

The Effect of Internal Financial Indicators on the Tendency of Accounting Fraud (A Case of Companies Listed in Indonesia Stock Exchange)

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Abstract

This research is carried out to prove factors of tendency of accounting fraud in companies empirically. Variable used in predicting the tendency of accounting fraud is profitability level, capital turnover, financial leverage, assets composition, and firm size tendency of accounting fraud. The population is companies registered in Indonesia Stock Exchange that are suspected to fraud the accounting during observation year 2013 – 2015. Samples are taken by using purposive sampling, there are 12 companies are proven to be done fraud accounting and 12 companies are not. Data is analysed by using logistic regression analysis and Hosmer and Lemeshow test to measure the model. The result shows that capital turnover and assets composition has significant influence on tendency of accounting fraud. Besides, profitability, financial leverage, and firm size has insignificant influence on tendency of accounting fraud variable. This research concluded that capital turnover and assets composition can be used as predictor of tendency of accounting fraud in a company.

Keywords: Accounting Fraud; Profitability; Capital Turnover; Composition of Assets; Financial Leverage; Firm Size

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INTRODUCTION

The most common case of accounting fraud is the fraudulent case of financial statements which can mislead various parties, such as investors, government, banks and other financial institution and other stakeholders. Data from the Association of Certified Fraud Examiner (ACFE) shows that there are 1,483 cases of occupational fraud. The report indicated that the financial statement fraud has the lowest in frequency, but has the highest average loss rate. The accounting fraud is a result of lacking in management accountability that increases the cost of oversight of management for shareholders. When agents and principals seek to maximize their own utility, and have different desires and motivations, the agent does not always act as requested by the principals and will act against the shareholders, therefore they will tend to commit accounting fraud (Hayati, 2013). Profitability describes the ability of the company to earn profits through all

the capabilities and existing sources such as sales activities, cash, capital, number of employees, number of branches, and so forth (Harahap, 2006). Summers & Sweeney (1998) and Persons (1995), states that firms with low profits are also contributing to management in the disclosure of over-the-counter revenues or under-expense. The result of Persons (1995) study stated that profitability has a significant effect on the tendency of accounting fraud. This is contrary to the results research of Ansar (2012) and Dalnial, Kamaluddin, Sanusi, & Khairuddin (2014) which states that profitability has no effect on the tendency of accounting fraud. Capital Turnover describes the level of sales ability compared to company assets. In addition, capital turnover also measures the ability of management in the face of business competition. The results of Souselisa & Mukhlisin (2008), which found empirical evidence that variable turnover significantly affects fraudulent financial reporting. And also in line with the results of research from Persons (1995), Ansar (2012), and (Dalnial et al., 2014). However, contrary to the results of Nia (2015); Persons (1995) which states capital turnover has no effect on the tendency of accounting fraud.

Jones & Hilbers (2004) dan Souselisa & Mukhlisin (2008) stated that companies with high levels of financial leverage no longer use loans as a source of funds and will switch to equity financing. Therefore, the company must have good performance and high profits to attract potential investors. This will create profit manipulation. Persons (1995) stated that financial leverage has a positive effect on the tendency of accounting fraud. However, this is contrary to research conducted by Nia (2015) dan Souselisa & Mukhlisin, (2008) which states that financial leverage does not affect the tendency of accounting fraud. The Composition of Assets includes current assets divided by total assets (CATA), receivables divided by total assets (RVTA), and inventory divided by total assets (IVTA). Inventories and receivables are easier to manipulate e.g. by presenting fictitious receivables and increasing inventory (Nia, 2015). Jones & Hilbers (2004) dan Souselisa & Mukhlisin (2008) stated that the Composition of Assets has a positive effect on the tendency of accounting fraud. Firdaus & Suryandari (2016) mentioned that large companies tend to find it easier to obtain loans from third parties, because of their ability to access other parties or the assurance they have in the form of assets of greater value than small companies. Such a situation will affect small companies to commit accounting fraud in order to obtain funding. Small firms are typically unknown to the public, therefore the opportunity for more open accounting fraud (Milyutina, 2013). This study will focus on variables of internal financial factors which have not been done in previous researches. Therefore, this research will further examine the effect of Corporate Internal Financial Factors on the Tendency of Accounting Fraud of Companies Listed in Indonesia Stock Exchange (IDX).”

