

fraud

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DETECTING FRAUD FINANCIAL STATEMENTS IN MANUFACTURING COMPANIES INDONESIA

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Abstrak

Kecurangan laporan keuangan lebih mungkin terjadi kepada perusahaan yang sedang mengalami kesulitan keuangan dibandingkan dengan perusahaan yang tidak memiliki kesulitan keuangan. Tujuan dari penelitian ini adalah menganalisis tekanan, peluang, dan rasionalitas untuk mendeteksi terjadinya kemungkinan financial statement fraud. Keempat elemen tersebut akan dibagi dalam 5 variabel yaitu financial stability, external pressure, nature of industry, ineffective monitoring, dan change in auditor. Penelitian ini menggunakan teknik sampling Purposive Sampling dengan ketentuan perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia (BEI) dari tahun 2018-2021 yang menyajikan laporan keuangannya. Teknik analisis data yang digunakan dalam penelitian ini adalah analisis regresi logistik. Hasil penelitian menemukan hanya nature of industry yang mempengaruhi financial statement fraud sedangkan yang lainnya tidak mempengaruhi.

Kata Kunci : Kecurangan; Keuangan; Manufaktur; Tekanan; Peluang; Rasionalitas

Abstract

Fraudulent activity on financial statements is more likely to take place in businesses that are currently facing financial difficulties as opposed to businesses that are not currently experiencing financial issues. Through an analysis of aspects such as opportunities, pressures, and rationalizations, the purpose of this study is to evaluate whether or not there was fraud committed with regard to financial statements. These four characteristics will each be split down into a separate variable, with the variables being referred to as financial stability, external pressure, the nature of the industry, inadequate monitoring, and changes in auditors. For the purpose of this study, the Purposive Sampling research method will be utilized, and all of the manufacturing businesses that will be listed on the Indonesia Stock Exchange (IDX) between the years 2018 and 2021 will be required to provide their financial information. In the present investigation, the method of analysis that was carried out was referred to as logistic regression analysis. The outcomes of the study showed that the only element that affected financial statement fraud was the kind of industry, whereas the other components did not have any effect.

Keywords: Fraud; Finance; Manufacturing; Pressure; Opportunity; Rationality

Introduction

One person commits fraud against another when they intentionally misrepresent a substantial fact with the intent to cause the target to place reliance on the misrepresented information despite knowing that doing so would harm him. The term "fraud" in the context of an organization is more nuanced. The term "fraud" refers to the illegal practice of intentionally misleading others for personal gain, misusing company resources, or falsifying financial records. Many synonyms for fraud exist in the accounting literature, including "denial," "embezzlement," and "impudence" (Hall & Singleton, 2005).

Business choices can be made with greater certainty thanks to the information provided by financial statements (Kelton & Montague, 2017). The financial statements are the end product of the accounting processes that are meant to depict the financial position and operating results of the organization (Bertomeu & Magee, 2014; Jin et al., 2019). External and internal stakeholders alike benefit greatly from access to accurate information on the company's financial health and operational performance (Omolaye & Jacob, 2018). Financial reports are sometimes said to as the "language of business" because of its usefulness in conveying information to those who have an interest in a company's financial standing (DeFond & Zhang, 2014; Quick, 2020).

Businesses that are suffering financial troubles are more vulnerable to financial statement fraud than those that are not (Mohamed & Handley-Schachler, 2015; Sarwoko & Agoes, 2014). A corporation's reputation in the outside world may suffer if fraud occurs within the company. There will be skepticism from outside parties regarding management's honesty. When this happens, the company's ties to its suppliers, potential lenders, and investors all deteriorate (Dalnial et al., 2014; Oyedokun, 2018). If there are mistakes in the reporting of finances, the reports will lose credibility.

