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Corporate Governance in Detecting Lack of Financial Report

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Abstract

Fraudulent financial statements begins with the act of manipulating the financial statements for personal gain. Efforts to fulfill obligations on the rights of stakeholders make corporate governance play an important role in minimizing the occurrence of fraudulent financial statements. This study aims to investigate the phenomenon of corporate governance in detecting fraud or irregularities in the preparation of financial statements. Fraud detection is measured by the Beneish model.. The sample used in this research is 694 with manufacturing company period 2011-2015. Sampling technique with purposive sampling method. To test the Hypothesis used logistic regression analysis with moderation model. The results obtained are foreign ownership, domestic ownership and public ownership significant negative effect on fraud financial statement. While firm size has a significant positive effect fraud financial statement. Firm size as a moderating variable further strengthens the relationship between foreign ownership, domestic ownership and public ownership of fraud financial statements.

Tata Kelola Perusahaan untuk Mendeteksi Kekurangan pada Laporan Keuangan

Abstrak

Kecurangan laporan keuangan diawali dengan perbuatan memanipulasi laporan keuangan demi mendapatkan keuntungan pribadi. Upaya pemenuhan kewajiban terhadap hak para stakeholder membuat corporate governance berperan penting dalam meminimalisir terjadinya kecurangan laporan keuangan. Penelitian ini bertujuan untuk menyelidiki fenomena corporate governance dalam mendeteksi kecurangan atau penyimpangan dalam penyusunan laporan keuangan. Sampel yang digunakan pada penelitian ini yaitu 694 dengan perusahaan manufaktur periode 2011-2015. Teknik pengambilan sampel dengan metode purposive sampling. Untuk menguji hipotesis digunakan analisis regresi logistik dengan model moderasi. Hasil penelitian yang didapat adalah kepemilikan asing, kepemilikan domestik, dan kepemilikan publik berpengaruh negatif signifikan terhadap fraud financial statement. Sedangkan firm size memiliki pengaruh positif signifikan fraud financial statement. Firm size sebagai variabel moderasi semakin memperkuat hubungan antara kepemilikan asing, kepemilikan domestik, dan kepemilikan publik terhadap fraud financial statement.

JEL Classification: G3, G34

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INTRODUCTION

Fraud is an act to conduct personal interests committed by management, employees or third parties to obtain errors in financial report on the first time, fraut is an discorrect action that refers to violations of laws, regulations, internal policies and market expectations in ethical business conduct. Fraud in the financial statements is very dangerous because it can cause 1) damage the reliability, quality, materialan and integrity of the financial reporting process, 2) threaten tintegrity and objectivity of the audit profession, especially external auditors and internal auditors; 3) reduce the confidence of the capital market, on financial reliability, 4) the capital market becomes less efficient and 5) the impact of economic growth and national prosperity is reduced.

Go public companies basically formed for providingprosperity to shareholders. The hope that with the company providing prosperity to shareholders, potential investors will be interested in that company. Investors that interest in certain companies will be marked by investors that investing in the company. The bigger the company will involve different interests between the principle parties with management who have the desire to achieve prosperity of each company.

This desire will create asymmetric information between management in order to improve its earnings management to trick the capital owners about the economic performance of the company. Given these relationships leads to the assumption of agency goals and the objectives of different principles will create conflicts within the firm because managers tend to have personal goals that result in management focusing only on increasing short-term profits rather than optimizing the prosperity of the principle through developments in increasing long-term profits .

The role of corporate governance as a process of managing, directing and monitoring corporate business to create shareholder value while protecting the interests of the other stakeholders (creditor, supplier, government and community) (Rezaee & Riley, 2010; Habib & Jiang, 2015; Nisasmara & Musdholifah, 2016). Corporate Governance plays an important role in increasing efficiency capital markets through the efficiency and effectiveness of company operations, revenue growth, employees and the integrity and quality of financial statements. Corporate governance is needed to avoid concentration of power in the hands of management and to create effectivity and balanced system in balancing power-sharing authority between shareholders, directors, management and lower levels in other stakeholders.

However, some cases management party is unable to give hope to the principle so that the achievement of the desired party principle is not appropriate on the management side. From the performance that does not match expectations, automatically the information displayed in the financial statements will be a satisfaction. This will make the management to doanyting for the information provided by the principle as expected by way of cheating in manipulating the financial statements. The cause of fraud in financial report manipulation, due to low performance, the company has low liquidity, high debt. This will create pressure on the internal company that makes the management have a lot of work to get a good performance.

