt to counteract the cyclical character of reported earnings, and hence tends to minimize the covariance of a firm's predicted returns with market portfolio returns (Pavlopoulos, 2018).

Furthermore, from studies on policy actions of a corporation, it is stated that one of the factors underlying the occurrence of these actions is agency costs (McColgan, 2001). Agency costs arise because of the agency problem. Agency issues arise when two parties to a contract have competing interests, and as a result, they are practically infinite in scope. However, in four important problem areas – moral hazard, earnings retention, risk aversion, and temporal horizon – both theoretical and empirical study has evolved.

Despite the above - mentioned issues, the company, with its dispersed share ownership that causes such conflicts, has remained popular among both corporate executives and outside investors. This can be ascribed in part to the advancement of internal and external monitoring equipment targeted at resolving such issues. According to agency theory, organizations should have enough monitoring or control measures in place to protect shareholders and management against conflicts of interest. Managers have to put their shareholders' interests ahead of their own. It is also critical to address agency difficulties by linking management's objectives with the aspirations of shareholders.

Entities can do include implementing IR, improving earnings quality, and making agency costs more efficient. From the research conducted by Obeng, Ahmed, & Miglani (2020) show that under the control and disciplinary impact justifications for corporate disclosure, IR practice is predicted get a connection to profits quality. Their research also demonstrates that IR enterprises have superior profits quality than non-IR firms. IR practice, according to proponents, serves as a technique of generating incremental improvements in the quality of accounting information. Furthermore, a rise in the amount of integration across IR businesses is connected with an accelerate on profits quality point. This result emphasizes significance of integration in accounting information disclosure. Moreover, although agency costs point critical in understanding IR practice's potential to shape profits quality, their importance diminishes as the amount of integration grows (Obeng, Ahmed, & Miglani, 2020).

THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

In this study, stakeholder theory, and agency theory was used as a framework. Stakeholder theory studies the interaction between a company and its stakeholders (Fernando & Lawrence, 2014). Freeman (1984);(Fernando & Lawrence, 2014) stated that stakeholder theory is any organization or individual who can impact or is motivated by the firm's achievement of its goals While some academics began with Freeman's definition of a stakeholder, others strove to be more specific by defining stakeholders in various ways. Since stakeholder theory emphasizes organizational accountability over mere financial and economic success, an organization must fulfil the many expectations of its various parties rather than just shareholders' expectations, as traditional shareholder theories do (Fernando & Lawrence, 2014). Per the stakeholder theory, an organization's management is obligated to its stakeholders by engaging in activities and delivering information that are important to them. As a consequence, the term "responsibility" is frequently associated with this concept, and the literature investigates how one central institution delivers accountability to its various constituents. (Fernando & Lawrence, 2014).

Stakeholder theory has given rise to several assumptions. They exist in stakeholder literature in a range of domains, including strategic management, corporate social responsibility, business and society, and business ethics (Fernando & Lawrence, 2014). These assumptions, which may be summarized as follows, illustrate their scope, and give broad understanding into this theory. From the perspective of a single focus organization, stakeholders are identified. In order to fulfil its objectives, an organization must successfully manage its stakeholders. There are several types of stakeholders, and these groups frequently have competing interests. An organization must be able to balance the competing interests of stakeholders in the external and internal environments. Stakeholders exert pressure on an organization because they anticipate or have an interest in something. The ability of stakeholders to exert pressure on an organization is determined by the stakeholders' organizational characteristics. An organization's stakeholders have financial, social, and environmental obligations.

The ethical branch of stakeholder theory contends that, irrespective of stakeholder strength, all stakeholders have about the same duty to treat properly by an organization (Hawrysz & Maj, 2017). This ethical perspective is closely tied to the attribution model of stakeholder theory by Gray et al. (1996) (Fernando & Lawrence, 2014). As either a consequence, "the corporation bears a commitment to all of its stakeholders," rather than simply the more powerful or rich ones, from a moral code (Gray, Owen, & Adams, 2010). The ethical perspective's fundamental restriction is the managers' problem of treating all stakeholders equitably, especially when the stakeholders' interests are divergent and inconsistent.

According to Gray, Owen, & Adams (2010) stated that the management point of view of stakeholder theory, managers of the company attempt to fulfill the expectations of stakeholders who have influence over the firm's critical resources. The more important stakeholder assets are to companies, the higher the effort made by management to meet those stakeholders' expectations. (Deegan, 2009).

H1: Companies that implement the integrated reporting tend to have high earnings quality.

