Financial Shenanigans and Company Characteristics in Indonesia Public Company

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Abstract: Financial shenanigans are moves made by a company's management with the intention of falsifying the company's financial status and stated performance. The goal of this study is to clarify if financial considerations and company size have an impact on a company's propensity to engage in financial misdeeds in Indonesian public companies. Financial leverage, financial stability, personal financial need, and return on assets are the financial characteristics that were examined in this study. An Indonesian firm that has gone public serves as the study's sample. Purposive sampling was used in this study's sampling. This study's analysis method makes use of multiple linear regression. The findings revealed that the company was unaffected by all variables except for financial leverage.

Keywords: Financial leverage, financial stability, personal financial need, return on asset, financial Shenanigans

1. Introduction

A financial report presents information on an entity's performance and financial status in an organized manner. Financial reports must provide information that is focused on the needs of all users, not just those of specific parties. No commercial entity is permitted to disclose information that benefits some parties at the expense of others who have opposing interests, according to Skousen et al. (2009). An entity's financial statements reflect it. A good evaluation from the user's perspective will be provided through good financial reports. After some thought, it appears that many organizations still "polish" their financial reports to make them appear "good." Managers will be inspired to improve business performance once they recognize the significance of the information contained in financial reports, which will preserve the company's existence. The information in the financial report may not be satisfactory in some situations if the management was unable to meet their performance targets. This phenomenon is going to result in financial reports that are misleading (Financial Shenanigans) Salim et al. (2020). This can lead to biased financial reports that affect decisions. In the Asia-Pacific region, fraud is a significant problem. According to a survey by the Association of Certified Fraud Examiners (ACFE), financial statement fraud occurred at a rate of 13% in 2018 and resulted in a loss of $700,000; the rate increased to 14% in 2020 and resulted in a loss of $700,000, according to a special report for the Asia-Pacific region. incredible $3,000,000. This demonstrates that there are significant issues with external auditors being able to identify warning signs of false financial reporting (Sakti et al. 2020). Stakeholders require financial reports as a source of information.

Agency theory states that financial statement manipulation typically has the effect of lowering conflict between the principal and agent. By raising wealth reports for owners and creditors,
management (agents) tries to produce strong financial reports. Financial crime is one method of "polishing" an entity's financial statements. Financial crimes are decisions made by company management with the goal to falsify the company's reported performance and financial status (another word for fraudulent financial reporting). Simple adjustments to accounting projections to intentional fraud are all examples of financial crimes. The manipulation used when a firm engages in financial fraud, whether legally or not, serves to conceal the true operating performance of the business, and all of these acts have an impact on shareholder value. Making poor financial judgments is just one of the issues that might result from financial report manipulation. What drives a company to commit financial crimes and defend their actions? According to Albrecht et al. (2016), there are three factors that might lead to fraud: pressure, opportunity, and rationale. An entity will undoubtedly face all three of these. According to Soselisa and Mukhlasin (2020), there are a number of variables that affect accounting fraud. These include organizational, managerial, financial, and auditor culture, all of which have an impact on the likelihood of fraud, as well as Firdaus and Suryandari's (2008) findings from organizational culture, management, strategy, finance, and auditor variables. and the government provides evidence showing how management, company culture, and auditors all affect the propensity for accounting fraud. Researchers wish to further investigate financial aspects, forms of KAP, and company size in financial shenanigans because there are still discrepancies in research results regarding various elements that influence financial shenanigans (fraudulent financial reporting). This is because prior study revealed that there are still differences in research results regarding these factors. The purpose of this study's research is to clarify how a company's size and financial parameters affect its propensity to engage in financial mischief in Indonesian public firms.

