

# A STUDY OF FINANCIAL STABILITY, NATURE OF INDUSTRY AND RATIONALIZATION IN EARNING MANAGEMENT IN PERSPECTIVE OF THE TRIANGLE

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## *Abstract*

*This study aims to detect fraudulent financial statements based on fraud triangle analysis. Financial statement fraud in this study is proxied with earning management. The population of this study are property and real estate companies listed in Indonesia Stock Exchange Period 2010-2016. The sample selection was done by purposive sampling method and the research sample was 77 samples of the company. Hypothesis testing using multiple linear regression method. The result of this research stated that financial stability variable has significant value of 0,007 and nature of industry has significant value equal to 0,027 which states influence to financial statement fraud proxy with earning management, while rationalization variable has significant value equal to 0,176 which states that there is no influence to financial statement fraud.*

**Keywords:** *Fraud Triangle, Financial statement fraud dan Earning Management*

## **Introduction**

This fraud or fraud occurred in the British Telecom company in 2016. British Telecom company is a company engaged in the telecommunications services sector. This fraud was carried out by its public accountant, Price Waterhouse Coopers (PwC). Price Waterhouse Coopers (PwC) cheated by raising the company's income through fake contract extensions and invoices, as a result of fraud committed by British Telecom companies due to loss of income tax on profits that actually did not exist, so the company had to reduce GBP530 million and cut the cash flow projection for this year by GBP500 million to pay the hidden debt (not reported) (wartaekonomi, 2017)

ACFE said that most actors who commit financial report fraud are none other than management, because management is more aware of the conditions of the company, so that management can provide information on the performance of the company itself. According to Cressey (1953) cited by Skousen et al (2009) there are three conditions that are always present in acts of fraud such as pressure, opportunity and rationalization called fraud triangle. These three actions that influence the occurrence of fraud in various situations, so that in this study using this concept which was also introduced in the professional literature on SAS No.99

When the company publishes its financial statements at that time the company wants to describe its condition in good health without any shortcomings, even if the company is not stable even the company will show that the company is in a stable condition with

Such pressure can cause companies to cheat on financial statements that will mislead investors and users of financial statements. When the financial statements are found to be materially misstated, the information in the financial statements becomes invalid so that when making a decision the information analysis that will appear is not in accordance with the actual information. This has led researchers to take financial stability as the variable used in the study.

In a study conducted by Skousen et al. (2009) and M. Iqbal (2016) stated that the nature of industry has no effect on financial statement fraud, but also the research conducted by Summers and Sweeney (1998) and Mukhlis Eko (2017) which states that the nature of industry influences the financial statement fraud. This difference (GAP) causes researchers to explore the nature of industry as the variables used in the study.

According to Skousen et al. (2009) stated that rationalization is a fraud actor who feels that he is justifying his actions of cheating, based on innocent thinking, indifferent to the company, so that researchers are interested in taking rationalization as a variable used in the study.

According to Norbarani (2012), quoting from Rezaee (2002) states that financial statement fraud or financial statement fraud occurs when misstatements or earnings management are considered immaterial so that they can cause massive fraud and can produce financial reports that are misleading. the researcher added earnings management as dependent.

Development of a research model to detect financial report fraud was carried out by Cressey (1953), Turner et al. (2003), Lou and Wang (2009), Skousen et al. (2009), Molida (2011), Norbarani (2012), Kusumawardhani, P. (2013) and M. Iqbal (2016). The difference between this study and previous research lies in the differences in the variables used in the study. Researchers conducted by Molida (2011) and Kusumawardhani, P. (2013) using variables of financial stability, financial need and ineffective monitoring personnel. While this variable uses financial stability, nature of industry and rationalization.

Fraud or fraud is increasing year by year, almost 80 percent of fraud cases handled by the Corruption Eradication Commission (KPK) are from the Procurement sector of goods and services (kompas.com, 2017). In the property and real estate sector service companies are companies that are prone to fraud. According to Sudaryatmo who served as chairman of the Foundation. The Indonesian Consumer Institution said that many consumers report the legal cases of the property and real estate sector by consumers to the Indonesian Consumer Institution Foundation (Tribun Timur, 2015).

