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## PROFITABILITY, LIQUIDITY, LEVERAGE AND CORPORATE GOVERNANCE IMPACT ON FINANCIAL STATEMENT FRAUD AND FINANCIAL DISTRESS AS INTERVENING VARIABLE

*Financial statement can show the company management performance after human resource trust. Each public company is obligated to reveal the annual financial report. This research examined correlation among profitability, liquidity, leverage and corporate governance to financial statement fraud and financial distress as mediation variable. Based on the Association of Certified Fraud Examiners (ACFE) 2016, the financial statement fraud continuously grew from 2012-2016. It means that there were more companies having financial statement fraud motivation. In this research, financial distress had been a mediation variable before the financial statement fraud event. This research applied quantitative research using the fraud diamond theory. This research proved that there was an impact of profitability, leverage, shareholder > 3% and directors quantity to financial distress. This research showed that the higher company's profitability, the lower financial distress company risks. Based on the research, the companies that had financial distress would tend to do the financial statement fraud.*

**Keywords:** Financial statement fraud, profitability, liquidity, leverage.

**INTRODUCTION.** Companies compose a financial statement to give information about financial condition, performance and position changing. It is very beneficial to information usages regarding to economy decision taking (PSAK 1 2014). Financial statement can show the company management performance after human resource trust. Each public company is obligated to reveal the annually financial report. Also, it is openly characterized to government and society, as stated to PP n.24 98 Verse 2, about financial information company annually. Based on Association of Certified Fraud Examiners (ACFE) periods 2012-2016, it was showed that the financial statement fraud grew globally. It means that there are many companies trying to manipulate the financial statement data.

Financial statement manipulation activity aims to seek the profit that done by a company. Fraud is a fake or erroneous act that done by someone or institution, which causes bad things to an individual, entity or other parties. The fraud phenomenon has been happening all over the world with any various types. Association of Certified Fraud Examiners (ACFE) divides into three things. Those are financial report fraud, asset misappropriation and corruption. The highest fraud type is (83.5%) on asset misappropriation and the lowest is (9.6%) on financial statement based on ACFE research. However, regarded to the loss, asset misappropriation placed on the lowest rank, whereas the financial statement placed on the highest rank. The amount was 125.000 US\$ for asset misappropriation fraud, whereas fraud financial statement is 975.000 US\$.

This research proved that the significant financial statement fraud impacted to financial aspect than others. Whereas, regarded to the non-financial aspect, financial statement fraud has negative effect, such as investor trust lost, reputation damaged, potential fine and criminal act. This fraud case could cause the trust lost to finance trade, information and accountant occupation all over the world [22].

Based on ACFE 2016, the financial statement fraud continuously increased from 2012-2016. It means that financial statement fraud scandal happens all over the world including Indonesia. The financial statement fraud

has appealed an accountant report scandal few cases that is known widely such as Cakra Mineral Ltd (CKRA) Tbk, Inovisi Infracom Ltd (INVS) and Tirta Amarta Bottling Ltd. In 2015, Tirta Amarta Bottling Ltd, proposed a credit extension to Mandiri Bank. The company involved in financial statement fraud to get credit facility from Mandiri Bank. The fraud was in the form of untrue asset statement. The case initially began by non performing loan (NPL) in 2016 that caused 1.4 trillion of government lost. Those are consisting of main, interest and fine [44].

The financial statement fraud also happened in huge electronic company, Toshiba. The financial revealed by Japan Judiciary. The company had exaggerated the profit 1.2 Billion US\$ or 151.8 Million Yen. It happened in 2008 – 2014. Tanaka and Sasaki had a fake design. However, they had already admitted. It was designed to be difficultly known by auditors. Based on Reuters, as the punishment, Toshiba would be fined 300-400 billion Yen. The fine amount would still be waiting to the further investigation from third parties. The crises caused a half of directors left the position. From the sixteen director, eight of them left their positions [45].

The research would combine the affected factors towards financial statement fraud and financial distress based on research done by Dalnial et al. [10] and Ngan [29] related to financial statement fraud, Wang and Deng [24] and Ugurlu and Aksoy [38] related to financial distress. The researcher added financial factors to examine and analyze the impact on financial statement fraud. It was also answered the advice from Mardiana [26] that the next research could use financial ratio to predict fraud on a company. The researcher added financial distress variable as intervening before the financial statement fraud event.

This research is different from previous researches. The difference is on financial distress as mediation variable. Financial distress was one factor that impacted on financial statement fraud (Ngan [29], Dalnial [10], and Mardiana [26]). Based on fraud diamond theory, one of factors that could cause the fraud, was company experienced financial distress pressure. It would get the pressure from investor and creditor, and supported the

company's financial fraud. This research would review the correlation between profitability, liquidity, leverage and corporate governance towards financial report fraud and financial distress as intervening variable.

Financial distress was one factor that impacted on financial statement fraud (Mardiana [26], Ngan [29]). Financial distress was a financial company situation that experienced difficulty at fulfilled the obligation. In the end, it could cause bankruptcy [19]. A company was on financial distress state if experienced difficulties at funded the obligatory finance or negatively profit result [5]. Companies that experienced financial distress generally could use finance ratio and non-financial information from income statements, financial position statement, cash flows statement and disclosure. Those were inside finance report. Financial distress researches had been done by Priego and Merino [25], Siregar and Fauzi [33], Hapsari [17], Ilman et al [19], Widarjo and Setiawan [42] and Li, Wang and Deng [24].

