Indication of Financial Statement Fraud in Companies Experiencing Financial Distress

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Abstract. The existence of Covid-19 has caused many companies to experience losses and experience financial distress. This condition makes some company managers take steps to practice fraud financial report so that the company continues to reflect good performance, namely by maximizing profits. This study aims to obtain empirical evidence about the effect of financial distress on indications of fraud financial report. This study uses a population with a total of 213 manufacturing companies listed on the IDX for the 2019–2021 period. The total sample used was selected by purposive sampling method as many as 31 companies. This study also used binary logistic regression with SPSS 22 as data analysis. This research is expected to be additional literature that can be used by companies to prevent fraudulent practices.

Keywords: Covid-19 · fraud financial report · financial distress

1 Introduction

It was detected that the COVID-19 virus that hit Indonesia in March 2020 resulted in a decline in the Indonesian economy. In Indonesia, economic growth in the first quarter of 2020 was 2.97%, followed by a decline in the second quarter, which was minus 3.1%. The decline occurred during the PSBB, PPKM, and other policies (Damastuti et al., 2021) [1].

The policy made by the government is an effort to suppress the increase in the positive rate of COVID-19 and certainly has a considerable influence on companies in Indonesia. The enactment of this policy has made many companies experience losses and financial distress. This condition makes some company managers take steps to carry out fraudulent practices so that the company continues to reflect good performance, namely by maximizing profits. This action of maximizing profits is an effort to attract investors to believe and continue to invest in the company.

Based on data from the ACFE report (2022), fraud cases in various countries reached 2,110 which were investigated between January 2020 to September 2021, with the majority of fraud committed by Managerial at 39%, Employees at 37%, Owners and Executives at 23%, others at 1%. Based on the results of a survey that has been identified by ACFE

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(2022), there are several industries that are affected by the most significant number of cases, including the Manufacturing industry with a percentage of 12%, Banking and Financial Services with a rate of 11%, then the Government and Public Administration with 8% [2].

The action of maximizing profit (income maximization) is carried out when the company's financial condition is declining, intending to report high income and higher bonuses (Rohmatika & Triyono, 2022) [3]. However, maximizing profits excessively and not based on accounting standards will cause problems, namely fraudulent actions or manipulations in the company's financial statements.

One example that has been reported is related to fraud committed in 2018 by Garuda Indonesia, where Garuda Indonesia scored a net income in collaboration with Mahata Aero Technology. The acquisition of net income with a large amount from the collaboration results is still a calculated receivable, but it has been recognized as income. This increases the net profit sharply, which the company should have suffered a loss. Preparation of financial statements of Garuda Indonesia is not following PSAK and has violated OJK regulation No. 29/PJOK.04/2019 regarding the Annual Report of Public Companies, and the company is subject to sanctions in the form of fines worth Rp. 100,000,000 (https://www.cnnindonesia.com) [4].

This situation of financial distress is a big warning for companies to increase efforts and pay more attention to avoiding bankruptcy. Companies that experience financial distress and are threatened with bankruptcy will cause new problems, such as committing fraud by maximizing profits on companies that should have suffered losses.

Based on the above phenomenon regarding fraud financial report and financial difficulties, researchers are interested in researching "Effect of Financial Distress on Indications of Fraud".

2 Literature Review

A. *Agency Theory*

Jensen and Meckling (1976) [5] sparked a theoretical exploration of agency theory, the creation of agency theory to solve a problem that occurs due to incomplete information and dishonesty in conveying information related to the company in the form of financial statements. Information asymmetry can occur on both parties, namely the principal and the agent, which will cause agency problems. To minimize this agency problem, adequate information and a contract (agreement) between the agent and principal are needed. If the information system is sufficient and there is an agreement, then the management will act following the owner's interests.

B. *Fraud Financial Report*

According to ACFE (2022) [2], fraud financial report is a situation in which an employee knowingly causes the omission of material information and misstatements in the financial statements of the organization. According to Beneish et al., (2013) [6], with the increase in various scandals, this fraud case can be detected with a model that specifically shows the act of cheating. One of the models that can detect the manipulation of financial statements is the model developed by Messod D. Beneish, namely the Beneish M-Score (Oktafiana et al., 2019) [7].