From the performance measurement conducted by the company, the pattern of ownership structure becomes an important role in shaping the performance of the company. This ownership structure consists of foreign ownership, domestic ownership and public ownership. The ownership structure is in institutional ownership. This ownership can be trusted in reducing conflicts arising between the owner and management due to being able to controlsupervising, controlling or monitoring the management. Large institutional ownership will provide a larger monitor to institutional investors, thereby preventing the occurrence of actions that provide management opportunities in conducting an enterprise fraud.

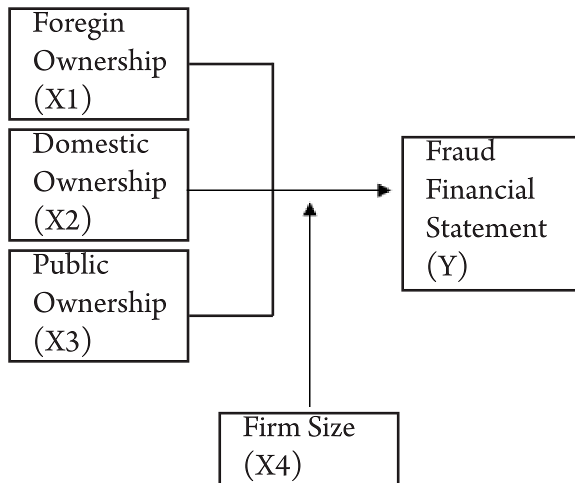

Figure 1. Model Moderated Analysis Fraud Financial Statement.

Hypothesis Development

Foreign Ownership is the proportion of shares owned by foreign companies in foreign shareholders. A company that owns foreign ownership shares shows that the company is capable of expanding its business with a wider scope because the shares owned there interfere with foreign parties. Ownership of foreign investors residing in a company is more likely to have asymmetric information problems as it is usually hampered by language and geography (La Porta, 1999; Hoglund & Sundvik, 2016). Nevertheless, foreign ownership promotes a much better governance system and also strengthens internal systems in protecting outsiders, so as to provide a better corporate management system as foreign ownership will require management to transparently in the form of financial reporting so that supervision and control systems will be more effective so that will minimize the fraudulent acts of financial statements (Höglund & Sundvik, 2016). From the above explanation Hypothesis proposed as:

H1: Foreign Institutional Ownership Affects Disclosure of Financial Reporting Fraud.

Effect of Domestic Ownership on Fraud Financial Statement

Domestic ownership is a share ownership owned by institutions such as banks, insurance, etc. (Widarti, 2015). Great domestic ownership will have the ability to monitor management's behavior in managing the company. The greater the domestic ownership will be more effective in controlling all the actions that are opportunistic made by management. Controls will leading the management to be careful at low levels in using debt to anticipate financial distress and Financial risk and will minimize fraud in financial reporting (Crutchley, 1999; Dowdell, et al., 2014; Houcine, 2017). Domestic share ownership has a better ability to supervise management in managing the company.

H2: Domestic Institutional Ownership Affects Disclosure of Financial Reporting Fraud.

Effect of Public Ownership on Fraud Financial Statement

Public ownership is a percentage of shares owned by public investors. The existence of a public investor causes the manager or the company concerned to provide all information about the company to the public that can be trusted. Jensen and Meckling (1976) argued that public ownership would result in better management of the corporate system due to more corporate oversight of shareholders. The higher the percentage of public stock ownership of the company will press the management in the presentation of information on a regular basis and on time, because the accuracy will have an impact on economic decision-making (Houcine, 2017)

H3: Influential Public Institutional Ownership in Fraud Disclosure Financial Reporting.

Influence of firms size to Fraud Financial Statement

According to Ferry and Jones (1979). The size of a company describes the magnitude of a company associated with the amount of capital used, the assets owned and the level of total sales gained. Large companies tend to have a high demand for public information when compared to a small companies. More detailed disclosure of the company to external parties would

endagered the company's smaller competition so that the disclosure of financial statements is not as great as large corporations (Suripto & Baridwan, 1999; Lupu, 2015). The greater the capital, more assets were used, the greatest impact in achieving the targets and the various interests of the company will provide the special pressure facing management. Shareholder will make a pressure to give big target. The presence of pressure provided will give management the disclosure of financial statements in a timely manner and affect the fraudulent actions in the financial statements.

H4: Firm size affects the disclosure of financial fraud reporting.

Effect of Moderation Firm Size between Ownership Structure Against Fraud Financial Statement

Previous research on ownership structure with fraud financial statement is still limited. even the ownership structure used to be limited to the disclosure or transparency of the quality of financial statements so that it needs further explanation with a strong analogy. While the concept formed with the model of moderation appears as a model that is still considered new to the fraud financial statement. The firm size moderation model connects the ownership structure with the fraud financial statement.