#### LITERATURE REVIEW.

##### Fraud Diamond Theory

Fraud Diamond Theory stated there are four affected factors. Those are pressure, opportunity, rationalization and capability. Pressure is a situation, where the management gets pressure from the stakeholders. One of them is investor to increase the company profit. This aims to press the company financial report fraud.

Another pressure is financial distress. Company would feel pressed to do the financial statement fraud, when the company experienced financial distress. The pressure is obtained from external parties. Those are investor and creditor. This causes the company to be motivated to do the fraud based on external fund pursuit.

The next impact factor is "chance". This happened when there is a management profit company. The third is rationalization. It happens when particular ethical values are allowed to do dishonest thing in the management. The last element is capability. Capability is someone's ability to do the fraud.

Based on agency theory, company has to be responsible about the company's performance towards investor because of the contract's. When company in a financial distress condition, then company would get pressure to do the fraud based on company's motivation distress.

##### Agency Theory

This subchapter will review about agency theory related to this research. The correlation perspective agency becomes the basic measure to explain and understand corporate governance. Jensen and Meckling (1976) explained that the agency correlation was a contract between agent and principal in a business cooperation relation. The interest conflict between an investor and agent is caused by unsuitable deed or policy with principal's interest. Therefore, it causes the agency cost which is burdened to investor.

According to Eisenhardt [11], agency theory has three basic assumptions about human characteristics, those are: 1) self-interest, 2) bounded rationality, 3) risk averse. Those three basic human characteristics cause unreliability to each other humans. The given information is not usually the same as the actual company's condition.

The imbalanced information by management and investor is called asymmetry information. It is one of inefficient contract between them. Agency conflict in a company blocks the company's goal. Those are stock value minimalized, company owner prosperity, profit report quality. Besides that, asymmetry information could give the management "chances" to do fraud in profit management form [39].

Investor as company's owner generally does not want the company to be involved in a fraud scandal. Thus causes the management and investor having contract or efficient relation consisting of authority and responsibility which agreed altogether. Several supervision mechanism forms could be undertaken to harmonize the relation between management and investor [18]. Therefore, the goal congruence is existed to avoid the fraud.

##### Pecking Order Theory

Pecking order theory is one theory related to company capital structure. There are two capital structures. Those are internal and external. Internal fund is from the company's profit deposit, whereas external fund from the company's obligation and right issue.

Pecking order is a theory that gives an advice about fund decision by following a hierarchy. Pecking order theory prioritizes the internal funding compares to external funding. Company more prioritizes the internal funding to avoid the public spotlight as right issues. Pecking order theory explains that external funding as priority is mainly from obligation than issuance of new shares.

The higher the profit of companies, the more those companies will avoid obligation. They will product inherently cash therefore it shows the external fund shortage need. Companies regarding to seek additional capital will prioritize the retained earnings than debt. Wardianto [43] showed the negative correlation between obligation level and profitability, it means that the higher the profit, the lower the company's external fund. Based on Sjahrial [34] company tends to use their own equity, because the obligation has failure risks. Each company have their own companies risks, based on the finance. The initial investment must use profit deposit, then it showed that the company have to have low obligation deposit ratio in capital structure. It is caused by increasing book value and equity trade value.

In pecking order theory, the deficit company will use the external fund. The main external fund is mainly on obligation. Bhama et al. [7] stated pecking order theory affected on company's life. A company which applies pecking order theory will have more long-term life.

##### Hypothesis Development

##### Profit Affection on Financial Distress

Based on pecking order theory, it tends to use internal fund from profit deposit by company's operational performance. The company's finance performance can be measured by profitability ratio. Profitability is an end result ratio and decision in companies. It is related to decision and policy which are used as a tool for measuring the company's ability to gain profit by selling. Whereas, ROA (return on asset) was a ratio to measure the profit company's result ability which was counted by using total company's asset after shortened the existed cost assets [16].

The higher ROA showed the efficiency and effectiveness of asset management. It means that the owned asset was to produce profit by selling, whereas investment by company's undertaking (Widarjo and Setiawan [42]). Also, the higher profitability ratio, the more company experiences financial distress.

Based on Hapsari [17], Widarjo and Setiawan [42] profitability which was proxied by ROA affected negative on financial distress. Ilman et al [19], Siregar and Fauzi [33], Amendola et al. [3] showed the impact between profitability and financial distress. Whereas Kristanti et al (2015) proxied profitability on sales did not affect financial distress. This shows that the higher the profitability ratio production of a company, the bigger the prevention of company experiences financial distress. Based on them, the hypothesis was:

H1: Profitability had negative impact on financial distress.

#### **Liquidity impact on financial distress**

Liquidity is company's ability to fund the operational and short-term obligation repayment. The liquidity measure could be divided into three types. Those were current ratio, quick ratio and cash ratio [42]. This research used current ratio to fulfill the short-term obligation by using company's current asset. If the short-term obligation is not added and has overwhelm current asset which is shown by cash that as the same as profit deposit, then a company will not have any problem with liquidity. Then, with the higher liquidity, there are not any tend to financial distress event in the future.

