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THE EFFECT OF FINANCIAL RATIOS ON FRAUDULENT FINANCIAL REPORTING

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ABSTRACT

This study aims to examine the effect of Financial Ratios on Financial Statement Fraud in Manufacturing Companies Listed on the IDX for the 2014-2019 period. The population of this study were 15 companies. The sampling method used was purposive sampling method in order to obtain 15 companies as research samples. The data analysis technique used is Logistic Regression, Coefficient of Determination and Descriptive Analysis and Hypothesis Testing using the Wald Test and the Omnibus Test of Model Coeficients with a level of significance of 95%. The results partially show that profitability has a significant positive effect on Financial Statement Fraud, and Liquidity has a significant negative effect on Financial Statement Fraud. Meanwhile, it simultaneously shows that Profitability and Liquidity have a significant positive effect on Financial Statement Fraud in Manufacture Companies Listed on the Indonesia Stock Exchange (IDX) for the 2014-2019 Period.

***Keywords**: Financial Ratios; Fraudulent Financial Reporting; Fraud.*

INTRODUCTION

Financial statements are the presentation of information that describes the financial records and performance of a company during the accounting period. The purpose of financial statements is to provide financial information that is useful for certain interested parties in the company for making decisions about providing resources to the entity (IAI, 2019).

A good financial report is a report that must have complete, clear information and can accurately describe economic events that affect the operating results of an entity. Financial reports that are useful for users and the preparation of financial statements must present accurate information or data in accordance with applicable accounting rules.

When preparing financial statements, every organization would want to describe the state of the organization in very good condition. It is intended that clients who require financial statement information assess that their performance is acceptable. Executives will try to do various ways to describe the state of the organization in a healthy state, even this can encourage controlled financial reports so that the condition of the organization looks acceptable. Data that cannot be utilized is data that has been controlled by the organization concerned.

The act of fraudulent financial statements is a form of fraud. Based on the results of a survey conducted by the Association of Certified Fraud Examiners (Indonesia, 2019), describing that financial statement fraud is fraud in the form of material errors in financial statements carried out by company insiders that can be carried out by management or company directors. Itself which can harm certain parties related to the company. Fraudulent practices in financial reporting are known as financial statement fraud (financial statement fraud) (Ramadhan & Muid, 2022).

This fraud results in several things that are not good for the individual or entity. Fraud not only breaks the chain of trust between management and investors but can also undermine accounting values themselves. Financial statements that generate fraud on the one hand can benefit business people by overestimating their business results and their financial condition. This can affect their financial statements so that the financial statements they prepare look good in the eyes of the public. Increasing high-risk financial statements is also very detrimental to users who rely heavily on decision-making on financial statements.

Other research shows that financial statements that are exposed to risk have a serious and most detrimental impact from a financial perspective compared to other events. From a non-financial perspective, fraudulent financial statements are a type of fraud that has a fairly large negative impact, such as the impact of investor confidence, damage to reputation, potential fines, and criminal acts. The loss of trust in financial markets, financial information, and also the accounting profession worldwide is due to the increasing number of financial statement fraud cases (Law, 2011) in (Janrosl & Yuliadi, 2019).

According to the Association of Certified Fraud Examiners (ACFE, 2019), financial reporting cases that often occur in companies that are members of the manufacturing sector. However, this research only makes manufacturing companies the object of research. The reason for choosing a manufacturing company is because a manufacturing company is the type of company that publishes its financial statements that have gone public on the Indonesia Stock Exchange (IDX) in 2020, so the data for each variable is very easy to compare with other types of companies that have not gone public. Organizations indicated to report financial statements that occurred in 2019-2020 were mostly found in manufacturing companies.

Disclosure of fraudulent financial reporting causes many concerns regarding the reliability of financial statements. Capital market participants have high expectations for the integrity, transparency, and quality of financial information. Therefore, an analytical tool is needed that can detect fraudulent financial reporting. This is necessary because financial statements are a means of communication between management and investors as well as parties who are directly related to the company, and are used for decision making. One of the analytical tools used to detect fraudulent financial reporting is financial ratios consisting of profitability and liquidity ratios (Milasari & Ratmono, 2019).