Empirically has not found the role of moderation with firm size (firm size) linking the ownership structure with fraud financial statements. In the form of this research study, firm size factors have a significant influence and moderate the relationship between ownership structure and fraud financial statements (Dowdell et al., 2014; Houcine, 2017). The size of the firm is an important factor related to the ownership structure because if the size of the firm is bigger, more information for investors in relation to the investments were made.

The information provided relates to the company's position in the form of financial statements where the management will always meet investor expectations because the ownership structure will also have stronger control which will reduce the fraud level in the financial statements. That means the assets spent in the management of the company on the management will be considered in detail in the transparency of asset use by shareholders by controlling and controlling the company that will have an impact on the fraud of the financial report. The more use of the company's assets the shareholders will exercise strict supervision and control. In such circumstances will minimize the fraudulent acts of financial statements. In the above explanation the Hypothesis leads to:

H5: Firm Size Minimizes the Influence of Ownership Structure With Fraud Financial Statement.

METHOD

This study aims to see the effect of ownership structure on fraud financial statements moderated with firm size. The data used is secondary means Data taken is made by the party concerned with other words the researchers only as users only. In the use of ownership structures include foreign ownership, domestic ownership and public ownership, the value depicted by percentage and Firm size using total assets owned by the company. The method of description is used to describe the data used in each of these research variables. Sampling technique with purposive sampling method is the sample taken based on a specific purpose. Data used in this research is financial report data published by Indonesia Stock Exchange with period 2011-2015. The sectors studied are Agriculture, Consumer Goods Industry, Miscellaneous Industry and Mining. The company population used 160 companies with 5 years so that the data used 800 companies.

Variables Measurement

The dependent variable is the variable that becomes the subject in the research or becomes the appointed litter. fraud financial statement determination using Beneish model with formula (Gaspersz, 2013; Zack, 2013):

M-score = 4.84 + 0.920 (DSR) + 0.528 (GMI) + 0.404 (AQI) + 0.892 (SGI) + 0.115 (DEPI) - 0.172 (SGAI) + 4.670 (TATA) - 0.327 (LEVI)

Indicator to declare non manipulator with manipulator on beneish model using M-score is if M-afternoon value more than -2.22 then can be grouped company manipulator and if M-score less than -2.22 then can be stated non-manipulator company.

Fraud indication using financial ratio analysis that has been presented in detail such as: Days Sales Receivable Index (DSRI) is a ratio showing the relationship between accounts receivable and sales that generate income from third parties. The formula used is:

$$DSRI = \frac{\frac{Receivable_t}{Sales_t}}{\frac{Receivable_{t-1}}{Sales_{t-1}}}$$

Gross Margin Index (GMI) is a ratio that describes the increase in after-tax earnings on each sale made by the company. The formula used is:

$$GMI = \frac{Gross\ Margin_t}{Gross\ Margin_{t-1}}$$

Asset Quality Index (AQI) is a change in the percentage of assets other than fixed assets and current assets that may indicate excessive capitalization expenditures. The formula used is:

$$AQI = \frac{\frac{[1 - (Fixed\ Asset_t + CA_t)]}{TA_t}}{\frac{[1 - (Fixe\ Asset_{t-1} + CA_{t-1})]}{TA_{t-1}}}$$

Sales Grow Index (SGI) is a ratio that describes the level of company performance in maintaining growth. The formula used is:

$$SGI = \frac{Sales_t}{Sales_{t-1}}$$

Depreciation Index (DEPI) is a ratio that indicates the physical depreciation used in costs over a certain period. The formula used is:

$$Depreciation\ rate = \frac{depreciation}{depreciation + fixed\ asset}$$

Sales, General and Administrative Expanses Index (SGAI) is a Index that describes the level of comparison between sales with the cost of sales, general and administration produced greater or less. The formula used is:

$$SGAI = \frac{\frac{SGA_t}{Sales_t}}{\frac{SGA_{t-1}}{Sales_{t-1}}}$$

Accrual (Total Accrual to Total Assets (TATA)) is to show that any account created in the account can be viewed correctly without making it up or in a fictitious form meaning that the reports made are not real. The formula used is:

$$TATA = \frac{Net\ Income - Cash\ From\ Operation}{Total\ Aset}$$

Leverage Index (LEVI) is a leverage index created due to changes in financial obligations of a fixed nature that must be issued by the company (Syamsudin, 2009). The formula used is:

$$Levi = \frac{Laverage_t}{Laverage_{t-1}}$$

The research will reveal the Fraud Financial Statement (FFS). In FFS use terms based on Dummy variables:

Fraud: 1 if the company performs an indication of the manipulation of financial statements.