Based on Widarjo and Setiawan [42] and Ilman et al. [19] Liquidity ratio which was measured by current ratio, affected positively on financial distress. The contrast result was on Hapsari [17] liquidity ratio which was measured by current ratio, affected negatively on financial distress. Kristanti et al. (2015), Vekanda salam [40], and Amendola et al. [3] found the impact between current ratio with financial distress. Based on above explanation, the hypothesis as follows:

H2: Liquidity had negative impact on financial distress

#### **Leverage Impact on Financial Distress**

Leverage ratio is used to measure the company's asset, which is funded by obligation. The high leverage transaction was a general cause of financial distress in a company [41]. If it uses more external fund than internal fund, then it causes the high leverage at a company. Then, if the leverage becomes higher, it affects the finance company condition in the future.

Based on Ilman et al. [19] leverage had positive impact on financial distress, whereas Hapsari [17]; and Widarjo and Setiawan [41] leverage had negative impact on financial distress. Ilman et al. [19], Kristanti et al.(2015) and Gruszczynski [15] also stated that leverage affected financial distress. Based on the above, the hypothesis as follows:

H3: Leverage had positive impact on financial distress

#### **Corporate Governance Impacts on Financial Distress**

Agency problem appeals because of the separation between the principal and agent. Based on agency theory, the conflict of interest between them could impact the company operations in achieving the goal. Asymmetry information which is one of agency problems defined as opportunist behavior. Thus, agent as the company's management who knows company's finance condition better, does not tell the whole company's finance condition to owner, In other words, the owner does not have much information about company's finance condition. Management has more chance to policy and decision making regarding to obligation and investment. Therefore, the company experiences financial distress.

Corporate governance is an effort to find the best way regarding to company's operation in corporate governance to control the management [18]. Therefore, it can be known that management decision making is beneficial for company as a whole or not. Lehman and Warning [23] stated that corporate governance efficiency divided into three aspects. Those were investment, company's growth and profitability. The more efficient a corporate governance, the lower company experiences financial distress.

Based on Priego and Marino [25] corporate governance mechanism could decrease the company's financial distress probability. Li et al. [24], Kristanti et al. (2015), and Manzaneque et al.[25] also stated that corporate governance mechanism had negative impact on financial distress. The hypothesis as follows:

H4: Corporate governance had negative impact on financial distress.

#### **Financial Distress Impact on Financial Statement Fraud**

Pressure is one element of fraud in fraud triangle theory. Pressure could be divided into four categories. Those are financial, non-financial, politics and social [1]. A company that experiences financial distress had lease one interest cover ratio (<1). If this event continued, the company's finance could be worsen or bankrupt [41].

Management would feel pressure to do the fraud by company's financial distress. It could be from the external parties (stockholder and creditor) that have certain expectation to the company or the unhealthy finance condition. One of various ways to solve is to do the finance statement fraud. Therefore the company haswell-looked finance condition. It means that the higher financial distress, the more finance report fraud happening. Based on Mardiana [26] and Waznah et al. [41], financial distress had negative impact on financial report fraud, whereas Ngan [29] financial distress had positive impact on financial report fraud. Danial et al. [10]; Bisogno and Luca [9] stated that there were impact between financial distress and financial statement fraud. The hypothesis as follows:

H5: Financial distress had positive impact on financial report fraud.

**METHODOLOGY.** This study combined several constructions to determine the variables such combining among the factors affecting the financial distress and financial report dishonesty [10, 29, 38] Ugurlu and Deng, 2006., and Ugurlu and Aksoy, 2006). The fundamental theory used in this study was Fraud Diamond theory.

This study applied Fraud Diamond theory, in which one of the factors is pressure causing financial distress. Ngan et al. (2013), stated that financial distress had influence toward the financial report dishonesty which increase the level of financial distress. It might cause the increasing of financial report dishonesty in a company. In other words, it supported fraud diamond theory which mentioned that one of the factors a company doing a fraud is pressure. Additionally, factors that determine a financial distress are profitability, liquidity, and leverage.

In addition, pecking order theory is a theory which suggests financing which follows a hierarchy; internal financing and external financing). Based on the theory, a company is commanded to produce high profitability and liquidity and low leverage. In other words, a company must achieve high profit goal and owe little in order to avoid the existence of financial distress. Ugurlu and Aksoy [38] found negative influences between liquidity and profitability toward financial distress which means the higher the liquidity and profitability of a company, the lower dept and financial distress a company has.

Theory of agency is a theory which relates the stakeholder and the company. Harahap and Wardhani [18] found a relation between corporate governance and agency conflict. The higher an agency conflict, the higher potency of financial distress happened and financial report dishonesty. Wang et al. [24] showed the existence of negative relation between proxied corporate governance and ownership concentration, including state ownership, independent commissaries and auditor opinion regarding financial distress.

This study also examined the indirect influence among profitability, liquidity, leverage and corporate governance toward financial report dishonesty and financial distress. Financial distress is one of the factors of financial report dishonesty [26, 29]. It is situations where a company experiences difficulties in fulfilling the responsibility which then cause a company bankrupt [19]. A company can be in

financial distress if it is not able to fund the obligation and to produce negative profit [5].