The organization's ability to create profit can be seen from its profitability ratio. What if the benefit target that has been made is not achieved or has strayed far, this is one of the reasons executives can manipulate the organization's financial statements. Unsafe organizational conditions will put executives under pressure, given the declining presentation of the organization's performance in the eyes of the public and this condition will also hamper the development of the flow of investment funds in the coming year. Therefore, organizations that have a proportion of profits or low levels of profitability tend to make fraudulent financial disclosures or are often called fraudulent financial statements. However, it is possible that when the organization generates a high proportion of profits, it can also trigger management to commit fraudulent financial statement actions with the aim of generating greater profits than the previous profit (Milasari & Ratmono, 2019).

Management motivation in submitting false financial reports can increase, one of which is because the organization is in a lower liquidity condition. This is in accordance with the condition of the stressors contained in the fraud triangle theory, where management will act in different ways when the organization is in a bad condition, including manipulating financial statements so as to show investors that the organization is in a healthy state (Janrosl & Yuliadi, 2019).

METHOD

This research uses quantitative research methods. Quantitative research is a research method that relies on positivist thinking used to analyze a particular population or sample, collecting data using research instruments, investigating quantitative or statistical information, with the aim of testing pre-defined hypotheses.

This study also uses an associative problem formulation. The associative problem formulation is a research formula that asks about the relationship or influence between two or more variables. The object of research in this study is a manufacturing company listed on the Indonesia Stock Exchange (IDX) in 2014-2019.

Based on the purposive sampling technique that has been carried out, the publicly listed manufacturing companies listed on the IDX all meet the criteria, namely 15 certain companies. The period used is 6 years, in 2014-2019 to be exact, so there are 90 data to be studied.

The hypotheses in this study were tested using logistic regression analysis. Logistic regression is taken into account because the dependent variable response is a dichotomy (dummy) variable. Dummy variables generally only consist of two qualities or are categorical that discuss the occurrence of an event.

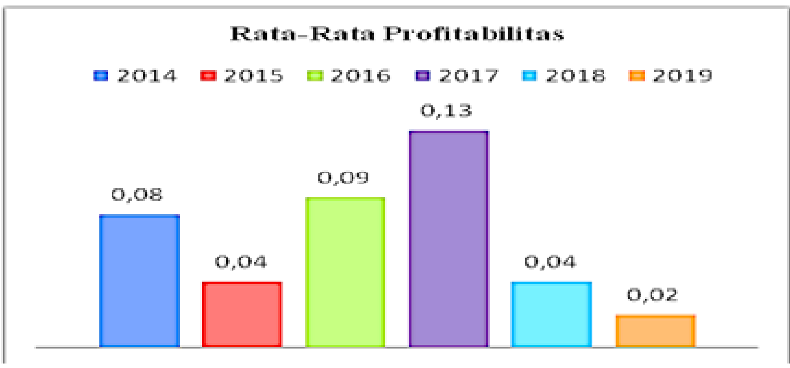
RESULT AND DISCUSSION

A. Profitability Data on Manufacturing Companies Listed on the Indonesia Stock Exchange Period 2014-2019

Table 1. Manufacturing Company Profitability Data 2014-2019

Average Profitability					
2014	2015	2016	2017	2018	2019
0,08	0,04	0,09	0,13	0,04	0,02

Source: SPSS V.25



Based on these tables and graphs, the average profitability as proxied by ROA in manufacturing companies for the 2014-2019 period has increased and decreased significantly. The highest average profitability from 2014-2019 was obtained in 2017 of 0.13. The high average profitability means that the company is able to generate a profit of 0.13 or 13% through its resources. This condition shows the company is in fairly good condition.

In 2014 the average profitability was 0.08. However, in 2015 the average profitability decreased by 0.04. This decrease indicates that the company's ability to decline in obtaining profits generated from its assets or the company's condition is not in good condition.

