



## Audit Quality Moderates the Effect of Independent Commissioners, Audit Committee, and Whistleblowing System on the Integrity of Financial Statement

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### ABSTRACT

This study aims to analyze the moderation effect of audit quality on the relationship of independent commissioners, audit committee, and whistleblowing system on the integrity of financial statements. The population used State-owned companies listed on the IDX during 2014-2018. The sampling method used purposive sampling which produced 18 companies. The study used logistic regression and MRA through SPSS 23. The study results showed that independent commissioners and whistleblowing systems do not influence the integrity of financial statements. On the contrary, there is a significant positive effect of the audit committee. Audit quality moderates the relationship of independent commissioners on the integrity of financial statements. On the contrary, it does not moderate the audit committee and whistleblowing system variables. The conclusions of this study are there is a significant positive effect between the audit committee and the integrity of financial statements while there is no effect of independent commissioners or whistleblowing system on the integrity of financial statements. Audit quality strengthens the relationship of independent commissioner on the integrity of financial statements but it is unable to moderate the relationship of the audit committee and whistleblowing system on the integrity of financial statements. The absence of research using the whistleblowing system variable as the independent variable on the integrity component of financial statements makes it an important study to be examined.

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### INTRODUCTION

Business people will always need business information in the form of financial statements to influence interested parties in making decisions. A structured presentation of an entity's financial position and performance is called financial statement (PSAK No 1, 2017). Kurniawan & Khafid (2016) stated financial statements as media for related parties to the entities to communicate. Accordingly, the entities are required to prepare financial statements that have certain quality and integrity as well as the information contained should not mislead report users.

Financial statements contain information that is fair, honest, and not deviant is the definition of the integrity of financial statement information (Statement of Financial Accounting Concepts No. 2). Thus, the presentation of financial statement contains the actual condition without manipulation elements and complies with applicable accounting rules. The financial state-

ments presented must have qualitative characteristics of the financial statement integrity so that it is more trusted by users of the reports.

Financial statements should be presented with high integrity, which is now different from the existing phenomenon where there have been many scandals/fraud of financial information committed by entities. Financial statement manipulation is carried out in order to get a good image in the eyes of investors and other users. This becomes evidence that the level of integrity in financial statements is still low and has become a difficult thing to do.

Based on a survey of anti-fraud organizations (ACFE) in 2018, it is stated that the categories of fraud include fraudulent financial statements, misuse of assets, and corruption. The survey results show financial statement fraud as cases with the lowest proportion of 13%. However, this category caused the largest loss with an average loss of US \$ 700,000. The survey results also show the type of organization indicated fraud where government companies are the third organization indicated to have committed fraud by 17%.

The scandal of financial statement manipulat-

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on in Indonesia involves state-owned companies. One of them is the case that happened to PT Waskita Karya in 2009. In the 2004-2008 financial statements, an overstated profit of Rp 500 billion was recorded, which recorded business income in the last profit period, which should have been recorded in the following year's report. In 2019, the company was again suspected of corrupting 14 fictitious projects done by Waskita officials where they did fictional project work by appointing four sub-contractor companies so that the state suffered a loss of Rp. 186 billion (Novellino, 2019).

The Garuda Indonesia case is the latest case in 2018, in which the airline company acknowledged receivables from the result of cooperation with PT Mahata Aero Teknologi worth USD239.94 million as revenue. Revenue recognition is regarded not in accordance with the principles of SFAS No. 23. This recognition has resulted in a net profit of US\$ 809 thousand. This situation is not in accordance with the results of the second quarter in 2018 which lost US\$ 114.08 million (Pratiwi, 2019).