This research further examines the corporate internal factors namely profitability, financial leverage, composition of assets, and company size significantly affect the corporate tendency of accounting fraud. This study will empirically answer the research question on the significance of internal financial factors of the company affect the tendency of accounting fraud. This study can be useful for users such as investors, bankers, and others to know what to focus when examining the tendency and the possibility of accounting fraud in companies' financial statement.

Jensen & Meckling (1976) define agency theory as a contract in which one or more principals involve management (agent) to perform some services on their behalf. Management is a party contracted by shareholders to work for the benefit of shareholders and agents will always act best for shareholders' interests. The different interests between agent and principal cause the conflict. This conflict is triggered by the asymmetry of information between the two parties. Agents as internal parties of course have more information when compared with the principal because everything associated with the company becomes the responsibility of the agent because the agent's performance determines the future of a company. This is what agents use to hide information for the principal. Information that managers do not need to be known by the principal can easily be hidden for particular purposes. In addition, the high compensation expected by an agent could make them to perform various ways to get this compensation which can cause a manager to cheat. Therefore, the lack of information gained by the principal on the

performance of agents leads to an imbalance of information between the two. This is the gap of agents to commit fraud (Ndofor, Wesley, & Priem, 2015; Rachmawati & Marsono, 2014).

According to ISA 240, fraud – an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage (Tuanakotta, 2010). Based on Belkaoui, Yulianto, & Dermauli (2006) describes the definition of fraud as follows: “Fraud is a generic term, and summarizes the full range of ways that human intelligence can be created by someone to benefit from others through false representation. There are no definite rules and no variables can be expressed as general statements in defining cheats, because they include shocks, tricks, cunning, and dishonest methods used to deceive others, the only limits that define are Things that limit human dishonesty”.

The fundamental theory in this research is fraud triangle theory. Fraud triangle which is the result of research and thought of Cressey (1953) that stated three factors in the fraud triangle yakni pressure, opportunity, and rationalization. According to Tuanakotta (2010), the pressure or incentive perceived by the perpetrator of fraud viewed as a non-shareable financial need or non-shareable problems. According to Kapardis & Krambia-Kapardis, (2016); Milyutina, (2013); Sitorus & Scott, (2009), pressure usually arises from a critical need or greed in a person who commits fraud. Sometimes it is more related to psychological satisfaction, which proves that one can beat the system. Cressey (1953) argues that there are two components of the perception of opportunity. The first is that general information which is the knowledge that positions containing trust can be violated without consequences. This knowledge is derived from what he hears or sees. Second, technical skills or skills required to carry out the crime. This is usually the skill or skill that the person possesses and causes him to gain a position (Tuanakotta, 2010). Rationalization is a “whispered” justification against the conscience of the perpetrator of fraud (Anand, Ashforth, Joshi, & Martini, 2004; Boyle, Boyle, & Mahoney, 2015). Rationalization or justification is done before committing a crime, not after. Seeking justification is actually a necessary part of the crime itself, even part of the motivation to commit a crime. Rationalization is necessary so that the offender can digest his unlawful behaviour in order to maintain himself as a trusted person (Tuanakotta, 2010).

The tendency of accounting fraud can be interpreted as an inclined, encouraged, partial stance toward intentional, deliberate actions to benefit outside or within the organization (Wilopo, 2006). The accounting fraud itself is a desire to do everything to profit by dishonest means such as covering the truth, fraud, manipulation, cunning or fooling that can be misstatements of financial statements, misuse of assets, and corruption (Anand et al., 2004; Lei, 2009).