2. Literature Review

Agency theory describes a contract between one or more parties (principals) that entrusts a third party (agent) to carry out their objectives and delegate decision-making to the agent. In agency theory, the shareholder is referred to as the principal, and the management that oversees the company is referred to as the agent. An agent reports their performance to the principal in the financial report. Because each party has different interests, this could lead to a conflict of interest between the agent and the principal. In order for stakeholders to have confidence in the information provided by the entity (agent), there is a tendency for financial shenanigans to be committed during the compilation of financial reports. An auditor's competence can therefore lower the level of fraud.

Financial shenanigans, another word for fake financial reporting, are actions made by management of a corporation with the purpose of misrepresenting the company's reported performance and financial condition. Financial deception cannot be perpetuated over the long term, although it can temporarily disguise a company's economic realities. Investors will eventually discover the truth, and the company's stock price will change. Managers may attempt to manipulate the reported profitability of a company by engaging in accrual-based crimes (such as purposefully amortizing costs too slowly) or genuine economic crimes (such as reducing expenditure on maintenance, R&D, or advertising in order to reach revenue objectives). The main goal, regardless of the technique, is to embellish the company's stated success, potentially to serve the manager's personal self-interest. Other studies support the idea that crime is used to boost overall executive compensation. For instance, Healy (1985) found that managers who do not have a limited number of performance bonuses tend to choose accounting procedures that increase reported earnings, while managers who have a limited number of bonuses are more likely to choose accounting procedures that minimize reported profits. According to Schilit (2002), there are seven (seven) basic forms of financial crimes,
including: "(1) recording money before it is produced, (2) creating false income, (3) raising profits with one-time transactions, (4) shifting current expenses to the last period, and (5) failed to report or revealing liabilities, (6) carrying forward current revenue to the following period, and (7) carrying back future expenses to earlier periods. It's important to remember that not all financial crimes involve legal violations or deviations from recognized accounting practices. Financial crime (financial fraud) refers to a wide range of actions including the purposeful underreporting of financial performance or financial position.

Profit management and financial crimes can take many forms, from the highly courteous (quite benign) to the dishonest, including recognizing phony money (Schilit, 2002). Factors Various issues might arise from financial statement manipulation. Financial statements are interpreted by the average reader solely on the surface, without any deeper understanding. In addition to selecting accounting practices that will be advantageous for the business, there are other elements that influence whether or not corporations prefer to manipulate profits. These elements may result from both internal and external components of the business. This study talks about a few things that can drive businesses to commit financial fraud.

Hypothesis Development

Financial Leverage

According to Sartono (2008:263), "financial leverage is the use of funding sources that have a fixed burden in the hope that it will be able to provide additional profits that increase from the fixed burden so that it will be able to increase profits for shareholders." Financial leverage is a result of the use of debt-based funding sources, which forces businesses to take on debt and pay interest charges (Syaifullah, 2018). Leverage has a favorable association, according to Christie (1990). on how often businesses control their profits. According to Persons (1995), financial leverage has an impact on a company's propensity to perpetrate fraud. Financial leverage, according to Soselisa and Mukhlasin (2008), does not influence the propensity for accounting fraud, hence the hypothesis in this

H1: Businesses that have a lot of debt tend to engage in financial shenanigans.

Financial Stability

Financial stability is a term used to characterize a company's stable financial situation. The company's asset condition can be used to gauge how stable the company's financial situation is. When the company's financial stability is in jeopardy, management will take numerous actions to make the stability appear strong. Assets are defined by FASB (1980), Ghozali and Chariri (2007) as potential future economic benefits acquired or controlled by a certain entity as a result of previous transactions or occurrences.

As evaluated by financial stability:

\[
\text{Financial Stability} = \frac{\text{Total Assets}_t - \text{Total Assets}_{t-1}}{\text{Total Assets}_t} \times 100\%
\]

Information:

Total Assets \( t \) : Total Assets for the current year
Total Assets \( t-1 \) : Total Assets of the previous year

This description leads to the following suggested study hypothesis:

H2: There is a propensity for financial shenanigans when the total asset percentage changes.