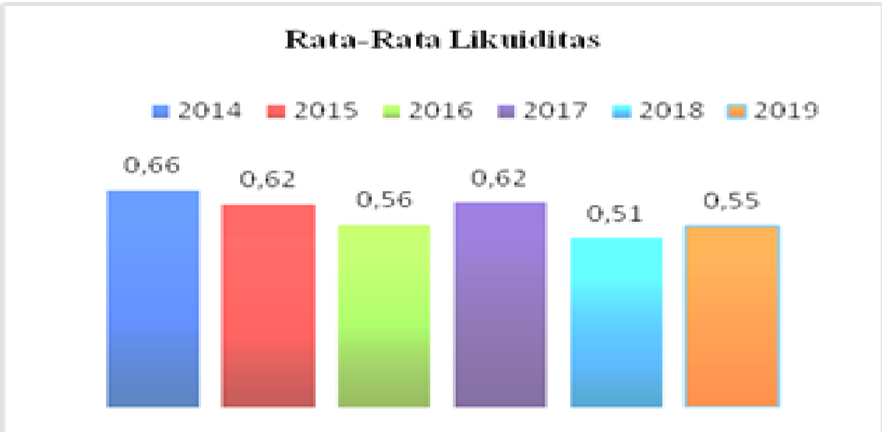
The average profitability in 2016 to 2017 experienced a significant increase from last year, which was 0.04 to 0.09 in 2016 and 0.13 in 2017. Meanwhile, in 2018 it again decreased by 0.04. The low level of profitability in 2018 caused the company to experience a decline again in 2019 which was 0.02. This decline is the most significant decline in manufacturing companies in 2014-2019.

B. Liquidity Data on Manufacturing Companies Listed on the Indonesia Stock Exchange Period 2014-2019

Table 2. Manufacturing Company Liquidity Data 2014-2019

Average Liquidity					
2014	2015	2016	2017	2018	2019
0,66	0,62	0,56	0,62	0,51	0,55

Source: SPSS V.25



The tables and graphs show the average liquidity data for manufacturing companies for the last six years, namely 2014-2019. As can be seen in the graphs and tables, the highest average liquidity was achieved in 2014 of 0.66. This increase indicates that the risk of default faced by the company is low or in the sense that the company pays more attention to the risks to be faced rather than thinking about obtaining higher returns or profits for the company.

The high level of liquidity in the past year does not become a reference that the company will always pay attention to risk. Every company would want higher profits for the survival of the company so that in 2015-2016 the level of liquidity decreased, although not significantly, to 0.62 and 0.56, respectively. This shows that the company is unable to pay its increasing short-term debt. This increase in debt is caused by companies that always borrow funds from creditors to be used as capital in generating greater profits without regard to the organization's capacity to repay the loan.

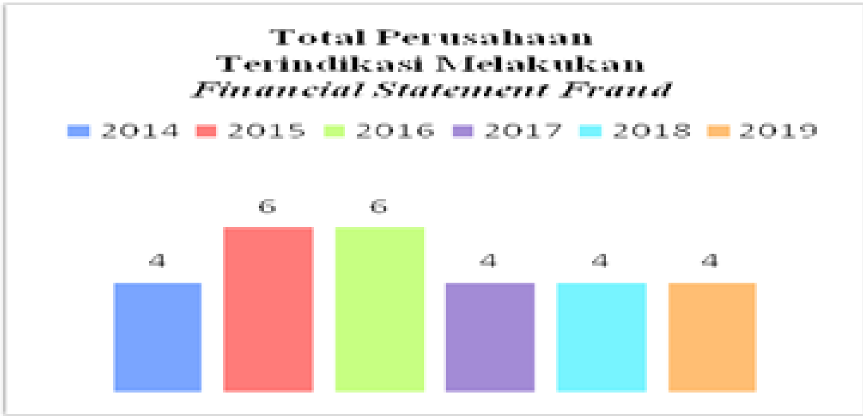
In 2017 the liquidity level increased again by 0.62. However, this increase did not last long because in 2018 the liquidity level decreased again by 0.51. The reason is that the increase that occurred in 2016-2017 was not significant so the company had to experience a decline again in 2018. The increase was again obtained in 2019 which was 0.55.

C. Fraud Financial Statement Data on Manufacturing Companies Listed on the Indonesia Stock Exchange for the 2014-2019 Period

Table 3. Fraud Financial Report Data on Manufacturing Companies 2014-2019

Number of Companies Indicated to do Financial Statement Fraud					
2014	2015	2016	2017	2018	2019
4	6	6	4	4	4

Source: SPSS V.25



From 2017 to 2019, the number of companies indicated for fraudulent financial statements decreased by 4 companies. One of the companies indicated to commit fraudulent financial statements.