Profitability is the company’s ability to earn profit in relationship with sales, total assets and own capital. Profitability is the result of various policies and management decisions. Profitability is used to measure the effectiveness of management as a whole as shown by the size of the profits obtained in relation to sales or investment. Profitability ratios will illustrate the level of effectiveness of corporate management (Jayawardhana, 2016; Schönbohm, 2013). Summers & Sweeney (1998) stated that if expectations to maintain or improve past profitability levels cannot be met by actual performance that will provide motivation for fraud violations of reporting. Therefore, the first hypothesis is as follows:

H1: profitability affects the tendency of accounting fraud.

According to Agha, (2014); Shivakumar & Thimmaiah (2016); Willy (2016), capital turnover is one of the ratios to measure or assess the effectiveness of working capital during a specified period. This means how much working capital spins over a period or in a period. According Persons (1995), capital turnover also measures the ability of management in the face of business competition. Managers of cheating companies are usually less competitive than corporate managers who do not commit fraud in utilizing company assets to generate revenue. The inability of a company to compete can provide an initiative for the manager to commit fraudulent financial reporting. Therefore, the second hypothesis is as follows:

H2: capital turnover affects the tendency of accounting fraud

Financial leverage is the use of funds with fixed expenses in the hope that it will provide an additional benefit greater than the fixed expense so that it will increase the profit available to shareholders. In fact, companies find it difficult to achieve optimal capital structure in an appropriate spending composition, even when setting a range for optimal capital structure is very difficult. Therefore, most companies only pay attention to whether the company is using too much debt or not. The use of such debt will create financial leverage that encourages the risk of ordinary shares and encourages shareholders to demand a higher rate of return. The level of leverage is one of the factors that influence fraud tendency (Noor, Sanusia, Heang, Iskandar, & Isa, 2015; Velikonja, 2010). Therefore, the company must have good performance and high profits to attract potential investors. This will create the motivation to earn profit manipulation. The third hypothesis is as follows:

H3: financial leverage affects the tendency of accounting fraud

The composition of the asset, in this case, includes current assets and the stock will be related to the tendency of accounting fraud. The Composition of Assets is a representation of the stock and receivable composition contained in total assets. According to Schönbohm (2013), the composition of assets measures the company's ability to meet its obligations by not taking into account the stock, since the inventory takes a relatively long time to be realized into cash, although the fact may be more liquid than receivables. Persons (1995) states that changes in the composition of the company's assets at year t in material quantities will give rise to auditors' demands on year $t + 1$. Therefore, the fourth hypothesis is as follows:

H4: Composition of assets affects the tendency of accounting fraud

Firm size is the level of identification of small or large company. According to Mutia, Zuraida, & Andriani (2011) firm size is an improvement from the fact that large companies will have large market capitalization, large book value and high profits. According to Dang & Li (2015), the size of the company seen from the value of equity, sales value or asset value. The size of the company can affect the ease of the company in obtaining the source of funding both external and internal. Large companies tend to find it easier to obtain loans from third parties, because of their ability to access other parties or the assurance they have in the form of assets greater than small companies. Such a situation will affect small companies to commit accounting fraud to raise funds. Small companies are usually not known to the public, therefore the opportunity to commit accounting fraud is greater. The last hypothesis of this research is:

H5: firm size influences the tendency of accounting fraud

METHOD

The purpose of this study is to determine the effect of profitability, capital turnover, financial leverage, asset composition, and firm size against the tendency of accounting fraud. This study uses secondary data in the form of annual reports of companies listed on the Indonesia Stock Exchange (BEI) in 2013-2015. The data required in this study was obtained from the official website of Indonesia Stock Exchange (BEI) i.e. www.idx.co.id. Companies that has tendency of accounting fraud are list of companies subjected to sanctions by the Financial Services Authority for violations of Rule VIII.G.7 regarding the presentation and disclosure of financial statements of issuers or public companies in 2013-2015. The proxy used for the variables in this study is shown in Table 1.

