Jurnal Akuntansi, Manajemen, dan Perencanaan Kebijakan, Volume 2, Number 4, 2025, *Page*: 1-8

The Role of Financial Statement Transparency in Preventing Profit Manipulation

Nada Syifa Athaya*, Tsamara Nayla Safitri, Marcella Chintya Manao, Fitri Yani Panggabean

Accounting, Faculty of Social Science, Universitas Pembangunan Panca Budi Medan, Indonesia

DOI:
https://doi.org/10.47134/jampk.v2i4.762
*Correspondence: Author
Email: nadasyifaathaya@gmail.com

Received: 29-04-2025
Accepted: 29-05-2025
Published: 29-06-2025

Abstract: This study aims to examine the role of financial statement transparency in preventing profit manipulation practices in public companies. The approach used is descriptive qualitative through a literature review of relevant scientific journals in the last five years. The main focus is on the relationship between the level of transparency and the tendency for profit manipulation in financial reporting practices. The results of the study indicate that high financial statement transparency can enhance accountability, strengthen internal and external oversight mechanisms, and reduce managerial discretion for manipulation. Additionally, transparency contributes to the creation of reliable, relevant, and verifiable information, thereby strengthening investor confidence and the integrity of the capital market. Therefore, transparency is not merely a technical presentation of financial reports but also an important control mechanism in promoting ethical and responsible reporting.

Keywords: Transparency, Financial Statements, Profit Manipulation, Accountability, Good Corporate Governance.

Introduction

Financial statements are the primary means of communicating a company's financial information to external parties, such as investors, creditors, regulators, and the public. Amid increasing economic complexity and the demands of an increasingly open capital market, the quality of information presented in financial statements is crucial. One indicator of this quality is the level of transparency, namely the extent to which the information presented is honest, complete, and understandable.

However, in practice, many companies are still not fully transparent in preparing their financial statements. Earnings management is the most common form of financial information distortion. This practice involves accelerating or deferring the recognition of revenue and expenses to adjust earnings to management targets. Such manipulation not only creates misleading reports, but also undermines investor confidence and market efficiency.

Profit manipulation not only has a negative impact on the company itself, but also on market stability and investor confidence as a whole. According to research by (Kosasih

& Astawa, 2025), financial manipulation practices carried out by issuers to present financial reports that are better than reality can damage capital market transparency, increase investment risk, and reduce public confidence in the integrity of financial markets.

Previous studies have discussed the importance of financial reporting in the context of governance and accountability. (Marchewka & Kustra, 2019) show that transparency increases market confidence in financial reports, but have not discussed its effect on profit manipulation practices. (Alfraih, 2020) concluded that financial reporting transparency promotes information efficiency, but this has not been tested in the Indonesian context, which has its own reporting complexities. (Sari et al, 2022) stated that companies in Indonesia are still weak in providing honest and complete information, which increases the risk of financial statement manipulation. (Ramadhan & Zulaikha, 2023) prove that low transparency increases the likelihood of financial statement manipulation in companies. Finally, (Hakim & Setiawan, 2024) find that non-transparent financial statements lead to negative investor perceptions of company value, but this has not been examined qualitatively.

This phenomenon shows that financial statement transparency is not merely a technical aspect, but is also closely related to management integrity and the effectiveness of governance systems. Therefore, it is important to further examine how transparency acts as a preventive mechanism against profit manipulation practices. This study is expected to contribute both theoretically and practically to promoting more honest, accountable, and public interest-oriented financial reporting practices.

Theoretical Foundation

Transparency in Financial Reporting

Transparency in the context of financial reporting refers to the extent to which financial information presented by a company can be accessed, understood, and trusted by external parties, including investors, creditors, and regulators. Transparency not only conveys information in accordance with accounting standards, but also includes disclosure of risks, accounting policies used, and compliance with regulations. According to (Zelovena et al., 2023), transparency is an important element of corporate governance that aims to ensure integrity and accountability in financial reporting, thereby reducing information asymmetry between management and stakeholders.