Apart from the existence of gaps in the phenomena above, indicators on the integrity of financial statements still have inconsistencies in results from the previous studies. Research conducted by Verya (2017), Nurdiniah & Pradika (2017), Arista et al.(2018), and Ayem & Yuliana (2019) found independent commissioners have a positive effect on the integrity of financial statements, but Qoyyimah et al.(2015) and Qonitin & Yudowati (2018) found independent commissioners have no effect. Research conducted by Verya (2017), Echobu et al.(2017), Sofia (2018), Bajra & Cadez (2017), Arista et al. (2018), Qonitin & Yudowati (2018), and Badewin (2019) stated audit committee has a positive effect on the integrity of financial statements, but Qoyyimah et al.(2015) and Nurdiniah & Pradika (2017) found that audit committee has no influence.

Research gaps on similar research arise because of the variety of results found by previous studies that make researchers re-examine the issue. This study aims to analyze the moderating effect of audit quality on the relationship of independent commissioners, audit committees, and whistleblowing systems on the integrity of financial statements. The originality of this study is the use of the whistleblowing system as an independent variable of the integrity of financial statements since the researchers have not found this variable as an independent variable in the previous studies. In addition, the study adds a moderating variable, namely audit quality and a research object, namely BUMN entities listed on the IDX for the 2014-2018 period which are still rarely used in the previous studies.

Agency theory is a grand theory that underlies this research. The relationship between management (agent) and owner (principal) is the basis for agency theory (Jensen & Meckling, 1976). The assumption of human nature, information, and organization are the three assumptions that underlie agency theory (Eisenhardt, 1989). The party who gives responsibility to agents to act on the other party is called principal, while the party who receives the mandate to carry out the company's

duties is called agent. Thus, the mandate given by the principal must be accounted for by the agent, one of which is by providing information through financial statements with high integrity. Another grand theory used is signaling theory. This theory explains management in giving signals regarding the success or failure of performance to the principal is in the form of fair financial information without manipulation thereby reducing the presence of information asymmetry.

Members of the board of commissioners who come from outside the entity are called independent commissioners. Companies that have independent commissioners with a proportional size will improve the monitoring function against the risk of fraud in financial data manipulation and cause financial statement information to be presented with integrity. The research conducted by Ayem & Yuliana(2019), Arista et al.(2018), and Verya (2017) show that independent commissioners have a significant positive effect on the integrity of financial statements.

**H<sub>1</sub>: Independent commissioners have a significant positive effect on the integrity of financial statements**

Audit committee has function as supervisor over management actions, especially when presenting financial statements. The measurement of audit committee can be made through the frequency of meetings which proxies the effectiveness of the committee's supervision. The higher the frequency of meetings, the better the supervision carried out by the committee, the better the integrity of the financial statement presentation. The research conducted by Badewin (2019), Arista et al.(2018), and Verya(2017) found that there is a positive effect between audit committee and the integrity of financial reports.

**H<sub>2</sub>: Audit committee has a significant positive effect on the integrity of financial statements**

Whistleblowing system is used as an anti-fraud strategy in companies (Suh & Shim, 2019) and aims at preventing the practice of falsification, untrue, and unreal in the institution (Zakaria, 2015). Whistleblowing system is a factor that supports the implementation of good corporate governance in order to prevent fraudulent behavior in companies. Reporting system serves as a channel for delivering fraud to internal and external parties against fraud committed by management and other parties in the company. The existence of this system can minimize the occurrence of fraud, one of which is fraud in the presentation of financial statement information. Pamungkas et al.(2017), Johansson & Carey(2016), and Lee & Fargher(2013) stated that there is a positive effect between whistleblowing system and fraud prevention so that financial statement is presented with integrity. Thus, the better the implementation of whistleblowing system, the better the prevention of fraud so that the integrity of financial statements increases.