H2: The quality of integrated reporting has a positive effect on earnings quality

According to Dye and Sunder (2001), as well as Obeng, Ahmed, and Miglani (2020), the association between IR execution and revenue quality is generated by the capabilities in the IR project execution to restrict opportunistic managerial policy making and improve the income of accountability in order to conduct out an ongoing process of proper stakeholder monitoring (i.e. Ewert and Wagenhofer, 2005; Bova and Pereira, 2012). As a consequence, a theoretical narrative for IR practice with earnings quality exists prior to the interaction among agency difficulties, IR practice, and earnings quality. The management's self-interest desire to satisfy incentive requirements or contracts based on incentives or capital market-related objectives has largely affected the quality of reported results (Healy and Wahlen, 1999).

Alhadab et al. (2016) complement previous view by providing ideas for the period that happened prior to the IPO connected to income to boost the profits quality attained. According to reports, if people employ earnings management aggressively in order to enhance personal gains, the securities disposal regulation is relaxed (Chowdhury et al., 2018). According to expert findings, there is a link between management personal interests that take personal gains and earnings quality. As a result, we argue that there is a value relevance between firm-level agency costs associated with IR activities and the quality of current earnings. As a result, we reach the following conclusion:

H.3: The Effectiveness of the Integrated Reporting Implementation and the quality of Integrated Reporting on Earnings Quality Depends on Agency Costs.

RESEARCH METHOD

The technique utilized in this study will be explained in this chapter. A brief description of the definition and variable operationalization, population, data sample, data collecting technique, and analytic method will also be provided.

Earnings Quality is dependent variable. Earnings quality is assessed using modified Jones models, as shown below (Thohari et al., 2005). The modified-jones formula disclosed is the most updated formula for detecting earnings quality. The resulting discretionary accrual value is sufficient to describe the state of the earnings quality of the entity being studied. Total accrual (TAC) is calculated as net income in year t less operational cash flow in year t using as below:

TAC = NIit – CFOit

Furthermore, the total accrual (TA) is estimated used Ordinary Least Square as below:

$$\frac{TA_{it}}{A_{it-1}} = \beta_1 \left(\frac{1}{A_{it-1}}\right) + \beta_2 \left(\frac{\Delta Rev_{it}}{A_{it-1}}\right) + \beta_3 \left(\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon$$

Nondiscretionary accruals (NDA) are calculated used same regression coefficient as in the preceding formula:

$$NDA_{it} = \beta_1 \left(\frac{1}{A_{\ it-1}}\right) + \beta_2 \left(\frac{\Delta Rev_{it}}{A_{it-1}} - \frac{\Delta Rec_{it}}{A_{\ it-1}}\right) + \beta_3 \left(\frac{PPE_{it}}{A_{it-1}}\right)$$

The following formula is used to calculate Discretionary Accruals (DA) as a measure of earnings management:

$$DA_{it} = \frac{TA_{it}}{A_{it-1}} - NDA_{it}$$

Description:

DAit	: Discretionary Accruals of company i in year period t
NDAit	: Nondiscretionary Accruals of company i in year period t
TAit	: Total Accruals of the company i in year period t
Niit	: Net profit of company i in year period t
CFOit	: Operating Cash Flow activities of company i in year period t
Ait-1	: Total Assets of company i in year period t

ΔRevit : Company income i in year t is reduced by the income of company i in year t-1
PPEit : Fixed assets of company i in year period t
ΔRecit : Trade Receivables of company i in year t minus income of company i in year t-1
E : Error

The independent variable is using Implementation of Integrated Reporting (X1). This variable is a dummy variable with a value of 1 for firms that have published integrated reporting and a value of 0 for firms that have not disclosed integrated reporting in certain period (Obeng, Ahmed, & Miglani, 2020). The second independent variable is the Quality of Integrated Reporting (X2). The integrated reporting quality is indeed an evenly weighted ranking system that measures the company's annual report in the seventh part of IR: organizational overview and external environment, governance, business model, risks and opportunities. Strategy and resource allocation, Performance and Outlook, and Presentation Basis (Cooray, Gunarathne, Senaratne, & Herath, 2021).

$$IR\ quality = \frac{n}{k}$$

Where:
IR Quality = IR Quality
N = number of items disclosed by the company
K = number of items expected

Content analysis reference of Integrated Reporting using the indicator table used by Pratama (2017).

This research also has moderating variable. Agency Cost was employed as a moderating variable in this study. Agency costs at the firm level show the performance degradation associated with a contradiction of interest between managers and shareholders. One approach for estimating agency costs is to compute the expenditure ratio, which is calculated as the ratio of operating expenses to yearly revenues (Fleming, Heaney, and McCosker, 2005).

$$Operating\ Expense\ Ratio = \frac{operating\ expense}{annual\ sales}$$

This study employs descriptive analysis as well as multiple regression analysis, particularly Moderated Regression Analysis (MRA). This study's research subjects were mining businesses listed at Indonesia Stock Exchange (IDX) between 2017 and 2020. The sample selection of mining businesses takes into account the fact that mining corporations have a significant environmental effect in their operations. As a result, mining companies should focus more on integrated reporting implementation. Furthermore, several particular accounting techniques in the mining industry allow for financial window dressing.

