

The Influence of Financial Reporting Quality on Profit Quality in Companies in Medan City

Gita Mori Sevira Br Tarigan
Putri Yasmin
Muhammad Rizal

Universitas Negeri Medan

ABSTRACT

This study aims to analyze the effect of financial reporting quality on earnings quality in companies in Medan City. Financial reporting quality is an important aspect in presenting relevant, reliable, and transparent information to stakeholders, particularly in assessing company performance through earnings information. However, in practice, reported earnings do not always reflect actual economic conditions due to the flexibility of accounting policies and the potential for earnings management practices. This study uses a quantitative approach with an associative research type. The data used are secondary data obtained from the financial statements of companies in Medan City. Data analysis techniques were carried out using regression analysis to test the effect of financial reporting quality as an independent variable on earnings quality as a dependent variable. The results show that financial reporting quality has a positive and significant effect on earnings quality. This indicates that the better the quality of financial reporting prepared transparently and in accordance with accounting standards, the higher the resulting earnings quality. Quality earnings tend to be more stable, sustainable, and supported by adequate cash flow, thus gaining more trust from financial statement users. This study confirms that improving the quality of financial reporting is crucial in producing credible earnings information and supporting appropriate economic decision-making.

Keywords: financial reporting quality, profit progress, profit management

Background

Financial reports are one of the primary sources of information used by various parties to assess a company's condition and performance. The information presented in financial reports forms the basis for economic decision-making by investors, creditors, management, and the government. Therefore, the quality of financial reporting is crucial to ensure the information produced is reliable, relevant, and reflects the company's true economic condition.

One of the most closely watched pieces of information in financial reports is profit. Profit is often used as a primary indicator for assessing company performance and forms the basis for various decisions, such as investment decisions, credit granting, and management performance assessments. However, in practice, reported profits do not always reflect the actual situation. This is due to the flexibility in the application of accounting standards, which allows management to make certain adjustments, potentially even engaging in earnings management practices.

This situation raises attention to the importance of earnings quality. Earnings quality indicates the extent to which reported earnings reflect a company's true and sustainable economic performance. High-quality earnings are generally supported by strong, stable, and non-transitory cash flows,

making them more reliable in predicting future company performance. Conversely, low-quality earnings tend to be volatile and vulnerable to manipulation.

Earnings quality is inextricably linked to the quality of a company's financial reporting. Financial reporting that is transparent, relevant, and in accordance with applicable accounting standards will produce higher-quality earnings information. Conversely, poor financial reporting can mislead users and undermine trust in the company. Therefore, there is a close relationship between the quality of financial reporting and the quality of earnings generated.

Medan, as one of Indonesia's economic centers, is home to numerous companies operating across various business sectors. The growth of business activity in Medan requires companies to present high-quality financial reports to boost investor and other stakeholder confidence. In this context, it is important to examine how the quality of financial reporting impacts earnings quality in Medan-based companies.

Based on this description, this study was conducted to analyze the influence of financial reporting quality on earnings quality in companies in Medan City. This research is expected to contribute to the development of accounting science and serve as a reference for companies in improving the quality of their financial reporting and resulting earnings.

Research methods

This study uses a quantitative approach with an associative research type that aims to examine the effect of financial reporting quality on earnings quality in companies in Medan City. The population in this study were all companies operating in Medan City, with a sampling technique using purposive sampling based on certain criteria, namely companies that have complete and consistent financial reports throughout the study period. The data used are secondary data in the form of company financial reports obtained from official publication sources. The data collection technique was carried out through the documentation method. The variables in this study consist of financial reporting quality as the independent variable and earnings quality as the dependent variable. Data analysis techniques used include descriptive statistical analysis, classical assumption tests, and simple linear regression analysis to examine the relationship between variables. Hypothesis testing was carried out using the t-test and the coefficient of determination (R^2) to determine the level of influence of the independent variables on the dependent variable.