In addition, transparency is also an effective control instrument for investors in assessing managerial performance. In practice, transparency encourages management to act cautiously because their every action will be clearly reflected in the financial statements. Research by (Farouk, 2021) confirms that financial statement transparency increases accountability and enables employees and external parties to understand the company's financial performance more clearly, which ultimately encourages improved performance and more accurate decision-making.

Financial Statements as the Main Source of Information

Financial statements are formal documents that present the financial position, performance, and changes in the financial position of an entity within a certain period. Financial Accounting Standards (FAS) regulate that financial statements be prepared based on the principles of relevance, reliability, and comparability. Financial statements play an important role as a means of communication between entities and external stakeholders such as investors, creditors, regulators, and the general public.

According to (Wati et al, 2023), financial reports play a crucial role in conveying information that is useful for economic decision-making, and the quality of these reports is greatly influenced by the Company's governance structure and internal control system.

However, financial statements do not always fully represent the actual condition of a company. In some cases, financial statements may be prepared with malicious intent to embellish the company's performance through manipulation of figures, known as earnings management or even financial statement fraud. Therefore, transparency in the financial statement preparation process is vital in maintaining the objectivity of the information reported.

(Rosidah et al, 2023) also emphasizes that transparency and accountability in financial reporting are key foundations for preventing manipulation and enhancing institutional integrity, both in the public and private sectors.

Profit Manipulation and Its Impact on the Credibility of Information

Earnings management is a practice of misrepresenting financial statements for specific purposes, such as increasing profits to meet market expectations or decreasing them for tax purposes. This practice is often carried out through the selection of specific accounting methods or the timing of transaction recognition, with the aim of creating a positive perception of the company's performance.

(Muninggar, 2025) explains that profit is one of the most vulnerable components of financial statements to manipulation, as it has a significant influence on the perceptions of stakeholders, such as investors and creditors. Management has authority over the recording of transactions, so they can choose specific accounting methods that allow for the shifting of profit figures to achieve personal goals or external pressures.

Profit manipulation poses a serious threat to the integrity of financial information. In addition to misleading users of financial statements, this practice also disrupts the efficiency of capital markets because investment decisions are no longer based on accurate information. When confidence in the credibility of financial statements declines, systemic impacts such as increased capital costs and reduced investment interest may occur. As explained by (Husein et al, 2023), the results of manipulation in financial statements have been proven to cause distortions in profit values and create a false impression of solvency to the public, despite the underlying fundamentals not supporting it.

The Relationship between Transparency, Financial Reporting, and Profit Manipulation

These three elements are closely causally related. Transparency is a fundamental value that should be the foundation for preparing financial statements. When transparency is upheld, opportunities for profit manipulation can be minimized. Conversely, low transparency provides greater scope for management to manipulate financial statements without being detected.

According to (Panjaitan et al, 2025), financial statement manipulation is generally carried out through techniques such as untimely revenue recognition, recording fictitious transactions, or concealing liabilities. These techniques often arise in environments with minimal transparency, where financial information is not adequately disclosed to external parties, making early detection by investors and auditors difficult.

Furthermore, transparency acts as an internal control tool as well as a form of public accountability. In a study by (Wijayanti, 2025), it is explained that transparent financial reports strengthen the perception of a company's credibility and reduce the tendency for managers to manipulate profits. Transparency also encourages management to act more cautiously because the financial information they present will be widely assessed by stakeholders.

The existence of an effective monitoring system, whether from internal auditors, audit committees, or external regulators, will further strengthen the link between transparency and the prevention of manipulation. Without an open reporting system, users of financial statements face difficulties in assessing the accuracy of information, thereby distorting the purpose of financial reporting as a means of rational decision-making.

Research Method

This study uses a descriptive qualitative approach with a literature review method (library research). This type of research was chosen to explore in depth the theoretical concepts and empirical findings that have been published regarding financial statement transparency and earnings manipulation.