**H<sub>3</sub>: Whistleblowing system has a significant positive effect on the integrity of financial statements**

One of the corporate governance structures that can minimize information asymmetry is independent commissioner (Vera, 2017). This is since board of commissioners will oversee management's actions (Arista et al., 2018). Information asymmetry can also be minimized by external mechanisms in the form of qualified audit services provided by KAP. De Angelo (1981) explained audit quality is a combination of the probability of detection and reporting of errors in the material financial statements. The measurement of indicators can be through KAP size, where large accounting firms provide high-qualified audit services. If the quality of the audit is obtained properly, the resulted financial statements have reliability in which have been avoided from errors or fraud. When a company uses a large accounting firm with good audit quality, the company is required to implement good corporate governance, one of which is through the supervision of independent commissioners. Independent commissioners with ideal proportions are required to supervise management so that there is less opportunity for management to commit fraud. Thus, a large proportion of independent commissioners along with high audit quality will encourage compliance with financial accounting standards as well as transparency in the presentation of financial statements and the integrity of financial statements increase.

**H<sub>4</sub>: Audit quality strengthens the relationship of independent commissioners on the integrity of financial statements**

The party with the function as supervisor of management actions to present financial statement with integrity is audit committee (Badewin, 2019). The role of audit committee can be strengthened by qualified auditors in carrying out audit tasks. External auditors are chosen to increase the reliability of corporate financial information. De Angelo (1981) explained the size of the audit firm is related to audit quality. Large accounting firms provide audit services with high quality. Financial statements can be trusted in making decisions when these resulted from a good audit quality (Puspita & Utama, 2016). Companies will be required to carry out good governance through the supervision of audit committee when the companies use large KAPs which have a large quality of audit services. The stronger the supervision of the audit committee on management, the more the opportunities for entities to commit fraud can be reduced so that the financial statements are presented with integrity.

**H<sub>5</sub>: Audit quality strengthens the relationship of audit committee on the integrity of financial statements**

Whistleblowing system is an error reporting in companies (Farooqi et al., 2017) and one of the ways to avoid a negative image of the company (Nurhidayat & Kusumasari, 2018). Triantoro et al. (2019) stated whistleblowing system is a component of internal control as a preventive to deviant and fraudulent practices and to strengthen the implementation of corporate governance. Pamungkas et al. (2017) stated that there is a

positive effect between whistleblowing system and the prevention of financial statement fraud. The condition of internal control within the company will be seen by the external auditor for the auditing process. If the entity uses big 4 auditors who have high auditing quality, the company is required to implement a stronger internal control system through the whistleblowing system. The stronger the internal control system implemented by the company, the smaller the opportunity to commit fraud, especially when preparing financial statements. Thus, the implementation of a good whistleblowing system with good audit quality will also reduce manipulation and the integrity of financial statements can be maintained.

**H<sub>6</sub>: Audit quality strengthens the relationship of whistleblowing system to the integrity of financial statements**

**RESEARCH METHODS**

The study design was included in associative research which was conducted with the aim of analyzing the effect between 2 or more variables through a quantitative approach. Secondary data in the form of corporate annual reports and financial statements obtained from the IDX website and the web of each company were the type of data in this study.

State-owned companies listed on the Indonesia Stock Exchange (IDX) for the 2014-2018 periods were used as the population of this study, where the sample determination was based on purposive sampling technique. According to Wahyudin (2015:126), when researchers have a specific intention of the required population size, they can apply this sampling technique. Thus, the sampling method produced a sample of 18 companies for five observation periods and the total obtained was 90 units of research analysis. A summary of the research sample determination is presented in table 1.

The integrity of financial statements was the dependent variable in the study. The independent variables used were independent commissioners, audit committee, and whistleblowing system, while audit quality was the moderating variable. The description of the operational research definition is set out in table 2.

The research data collection used documentation

**Table 1.** Research Sample Criteria

No	Explanation	Deduction	Total
1	State-owned companies listed on the IDX 2014-2018		20
2	The companies published annual and financial reports for 2014-2018	-	20
3	The companies had complete data	(2)	18
	Research sample		18
	Total observation during 2014-2018		90