Table 1. Fraud Each Sector in Indonesia

Industry Sector	Percentage
Financial and banking	41,4 %
Government	33,9%
Mining	5,0%
Healthcare	4,2%
Manufacturing	4,2%
Other	3,7%
Transportation	2,1%
Housing	1,7%
Education	1,7%
Hospitality and tourism	1,3%
Fishing and marine	0,8%

Intentional omissions, manipulation of accounting records, and the improper application of accounting principles are all examples of reporting errors made on purpose by management in order to mislead users of financial reports (Darise, 2019; Smieliauskas et al., 2018). Inflating or falsifying financial accounts can be advantageous for business owners because it allows them to present a more favorable picture of their company's financial health than is actually the

case (Alali, 2020; Rungcharoenkitkul, 2012). However, the public suffers greatly as a result of the rise in misleading reporting since they place so much trust in the information provided in these financial reports (Darmawan et al., 2017; Salehi et al., 2019; Wang & Wu, 2011). Association of Certified Fraud Examiners data for 2020 shows that manufacturing is the fifth most fraudulent industry in Indonesia (Table 1).

Investigations into fraud have been conducted often. Since fraud instances are progressively causing harm to many parties, it is nevertheless important to examine this phenomenon. As a result, this investigation builds upon prior work by concentrating on the industrial sector. This industry was chosen because of its high productivity and consequent potential for widespread impact. This industry also employs a sizable number of people, making it a major source of tax revenue and export earnings. Despite the fact that it has been under stress since 2020 because to the Covid-19 outbreak, Indonesia's Manufacturing Sector has been the single most important contributor to the country's rising Gross Domestic Product (GDP).

The study's overarching objective is to dissect the interplay between manufacturing firms' financial health, external factors, the characteristics of the industries they operate in, insufficient internal controls, and the frequency with which auditors are replaced. This research provides important information that can be used in a number of contexts. First, the literature on the fraud triangle and its effects on fraudulent financial statements in manufacturing organizations will benefit greatly from these findings. Second, help stakeholders become more impartial when compiling financial reports by giving them access to relevant data. Third, we'll help investors prepare for any false financial statement manipulation by corporations.

Literature Review

Agency theory is the overarching framework for this investigation. According to agency theory, managers act as agents for the benefit of the company's owners. In this view, a conflict of interest arises when there is a disparity in the amount of knowledge held by management and the stakeholders. The agent's performance dictates the firm's future, thus in this situation, management has an advantage when deciding which information to send to stakeholders because they have a better grasp on what goes on within the company (Putra & Dinarjito, 2021; Rachmawati & Marsono, 2014). The agent is free to withhold information that serves no useful purpose to the stakeholder. It is common for stakeholders and agents to have competing interests due to information asymmetry that arises during the execution of agency interactions (Bergh et al., 2019; Gatfaoui, 2017). When stakeholders want agents to act in a certain way, yet the agents' own goals are different from those of the stakeholders, a conflict of interest arises (Panda & Leepsa, 2017; Werner, 2016).

As long as the company's growth rate is below the industry average, management has room to alter financial records in order to boost the company's performance. Due to the public's perception that the company is performing poorly, the flow of investment capital will be hampered in the coming year, putting added stress on management. These issues show that the company is in a precarious position, where it cannot fully capitalize on its assets and make effective use of the investment capital it receives (Campello & Graham, 2013; Guzman et al., 2018). Research by Annisya et al. (2016) and Aprilia (2017) demonstrated that pressure with a financial stability proxy influences the level of fraud in financial statements.

H₁: asset growth (ACHANGE) affects financial statement fraud.

Generally understood pressure from outside sources includes the need to make payments, keep records, and comply with other terms of a debt deal. Companies often face pressure from the outside in the form of debt. To finance a growth strategy that has the potential to dramatically impact the company's performance, debt financing is being utilised. Leverage

refers to a firm's reliance on debt financing in order to run its day-to-day business. Leverage is correlated with increased likelihood of financial statement fraud. In order to get loans and pay dividends to shareholders, directors and management of companies with high leverage ratios may engage in deceptive financial reporting by artificially lowering the ratio (Innocent et al., 2014; Majdoub & Mansour, 2014; Ng & Ariff, 2019). The degree of financial statement fraud can be affected by the pressure variable with leverage proxy, according to studies by Sihombing & Rahardjo (2014) and Yesiariani & Rahayu (2017).