#### Sample

This research used all manufactures population in Indonesian Stock Exchange for 2013-2016. This manufacture company was chosen to be the sample based on ACFE 2016 data that the manufacture company had the highest financial report fraud. Indonesian Stock Exchange 2017 stated that the manufacture had the highest financial report fraud than others.

It has eight measure indicators compared to other probability 5 measure indicator models. Therefore it has more precise detection. *Beneish M-Score* as followed:

$$M = -4,840 + 0.920 \times DSRI + 0.528 \times GMI + 0.404 \times AQI + 0.892 \times SGI + 0.115 \times DEPI - 0.172 \times SGAI + 4.697 \times TATA - 0.327 \times LVGI$$

The formula above was obtained from a few patterns, which stated by Beneish et al. [8]. Those are:

- a. **Days Receivable Index (DSRI)** = (Net Receivablest / Salest) / (Net Receivablest-1 / Salest-1)
- b. **Gross Margin Index (GMI)** = [(Salest-1 - COGSt-1) / Salest-1] / [(Salest - COGSt) / Salest]
- c. **Asset Quality Index (AQI)** = [Total Assett - (Current Assetst + PPdanEt) / Total Assetst] / [Total Assett - ((Current Assetst-1 + PPdanEt-1) / Total Assetst-1)]
- d. **Sales Growth Index (SGI)** = Salest / Salest-1
- e. **Depreciation Index (DEPI)** = (Depreciation-1/ (PP and Et-1 + Depreciation-1)) / (Depreciation / (PP and Et + Depreciation))
- f. **Selling, General, and Administrative Expense Index (SGAI)** = (SG and A Expenset / Salest) / (SG and A Expenset-1 / Salest-1)
- g. **Leverage index (LVGI)** = [(Current Liabilitiest + Total Long Term Debtt) / Total Assetst] / [(Current Liabilitiest-1 + Total Long Term Debtt-1) / Total Assetst-1]
- h. **Total Accruals to Total Assets (TATA)** = (Income from Continuing Operationst - Cash Flows from Operationst) / Total Assetst.

If  $M > 22$  then the company tended to do the financial report fraud.

#### Financial Distress

It is defined as a financial hardship because of company's operational or insufficient profit to fulfill its obligations. Febrina [13] explained several tools to test company's financial distress such as: Model Z-Score, Model Zeta, Model O-Score, Model Zmijewski, and Camel ratio. The strongest and the lowest error checking level is

#### Variable Definition

##### Financial statement fraud

The financial statement fraud was represented by profit manipulation. It was tested by *Beneish-MScore*. *Beneish-MScore* was a usage method to detect company's fraud on financial report [8]. Empirically, company with high M-Score has higher fraud undertaken tendency. *Beneish MScore* was a probabilistically model. Hence, the research framework as followed:

Altman Z-Score model. Hence, this research used Altman Z-Score to measure financial distress.

Financial distress measured by *Altman Z-Score* and *dummy* variable which is given score 1 if the Altman Z-Score company score was  $< 2.073$  and score 0 if the Altman Z-Score company was  $\geq 2.073$ . Altman stated a company that had Z-Score  $< 2.073$ , tended to do the financial report fraud.

Altman Z-Score as followed:

$$Z = 1.2 X1 + 1.4 X2 + 3.3 X3 + 0.6 X4 + 1.0 X5$$

Source: [29]

Note:

**X1 = Working Capital to Total Asset**

**X2 = Retained Earning to Total Asset**

**X3 = EBIT to Total Asset**

**X4 = Market Value of Equity to Total Liabilities**

**X5 = Net Sales to Total Assets**

#### Profitability

Profitability variable used in this research was ROA (return on asset). Profitability measure actually could undertake by a few proxies such as Return on Equity (ROE) and return on Investment (ROI). However, regarding to explain the whole profit, the researcher used ROA. Ugurlu and Aksoy [38] stated that the best measure was ROA regarding to profitability level.

Generally, the financial performance was well said if it had ratio 1 or more than 1. Therefore, the higher the profitability ratio, the more effective the management to get higher profit. ROA ratio could be obtained by:

$$ROA = \frac{\text{Net income}}{\text{Total asset}}$$

Source: [16, p. 86].

#### Leverage

Leverage is a ratio to measure the obligation company ability fulfillment whether in short or long term. We could use debt to equity ratio (DER) and debt to asset ratio (DAR). This research used debt to asset ratio. The fraud proxied leverage company was company's ability to fulfill their obligation whether in short or long term if it would be liquidated or dissolved [42]. Therefore, the leverage measure conceptual used debt ratio with owned asset.

Generally, well-finance company had 1 DAR ratio or below 1. The higher the ratio result, the higher the debt ratio level owned by a company. The ratio DAR pattern as followed:

$$ROA = \frac{\text{Total debt}}{\text{Total asset}}$$

Source: [16, p. 89]

**Liquidity**

Liquidity is a ratio to measure the company's liquidity level. In other words, it is the company's ability to pay off the short-term debt. The liquidity could be measured by current ratio, quick ratio and cash ratio [31, p. 286]. This research used current ratio to measure the liquidity. Generally, a company is on liquid state, when has 1 liquidity ratio or above. Hence, the higher the production ratio, the more the company experiences liquidity. The pattern as follows:

$$\text{Current Ratio} = \frac{\text{current asset}}{\text{Current liabilities}}$$

Source: [16, p. 79]

**Corporate Governance**

Corporate governance is a company's management pattern which connects to company's owner and management. Corporate governance could be measured by ownership concentration, institutional ownership, stock's

proportion board ownership, CEO duality, independent board proportion, board size, auditor committee amount, director amount and etc.