Personal financial need is a situation where corporate finances are also impacted by the financial health of company executives (Skousen et al., 2009). Executive stock ownership may
have an impact on management's decision to disclose financial performance. The degree of financial statement distortion can be influenced by the share ownership structure of the organization. The following formula is used to calculate an individual's financial need:

\[ \text{PFN} = \frac{\text{Number of insider shares} \times 100\%}{\text{Number of shares outstanding}} \]

Beasley (1996), Committee of Sponsoring Organization of the Treadway Commission (COSO) (1999), then based on the presentation of previous research results, the following hypothesis can be formulated:

**H3: Personal Financial Need has a tendency to do financially shenanigans.**

**Return on Assets (ROA)**
An indicator of management effectiveness, return on assets (ROA) is a ratio that displays the results of the amount of assets utilised by the business. No matter where the money comes from, ROA displays the return on all assets under management. The return on average assets (ROA) can be used to gauge a company's capacity to turn a profit. The higher the company's level of profit and its position in terms of asset utilisation are, respectively, inversely correlated with the ROA produced. Indarto and Ghozali's (2016) research findings have demonstrated that financial targets represented by ROA have a favorable impact on financial statement fraud. The company's susceptibility to data manipulation increases with the company's aim.

This study infers from financial aims that firms boost profits with unintended consequences, which affects the existence of financial shenanigans. On the basis of the presentation of the findings from earlier studies, the following theory can be developed:

**H4: Return on assets frequently engages in financial fraud.**

**Company Size**
The more a company grows, the more stakeholders will draw attention to it. Stakeholders will keep an eye on how the business is doing. The shareholder expectations that the company's performance would continue to improve increase with the size of the business. Due to this, businesses frequently engage in financial mischief. Accounting for total assets, total revenue, profit margins, and other factors can help determine a company's size. Total assets are used in this study to calculate firm size. The research's premise is as follows, based on the study's prior exposure:

**H5: Financial shenanigans is more likely to occur in larger companies.**

### 3. Method

**Operational Definition of Variables**
The tendency to engage in financial mischief, as determined by Discretionary Accruals based on the Accrual Profit Management Measurement Model with modified Jones a, is the dependent variable (Y) in this study. Total accruals are first calculated, then discretionary accruals. Applying the formula \( TAC_{it} = NIt - OCF_{it} \)

Details:
- Total Accruals: TAC
- NIt: Net Income
- Operating Cash Flow (OCF)
The total accrual components are then divided into two categories: discretionary accruals and non-discretionary accruals. The modified Jones model listed below is used to perform this decomposition (Dechow et al. 1995):

\[
\frac{TAC_{it}}{TA_{it-1}} = a_1 \left( \frac{1}{TA_{it-1}} \right) + a_2 \left( \frac{\Delta REV_{it}}{TA_{it-1}} \right) + a_3 \left( \frac{PPE_{it}}{TA_{it-1}} \right) e^{it}
\]

Detail:
TAt-1 : Total Assets in the year before the study
\( \Delta REV_{it} \): The difference between the research year's income and the previous year
PPEit: plant, property and equipment
\( \beta \) : coefficient

Then look for the *nondiscretionary accrual* (NDAC) value calculated by the formula as following:

\[
NDAC = a_1 \left( \frac{1}{TA_{it-1}} \right) + a_2 \left( \frac{\Delta REV_{it} - \Delta REC_{it}}{TA_{it-1}} \right) + a_3 \left( \frac{PPE_{it}}{TA_{it-1}} \right)
\]

Detail:
NDAC: *Nondiscretionary Accruals*
\( \Delta REC \): Difference between receivables from the research year and the previous year

The coefficient of each variable from the equation above is obtained from the regression results.