Non Fraud: 0 If the company does not perform any indication of financial statement manipulation

Independent variable is a formulation variable raised in this study include Foreign Ownership is shares owned by foreign parties within

the company. In the form used is the percentage of shares owned by foreign parties in a company. While Domestic Ownership is a shareholding of a company owned by an institution such as a bank, insurance, etc. and on a form used as an analysis with a percentage of domestic ownership in the company. In public ownership is a percentage of shares owned by public investors. Firm size as moderating variable, closely related to foreign ownership, domestic ownership and public ownership in the disclosure of fraud in the financial statements.

The method of analysis conducted in this research that is: 1) Moderated Regression Analysis Model (MRA Test), this model is a test that will show the independent variable will strengthen or weaken the dependent. This model uses SPSS 20 Software with logistic regression analysis test; 2)Logistic Regression Model, this model uses equations with maximum likelihood parameter estimates in the output display in the equation. Logistic regression can be expressed as follows (Ghozali, 2011); 3) Good of Fit Model the accuracy of regression testing can be forecasted in the actual value measured using the Good of fit.

RESULT AND DISCUSSION

The result of this research analysis shows that foreign ownership has significant negative effect to fraud financial statement which is proved by probability value that smaller than 0.05 or wald statistic value of 4.799 is greater than Chi Square 3.841. This indicates that a foreign party investing in a company will provide the ability to control the company. Foreign parties related to the protection of share management and financial reporting require foreign investors to encourage the management to be more transparent in disclosing the results of the company's financial statements (Table 1).

This corporate governance mechanism as a function to convince foreigners will be given a profit on the capital investment provided to the company or managers assure that the funds invested will not be embezzled or will not be used on projects that are unfavorable to foreigners as well as how much to control managers (Shleifer & Vishny, 1997; Liu, 2015; Hodgdon & Hughes, 2016)

Table 1. Logistic Regression Test Results After Interaction/ moderated firm size

Variable	ß	Wald	Sig.
Foreign Ownership	-38.591	4.799	0.0285
Domestic Ownership	-38.672	4.817	0.0282
Public Ownership	-38.704	4.825	0.0280
Company Size	0.000134	3.868	0.0492
FO*CS	0.000001341	3.850	0.0497
DO*CS	0.000001357	3.914	0.0479
PO*CS	0.000001348	3.886	0.0486
Intercept		3869.570	
R Square Negelkerke		0.404	

FO*CS = Represents Company Size Moderate Foreign Ownership Statement Against Financial Fraud

DO*CS= Represents Owners Moderating Company Size Financial Statement Fraud Against Domestic

PO*CS = Represents Company Size Moderating Public Ownership Statement Against Financial Fraud

An addition to applying corporate mechanisms, foreigners will be able to use qualified auditors to assess the reliability of the company's financial management reporting. So it will lower the fraud financial statement.

The result of this research analysis shows that domestic ownership has significant negative effect to fraud financial statement which is proved by probability value that smaller than 0.05 or wald statistic value of 4.817 is greater than Chi Square 3.841. Ownership of domestic institutions is the largest shareholder in the company so it becomes one of the means in monitoring management. Increase in domestic ownership percentage will result in management performance can be monitored optimally. With supervision conducted, the management will avoid actions that could harm shareholders.

Efforts undertaken in the supervision will be more effective, because it can control the actions that are opportunistic to be done by management. According to Jensen and Meckling (1976) also in the ownership of shares owned by insiders will provide motivation in optimizing the performance of the company so that a manager will act carefully in managing the company because it will have its own consequences. So this will have an impact on the decrease in fraud financial statements (Table 1).

The result of this research analysis shows that domestic ownership has significant negative effect to fraud financial statement which is proved by factor (e-38,704) t sig value. 0.0280 is smaller than 0.05 or wald statistic value 4.825 is greater than Chi Square 3.841. That means, the greater the public ownership of the company then the power in controlling the activities of the company from outside will be stronger so that will reduce the action fraud financial statement. Public ownership has a great power in the company. The power built in influencing companies with mass media. Public ownership is considered to represent the public voice in the form of criticism of thecompany performance (Table 1).