This research, corporate governance was measured by ownership concentration, direction board size and auditor committee. Ownership concentration was measured by stock ownership percentage that owned by the biggest stockholders. The biggest stockholder is by 3% or more from the total stocks [21]. Direction board is measured by total direction boards from a company (Aghghaleh et al. [1], Ainul et al. [2]; Andreas et al. [5], Priego & Merino [25]). Then, the auditor committee is measured by total members from an auditor committee in a company [1].

**Sample Descriptions**

This research used purposive sampling by using Manufacture Company that listed on Indonesian Stock Exchange in 2013-2016. Based on Survey Fraud Indonesia, ACFE 2016 and Indonesian Stock Exchange 2017, it is known that the manufacture company is the biggest fraud company type.

**Descriptive Statistic**

Descriptive statistic was description of variable that would be studied. It was taken from each research variables. Generally, descriptive statistic described the mean, medium, maximum, minimum, standard deviation and also several other description in the research. The data was processed by views9 application. It could be seen in the table below:

Table 1. Descriptive Statistic

	X1	X2	X3	X4	X5	X6	Y	Z
Mean	4.788483	2.334374	0.595396	3.847500	4.975000	3.105000	-2.279521	4.259082
Median	2.700000	1.431030	0.499151	4.000000	4.000000	3.000000	-2.485640	3.082027
Maximum	71.51000	15.164470	10.17060	8.000000	16.00000	5.000000	8.483474	23.65747
Minimum	-54.85000	0.106449	0.037231	1.000000	2.000000	2.000000	-9.946233	-10.91578
Std. Dev	10.70778	2.304519	0.730404	1.541162	2.372435	0.405445	1.817388	4.745450
Skewness	1.158306	2.864822	7.666953	0.807546	1.362549	2.367332	2.026646	1.514435
Kurtosis	12.68524	9.676207	84.51402	3.241898	5.073618	11.45544	12.92119	7.035195
Sum	1915.393	933.74963	238.1583	1539.000	1990.000	1242.000	-911.8083	1703.633
Sum SqD.	45747.99	8594.318	212.8624	947.6975	2245.750	65.59000	1317.856	8985.199
Observation	400	400	400	400	400	400	400	400

Based on table 1, profitability (X1), liquidity (X2), leverage (X3), total stockholder > 3 % (X4), direction board measure (X5), total audit committee (X6), Financial Distress (z) and fraud (Y). It was consisted of 400 cases, which meant, there were no missing data. Profitability had 4.79 mean by minimum score of -54.85 (IKAI (Indonesia Accountant Society company) and maximum score of 71.51 (UNVER Company 2013). Liquidity had mean of 2.33 by 0.11 minimum score (POLY company 2016), and maximum score of 15.16 (DPNS company 2016). Leverage had mean value of 0.60 by minimum score of 0.04 (JPRS company, 2014) and maximum score of 10.17 (IMAS company, 2013). The stockholder > 3% had 3.85 mean by 1 minimum total stockholder (HMSP company) and total 8 maximum stockholder (AISA, INAI, KLB and LMPI company). Direction board measure had 4.98 mean, by minimum 2 total persons direction (FPNI < INDR and UNIT company) and total 16 maximum persons direction (TCID 2016, company). Total audit committee had 3.11 mean by total 2 persons minimum auditor committee (MBTO, FPNI, KBRI and SKLT company) and total 5 maximum auditor committee (CPIN and MAIN company). Financial distress had mean of 4.26 by minimum score of -10.92 (POLY company 2015) and maximum score of 23.66 (company). The financial statement fraud had -2.28 mean by minimum score of -9.95 (company), and maximum score of 8.48 (KLBF company 2014).

**Regression test**

Regression test result consisted of two models. Those were regression model 1 and regression model 2. Each from this regression test model will discuss about the regression similarity to be produced, test F (impacts on independent variable simultaneously to dependent), test t (independent variable partial impact to dependent variable), and determination coefficient score (R square).

Based on regression test result from table, it could be known simultaneously that score F was 24.037 with Sig F Score of 0.000, which meant < 0.05. Then, H0 was rejected and H1 was accepted. Independent variable were X1 (ROA), X2 (Liquidity), X3 (Leverage), X4 (stock ownership > 3%), X5 (total direction board), and X6 (total auditor committee) impacts on variable Z (financial distress). Based on table 2 score R Square (used adjusted R square) as 0.858 or 85.8 %. It defined variable Z (financial distress) was 85.8 % by independent variable. Those were X1 (ROA), X2 (Liquidity), X3 (Leverage), X4 (stockholders > 3 %), X5 (total direction board), and X6 (total auditor committee). Whereas, the rest was 14.2 % explained by other variable or independent variable at this same regression. Profitability partial stockholders, total direction boards impacted negative on financial distress. Leverage impacted positive on financial distress.