H2: the amount of debt (LEVERAGE) affects financial statement fraud.

Weaknesses in supervision and in the system create openings through which dishonest actors can operate. The economic and regulatory climate in the industry where the business works is two examples of the kind of industry that could lead to misstatements stemming from fraud in financial statements. Accounting for uncollectible accounts receivable and obsolete stock in the inventory and receivables ledgers requires the use of judgment and discretion (Liu & Lin, 2012). Management may use the account to artificially inflate profits or reduce losses in the financial statements due to the subjective nature of establishing the account's value (Ali & Lesage, 2013; Campello & Graham, 2013). Financial statement fraud can be affected by the opportunity variable combined with the proxy character of industry, as shown by studies by Fadhillah & Widyananto (2022) and Dendramis et al. (2018).

H3: nature of industry (RECEIVABLE) affects financial statement fraud.

An organization with ineffective monitoring has an inefficient internal control mechanism. One result of insufficient oversight is the proliferation of dishonest behaviors, such as earnings management by agents and managers (Coibion et al., 2020). This can occur when there is an excessive amount of power held by a few individuals in management, when there are no checks and balances on compensation, and when the board of directors and the audit committee fail to keep tabs on the company's financial reporting and internal controls. Financial report fraud can be affected by the opportunity variable with Ineffective monitoring proxy, according to studies by (Anggraini et al., 2019).

H4: Ineffective Monitoring (BDOUT) affects financial statement fraud.

With a rationalizing mindset, one might easily come up with compelling justifications in his head for why he performed fraudulent behavior and convince himself that it was perfectly normal. A change in auditor may be interpreted as rationalization when it is the result of efforts to cover up fraud discovered in prior audits. This claim is supported by several studies, including one by (Loebbecke et al., 1989) that revealed the majority of fraud was uncovered during the auditor's first two years on the job. Rationalization variable via proxy change in auditors affects the degree of fraud in financial statements, according to studies conducted by Lestari & Bernawati (2020).

H5: Change in auditor (AUDCHANGE) affects financial statement fraud

Method

The manufacturers that have issued quarterly financial reports between 2018 and 2021 are the ones that have been considered for inclusion in this research. In addition, the Beneish M-Score algorithm is utilized in order to ascertain the level of false financial reporting that occurs, which acts as the dependent variable for the purpose of this investigation. If the M-score for the company is less than -2.22, it is not suggested that the company is engaging in fraudulent financial reporting, and it is classified as a non-manipulator. On the other hand, the company is classified as a manipulator if the M-score is larger than -2.22. Proxies for financial

stability (ACHANGE) and external pressure (LAVERAGE), opportunities (RECEIVABLE) and ineffective monitoring (BDOUT), and rationalizations (with a change in auditor proxy) are the independent variables (AUDCHANGE). Finding solutions to the study's aims via logistic regression. This model was chosen since the dependent variable is a dummy. In this situation, the dependent variable takes the form of a dummy variable, and logistic regression analysis is employed to assess the extent to which the independent variable affects the latter (0 and 1). In this equation, ACHANGE represents the asset growth rate, LEVERAGE represents the ratio of changes in debt levels, RECEIVABLE represents the ratio of changes in receivables, BDOUT represents the proportion of independent commissioners, AUDCHANGE represents the ratio of changes in auditor turnover, and ε represents the error.

$$M\text{-SCORE} = \alpha + \beta_1 (\text{ACHANGE}) + \beta_2 (\text{LEVERAGE}) + \beta_3 (\text{RECEIVABLE}) + \beta_4 (\text{BDOUT}) + \beta_5 (\text{AUDCHANGE}) + \varepsilon$$