RESULT AND DISCUSSIONS

Description of the sample

Purposive sampling used to select sample of study, which implies that the sample chosen based on certain criteria. Mining companies listed at Indonesia Stock Exchange are among those required between 2017 and 2020, the mining industry presenting annual reports that form a component of Integrated Reporting between 2017 and 2020, and having all data required for research. Table 1 will provide information regarding the research criteria. The sample selection of mining businesses takes into account the fact that mining corporations have a significant environmental effect in their operations. As a result, mining companies should focus more on integrated reporting implementation. Furthermore, several particular accounting techniques in the mining industry allow for financial window dressing.

Table 1
Data Samples

No.	Criteria	Total of Samples
1	Mining companies listed at Indonesia Stock Exchange (IDX) in 2017-2020	188
3	Mining companies do not have completed data for the research	-24
4	Outlier data	0
5	The number of samples for the research	164

Table 1 reveals that 47 firms were listed at Indonesia Stock Exchange (IDX) from 2017 to 2020; however, because the study period is four years, the total data that should be employed is 188. Furthermore, data collecting findings revealed that six firms did not offer complete data, hence the six companies were omitted from this study. Based on this, the total number of firms used in this study is 41 during a four-year period, resulting in 164 data processed.

In accordance with the rules of statistical testing, before testing the hypothesis, it is necessary to test the classical assumptions. The data collected met the classical assumption criteria consisting of normality test, multicollinearity test, autocorrelation test, and heteroscedasticity test.

Hypothesis Testing

In this study, the mathematical model of the relationship between variables is as follows:

$$Y = \alpha + \beta_1 IR_{Imp} + \beta_2 IR_{Rating} + \beta_3 AC + \beta_4 CG + \beta_5 IR_{Imp} * AC + \beta_6 IR_{Rating} * AC + \beta_5 CG * AC + e$$

Where:

Y = earnings quality
α = Constanta
IRimp = Implementation of IR
IRrating = IR Quality
AC = Agency Cost as moderating variable
CG = Corporate Governance as control variable
IRimp*AC = Interaction variable between implementation of IR and Agency Cost
IRrating*AC = Interaction variable between IR Quality and Agency Cost
CG*AC = Interaction variable between Corporate Governance and Agency Cost
E = Error

The hypothesis was evaluated in this study using Moderated Regression Analysis (MRA). This segment will go over the results of the tests, specifically the highly significant parameter test (t test), the simultaneous test (f-test), also coefficient determination test (R^2).

Statistic t-test

The T-test, which been choose for quantify proportion affect from each independent variable to dependent variable (Ghozali, 2018). If p-value statistical test below 0.05 or 5%, hypothesis is not rejected.

Table 2
Hyphotesis Test Regression Model

Variable	t value	t table value	p-value	Partial Hypothesis Test Result
X1. Dummy IR Impl	-2.624	1.975	0.010	Significant
X2. Rasio IR Quality	-2.700	1.975	0.008	Significant
K1. BOC	2.934	1.975	0.004	Significant
K2. AudCom	3.876	1.975	0.000	Significant
Moderation Z x X1	63.511	1.975	0.000	Significant
Moderation Z x X2	-1.302	1.975	0.195	Not Significant

It is clear from the table above that practically all variables, both independent variables (X1, X2) and control variables (K1, K2) are declared to have a significant effect on Ern Qual, as well as the interaction of moderating variables with X1 or Z*X1 is stated to have a significant effect on Ern Qual. However, the interaction between the moderating variable and X2 or Z*X2 was stated to have no significant effect on Ern Qual (p-value > 0.05).

Based on the findings, it is possible to deduce that the variable Z acts as a pure moderator variable in strengthening the influence of the X1 variable on Y, but does not become a moderator variable or does not strengthen the influence of the X2 variable on Y.

Statistic F-test

The F-test determines if all of the independent variables in a regression model have an impact on the dependent variable. The following are results from hypothesis test for every regression research model using the F statistical test:

Table 3
Simultaneous Hypothesis Test Results (ANOVA)

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	509.548.210.463	6	84.924.701.744	1.153.223	.000^{b}
	Residual	11.561.661.650	157	73.641.157		
	Total	521.109.872.113	163			

The computed F value is 1153,223 and probability value (p-value) is 0.000, according on table above. The F table value is 2.157 from the distribution table F, with =0.05, db1=6, and db2=157. Because the values above show that F count (1153.223) > F table (2.157) and p-value (0.000) 0.05, the conclusion is to reject H0 and accept H1, implying that the variables independent variables, control variables, and moderating interaction variables all have a simultaneous effect on Earning Quality.