C. *Financial Distress*

Financial distress is a decline in financial company situation before bankruptcy. Financial distress can be predicted earlier by using a model, namely the Altman Z-Score model initiated by Altman (1968). There are five ratios in measuring the Altman Z-Score, which are independent variables in this study:

X1 = Working Capital to Total Asset Rasio (WCTA)
X2 = Retained Earning to Total Asset Rasio (RETA)
X3 = Profitability Rasio
X4 = Market Value of Equity to Total Liability Rasio (MVETL)
X5 = Sales to Total Asset Rasio (SALTA)

D. *Hypothesis Development*

1) *WCTA Ratio as a variable to detect Fraud Financial Report*

Research conducted by Pribadi et al., (2018) [8], Rianghepat & Hendrawati (2021) [9] shows that the WCTA ratio is the liquidity ratio. The liquidity ratio is a ratio that measures a company's ability to meet short-term obligations promptly. An entity with low working capital compared to its total assets shows that the company cannot fulfil its obligations, so it will tend to commit fraud financial report.

H1: WCTA Ratio affects Fraud financial report

2) *RETA Ratio as a variable to detect Fraud Financial Report*

This parameter is useful for measuring whether profits are cumulatively capable of financing its assets and for measuring management efficiency in production, sales, administration and other activities. The lower the value of this ratio indicates that the company cannot finance the assets from the profits owned, but rather the assets are financed by debt. So that management will manipulate financial statements by maximizing profits to finance its assets.

H2: RETA Rasio affects Fraud financial report.

3) *Profitability Ratio as a variable to detect Fraud Financial Report*

Research conducted by Chantia et al., (2021) [10], Murtanto & Sandra (2019) [11], and Janrosl & Yuliadi (2019) [12] shows that the Profitability Ratio is a ratio used to measure the performance of an entity, which generally looks good when achieving profits or profits obtained by the target set. When the profit generated by an entity is low, it allows management to manipulate financial statements by maximizing profits.

H3: Profitability Rasio affects Fraud financial report.

4) *MVETL Ratio as a variable to detect Fraud Financial Repor*t

This parameter is useful for measuring the level of leverage of an enterprise. Too large a debt will be dangerous for the continuity of the company, especially if behind it there is interest to be paid. Companies will tend to cheat when they company has a high level of leverage. Fraud is committed to avoiding debt agreement contracts (Pribadi et al., 2018) [8].

H4: MVETL Rasio affects Fraud financial report.

5) *SALTA Ratio as a variable to detect Fraud Financial Report*

Research conducted by (Widyanti & Nuryatno, 2018) [13] and (Saiful et al., 2017) [14] shows that the Sales to Total Asset Ratio is part of the capital turnover ratio, which is used in measuring the level of sales ability compared to the assets

owned by the company. This ratio is also used to measure the ability of the company and management to face business problems. Companies will tend to cheat when the sales generated are smaller than the total assets owned.

H5: SALTA Rasio affects Fraud financial report.

3 Methodology and Data Analysis

A. *Population and Sample*

This study uses a population with a total of 213 manufacturing companies listed on the Indonesian Stock Exchange (IDX) for the 2019–2021 period. The total sample used was selected by purposive sampling method as many as 31 companies (Table 1).

B. *Variable Measurement*

Table 1. VARIABLE MEASUREMENT

Variable	Measurement	Scale
Beneish M-Score (Y)	1 = fraud, if M-Score is more than -2.22 0 = non fraud, if M-Score is less than -2.22	Dummy
WCTA	Working Capital/Total Asset	Rasio
RETA	Retained Earning/Total Asset	Rasio
EBITTA	EBIT/Total Asset	Rasio
MVETD	Market Value of Equity/Total Debt	Rasio
STA	$\text{Penjualan}_t/\text{Penjualan}_{t-1}$	Rasio

C. *Data Analysis Methods*

This study also used binary logistic regression with SPSS 22 as data analysis, hypothesis test, and statistic descriptive.

4 Research Result and Discussion

A. *Descriptive Statistics*

Table 2. DESCRIPTIVE STATISTICS RESULTS.