1) The object of this study is the relationship between the level of financial statement transparency and the tendency for profit manipulation in public companies, particularly in the context of financial reporting practices in Indonesia. The main focus is on how transparency acts as a preventive mechanism against manipulative practices in the preparation of financial statements.
2) Research data was obtained from secondary sources, including national and international scientific journals. Literature selection focused on publications from the last seven years (2019–2025), with priority given to sources from the last five years to ensure data relevance and currency.
3) Data collection techniques were carried out through a literature study method, namely by reviewing, selecting, and classifying scientific documents based on research themes or indicators. The main indicators of concern in data classification included the level of

reporting transparency, forms of profit manipulation, and relevant financial governance and oversight mechanisms.

4) The data analysis technique used is content analysis, which is a qualitative approach to systematically interpreting data from various sources. The analysis was conducted to identify the relationship between financial statement transparency and profit manipulation practices, and to draw theoretical conclusions about the effectiveness of transparency as a preventive instrument.

Result and Discussion

Financial statement transparency serves as a key element in preventing profit manipulation practices, as it allows financial information to be accessed and understood objectively by all stakeholders. When financial statements are prepared transparently, the chances of irregularities and information manipulation can be minimized. As emphasized by (Panggabean, 2019), relevant, reliable, comparable, and understandable financial reports must be free from manipulation, as non-transparent presentation can mislead information users and undermine public accountability. Additionally, transparency reflects the quality of good governance, as accountability and transparency form the foundation of governance free from irregularities.

Research by Isnawati et al. (2024) reveals that profit manipulation tends to increase under financial pressure, especially when financial reporting transparency is low. Information that is presented openly signals to management that their actions can be monitored by the public, thereby creating a strong internal control effect.

In addition, transparency also narrows the gap of information asymmetry between management and shareholders. According to (Kurniawan et al., 2020), companies that consistently apply the principle of transparency are able to reduce earnings management, because accurate and accessible information encourages stakeholders to actively participate in supervision. The findings of (Costa & Sofian, 2023) show that transparency has a close relationship with good corporate governance (GCG) mechanisms, particularly through the role of the audit committee and the independent board of commissioners. Financial reports that are prepared transparently facilitate the oversight process and minimize opportunities for opportunistic manipulative practices.

In the context of professionalism, the role of external auditors is very strategic in maintaining the transparency of financial reports. (Rosyid et al., 2024) states that public accountants who perform their duties independently can be an initial barrier to profit manipulation, especially in detecting and exposing irregularities that occur in the reporting process.

From a legal perspective, (Pridehan et al., 2024) asserts that weak transparency in financial reporting has a serious impact on investor confidence and capital market stability. Manipulation of financial reports causes misinformation, which, if not corrected legally, can damage a company's reputation and create systemic risk.

In terms of values and principles, transparency also has ethical and spiritual dimensions. (Farizi & Aulia, 2025) in their study on Islamic accounting state that transparent financial reporting reflects the values of responsibility and trust in the management of public funds. This shows that transparency is not only a regulatory requirement but also a moral obligation that can prevent harmful manipulative actions. (Christian et al., 2024) add that when companies are under economic pressure, the risk of manipulation increases. However, with high transparency and proper disclosure, these potential deviations can be identified early on and prevented through internal or external intervention.

Based on the results of various journal studies, it can be concluded that financial statement transparency plays a key role in preventing profit manipulation. With transparency, information becomes accessible, verifiable, and accountable, thereby narrowing the scope for management to engage in opportunistic behavior. Transparency is not only a communication tool but also an effective control mechanism, both structurally (through GCG and audits) and ethically.

Conclusion

Financial statement transparency plays a very important role in preventing profit manipulation that can damage a company's credibility in the eyes of stakeholders. Good transparency practices ensure that the financial information presented is accessible and clearly understood, reducing the opportunity for management to manipulate financial statements. This study found that a high level of transparency is directly associated with a reduction in profit manipulation practices, driven by stricter oversight from auditors and regulators. Therefore, companies must continue to prioritize transparency in all aspects of financial reporting to maintain the integrity and stability of the capital market, as well as enhance investor confidence. For future research, it is recommended to conduct an empirical study using a quantitative approach on financial data from companies listed on the Indonesia Stock Exchange (IDX) to provide stronger statistical evidence regarding the relationship between transparency levels and profit manipulation practices. Additionally, exploring the role of digital reporting technology could be an interesting focus to enhance the efficiency and accountability of financial reporting.

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