Coefficient of Determinant

The Determination Test coefficient (R2), which ranges from 0 to 1, examines the degree of variance of independent variables which may impact dependent variable. Table below is test hyphotesis results for each regression model based on the coefficient of determination.

Table 4
Coefficient Determination Regression Model

Model Summary			
Model	R	R Square	Adj R Square
1	,694	,482	,466

According to the output table above, the simultaneous correlation value R is 0.694, indicating that the association of the seven variables evaluated is quite near to Earning Quality. While the coefficient of determination found is 0.482, which the contribution provided by the six factors with a significant effect on Earning Quality is 48,2 percent, while the influence of other variables not investigated is 51,8 percent.

Discussions

The influence of IR implementation on Earnings Quality

Test Findings A statistical t-test to examine relation between IR Practices and Earning Quality yields a p-value lower from 0.05, indicating Ho is rejected and Ha approved. As a result, it is possible to deduce that companies that implement IR practices tend to have good earnings quality. This is in line with research Obeng, Ahmed, & Miglani (2020). A further rationale that encourages the findings of this study is that IR aims to upgrade the quality of information provided to financial capital providers in order to effectiveness also accurate capital deployment, and to promote a more truly united and efficient understanding of corporate reporting which encompasses many reporting strands and interacts the comprehensive variety of components which have a significant impact on an organization's performance (IIRC, 2013).

The influence of IR quality on Earnings Quality

Amount of IR reporting has a substantial influence on Earnings Quality, similar to the relationship of IR practices that have a major effect on Earnings Quality, where the more IR components declared by firm, the higher the quality of the company's earnings. The higher organization's IR grade, the more conscious the company is of the dependability of the information supplied to stakeholders. As indicated in the preceding explanation, the use of IR is a type of Good Corporate Governance implementation. One of the ideas of GCG is that in order to maintain objectivity in business, organizations must give key relevant information of path that not hard accessible or understood by all stakeholders.

Companies have to get the lead in exposing not just the issues on law, but also the matters crucial to shareholders, creditors, and other stakeholders' decision-making processes. As a result, the management of firms with high IR Quality will go to great lengths to provide relevant and timely information. As a result, companies with a high IR Quality are more likely to have greater profit quality. Another factor underlying the introduction of IR is the company's realization of the need of transparency in reporting. It is a crucial tool for restoring public trust since reporting reveals how a firm sees itself and its position in society. It conveys a company's performance, both positive and negative. It generates accountability for accomplishing targets and makes pledges to improve future performance. Furthermore, integrated reporting should be considered as part of a larger reform effort to support financial stability (Krzus, 2011). According to Obeng, Ahmed, and Miglani (2020), IR practice serves like means of achieving incremental improvements in the quality of accounting information.

Agency Cost as Moderating Variable between the Effect of Implementation and quality of IR to on Earnings Quality.

CONCLUSION

The purpose was to investigate impact of IR implementation also quality on earnings quality, with agency cost serving as a moderating variable. Sample are employs 164 data from 47 mining companies listed at Indonesia Stock Exchange (IDX) between 2017 and 2020. Purposive sampling was employed to determine the sample, and based on criteria. The following are the study's results:

1. The IR implementation has a significant effect on Earning Quality.
2. The IR quality has a significant effect on Earning Quality.
3. Agency Cost has a significant effect on Earning Quality, and acts as a pure moderator in strengthening the influence of the IR Implementation variable on Earning Quality but does not become a moderator variable in strengthening the influence of the IR Quality variable on Earning Quality.
4. The Corporate Governance as control variable which is proxied by the amount of Board of Committee and Audit Committee got significant impact on Earning Quality.
5. Based on the coefficient of determination test, dependent variable, either with or without a moderator, together with the control variable has an effect of 48,2% on the independent variable.

Limitations

The limitations of this research are as follows:

1. The sample from this research only takes one focus on the industrial sector. On the other hand, other researchers reveal the influence of the industrial sector in terms of the application of IR.
2. There are other variables that are not examined, especially those related to earnings management practices.
3. There is potential subjective assessment in the content analysis performed for the IR Quality.

Suggestions

The current study get couple suggestions in further discussion.

1. Future research mostly to include additional factors not employed in this study that may alter dependent variables.
2. Future study is intended to include a larger population sample in order to eliminate bias and enhance outcomes.

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