Results and Discussion

Results

Based on the data analysis, we obtained an overview of the influence of financial reporting quality on earnings quality in companies in Medan City. The descriptive statistical analysis showed that the research variable data were fairly well distributed, with average values reflecting the general condition of the companies in presenting financial reports and generating earnings. Furthermore, the results of the classical assumption test indicated that the regression model met the assumption of normality, with no multicollinearity, heteroscedasticity, or autocorrelation, making the model suitable for use in hypothesis testing.

The results of a simple linear regression analysis indicate that financial reporting quality has a positive effect on earnings quality. This is indicated by the positive regression coefficient, indicating that the better the quality of financial reporting, the higher the quality of earnings generated by the company.

Furthermore, the t-test results indicate that financial reporting quality significantly impacts earnings quality. This is evidenced by the significance value being lower than the established significance level ($\alpha = 0.05$), thus accepting the research hypothesis. Therefore, it can be concluded that financial reporting quality plays a significant role in improving a company's earnings quality.

Furthermore, the coefficient of determination (R^2) results indicate that financial reporting quality can explain most of the variation in earnings quality, while the remainder is influenced by factors outside the research model. This suggests that while financial reporting quality is an important factor, other variables also influence a company's earnings quality.

Overall, the results of this study indicate that companies in Medan City that prepare financial reports in a transparent, relevant manner and in accordance with accounting standards tend to generate profits that are of higher quality, stable and can be trusted by stakeholders.

Based on the results of data processing using SPSS, the following results were obtained:

Table 1. Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Standard Deviation
Financial Reporting Quality (X)	50	60.00	95.00	78.50	8,214
Earnings Quality (Y)	50	55.00	92.00	75.30	7,856

Based on Table 1, it is known that the quality of financial reporting has an average value of 78.50 with a standard deviation of 8.214, while the quality of earnings has an average value of 75.30 with a standard deviation of 7.856. This indicates that the research data is fairly well distributed and relatively stable.

Table 2. Results of Simple Linear Regression Analysis

Variables	B (Coefficient)	Std. Error	t Count	Sig.
Constant	20,145	5,321	3,786	0.000
Financial Reporting Quality	0.702	0.085	8,259	0.000

The regression equation obtained is: $Y = 20.145 + 0.702X$

Based on Table 2, the regression coefficient value of 0.702 indicates that financial reporting quality has a positive effect on earnings quality. This means that any improvement in financial reporting quality will improve earnings quality.

Table 3. t-test

Variables	t Count	t Table	Sig.	Information
Financial Reporting Quality (X)	8,259	2.011	0.000	Significant

Based on Table 3, the calculated t-value of 8.259 is greater than the t-table of 2.011, and the significance value is $0.000 < 0.05$. This indicates that the quality of financial reporting has a significant effect on earnings quality, thus the research hypothesis is accepted.

Table 4. Coefficient of Determination (R²)

Model	R	R Square	Adjusted R Square	Standard Error of Estimate
1	0.765	0.585	0.577	5.102

Based on Table 4, the R Square value of 0.585 shows that 58.5% of the variation in earnings quality can be explained by the quality of financial reporting, while the remaining 41.5% is influenced by other variables outside the study.

Table 5. Normality Test

Variables	Asymp. Sig (2-tailed)	Information
Residual	0.200	Normal Data

Based on Table 5, the significance value is 0.200 > 0.05, so it can be concluded that the data is normally distributed and the regression model is suitable for use.

Discussion

Based on the research results, it was found that the quality of financial reporting has a positive and significant impact on earnings quality in companies in Medan City. This indicates that the better the quality of financial reporting presented, the higher the resulting earnings quality. Financial reporting that is prepared transparently, relevantly, and in accordance with accounting standards can provide more accurate and reliable information to stakeholders.

The results of this study align with the theory that high-quality financial reporting will produce earnings information that reflects the company's true economic condition. High-quality earnings are generally sustainable, stable, and supported by adequate cash flow. Conversely, poor-quality financial reporting can open the door to earnings management practices, which can lead to low earnings quality. Furthermore, these results support previous research that suggests that the quality of financial reporting plays a crucial role in enhancing the credibility of earnings information. Transparent financial reporting enables users, such as investors and creditors, to make more informed and rational economic decisions.