Table 1. Proxy of Variables

Variable	Measurement Tool
Tendency of accounting fraud	Dummy
Profitability	Return on Asset (ROA)

Capital Turnover	Sales/Total Asset (SATA)
Financial Leverage	Total Liability/Total Asset (TLTA)
Asset Composition	Receivable/Total Asset (RVTA)
Firm Size	Natural logarithm of total book value of assets

Regression used is logistic regression. Logistic regression (logit) is chosen because the data in this study are nominal data and ratio data of both dependent and independent variables. Otherwise, logit is chosen because the dependent variable is in a form of dummy variables. The following is a logistic regression equation in this study:

$$\ln \left(\frac{\text{Fraud}}{1-\text{fraud}} \right) = \alpha + \beta_1 \text{ROA} + \beta_2 \text{SATA} + \beta_3 \text{TLTA} + \beta_4 \text{RVTA} + \beta_5 \text{SIZE} + e$$

Hypothesis testing in this research applies logistic regression analysis. A multicollinearity test is done beforehand to find out if there is strong correlation between independent variables. The goodness of fit test is done to test whether the model used is suitable for research. Logistic regression tests do not require assumptions of normality, homoscedasticity, and have few strict assumptions. The data obtained through requesting data into the Otoritas Jasa Keuangan (OJK) directly by visited the Learning Centre Division of OJK then forwarded into Directorate of Public Relations and Directorate of Sanction and Objection of Capital Market OJK. Total companies that conduct fraud based on OJK data are 19 companies. After purposive sampling, the samples used for this research were 12 fraud companies and 12 comparator companies (non-fraud).

RESULT AND DISCUSSION

This research about the tendency of accounting fraud uses logistic regression model, because the dependent variable using dummy variable 0 for non-fraud and 1 for fraud companies sanctioned by OJK. In the logistic regression model required a test that serves to test whether the model used is suitable for research. According Ghazali (2013), the test of goodness of fit can be done by Hosmer and Lemeshow test.

Table 2. Hosmer and Lemeshow Test

H-L Statistic	7.1254	Prob. Chi-Sq(8)	0.5232
Andrews Statistic	26.4814	Prob. Chi-Sq(10)	0.0031

In Table 2, it can be seen that the Chi-square value of the model is 7.1254 with significance of 0.5232. From the Eviews output, we can see that the probability of Chi-Square for H-L Statistic is 0.5232 where the probability is greater than 0.05 which means H0 hypothesis is unable to be rejected. So it can be concluded that the model used for this research is fit or acceptable.

The coefficient determination test is done to measure how far the ability of the model in explaining variation of the dependent variable or in other words measure how far the ability of independent variables to explain the dependent variable. In the regression equation model LOGIT, will be used coefficient of determination named Pseudo R Square. In this research used Eviews application for data processing, so Pseudo R Square provided by application that is McFadden R-Square.

Table 3. Coefficient Determination

McFadden R-squared	0.151784	Mean dependent var	0.166667
S.D. dependent var	0.375293	S.E. of regression	0.355561
Akaike info criterion	0.931013	Sum squared resid	8.343980
Schwarz criterion	1.120735	Log likelihood	-27.51647
Hannan-Quinn criter.	1.006542	Deviance	55.03295
Restr. Deviance	64.88081	Restr. log likelihood	-32.44041
LR statistic	9.847868	Avg. log likelihood	-0.382173
Prob(LR statistic)	0.079662		

Based on the test results presented in Table 3, obtained the value of McFadden R-Squared this study is 0.151784 or 15.17%. This shows that the internal financial factors i.e. profitability, capital turnover financial leverage, asset composition, and company size can explain the dependent variable of research by 15%, and the rest of 85% may be explained by other variables that are not discussed in this research. The percentage coefficient of determination is small because the authors only consider the internal side of corporate financial factors, so the existence of external financial factors that can affect the tendency of accounting fraud.