	N	Min	Max	Mean	Std. Deviation
WCTA Rasio	93	-,16	,87	,2842	,23304
RETA Rasio	93	-12,60	10,47	,1456	2,02006
Profitability Rasio	93	,00	,66	,1168	,10668
MVETL Rasio	93	,00	18,64	3,5522	4,69675
SALTA Rasio	93	,40	8,05	1,1735	,90670
FFR	93	0	1	,59	,494
Valid N (listwise)	93				

Source: Output SPSS versi 22

B. *Logistics Regression Analysis*

1) *Hosmer and Lemeshow's Goodness of Fit Test*

Table 3. HOSMER AND LEMESHOW'S GOODNESS OF FIT TEST

Step	Chi-square	Df	Sig.
1	8,098	8	,424

Source: Output SPSS versi 22

From the test results above, the value of Hosmer test of 0.424 is greater than alpha ($\alpha = 0.05$), Therefore H0 is accepted and it can be concluded that the prediction probability is the same as that observed, in other words the regression model used has meet the adequacy of data (fit) (Tables 2 and 3).

2) *Overall Model Fit*

Table 4. OVERALL MODEL FIT

Iteration		-2 Log likelihood
Step 0	1	125,800
	2	93,937

Source: Output SPSS versi 22

Based on Table 4, shows that the initial -2LL value was 125,800. And after entering five independent variables, the final -2LL value becomes 93.937. When a variable is added to the model and there is a decrease in the value of -2LL, it can show a better regression model and improve model fit. It can be concluded, in this study the hypothesized model is in accordance with the data (Table 5).

3) *Coefficient Determinasi*

Table 5. MODEL SUMMARY TEST

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	93,937[a]	,290	,391

Source: Output SPSS versi 22

From the results of testing the summary model above, the Nagelkerke value is 0.391 and the Cox & Snell value is 0.290. This means that the independent variables WCTA, RETA, Profitability, MVETL, and SALTA can explain 39.1%, and 60.9% are explained by factors that do not exist in this study (Table 6).

4) *Hypothesis Test*

The first hypothesis test aims to prove that the WCTA Ratio affects the possibility of fraud financial report. The value of the above test is 0.000 which is less than $\alpha = 0.05$. Thus H1 is accepted. This research is supported by Pribadi et al. (2018) [8] and Rianghepat & Hendrawati (2021) [9], who argue that an entity with low working capital compared to its total assets, shows the company cannot fulfill its obligations, so that will tends to commit fraud financial report.

The second hypothesis test aims to prove that the RETA Ratio affects the possibility of fraud financial report. The value of the above test is 0.932, which is higher than $\alpha = 0.05$. Thus H2 is rejected.

The third hypothesis test aims to prove that the EBITTA Ratio affects the possibility of fraud financial report. The value of the above test is 0.082, which is higher than $\alpha = 0.05$. Thus H3 is rejected.

Table 6. HYPOTHESIS TEST

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1[a]	WCTA	5,142	1,432	12,895	1	,000	171,015
	RETA	,011	,134	,007	1	,932	1,011
	EBITTA	6,039	3,467	3,034	1	,082	419,631
	MVETL	-,058	,056	1,067	1	,302	,944
	SALTA	-,144	,406	,127	1	,722	,865
	Constant	-1,234	,630	3,840	1	,050	,291

Source: Output SPSS versi 22

The fourth hypothesis test aims to prove that the MVETL affects the possibility of fraud financial report. The value of the above test is 0.302, which is higher than = 0.05. Thus H4 is rejected.

The fifth hypothesis test aims to prove that the SALTA Ratio affects the possibility of fraud financial report. The value of the above test is 0.722, which is higher than $\alpha = 0.05$. Thus H5 is rejected. In line with the results of research conducted by Janrosl & Yuliadi (2019) [12] and (Nugraha & Henny, 2015) [15], which argue that companies can manage the turnover of working capital in one period that has been set by the company well.

5 Conclusions and Suggestions

A. *Conclusions*

From the results of the data analysis above, hypothesis testing and discussion, the following conclusions can be drawn:

1. WCTA Ratio, SALTA Ratio significantly affects the detection of fraud financial report.
2. RETA Ratio, Profitability Ratio, and MVETL Ratio has no significant effect on the detection of fraud financial report.

B. *Suggestions*

Further research is expected and suggested to be able to use many additions from proxies for each variable. The research period used is also not only three years of research to provide even better results.

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