Based on the results of this analysis, the most companies that commit fraudulent financial statements in 2014-2019. Where this company for the last six years has been cheating financial statements in a row. This happened because the company was in a bad financial condition. Every year the company has a fluctuating level of liquidity and profitability. For example, in 2017-2018 the company had high profits, but besides that the company had a high level of liquidity. In general, this is illogical because when the profitability of the company increases, it must be balanced by giving up the company's liquidity level to be low. Liquidity expresses risk whereas profitability expresses returns. The higher the yield obtained by the company, the higher the risk that will be faced by the company. These conditions can motivate management to commit fraudulent financial statements so that the company's financial condition is in good condition.

D. Logistics Regression Analysis Results

Table 4. Initial fit model overall test result early to late

Iteration History[a,b,c]

Iteration		-2 log likelihood	Coefficients constant
Step 0	1	111,628	-0,756
	2	111,598	-0,795
	3	111,598	-0,795

Source: SPSS V.25

Iteration History[a,b,c,d]

Iteration		-2 log likelihood	Coefficients		
			Constant	Profitability	Liquidity
Step 1	1	101,356	-0,306	3,354	-1,132
	2	98,574	-0,102	6,425	-1,952
	3	98,332	-0,068	7,804	-2,192
	4	98,331	-0,068	7,895	-2,204
	5	98,331	-0,068	7,896	-2,204

Source: SPSS V.25

Based on the two tables above, it shows that there is a difference between the first -2 LogL value and the value -2 second LogL. The results in the table show that the initial -2 LogL value (Block Number = 0) is 111.598 while the final -2 LogL value (Block Number = 1) is 98.331. These results indicate that there has been a decrease from the results of the first test to the second. So, it can be concluded that the regression model fits the data. So with the addition of independent variables, namely profitability and liquidity into this research model, it can show a better regression model and is feasible to use.

E. Hosmer and Lemeshow's Goodness of Fit Test Results

Table 5. Hosmer and Lemeshow Test

Step	Chi-square	df	Sig.
1	4,155	8	.843

Source: SPSS V.25

The test results above show the Chi-square value of 4.155, with a significance value of 0.843 and df 8. These results indicate that the significance value is greater than 0.05, which means the null hypothesis (Ho) is accepted because there is no significant difference between the models. Predicted by the observed value. So it can be concluded that the regression model is feasible to use and has met the adequacy and data fit.

F. The Result of the Coefficient of Determination

Table 6. Coefficient of Determination Result

Model summary

Step	-2 Log likelihood	Cox & Snell R square	Nagelkerke R square
1	98,331a	.137	.193

Source: SPSS V.25

As shown in the table above, the value of Nagelkerke R Square is 0.193 which shows that the influence of profitability and liquidity variables on financial statement fraud is only 19.3% while the remaining 80.7% is explained by other variables outside of the two variables above.

G. Hypothesis Testing Results

Table 7. Wald Test

Variables in he Equation

		B	S.E	Wald	df	Sig.	Exp (B)
Step 1[2]	Profitabilitas	7,896	3,266	5,845	1	0,016	2685,856
	Likuiditas	-2,204	1,100	4,012	1	0,045	0,110
	Constant	-0,068	0,620	0,012	1	0,912	0,934

Source: SPSS V.25

Based on the table above, the logistic regression model in this study is as follows:

$$FSF\ AQ + FP = -0.068 + 7{,}896\ PROF - 2{,}204\ LIQ$$

The results of the above equation show that there is a positive relationship between the X1 variable, namely profitability to the Y variable, namely financial statement fraud and there is a negative influence between the X2 variable, namely liquidity on financial statement fraud as the Y variable. The figures obtained in the equation can be interpreted.

Table 8. Omnibus Test Results of Model Coefficients

Omnibus Test Results of Model Coefficients

		Chi-square	df	Sig.
Step 1	Step	13,267	2	0,001
	Block	13,267	2	0,001
	Model	13,267	2	0,001

Source: SPSS V.25

From the table, it can be seen that the chi-square value is 13,267, the df value is 2, then the significance value is 0.001 (0.001 <0.05 which indicates that there is a significant positive effect between the variables X1 (profitability) and X2 (liquidity) on Y (financial statement). fraud) simultaneously or together.