Discussion

The tendency of accounting fraud will be considered by users e.g. the investors to assess the condition of the company and to decide whether to invest or not. From the results of logistic regression testing in table 4, it is found that the variable capital turnover and Composition of Assets significantly affect the tendency of accounting fraud. Meanwhile, the variables of profitability, financial leverage, and firm size do not affect the tendency of accounting fraud.

Table 4. Logistic Regression Test

Variable	Coefficient	Std. Error	z-Statistic	Prob.
ROA	-2.143256	3.085773	-0.694560	0.4873
SATA	-1.574419	0.771406	-2.040974	0.0413
FL	3.514237	1.883766	1.865537	0.0621
RVTA	5.801670	2.792618	2.077502	0.0378
SIZE	0.395873	0.244974	1.615981	0.1061
C	-14.44319	7.280348	-1.983860	0.0473

The profitability variable result shows that there is no influence to the tendency of accounting fraud. The results can be seen from the probability value of 0.4873 or above 0.05 which indicates that H_0 is accepted. The results of this study are in accordance with researches conducted by Persons (1995) and Dalnial et al. (2014) where they find profitability projected by ROA has no significant effect on the tendency of accounting fraud. However, this study is not in line with a research conducted Ansar (2012) which states that profitability affects the tendency of accounting fraud. The research data show the most of companies, both fraud and non-fraud companies, experienced losses during years of observation. The number of samples that experienced losses in this study about 20.8% of the total sample. The data also shows that companies with positive income such EMDE has a profitability level of 0.04 in 2013, 0.04 in 2014, and 0.05 in 2015 was a company that was sanctioned by OJK for fraud in 2014. Moreover, SIAP, a sample company that experienced negative income respectively in 3 years observation also received sanction form OJK in 2015. Therefore, in the case of Indonesia, profitability is not a factor that will affect companies

to exercise an accounting fraud.

The capital turnover variable measured by the sales turnover ratio shows the variable probability of $0.0413 < 0.05$ significance level. It can be concluded that capital turnover is significantly affect the tendency of accounting fraud. Therefore, in this case, H_0 is rejected and H_2 is accepted. This research result is not in line with a research conducted by Firdaus (2008) which states that capital turnover does not affect the tendency of accounting fraud. However, the results of this study support researches conducted by Ansar (2012), Persons (1995), Dalnial et al. (2014); dan Soselisa dan Mukhlisin (2008) that capital turnover has a significant effect on the tendency of accounting fraud. The majority of capital turnover numbers have increased continuously during the year of observation. The increase in the number is because of the increase of the company's revenue. Such increase in the company's financial performance will then reducing the likelihood of a fraudulent accounting fraud undertaken by the company. The result shows negative coefficient which mean that the higher the rate of capital turnover the lower the tendency of accounting fraud becomes. As shown in the research data e.g. RDTX which has capital turnover rate of 0.27 in 2013, 0.26 in 2014, 0.23 in 2015 and involved in accounting fraud tendencies in 2015. Moreover, TBMS which has a capital turnover of 3.45 in 2013, 3.47 in 2014, and 3.95 in 2015 was involved in fraud accounting tendencies in 2013. Both companies experienced a tendency of accounting fraud on their low capital turnover figures. Therefore, it can be concluded that the capital turnover negatively affects the tendency of accounting fraud.