Table 2. Regression Model 1 (Fixed Effect Model)

Free variable	Regression coefficient	t count	Sig. t	Note
Constant	7.036362	3.665442	0.0003	-
X1 (ROA)	-0.065380	-3.649924	0.0003	Significant
X2 (liquidity)	-0.016212	-0.740841	0.4594	Non-significant
X3 (leverage)	1.746449	8.388333	0.0000	Significant
X4 (Stockholders > 3%)	-0.406662	-2.331626	0.0204	Significant
X5 (total direction board)	-0.500577	-2.923467	0.0037	Significant
X6 (total auditor committee)	0.181441	0.349563	0.7269	Non-significant
R-squared	0.895666			
Adjusted R-squared	0.858403			
F-statistic 24.03680				
Prob (F-statistic)	0.000000			

Based on table 2 score R Square (used adjusted R square) as 0.858 or 85.8 %. It defined variable Z (financial distress) was 85.8 % by independent variable. Those were X1 (ROA), X2 (Liquidity), X3 (Leverage), X4 (stockholders > 3 %), X5 (total direction board), and X6 (total auditor

committee). Meanwhile, the rest was 14.2 % explained by other variable or independent variable at this same regression. Profitability partial stockholders, total direction boards impacted negative on financial distress. Leverage impacted positive on financial distress.

Table 3. Regression Model 2 (Fixed Effect Model)

Free variable	Regression coefficient	t count	Sig. t	Note
Constant	-4.633373	-2.406351	0.0167	-
X1 (ROA)	0.007209	0.401283	0.6885	Non-Significant
X2 (liquidity)	-0.015389	-0.713974	0.4758	Non-significant
X3 (leverage)	-1.245389	-5.477943	0.0000	Significant
X4 (CG share > 3%)	0.163710	0.948218	0.3438	Non-Significant
X5 (total direction board)	0.030657	0.179939	0.8573	Non-Significant
X6 (total auditor committee)	0.429348	0.843132	0.3998	Non-significant
Z (Financial Distress)	0.224709	3.928091	0.0001	Significant
R-squared	0.317923			
Adjusted R-squared	0.071164			
F-statistic 1.288397				
Prob (F-statistic)	0.051153			

Based on table 3 regression test, It could be known that the score of F was 1.288 with score Sig F 0.051. It means > 0.05. Then Ho and H1 were rejected simultaneously. Independent variable was X1 (ROA), X2 (Liquidity), X3 (Leverage), X4 (stockholders > 3 %), X5 (total direction board), X6 (total auditor committee and Z (financial distress) was not impacted variable Y (fraud). Also, based on table 3 R Square (used adjusted R Square) was 0.071 or 7.1 %. It defined variable Y (fraud) was explained as 7.1 % by independent variable. Those were X1 (ROA), X2 (Liquidity), X3 (Leverage), X4 (Stockholders > 3 %), X5 (total direction board) and Z (financial distress). whereas the rest was 92.9 %. It was explained by other variable or independent variable in this similar regression. Leverage impacted positively on financial statement fraud, whereas financial distress impacted positively on financial statement fraud. Then, the profitability, liquidity and corporate governance were not impacted on financial statement fraud.

This subchapter will review the indirect impact between profitability, liquidity, leverage and corporate governance variable to financial statement fraud and financial distress. The total data could be formulated, as followed:

$$R^2_m = 1 - P^2_{e1} P^2_{e2} \dots P^2_{ep}$$

In which:

$$P^2_{e1} = 1 - R^2_1; \quad P^2_{e2} = 1 - R^2_2$$

Where  $R^2_1$  was R square to formula 1, in which 0.858,  $R^2_2$  is R to formula 2. That was 0.071:

$$P^2_{e1} = 1 - 0.858 = 0.142; \quad P^2_{e2} = 1 - 0.071 = 0.929$$

total determination coefficient was as followed:

$$R^2_m = 1 - (0.142 \times 0.929) = 0.132 \text{ atau } 13.2\%$$

The  $R^2_m$  indicated data diversity that could be explained by that model as 0.132, whereas 86.8% diversity was explained by other variable. This table served about indirect impact test result:

**Indirect Impact Analysis**

Table 4. Indirect test

Effect	a	b	SE a	SE b	Z-sobel	P-value	Note
X1→Z→Y	-0.065	0.225	0.018	0.057	-2.674	0.007	Significant
X2→Z→Y	-0.016	0.225	0.022	0.057	-0.728	0.467	Non-significant
X3→Z→Y	1.746	0.225	0.208	0.057	3.557	0.000	Significant
X4→Z→Y	-0.407	0.225	0.174	0.057	-2.005	0.045	Significant
X5→Z→Y	-0.501	0.225	0.171	0.057	-2.345	0.019	Significant
X6→Z→Y	0.181	0.225	0.519	0.057	0.348	0.728	Non-significant

Based on table 4, it could be known the profitability, leverage, stockholders, total directions impacted on financial statement fraud by financial distress, whereas liquidity and total auditor committee were not significant to financial statement fraud through financial distress.