Source: Data processed, 2020



**Table 2.** Operational Definition of the Research

No	Variables	Variable Definitions	Measurement
1	Integrity of Financial Statement (ILK)	To what extent the financial statements are presented with honest and appropriate information (Ayem & Yuliana, 2019)	$ILK = NI_{it} - CF_{it}$ Where: ILK = Integrity of Financial Statement $NI_{it}$ = Net income - depreciation/ amortization $CF_{it}$ = Operating cash flow With dummy 1 = Prudence (the difference is negative) 2 = Optimistic (the difference is positive) (Qoyyimah et al., 2015)
2	Independent Commissioner (KI)	Members of the board of commissioners come from outside the entity who have independent characters and are contained in an existing body in the company (Arista et al., 2018)	(Total Independent Commissioners)/(Total Independent of Commissioners) (Arista et al., 2018)
3	Audit Committee (KA)	A committee elected from members of the board of commissioners with the responsibility of overseeing the reporting process or financial disclosure (Badewin, 2019)	Total audit committee meetings for one year (Sari & Indarto, 2018)
4	Whistleblowing System (WBS)	A fraud reporting system as a preventive to fraudulent, untrue, and intangible practices within the company (Zakaria, 2015)	$WBS = n/i$ Where: WBS = Whistleblowing system index n = Total items disclosed i = Total items expected by KNKG 2008 (Sofia, 2018)
5	Audit Quality (KUA)	The ability of auditors to obtain or report errors in the financial system of the client entity (Puspita & Utama, 2016)	With dummy: 1 = KAP big four 0 = KAP non-big four (Ayem & Yuliana, 2019)

Source: Previous research, 2020

techniques on the annual and financial reports of state-owned companies listed on the IDX for the period 2014-2018. Descriptive statistical analysis and inferential statistics were data analysis methods used through the help of IBM SPSS 23. Hypothesis testing used a significance level of 5%. The hypothesis testing of independent variable used logistic regression as shown in equation 1, while the moderating variable was examined by logistic regression through the absolute difference value test method which is written in equation 2 to equation 4. The use of the dependent variable with nominal data scales with two categories made the research used logistic regression.

$$\ln ILK / (1 - ILK) = \alpha + \beta_1 KI + \beta_2 KA + \beta_3 WBS + e \quad (1)$$

$$\ln ILK / (1 - ILK) = \alpha + \beta_1 ZKI + \beta_2 ZKUA + \beta_3 AbsZKI\_ZKUA + e \quad (2)$$

$$\ln ILK / (1 - ILK) = \alpha + \beta_1 ZKA + \beta_2 ZKUA + \beta_3 AbsZKA\_ZKUA + e \quad (3)$$

$$\ln ILK / (1 - ILK) = \alpha + \beta_1 ZWBS + \beta_2 ZKUA + \beta_3 AbsZWBS\_ZKUA + e \quad (4)$$

**RESULTS AND DISCUSSIONS**

The results of the descriptive statistical test are presented in table 3. The frequency statistical test on the integrity of financial statements shows that companies that apply prudence are 68.9% or 62 analysis units and the remaining 31.1% or 28 analysis units are considered optimistic. Meanwhile, the frequency statistics on audit quality show that companies which use KAP big four services are 73.3% or as many as 66 analysis units and the remaining 26.7% or 24 analysis units use KAP non-big four. On the other hand, descriptive statistical tests on independent variables including independent commissioners, audit committee, and whistleblowing system have uniform data distribution because the standard deviation value is greater than the average value of the variable.

Logistic regression analysis was used as a method for inferential statistical testing in this study. The condition that must be met in logistic regression is the regression model must be fit with the data so that it can be used at the next research stage. The overall model test aims to examine the regression model fits with the data where the result shows the value of -2LL has decreased so that the model is said to be fit with the data. Meanwhile, the Hosmer and Lemeshow Test is a table of feasibility testing for the regression model where the results have sig values of all regression models > 0.05, which

**Table 3.** Results of Research Descriptive Statistics

Descriptive Statistics of Frequency				Descriptive statistics					
Variables	Freq	Valid %	Variables	N	Min	Max	Mean	S t d . Dev	
Financial Report Integrity	Optimistic	28	31.1	Independent Commissioner	90	0.20	0.71	0.41	0.10
	Prudence	62	68.9						
	Total	90	100	Audit Quality	90	4	70	27.34	14.51
Audit Quality	KAP <i>big four</i>	66	73.3	Whistleblowing System	90	0.37	0.87	0.64	0.12
	KAP non- <i>big four</i>	24	26.7						
	Total	90	100						