Research conducted by Dianne M. Roden in her research entitled *The Fraud Triangle AS a Predictor of Corporate Fraud* (2016) with Opportunity Variables variables, Pressure Variables, Rationalization Variables, Control Variables using Logistic Regression Analysis techniques stated that fraud occurs when managers and the director compresses the inventory choices and when the auditor changes.

Research by M. Iqbal and Murtanto in his research entitled *Analysis of the Influence of Fraud Triangle Factors Against Financial Financial Fraud on Property and Real Estate Companies that are on the IDX* (2016) with a variable Financial Stability, Personal Financial Need, External Pressure, Financial Target, Nature Of Industry, Effective Monitoring, Rationalization by using Multiple Regression analysis techniques concludes that Financial Stability (ACHANGE) and Rationalization (TACC) has an influence on financial statement fraud. Meanwhile, LEV, OSHIP, ROA, BILLING and BDOUT do not have a significant impact on financial statement fraud.

## Research methods

This study uses a quantitative method in the form of a fraud triangle analysis on earnings management. This quantitative method is right to use in this research is because in this study many use financial statements as indicators of research variables to complete research. The population in this study uses annual financial reports on Property and Real Estate Companies Registered on the Indonesia Stock Exchange for the period 2010-2016.

The technique used in sampling in the study "Study of Financial Stability, Nature of Industry and Rationalization in Earning Management in the Fraud Triangle Perspective. (Empirical Study on Property and Real Estate Companies Registered on the Indonesia Stock Exchange for the Period 2010-2016)", carried out by purposive sampling, namely sampling techniques taken according to criteria or categories and limits to be carried out by researchers in accordance with the research objectives. The sample size or criteria used in the study are as follows :

1. Property and Real Estate Companies Registered on the Indonesia Stock Exchange Period 2010-2016
2. The company presents a complete annual report on the company's website in succession during the observation period.

In this study researchers conducted research on property and real estate companies. The types of property and real estate companies that are in accordance with the research criteria are nineteen companies and companies that are not in accordance with the research criteria there are thirty companies.

The type of data used in this study is secondary data. Secondary data referred to by researchers is the company's annual financial statements. The data used in this study are data obtained from the Indonesia Stock Exchange (IDX) in 2010-2016

## Operational Variables Definition

### Dependent Variables (Y)

The dependent variable or variable in this study is earnings management. Earnings management in financial statement fraud, because often fraudulent materials or misleading financial statements. According to Dechow et al (1995) cited by Ujijantho and Pramuka (2007) states that earnings management can be measured by a Discretionary Accruals (DACC), which is calculated by eliminating between total accruals (TACC) and nondiscretionary accruals (NDACC).

### Independent Variable (X)

According to Sekaran (2009) states that the independent variable or independent variable is a variable that explains or influences the dependent variable. The independent variables used in this study are variables that are developed by components that are in the fraud triangle theory.

#### Financial stability (X<sub>1</sub>)

According to Skosen et al (2009) cited by Molida (2011) states that financial stability is a condition that describes that companies managed by management or directors are in a stable condition, so that the company will manipulate corporate profits if the company is in unstable condition. Financial stability that is proxied as asset change ratio (ACHANGE), can be calculated using the following formula:

$$\text{ACHANGE} = \frac{(\text{Total Assets } t - \text{Total Assets } t-1)}{\text{Total Assets } t}$$

#### Nature Of Industry (X<sub>2</sub>)

M. Iqbal (2016) which quotes from Loebbecke et al (1989) states that cheating in the sample of the research he does involves receivables as opportunities used by managers. Nature Of Industry can be measured and calculated by using receivable or accounts receivable. The formula for calculating receivable or receivables is:

$$\text{Receivable} = \left( \frac{\text{receivable } t - \text{receivable } t-1}{\text{sales } t - \text{sales } t-1} \right)$$

#### Rationalization (X<sub>3</sub>)

According to M. Iqbal (2016), quoting from Skosen et al (2009) states that rationalization is the main factor that is in fraud, because fraud perpetrators have a mindset to defend their own fraud. Rationalization can be measured using the TAAC ratio, using the following formula:

$$\text{TACC} = \frac{\text{Total Accrual } t}{\text{Total Assets } t}$$

### Data analysis method

In this study using SPSS Version 21 to predict the relationship between dependent and independent variables. The linear regression equation can be described as follows:  $\text{DACC}_i = \beta_0 + \beta_1\text{ACHANGE} + \beta_2\text{RECEIVABLE} + \beta_3\text{TACC} + \epsilon_i$