It is customary practice to use likelihood for a global evaluation of model fit after receiving the outcomes of a logistic regression analysis. Second, the Hosmer and Lemeshow goodness-of-fit test demonstrates the viability of the regression model. Third, anticipating whether or not a corporation would engage in deceptive financial reporting. The hit ratio value, expressed as an aggregate percentage indicating whether the classifier is accurate or wrong, can be used to evaluate the prediction of the regression model in the classification table. Nagelkerke R^2 is a variation of the Cox and Snell R^2 coefficients that guarantees values between 0 and 1 when computing the coefficient of determination using Cox and Snell R^2 . Cox and Snell R^2 values are divided by their maximums to arrive at these estimates. When performing multiple regression, the Nagelkerke R^2 value can be understood in the same way as the R^2 value. The restricted capacity of the independent variable to explain the dependent variable is indicated by the low Nagelkerke R^2 value. The closer the value to 1, the more information about the dependent variable's variance may be gleaned from the independent variables.

Result and Discussion

There are a number of checks that must be made to ensure that the regression model will work before proceeding with a logistic regression study. In these steps, we evaluate the complete model, the viability of the regression model, and the reliability of the regression results. The Likelihood statistical test is used to derive the overall model evaluation. If the value of -2 Log likelihood (Block Number = 0) is less than or equal to the value of -2 Log likelihood (Block Number = 1), we can conclude that the entire model is viable. If the chi-square column has a significance level of 0.05, then the model can be considered viable. Overall model fit at -2 Log likelihood (Block Number = 0) indicates a drop at -2 Log likelihood (Block Number = 1).

Table 1. Overall Model Fit Test

Information	Value
-2 Log likelihood (Block Number=0)	77,561
-2 Log likelihood (Block Number=1)	57,464

After controlling for these five factors, the Log Likelihood value drops to -20.097 (77.561 - 57.464). These findings suggest a workable model, which is supported by the data in Table 2. Table 2 Chi-Square value is 20.097, and its significance level is 0.001, indicating that the difference between the values of -2 Log likelihood (Block Number = 0) and 2 Log likelihood

(Block Number=0) is statistically significant. In general, the regression model can be shown to be feasible at a 0.001 (<0.05) significance level.

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Tabel 2. Omnibus Tests of Model Coefficients

		Chi-square	df	Sig.
Step 1	Step	20.097	5	0.001
	Block	20.097	5	0.001
	Model	20.097	5	0.001

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Hosmer and Lemeshow goodness-of-fit tests provide statistical analyses that evaluate the practicability of the regression model. If the significance value (sig) of Hosmer and Lemeshow's Goodness and Fit Test is greater than 5% (> 0.05), we may say that the model is statistically in good agreement with the data. The significance value of the Hosmer and Lemeshow Test provided is 0.846 (> 0.05), as shown in Table 3, suggesting that the model is able to predict the observed value. Alternatively, the model is acceptable since it is consistent with the observations.

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Table 3. Hosmer and Lemeshow Test

	Chi-square	Df	Sig.
Step 1	3.397	7	0.846

The next step is to validate the regression model's ability to forecast whether or not a company has engaged in financial statement fraud (FRAUD). The regression model has a 77.8 percent chance of accurately predicting whether or not a corporation will commit fraud (FRAUD), as shown in Table 4. This demonstrates that out of a total of 56 samples who committed financial statement fraud, 21 samples (77.8%) were predicted to commit fraud using the regression model. There are a total of 29 samples that do not commit fraudulent financial reports, making the predictive power of the sample model that does not commit financial statement fraud 58.1%. Using the regression model, 21 samples (72.4% of the total) are predicted not to commit financial statement fraud (NON FRAUD). Overall, the regression model has a 75% success rate in making predictions.