When the criticism built by society is not good then it will have a bad impact with the company so that investor confidence will decrease with the criticism. Jensen and Meckling (1976) argued that public ownership would result in better management of the corporate system due to more corporate oversight of shareholders. Higher public ownership structures will put pressure on management to provide complete and transparent information in a timely manner so that financial reporting will affect the decisions taken. So with the pressure and through the criticism done will reduce the action fraud financial statement

The result of this research analysis shows that firm size has significant positive influence to fraud financial statement which is proved by probability value that smaller than or wald statistic value 3.868 bigger than Chi Square 3.841. This means that the high usage of firm size firm will have a big effect on fraud financial statement. Large companies will have great pressure so that the pressure factor becomes the most powerful in doing fraudulent actions such as the level of profit, target and business prospects of the company in the future and so forth (Chen et al., 2006; Yang et al., 2015).

The nature of investors in Indonesia, tends to capital gains and speculative make the desired corporate target too high. In the achievement of the target that is too high not achieved the results then the management or managers of the company will perform various ways of fraud in meeting the target or profit desired investors. Moses (1997) states that companies with a large level are more likely to have a boost in equity earnings by way of profit management compared with companies at a small level. Moreover, the state of existing companies in Indonesia like this, the size of the company's assets/ size can not be a benchmark in producing a good company performance.

Due to the size of the company has the ability to perform fraud financial statements. It may have a large asset but instead, the resultof the profit was decreased. With the losses gained and the target investor is too high then the manager or the management will do various ways of fraud to close, so that the target or profit generated remain high, one of them by doing fraud in manipulating the financial statements (Table 1).

The result of this research analysis shows that firm size to moderate foreign ownership to fraud financial statements has significant positive effect which is proved by probability value that smaller than or wald statistic value 3.850 is greater than Chi Square 3.841. This means that the larger firm size of a company will further encourage the information provided from the management to foreign investors will increasingly be asymmetry (Yang et al., 2015).. With the firm size is getting bigger then foreign investors may be unable to control the overall firm size of the company. The inability to control firm size of a large company will provide opportunistic behavior for the management to commit acts of cheating in manipulating financial statements (Chen

et al., 2006; Yang et al., 2017). A large organizational state will create a fraud. So, the control of foreign investor will decreased because the big firm size have ability to perform fraud financial statement (Table 1).

The result of this research analysis shows that firm size moderate domestic ownership to fraud financial statement have significant positive influence which is proved by probability value that smaller than or wald statistic value of 3.914 is greater than Chi Square 3.841. This shows that the larger Firm Size owned by the company will increasingly give the ability of domestic investors to control or manage the company in detail. The greater the assets owned, the domestic investors in the management of the longer line of staff of the company's operational activities (Chen et al,, 2006). This means that the longer operational chain activities will provide an enormous opportunity in fraud financial statements. So that large firm size has the ability to perform follow fraud financial statements.

The result of this research analysis shows that firm size moderate public ownership to fraud financial statement have significant positive influence which is proved by probability value that smaller than or wald statistic value 3.886 is greater than Chi Square 3.841. The larger the firm size of the firm the public investor will give more press in giving the information to the public in full and detail. Because public investors do not control, supervise and manage the company directly then in providing information about the company, opportunistic behavior can be done by the management in order to convince public investors that the company in good condition from the side of the company's operational activities and income from the firm size used.

It means that a large firm size company is required to provide complete information to public investors. The information provided by the company to the public can not be examined for the truth of the management to conduct fraud financial statement or not by public investors because public investors do not participate in controlling, supervising and managing directly so it is a big possible in order to meet the company's good information for the public, will perform a fraud financial statement. In other words, Firm Size has the ability to perform fraud financial statements (Table 1).

CONCLUSION AND RECOMMENDATION

Foreign Ownership has a significant negative effect in detecting or disclosing fraudulent financial statements. Domestic Ownership has a significant negative influence in detecting or disclosing fraudulent financial statements. Public Ownership has a significant negative effect in detecting or disclosing fraudulent financial statements. Firm Size has a positive and significant influence in detecting or disclosing fraudulent financial statements. In the ownership structure consisting of foreign, domestic and public ownership of the fraud financial statement reacted or moderated firm size further strengthens the fraud financial statement. Future research can add to the factors affecting fraud financial statements such as internal factors of the company (Cressey, 1950).

Internal factors of the company in the form of cheating motives are pressure, opportunity and rationalization.The management should consider the three ownership structures. when the management manages the operational activities of the company to perform actions that will harm the company will be quickly visible and responded by stakeholders. efforts to supervise company operations need to be improved.the investor is expected to pay more attention to the operasional activities, either from the income or expenditure made by the company by the management. supervision done regularly able to minimize the level of fraud financial statements generated by the management so that there will be no loss of the company made by the management itself.

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