H. The Effect of Profitability on Fraudulent Financial Statement

Based on the results of logistic regression analysis, it is stated that the X1 variable, namely profitability, has a significant positive effect on financial statement fraud. The test results show that this ratio obtains a beta value (B) of 7.896 and a significance value of 0.016. This result is smaller than the level of significance, which is 0.05.

The results of this study are in line with previous research conducted by (Haqqi et al., 2015); (Widyanti & Nuryatno, 2018) and (Fadilah et al., 2019) which stated that profitability had a significant positive effect on financial statement fraud. According to (Subramanyam, 2017) the profitability ratio is the company's ability to earn profits. This profitability ratio can be used as a measuring tool to assess management performance as seen from the size of the profits generated.

In this study, profitability has a significant positive effect on the possibility of financial statement fraud. This means that the profitability ratio as measured by return on assets is a very important ratio to see if the company is indicated to commit financial statement fraud. A high ROA indicates that the company is able to generate greater profits and the company's condition is in good condition. However, this great advantage becomes a reference or demand for the organization to be able to achieve benefits that are at least equal to the profits obtained. In other words, this profit will be the target for the following year, conditions like this will make management think harder to make a better strategy than the previous year in order to achieve the predetermined target. So that it can build the motivation of the executive to commit fraudulent acts of greater financial statements (Daljono, 2015).

Based on the theory and previous research described above, the following is a comparison of profitability with financial statement fraud in several manufacturing companies in 2014-2019 which is the evidence or reason for the acceptance of the first hypothesis.

I. The Effect of Liquidity on Fraudulent Financial Reporting

Based on the results of logistic regression analysis, it is stated that liquidity has a significant negative effect on financial statement fraud. The test results show that the value of liquidity is proxied by the current ratio of 0.045 <0.05 and the value of beta (B) -2.204. This means that the second hypothesis (Ha2) is accepted and Ho2 is rejected.

The results of this study support research conducted by (Widyanti & Nuryatno, 2018); (Milasari & Ratmono, 2019) and (Listyawati, 2020) which state that liquidity has a negative and significant effect on financial statement fraud. According to (Subramanyam, 2017) the liquidity ratio is the company's ability to meet short-term obligations through its current assets. The current ratio is used to measure the company's ability to settle its short-term obligations.

A low liquidity ratio can encourage management's motivation to commit fraudulent actions on higher financial statements in order to show the company's condition is in good condition (Mardianto & Tiono, 2019). The following is a comparison between liquidity and financial statement fraud in several general insurance companies from 2014 to 2019 which is the reason for the acceptance of the second hypothesis.

J. The Effect of Financial Ratio Against Financial Statement Fraud

Based on the test results, it is stated that profitability and liquidity simultaneously have a positive and significant effect on financial statement fraud. The results of the logistic regression analysis showed a chi-square value of 13.267 and a significance value of 0.001 which was smaller than the level of significance, which was 0.05 (5%).

Liquidity can also be interpreted as a risk that will be faced by the company. Low risk means that the company has a good level of liquidity, because risk in this case means that the company is able to settle its short-term obligations and avoid the risk of default. This can be achieved when the company is willing to give up the low profitability of the company (Mardiyanto, 2016). Profitability here can be interpreted as the returns to be obtained by the company. When the company wants higher returns, it must bear the risk of default. However, when the company wants high profitability and high liquidity, under these conditions it is possible that the company will act inappropriately (Mardiyanto, 2016).

CONCLUSION

Based on the results of the analysis and discussion on the effect of profitability and liquidity on financial statement fraud in general insurance companies in 2014-2019, the following conclusions can be drawn: The profitability ratio partially has a positive and significant influence on the possibility of financial statement fraud in general insurance companies for the 2014-2019 period. The liquidity ratio partially has a negative and significant effect on financial statement fraud in general insurance companies in 2014-2019. The ratio of profitability and liquidity simultaneously has a positive and significant effect on the possibility of financial statement fraud in general insurance companies from 2014 to 2019.

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