Table 4. Model Accuracy

Step 1	Observed		Non Fraud Company	Fraud Company	Percentage Correct
Y		Non Company	21	8	72.4
		Fraud Company	6	21	77.8
Overall Percentage					75

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In order to determine the likelihood of a certain influence of financial stability (ACHANGE), external pressure (LAVERAGE), nature of industry (RECEIVABLE), ineffective monitoring (BDOUT), and rationalization (AUDCHANGE) on financial statement fraud, a logistic regression analysis is conducted.

Table 5. Regression Logistic Results

	B	S.E.	Wald	Sig.	Cox & Snell R ²	Nagelkerke R ²
ACHANGE	-3.406	2.606	1.707	.191	.302	.402
LEVERAGE	-2.005	2.532	.627	.428		
RECEIVABLE	22.705	7.552	9.040	.003		
BDOUT	-.032	1.979	.000	.987		
AUDCHANGE	-.058	1.421	.002	.967		
Constant	1.039	1.133	.840	.359		

The processed data are displayed in Table 5, and using those data, we may deduce the logistic regression model. The coefficient of determination (R^2) that was determined using the Nagelkerke method indicated that the independent variable was responsible for explaining the dependent variable to the extent of 40.2% of the total. This indicates that factors that were not a part of the study can be ascribed to an additional 59.8% of the variance in the prevalence of financial statement fraud.

$$\text{FRAUD} = 1,039 - 3,406 \text{ ACHANGE} - 2,005 \text{ LEVERAGE} + 22.705 \text{ RECEIVABLE} - 0.32 \text{ BDOUT} - 0,058 \text{ AUDCHANGE} + e$$

2 Effect of Financial Stability (ACHANGE) on Financial Statement Fraud

The financial statement fraud is unaffected by financial stability (ACHANGE). Because of the unpredictability of the current economic environment, businesses are driven to manipulate their earnings and manipulate their financial statements, which is a form of fraud. The effect of financial stability demonstrates that firms in the manufacturing sector are not under increased pressure to engage in fraudulent activity as a response to an increase in the ratio of changes in total assets. This is demonstrated by the fact that the ratio of changes in total assets has not increased. An unstable business environment can result from ineffective management, which fails to make the most of the company's resources. This can lead to either a surplus or a deficit in the company's assets.

Naturally, the cash flow must also reflect the change in asset value, either positive or negative, to stabilize the financial condition. Company management felt pressured to inflate the company's assets and achieve financial stability, leading them to engage in fraudulent behavior in the form of statement manipulation. This study's findings are consistent with those of studies by Anggraini et al. (2019), Reskino & Anshori (2016), and Salsabila et al. (2020), all of which concluded that these factors did not influence the prevalence of fraud in financial reports. Nonetheless, it affects the level of fraud in financial reporting, as shown by studies by Annisya et al. (2016), Aprilia (2017), and Yesiariani & Rahayu (2017).

35 Effect of External Pressure (LEVERAGE) on Financial Statement Fraud

Fraud in financial statements is unaffected by external pressure (LEVERAGE). In the absence of any such pressure from without, the value of a company's debt cannot be interpreted as such. Valuable debt is an option for financing alongside equity money. A corporation can expand more rapidly with the help of debt than if it had to rely solely on its own resources. This study's findings are consistent with those of Adnovaldi & Wibowo (2019) and Ardiyani & Utaminingsih (2015), who also discovered that pressure from only one of the proxies did not significantly affect the overall degree of deception in the financial statements. Nonetheless, this finding differs from the findings of the studies by Adi et al. (2016) and Sihombing & Rahardjo (2014), which demonstrate that the pressure variable with one of the financial target proxies influences the level of deception in financial reports.

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Effect of Nature of Industry (RECEIVABLE) on Financial Statement Fraud

The business sector in which a corporation works has little bearing on the likelihood of it committing fraudulent activities regarding its financial statements (RECEIVABLE). Regardless of the sector in which it competes, the fact that the management of the firm is unfazed by either an increase or a drop in the inventory change ratio indicates that the company is involved in fraudulent activity with regard to its financial statements. The phrase "nature of industry" is commonly used in the context of business to indicate to a scenario in which all aspects of a certain company or organization function perfectly. One aspect of the industry's makeup is the condition of companies' receivables, in which a successful firm will work to limit and minimize the volume of receivables in order to boost its cash inflows. This is according to research conducted in Oktarigusta (2017).