**Discussion**

Discussion was focused on research's result, based on research hypothesis. Profitability, leverage, stockholders > 3 %, and the total board direction influenced financial distress. Then, it impacted on financial statement fraud. This research proved the negative impact on financial distress. The result supported Hapsari research [17],

Widarjo and Setiawan [42] profitability that proxied by return on asset (ROA) impacted negative on financial distress. This research was done by Ilman et al. [19], Siregar and Fauzi [33] revealed the impact between profitability and financial distress. This meant, the higher the profitability ratio, the higher the financial distress company prevention.

The result of data analysis proved that liquidity did not influence the financial distress of manufacture companies in Indonesia from 2013 until 2016. Liquidity is a ratio used to measure the ability of a company to pay the short-term debt. Munawir [32] mentioned liquidity as the creditor margin of safety in short term. In other words, the company's financial condition is stable or progressive so that the company is free from financial distress automatically. On contrary, the result of analysis showed that liquidity did not have any influence toward financial distress. However, the result of this study indicated that liquidity did not affect financial distress. The 315 samples showed that the composition of short-term debt is greater than long-term debt which means that companies prefer to use short-term debt for the company's operating needs compared to long-term debt nowadays. Such the condition resulted an asset balance is not equivalent to its profit, so that high liquidity of a company did not guarantee the lowering of financial distress. Besides, 327 samples showed that the current debt was lower than the company's lancer assets. On other words, the 327 samples showed that the company could pay off its current debt using the company's lancer assets.

Leverage proved positively on financial distress Manufacture Company in Indonesia in 2013-2016. This research was in line with Ilman et al. [19] which proved that leverage positively impacted financial distress of Manufacture Company in Indonesia (2009). This research was also different from Hapsari [17] research and Widarjo and Setiawan [43]. Those proved that leverage negatively impacted on financial distress. Kristanti *et al.* (2015) and Gruszczynski [15] stated that leverage impacted on financial distress although it was not detailed related to the correlation.

The research proved that the stockholders > 3% negatively impacted on financial distress Indonesian manufacture company in 2013-2016. The stockholders were part of corporate governance mechanism at a company. The prominent stockholders (more than 3%) concentrated to persons or institutions. Stockholders more than 3% distributed to many capitalist, viewed as increased the investors control to company's management, hence company's efficiency would increase and decrease the financial distress potential. This happened to Indonesian manufactures company with total prominent stockholders above five persons. Wang & Deng [24] and Miglani et al. [27] proved the negative ownership concentration to financial distress. Although this research contrasted to Priego and Merino [25], Amendola et al. [3], and Manzanque et al. [15] proved that the ownership concentration did not impact to financial distress.

The research also proved the negative director board impacted on financial distress to manufacture company in Indonesia 2013-2016. The total existed director board could anticipate agency problem, which was caused to miscommunication and interests contrast. The function is to be solved to create wise policies at a company. However, it prevented the financial distress. The importance of total director board, then a manufacture company at very least had 5 director boards. This research was based on Manzanque et al. [25]. It proved the size director boards,

impacted to agency problems, which in the end appealing financial distress potential.

In addition, the result of the study proved that the number of audit committees did not affect financial distress in manufacture companies in Indonesia from 2013 until 2016. This is not in line to the research hypothesis that the number of audit committees negatively affects financial distress. This is due to the current conditions, in which every manufacturing company only has 2 to 5 audit committees. The OJK regulations No.55/POJK.04/2015 and KEP-103/MBU/2002 stated that the ideal number of audit committees consist of 3 members which include 1 chairman and 2 members. Among 400 samples, 351 samples (88%) had 3 audit committees which mean that the company had used the ideal amount for the audit committee. According to Dalton (1999), too many members of audit committees can reduce the focus of the audit and cause conflict in decision making. However, the less member of audit committee would slow down the work performance. Unfortunately, the result of this study did not in line with Hazirol et al. (2017) which proved that the audit committee affected financial distress within the company. However, the result of this study was in accordance with Salloum et al. (2014) which mentioned that the number of corporate audit committees did not affect financial distress.

Financial distress impacted positively on manufacture company fraud in Indonesia 2013–2016. A company that has financial distress tends to do financial statement fraud. This research was the same as Ngan [29], Mardiana [26] and Waznah et al. [41] in which proved the impact of financial distress on financial statement fraud. Whereas, Dalnial et al. [10] and Bisogno and Luca [9] stated, that there were correlation between financial statement fraud.

**Conclusion.** From the analysis and discussion above, this study could be concluded that there are several factors to determine the financial distress and financial report dishonesty. The impacting factors of financial distress were profitability, leverage and stockholders > 3% and the number of directors. In addition, the higher company's profitability, the lower financial distress company risks would occur. On other words, the decreasing of profitability would cause the occurrence of financial distress and vice versa. Then, the result also showed that liquidity did not the determined factor on financial distress. This is caused by a company prefer short-term funding to long term funding. Besides, about 80% samples of company could pay the short term debt. thus, most company like to owe more in short-term funding to support the production. As the result, the internal financial is not balanced with the profit so that liquidity could not guarantee the existence of financial distress.