To calculate the value of *discretionary accruals* (DAC) which is a measure of management profit, the following formula is obtained:

\[
DAC = \frac{TAC_{it}}{TA_{it-1}} - NDAC
\]

Detail:
DAC: *Discretionary Accruals*
The Independent Variables in the research are as follows:
a. *Financial Leverage* calculated by Total Liabilities/Total Assets
b. *Financial Stability* which is calculated by \((\text{Total Assets } t - \text{Total Assets } t-1)/\text{Total Assets} \times 100\%\)
c. *Personal financial need* is calculated by \((\text{Number of insider shares/Number of shares outstanding}) \times 100\%\)
d. Return on Assets (ROA) is calculated by \((\text{Total net profit/Total Assets}) \times 100\%\)
e. Company size (SIZE) is measured by \(\log\text{Total assets}\)

**Population and Sample**
All non-manufacturing companies that have gone public in Indonesia are the population used in this study. The following criteria were utilized for purposive sampling in this study:
a. During the observation period, non-manufacturing companies are listed on the Indonesia Stock Exchange.
b. Delivering a yearly report for 2020–2022
c. Companies that commit fraud (fraud firms) are listed on the OJK's list of sanctions, and
d. Companies that aren't listed are excluded companies that don't commit fraud are included on the OJK's sanctions list (non-fraud firm).
Procedures for Data Collection
Tracing reports that were chosen as samples was the documentation approach employed in this investigation. For the 2020–2022 term, the annual report of the company may be seen on the company's website and in the Indonesia Stock Exchange's publication at www.idx.com.

Technique for data analysis
Techniques for multiple regression analysis were employed in this study. The general hypothesis being tested in this study is represented by the multiple linear regression equation:

\[ FS = \beta_0 + \beta_1 \text{LEV} + \beta_2 \text{FST} + \beta_3 \text{PFN} + \beta_4 \text{SIZE} + \beta_5 \text{ROA} + \epsilon \]

Detail:
- \( \beta_0 \) : Constant
- \( \beta \) : Intercepts
- FS : Financial Shenanigans
- LEV : Financial Leverage
- FST : Financial Stability
- PFN : Personal Financial Needs
- SIZE : Company Size
- ROA : Return on Assets
- \( \epsilon \) : error

4. Result and Discussion

General Information About Research Items
The companies listed on the Indonesia Stock Exchange between 2020-2022 that are not manufacturers are the study's subjects. Purposive sampling was utilized in this study to choose the research sample. Purposive sampling is the process of choosing samples based on predetermined standards. The results of data processing for the classic assumption test can be seen in the following table:

<table>
<thead>
<tr>
<th>Table 1. Classical Assumption Test Result</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<tr>
<td><strong>Uji Multikolieritas</strong></td>
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<tr>
<td>a. Tolerance Value</td>
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<tr>
<td>Leverage</td>
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<tr>
<td>financial stability</td>
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<tr>
<td>personal financial needs</td>
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<tr>
<td>size</td>
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<tr>
<td>ROA</td>
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<tr>
<td>b. VIF</td>
</tr>
<tr>
<td>leverage</td>
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<tr>
<td>financial stability</td>
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<tr>
<td>personal financial needs</td>
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<td>size</td>
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<tr>
<td>ROA</td>
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<tr>
<td>Auto Correlation Test</td>
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<td>Durbin Watson</td>
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<tr>
<td>Heteroscedasticity Test</td>
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<tr>
<td>Glesjer Test (all independent variables)</td>
</tr>
<tr>
<td></td>
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<tr>
<td><strong>Financial Shenanigans</strong></td>
</tr>
<tr>
<td><strong>Result</strong></td>
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<tr>
<td></td>
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<tr>
<td>0.809</td>
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<tr>
<td>There is no multikolinierity</td>
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<tr>
<td>0.801</td>
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<tr>
<td>0.920</td>
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<td>0.940</td>
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<td>0.896</td>
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<td>1.126</td>
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<td>1.116</td>
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<td>1.249</td>
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<td>1.69</td>
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<td>There is no autokorelation</td>
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<tr>
<td>1.000</td>
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<tr>
<td>There is no heteroscedasticity</td>
</tr>
</tbody>
</table>