### Research Results and Discussion

Researchers in this study used the F test with the provisions if the significance value  $f < 0.05$ , then H<sub>0</sub> is rejected, meaning that there is a significant effect between all independent variables on dependent variable, and vice versa if the value of  $f > 0.05$ , then H<sub>0</sub> is accepted, meaning all variables independent does not affect the dependent variable. From the results of simultaneous regression test or F test shows that the significant number is less than 0.05 which means that there is an influence between all independent variables on the dependent variable. Uji Parameter individual (Uji Statistik t).

In this study the researcher used t statistical test which was used to determine the effect of individual variables in explaining the dependent variable. This t test is used to find the most dominant influence between each independent variable to explain the dependent variable with a significance level of 5% and 10%. From the results of the individual parameter test or t test, it is stated that the independent variables consisting of financial stability, nature of industry and rationalization have significant and insignificant values, including:

#### Impact Financial Stability with Earnings Management

Financial stability has a significant value of 0.007 which indicates an influence on earnings management. This states that the higher the level of instability of the company's condition, the company has a great potential to cheat on financial statements with earnings management proxy. These results are in accordance with the research examined by Prisca Kusumawardhani (2013) and Skousen et al (2009) that managers find pressure to commit financial report fraud because financial stability or financial stability is threatened by the state of the economy, industry and an operating entity. The reason for management doing fraud because the management often gets pressure from the owner of the company to be able to show that the company is in good health, the

company owner wants to show investors that the company he owns can manage assets well. Therefore management manipulates profits, so that the resulting profits will appear to be higher.

### **Impact Nature Of Industry with Earnings Management**

Nature of industry has a value of 0.027 which shows that it has an influence on earnings management. This states that an increase in the number of accounts receivable can lead to fraudulent financial statements, for example in the company Agung Podomoro Land Tbk and the Alam Sutera Realty Tbk Company which have an increase in their accounts receivable. This increase in the number of accounts receivable has caused the company to experience a lack of operational cash, when the company's operational cash reduction has encouraged management to commit fraud in the financial statements. The results of this study are in accordance with the research examined by Summers and Sweeney (1998) and Mukhlis Eko (2017). the increase of receivable is very influential with financial statement fraud. This large amount of accounts receivable causes a lack of operational cash in the company, so that management makes fraudulent financial statements or financial statement fraud.

### **Rationalization dengan Earnings Management**

Rationalization has a significant value of 0.176 which indicates that there is no influence on earnings management. This is because not all management or directors' attitudes easily find reasons for justifying fraudulent financial statements because they have high morals, so they do not dare to commit financial report fraud. This result is in accordance with research conducted by Laila Tiffani and Marfuah (2015).

In this study researchers used the Determinant Coefficient ( $R^2$ ) which aims to measure the ability of the model in explaining the independent variables. The relative value of determination is between zero and one. If the value obtained is small  $R^2$ , then the independent variable to explain the dependent variable is of limited value. If the value obtained by  $R^2$  approaches one then the independent variable provides the information needed to predict the dependent variable. From the results of the determination test ( $R^2$ ) shows the R Square value of 0.170, this can be explained that 17.0% of earnings management variables can be explained by the variables of financial stability, nature of industry and rationalization, while the rest can be explained by other factors that do not examined in this study.

### **Conclusions and recommendations**

Based on the results of this study, the following conclusions are obtained: the first is Financial stability influences earnings management, the results of this study are the same as the results of research conducted by Skousen et al (2009) and Prisca Kusumawardhani (2013). The second is Nature of industry has an effect on earning management the results of this study are the same as the results of research conducted by Summers and Sweeney (1998) and Mukhlis Eko (2017); the Third is Rationalization has no effect on earnings management, the results of this study are the same as the results of research conducted by Laila Tiffani and Marfuah (2015)

### **Recommendation**

Future research is supposed to present better research results with the input of further research is expected to increase the number of variables in the fraud triangle theory in order to predict earnings management.

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