Accounts receivable are assets that are prone to manipulation due to the high receivables in sales, as found by research by Dalnial et al. (2014). Consequently, it is vulnerable to accounting fraud, namely through accounts receivable. Findings are consistent with those of Faradiza (2021), Oktarigusta (2017), and Septriani & Handayani (2018), who all concluded that the opportunity variable with one of the nature of industry proxies has no effect on the level of fraud in financial reports. Research by Lestari & Bernawati (2020) and Putri & Lestari (2021) contradicts that of Sihombing & Rahardjo (2014) by showing that the opportunity variable with the proxy nature of industry increases the level of fraud in financial reports.

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Effect of Ineffective Monitoring (BDOUT) on Financial Statement Fraud

It has been determined that financial statement fraud can occur even when monitoring is ineffective (BDOUT). There is no assurance that a corporation will be properly supervised just because it has an independent board of commissioners if such board is incapable of conducting effective monitoring. However, in most cases, a company's operational supervision is not much improved by raising the number or percentage of independent commissioners. Companies with few independent commissioners will have weaker internal controls and more fraud.

However, the restrictions on the role and function of an independent commissioner in minimizing the danger of fraudulent financial reporting do not factor into the evaluation of the outcomes of this study, which are solely expressed as percentages. These findings are consistent with those of Faradiza (2021) and Yunia & Nawawi (2019), all of whom concluded that the opportunity variable with one of the ineffective monitoring proxies had no effect on financial statement fraud. The opportunity variable with ineffective proxy monitoring increases the level of fraud in financial reporting, contrary to the findings of Kusumawardhani (2013).

2

Effect of Change in Auditor (AUDCHANGE) on Fraud Financial Statements

16 Financial statement fraud is unaffected by an auditor switch (AUDCHANGE). If a company's management is used to external auditors having high performance, then they are less likely to commit fraud and less likely to rationalize fraud regardless of whether or not the auditors have changed. These customs eventually grow to define the company's culture. A company's choice of external auditors is crucial, as is the reputation of the auditors they hire.

Moreover, businesses need to have the wherewithal to raise the issue of employees' rationalizing fraud and become accustomed to making this a part of the company culture (Ocansey & Ganu, 2017). This study's findings are consistent with those of Noviana et al. (2022), Setiawan & Trisnawati (2022), and Susanti (2018), all of whom concluded that a change in auditors did not result in an increase or decrease in financial statement fraud. Financial statement fraud is affected by auditor turnover, according to Lestari & Bernawati (2020), Anggraini et al. (2019), Crisna & Appriwenni (2021), and Sari & Lestari (2020), although our findings don't agree with those authors' findings.

Conclusion and Recommendation

This study's objective is to investigate the factors that influence the likelihood that manufacturing companies will engage in financial statement fraud. These factors include a company's level of financial stability (ACHANGE), the amount of pressure from the outside world (LEVERAGE), the characteristics of the industry (RECEIVABLE), inefficient monitoring practices (BDOU), and a change in auditor (AUDCHANGE). According to the results of the study, the type of firm (RECEIVABLE) was the only variable that had any impact on the likelihood of false statements being made on financial statements, whereas the other variables were completely insignificant.

Users of financial statements can utilize the nature of industry ratio (RECEIVABLE) as a fraud detector because it was shown in this study that the ratio influences indicators of financial statement fraud. This finding means that users of financial statements can use the ratio. The findings of this study may also provide helpful information that can be used to work responsibly to protect the principal and to be more objective when compiling financial reports. Both of these things are important to ensure that no instances of fraud take place within the company in order to preserve its reputation.

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