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Discussion

Hypothesis testing using double linear regression analysis. The results of the test of the hypothesis can be seen in Table 2 below:

<table>
<thead>
<tr>
<th>Variable</th>
<th>β</th>
<th>t</th>
<th>Sig (*α= 0.05)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constanta</td>
<td>4.906</td>
<td>1.234</td>
<td>0.944</td>
</tr>
<tr>
<td>Leverage</td>
<td>-0.009</td>
<td>-0.073</td>
<td>0.123</td>
</tr>
<tr>
<td>Financial Stability</td>
<td>-0.184</td>
<td>-2.669</td>
<td>0.010*</td>
</tr>
<tr>
<td>Personal Financial Needs</td>
<td>0.122</td>
<td>2.388</td>
<td>0.025*</td>
</tr>
<tr>
<td>Size</td>
<td>-0.632</td>
<td>-1.750</td>
<td>0.075**</td>
</tr>
<tr>
<td>ROA</td>
<td>0.759</td>
<td>12.587</td>
<td>0.000*</td>
</tr>
</tbody>
</table>

Nilai F test 35.380 dengan Sig 0.000

**Significant at level 0.10

The F test value is equal to a significant value that is less than the alpha level of 0.00, according to the findings of the hypothesis test, indicating that the regression model's goodness of fit is plausible. The leverage variable did not affect financial shenanigans, according to the results of the t test, which showed that its value was 0.944 and its significance value was greater than the alpha level (0.05). However, the financial stability variable did, with a t test value of -2.669 and a significance value of 0.10 that is lower than the alpha level (0.05). The personal financial needs has a t-test value 2.388, that's variable influences financial shenanigans, and the company size variable (SIZE) has a t-test value of -1.750 and a significance value of 0.075 which is smaller than the alpha level of 0.10, so there is an influence on financial shenanigans. The return on assets (ROA) variable has a t-test value of 12.587 and a significance value of 0.000 which is smaller from the alpha level (0.05). According to data processing results, the factors financial stability, individual financial demands, company size (size), and return on assets (ROA) encourage businesses to have a propensity for financial mischief. The analysis of the data reveals that a company that creates a company is more likely to engage in financial fraud because the company needs financial stability to be able to assure its stakeholders that it can continue operating as a going concern for a long time.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) (1999) and Dunn (2004) demonstrate that when company executives have a significant financial role in the company, the company's financial performance will also have an impact on the executives' personal financial needs (Skousen et al., 2009). Additionally, as a result of personal financial need data processing, there is a propensity for financial mischief to be committed. One of the factors that affects a firm's propensity to engage in financial mischief is its size (SIZE), because the more stakeholders there are, the more they will be interested in how the company is performing. The organization that will be able to offer significant benefits to stakeholders is what stakeholders wish for. The company's ability to offer significant advantages to stakeholders is what stakeholders anticipate. Companies tend to engage in financial mischief as a result of this. Financial mischief is also influenced by the variable Return on Assets (ROA), but why? Return on assets is a measure of a company's financial performance; the higher the level, the more beneficial it is perceived by stakeholders, particularly shareholders and creditors; as a result, companies tend to engage in financial shenanigans as a way to maintain performance. According to the analysis of the data, the leverage variable is the only one that does not have any bearing. Why? Utilizing a source of capital with a fixed cost in the hopes that it will be able to generate extra profits that rise from fixed costs in order to increase profits for shareholders is known as leverage. According to this
theory, leverage should encourage businesses to commit fraud, but the study's data processing findings had no bearing on this. This may be because the amount of leverage has little direct impact on stakeholders, which discourages the company from engaging in financial mischief, or because leverage is linked to the company's obligation to creditors.

5. Conclusions

Several inferences have been drawn from the research's findings, including the following: Return on Assets, Financial Leverage, Financial Stability, Personal Financial Need, and Personal Financial Need have a propensity to Engage in Financial Shenanigans.

References