Leverage is the determined factor of financial distress to manufacture company. Research also proved all corporate governance proxy is the determined factor to financial distress. The stockholders more than 3% which was distributed to many capitalist would tend to decrease financial distress. The adequate total company's need and expertise fields need will decrease financial distress potential. The total audit committee is not financial distress factor. Hence, audit committee has not been able to decrease financial distress potential. The research result proved that financial distress was one of the fraud factors in Indonesia periods 2013–2016. It means that the higher the financial distress, the more company experienced to do the financial statement fraud. Financial distress is one of the main reasons for Manufacture Company to do the financial statement fraud.

Overall, the result of this study showed that profitability, leverage, > 3 % stakeholder and the number of directors were the factors of financial distress of manufacturing company in Indonesia. When a company experienced financial distress, so a company would be probably do financial report dishonesty. Indeed, financial distress was one of the things that cause financial report dishonesty happened in manufacturing companies in Indonesia.

### Suggestions:

The suggestions are the importance of profitability maintenance such as; increasing effectiveness and efficiency of corporate governance by arranging the ideal audit committee, director boards, and also the stockholders. Definitely, it could bring forth the good policies and strategies at a company. The research's result shows that the financial distress has impact to financial statement fraud. Therefore, regarding to decrease that corrupt act, it could be done by increasing the financial distress potential prevention. Those are, re-arranging the short-term obligation policy and communication system between manager and investor. Particularly to the government, it is done by increasing the transparency, accountability and openness information.

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### КОРЕЛЯЦІЯ У ФОРМІ ПРОМІЖНОЇ ЗМІННОЇ МІЖ РЕНТАБЕЛЬНІСТЮ, ЛІКВІДНІСТЮ, КРЕДИТНИМ ПЛЕЧЕМ, КОРПОРАТИВНИМ УПРАВЛІННЯМ ТА ТЯЖКИМ ФІНАНСОВИМ СТАНОМ АБО ШАХРАЙСТВОМ ІЗ ФІНАНСОВИМИ ЗВІТАМИ

*Фінансова звітність може відображати ефективність управління компанією, якщо працівникам довіряють. Будь-яка державна компанія зобов'язана виставляти у вільному доступі свій щорічний фінансовий звіт. Було розглянуто як проміжну змінну взаємозв'язок між рентабельністю, ліквідністю, кредитним плечем і корпоративним управлінням щодо шахрайства у фінансових звітах і фінансовим лих. Ґрунтуючись на даних Асоціації сертифікованих експертів із питань шахрайства (ACFE) 2016, фальсифікація фінансовою звітністю постійно зростала, починаючи із 2012–2016 років. Це означає, що у безлічі компаній була мотивація до шахрайських дій із фінансовою звітністю. У цьому дослідженні у фінансовій кризі розглядалися проміжні змінні стосовно факту фінансового шахрайства. Кількісні оцінки проводилися на основі використання теорії шахрайства з діамантами. Дане дослідження підтвердило наявність взаємозв'язку між фінансовими труднощами з величиною рентабельності, кредитним плечем, кількістю акціонерів понад 3% і директоратом. Дослідження показало, що чим вище прибутковість компанії, тим менший ризик фінансових труднощів. Спираючись на дослідженні, можна дійти висновку, що компанії з фінансовими труднощами схильні фальсифікувати фінансову звітність.*

*Ключові слова: шахрайство у фінансовій звітності; рентабельність; ліквідність; кредитне плече.*

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### КОРЕЛЯЦИЯ В ФОРМЕ ПРОМЕЖУТОЧНОЙ ПЕРЕМЕННОЙ МЕЖДУ РЕНТАБЕЛЬНОСТЬЮ, ЛИКВИДНОСТЬЮ, КРЕДИТНЫМ ПЛЕЧОМ, КОРПОРАТИВНЫМ УПРАВЛЕНИЕМ И ТЯЖЕЛЫМ ФИНАНСОВЫМ ПОЛОЖЕНИЕМ А ТАКЖЕ МОШЕННИЧЕСТВОМ С ФИНАНСОВЫМИ ОТЧЕТАМИ

*Финансовая отчетность может отображать эффективность управления компанией, если работникам доверяют. Всякая государственная компания обязана выставлять в свободном доступе свой ежегодный финансовый отчет. В этом исследовании была рассмотрена в качестве промежуточной переменной взаимосвязь между рентабельностью, ликвидностью, кредитным плечом и корпоративным управлением в отношении к мошенничеству в финансовых отчетах и финансовым бедствиям. По данным Ассоциации сертифицированных экспертов по мошенничеству (ACFE) 2016, фальсификация финансовой отчетностью постоянно возросла, начиная с 2012-2016 годов. Это означает, что у множества компаний имелась мотивация к мошенническим действиями с финансовой отчетностью. В этом исследовании финансовое бедствие рассматривалось промежуточной переменной до факта финансового мошенничества. Количественные оценки производились на основе использования теории мошенничества с бриллиантами. Данное исследование подтвердило наличие взаимосвязи между финансовыми трудностями с величиной рентабельности, кредитным плечом, числом акционеров более 3% и директоратом. Исследование показало, что чем выше прибыльность компании, тем меньше риск финансовых трудностей. Основываясь на исследовании можно заключить, что компании с финансовыми трудностями склонны фальсифицировать финансовую отчетность.*

*Ключевые слова: мошенничество в финансовой отчетности; рентабельность; ликвидность; кредитное плечо.*