Source: Secondary data processed, 2020

means that the model fits the data. The hypothesis testing is written in the regression equation 5 to equation 8 and the hypothesis testing of this study shows the results as outlined in table 4.

$$\text{LnILK}/(1-\text{ILK}) = 2.631 - 1.411 \text{ KI} + 0.040 \text{ KA} - 3.542 \text{ WBS} \dots\dots\dots (5)$$

$$\text{LnILK}/(1-\text{ILK}) = -0.100 - 0.605 \text{ ZKI} + 0.984 \text{ ZKUA} + 0.966 \text{ AbsZKI\_ZKUA} \dots\dots\dots (6)$$

$$\text{LnILK}/(1-\text{ILK}) = 1.260 + 0.385 \text{ ZKA} + 0.463 \text{ ZKUA} - 0.411 \text{ AbsZKA\_ZKUA} \dots\dots\dots (7)$$

$$\text{LnILK}/(1-\text{ILK}) = 0.495 - 0.352 \text{ ZWBS} + 0.810 \text{ ZKUA} + 0.386 \text{ AbsZWBS\_ZKUA} \dots\dots\dots (8)$$

**The Effect of Independent Commissioners on the Integrity of Financial Statements**

The finding provides the evidence that there is no effect between independent commissioners and the integrity of financial statements. The result indicates that independent commissioners with a high proportion in the companies do not guarantee greater supervision which has an impact on the presentation of financial statements with integrity. This condition occurs as a large number of independent commissioners cause a diversity

of opinion so that decision making in carrying out supervision becomes less effective and efficient. The absence of the effect of independent commissioners is due to the selfish nature of management who will be more concerned with their own profits and interests so that the achievements of the entities are respected by investors so that management will prefer to commit fraud in presenting financial statements. This finding is in line with the findings of Qonitin & Yudowati (2018) and Qoyyimah et al.(2015) which state that there is no effect between independent commissioners and the integrity of the financial statements. Meanwhile, the finding is not in line with the findings of Ayem & Yuliana (2019), Arista et al.(2018), and Verya (2017) which show that there is a positive effect between independent commissioners and the integrity of financial statements.

**The Effect of the Audit Committee on the Integrity of Financial Statements**

The study proves that there is a significant positive effect between the audit committee and the integrity of financial statements. The finding is consistent with agency theory. The existence of an audit committee that serves as supervisor of entity management is a part of efforts to minimize information asymmetry. The quality of supervision can be proxied by the frequency of audit committee meetings. The higher the meeting intensity

**Table 4.** Summary of Hypothesis Testing

No	Hypothesis	β	Significance	Results
1	Independent commissioners have a significant positive effect on the integrity of financial statements	-1.411	0.540	Rejected
2	Audit committee has a significant positive effect on the integrity of financial statements	0.040	0.047	Accepted
3	Whistleblowing system has a significant positive effect on the integrity of financial statements	-3.542	0.117	Rejected
4	Audit quality strengthens the relationship between independent commissioners and the integrity of financial statements	0.966	0.018	Accepted
5	Audit quality strengthens the relationship between audit committee and the integrity of financial statements	-0.411	0.242	Rejected
6	Audit quality strengthens the relationship between the whistleblowing system and the integrity of financial statements	0.386	0.292	Rejected

Source: Secondary data processed, 2020

of the audit committee, the better the quality of the supervision. In addition, it also shows an effective committee performance which can prevent and reduce management fraud especially in the presentation of financial statements and the integrity of the reports will increase. The finding is in line with Badewin (2019), Qonitin & Yudowati (2018), Arista et al.(2018), and Verya (2017) who found a significant positive effect between the audit committee and the integrity of financial statements.