The coefficient of determination of 58.5% indicates that financial reporting quality contributes significantly to explaining variations in earnings quality. However, other factors still influence earnings quality, such as corporate governance, management policies, internal control systems, and the company's economic conditions, remaining 41.5%. Therefore, further research is expected to add other variables to obtain more comprehensive results. Overall, this study confirms that financial reporting quality is a crucial factor in improving earnings quality and increasing trust in a company's financial information.

Conclusion

Based on the research results and discussion, it can be concluded that the quality of financial reporting has a positive and significant impact on earnings quality in companies in Medan City. This indicates that the better the quality of financial reporting, prepared transparently and in accordance with accounting standards, the higher the resulting earnings quality. Good financial reporting quality can increase the credibility of earnings information, thus providing a basis for more informed

economic decisions by stakeholders. Therefore, companies are expected to continue improving the quality of their financial reporting to generate higher-quality and more reliable earnings.

Bibliography

- Dechow, P. M., Ge, W., & Schrand, C. (2010). Understanding earnings quality: A review of the proxies, their determinants and their consequences. *Journal of Accounting and Economics*, 50(2–3), 344–401.
- Ghozali, I. (2018). *Multivariate Analysis Application with IBM SPSS Program*. Semarang: Diponegoro University Publishing Agency.
- Harahap, SS (2016). *Critical Analysis of Financial Statements*. Jakarta: RajaGrafindo Persada.
- Healy, P. M., & Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. *Accounting Horizons*, 13(4), 365–383.
- Indonesian Institute of Accountants. (2022). *Financial Accounting Standards (SAK)*. Jakarta: IAI.
- Kieso, D. E., Weygandt, J. J., & Warfield, T. D. (2019). *Intermediate Accounting*. New York: Wiley.
- Scott, W.R. (2015). *Financial Accounting Theory (7th ed.)*. Toronto: Pearson Education.
- Siregar, SV, & Utama, S. (2006). Types of earnings management and the effect of ownership structure, firm size, and corporate governance practices: Evidence from Indonesia. *The International Journal of Accounting*, 41(1), 1–27.
- Wahlen, J.M., Baginski, S.P., & Bradshaw, M.T. (2018). *Financial Reporting, Financial Statement Analysis, and Valuation*. Boston: Cengage Learning.
- Rizal, Muhammad. "Asset Structure, Profitability, Business Risk and Their Influence on Capital Structure in Food and Beverage Companies in Indonesia." *Journal of Management and Finance* 8.3 (2019): 415-428.
- Simangunsong, JKM, Rizal, M. and Harahap, K., 2025. The influence of perceived value, perceived risk, and quality of accounting information on digital payment user satisfaction in MSMEs in Medan City. *Tambusai Education Journal*, 9(1), pp.7874-7897.
- Harahap, IO, & Rizal, M. (2023). *Moderation of Managerial Ownership in the Relationship between Investment Opportunity Set, Opportunistic Behavior, and Monitoring Mechanisms on Earnings Management*. Thesis, State University of Medan.
- Rizal, M. (2019). *Asset Structure, Profitability, Business Risk and Their Influence on Capital Structure in Food and Beverage Companies in Indonesia*. *Journal of Management and Finance*, 8(3), 415-428.
- Harmen, H., & Rizal, M. (2016). *Business Law*. Medan: Unimed Press
https://www.researchgate.net/publication/389041637_Hukum_Bisnis.
- Rizal, M. (2025). *Textbook of Sharia Accounting*. Published by CV. LARISPA.
<https://www.larispa.co.id/segera-terbit-buku-akuntansi-syariah>.
- Rizal M. The Influence of Company Characteristics on Social Disclosure of Public Companies in Indonesia. *Balance*. 2004 Sep;2:54-70.