The financial leverage variable is measured by total liabilities divided by total assets. The results of the research on the variable financial leverage show that financial leverage does not affect the tendency of accounting fraud. The result can be seen from the probability value of 0.0621 whose value is above the 0.05 significance level, so the result of the H_0 is accepted. The result is consistent with those of Soselisa & Mukhlisin (2008), and Ansar (2012) that financial leverage has no effect on the tendency of accounting fraud. Firdaus & Suryandari (2016) states that financial leverage does not affect the tendency of accounting fraud because many companies transfer their capital to equity financing resulting in a decrease in the amount of capital from operating activities causing the low financial leverage of the company. However, this result is in contrary with studies conducted by Persons (1995) and Dalnial et al. (2014). The research sample data shows that the financial leverage in fraud or non-fraud companies tend to decrease during the year of observation, especially in 2014. The decrease in financial leverage can be caused by companies that transfer their capital to equity financing. Therefore, higher financial leverage does not mean the company is in an unhealthy state which does not affect companies to have a tendency of exercising accounting fraud. The results of this study explain that management is not entirely under pressure when fulfilling its obligations. They have an obligation to pay their debt, but profit manipulation is not the only solution to meet its obligations. Companies will have to improve its performance to generate good profits to meet its obligations.

The Composition of Assets variable is measured by the receivable turnover ratio with a score of 0.0378 below the 0.05 significance level. It can be concluded that the Composition of Assets affects the company's tendency of accounting fraud. This result conflicts with research results of Firdaus & Suryandari (2016), which states that the composition of assets does not affect the tendency of accounting fraud. These different results may due to different samples and time period of these researches. While Firdaus & Suryandari (2016) using all companies listed in Indonesia Stock Exchange (BEI) in the year of 2002-2007. However, the results of this study support research conducted by Persons (1995), Dalnial et al., (2014); Soselisa & Mukhlisin, (2008) that the Composition of Assets significantly affects the tendency of accounting fraud. The sample data shows that the company's receivables tend to be increasing during the years of observation. This increase has resulted in high asset compositions indicating that there is a possibility for companies to engage in fraudulent accounting trends by presenting fictitious accounts. According to Feroz, Park, & Pastena, (1991) 75% of companies commit accounting fraud by overstatement of accounts receivable and inventory. Based on this research the positive coefficient of 5.816, a

higher the receivable turnover leads to a higher possibility to do the tendency of accounting fraud.

Firm size variables use natural logarithmic proxies of total asset book value. The results of research on firm size variables show that there is no effect of firm size on the tendency of accounting fraud with a P value of 1,061 > 0.05 significance level. Therefore, Ho is accepted. This research is not in line with the results of researches conducted by Soselisa & Mukhlisin, (2008), Persons (1995), and Firdaus & Suryandari (2016) where they stated that firm size affects the tendency of accounting fraud. Firdaus & Suryandari (2016) states that small-scale companies have a negative influence on the tendency of accounting fraud to be accepted because small firms are typically unknown to the public, therefore the opportunities for accounting fraud are more open. However, these results support research conducted by (Ansar, 2012) that firm size has no significant effect on the tendency of accounting fraud. Based on results in this study, the total value of assets owned by fraud companies and non-fraud companies tend to be the same. This research data shows that fraud companies in the sample are varied in size. The higher of the firm size in this case does necessarily caused management to have the tendency of accounting fraud.

CONCLUSION

The findings in this study prove that the capital turnover and Composition of Assets are the internal financial factors that significantly influence the tendency of accounting fraud. While other internal financial factors i.e. profitability, financial leverage, and firm size have no significant effect on the tendency of accounting fraud. This research conducted only observation for 3 years, which is 2013 - 2015. For further research it is suggested to increase the observation years of research longer between 5 or 10 years in order to increase the number of research samples. This study only examines five independent variables related to internal corporate finance allegedly having an influence on the tendency of accounting fraud. For further research can examine other variables related to the internal aspects of corporate finance, such as asset turnover and liquidity. In this study, the authors use only independent variables in terms of internal corporate finance. So the next research is expected to be able to examine in terms of external finance companies that have relationships related to the tendency of accounting fraud, such as audit opinions and transactions with privileged parties.

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