### **The Effect of the Whistleblowing System on the Integrity of Financial Statements**

The finding shows that the whistleblowing system has no effect on the integrity of financial statements. This is indicated because of the lack of courage from the whistleblowers to disclose suspected known fraud. Whistleblowers can come from internal or external (Al-Haidar, 2017). The whistleblower is afraid that this will create a risk that harms him. This has an impact on the existence of the WBS system that cannot run effectively. In addition, the absence of the whistleblowing system effect since the companies only consider that the most important thing is that the system already exists (it only meets regulations) without any effort from the companies to make improvements and evaluation of the system so that it runs effectively within the company so that fraud can occur and there is no integrity in the presentation of financial statements. It can be seen from the research data, that 67% of the total analysis units have not met the indicators for evaluating/ improving the whistleblowing system in the company. The finding is not in line with the research of Pamungkas et al.(2017) said there is an effect between the whistleblowing system and the prevention of financial statement fraud that causes the report to be presented with integrity.

### **Audit Quality Moderates the Relationship between Independent Commissioners and the Integrity of Financial Statements**

Audit quality seems to strengthen the relationship between independent commissioners and the integrity of financial statements. The finding is consistent with agency theory and signal theory. The existence of proportional independent commissioners reflects the higher level of control over management and causes more prevention of accounting data fraud or falsification in the report, added the high quality of audits make users of financial reports trust in the high reliability and integrity of the reports. On the other hand, the high quality of audits has led to increased supervision from independent commissioners on management and increase the integrity of financial statements since strong supervision can reduce the presence of information asymmetry.

### **Audit Quality Moderates the Relationship between the Audit Committee and the Integrity of Financial Statements**

The result of the study finds that the relationship between the audit committee and the integrity of finan-

cial statements cannot be moderated by audit quality. This indicates that the audit committees still influence the integrity of financial statements without being moderated by audit quality. The high and low audit quality will not affect the effectiveness of the audit committee as this committee has a supervisory role in ensuring the quality of the entity's financial statements. Thus, the optimization of management supervision from the audit committee must be carried out in order to always maintain the implementation of the prudence principle when the entity presents financial statements without depending on the audit quality. Thus, audit quality is not able to moderate the relationship between the audit committee and the integrity of the financial statements.

### **Audit Quality Moderates the Relationship between Whistleblowing System and the Integrity of Financial Statements**

The test shows that audit quality has not been able to moderate the relationship between the whistleblowing system and the integrity of financial statements. This is indicated because of the variation in the types of public accounting firms used by the entities in the research sample. Audit quality is not able to moderate the whistleblowing system, which indicates that the whistleblowing system will keep affecting the integrity of the financial statements without being moderated by audit quality. The effectiveness of the whistleblowing system in the companies does not depend on the level of audit quality. The implementation of the whistleblowing system will continue to be optimized to supervise the performance of the entity's management when preparing financial statements with integrity in order to avoid fraud without depending on audit quality. Thus, the relationship between the whistleblowing system and the integrity of financial statements cannot be moderated by audit quality.

## **CONCLUSIONS**

The components of the integrity of the company's financial statements are important issues to be discussed. The study provides empirical results related to the moderation of audit quality on the relationship between independent commissioners, audit committee, and whistleblowing system on the integrity of financial statements. The findings show that there is a significant positive effect between the audit committee and the integrity of financial statements while there is no effect between independent commissioners and the whistleblowing system on the integrity of financial statements. Audit quality proves to be able to strengthen the relationship of independent commissioners but has not been able to moderate the relationship between the audit committee and the whistleblowing system on the integrity of financial statements.

The researchers provide suggestions for further research, that is to examine the whistleblowing system with a larger research population in order to obtain broad data. This is due to the limitation of this study where the research sample is only 18 companies with



90 analysis units so that the data are less varied. In addition, it is expected that the implications of the findings can be used as input for entities to implement more effective governance so that financial report fraud can be prevented.

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