

FRAUD TRIANGLE (PRESSURE, OPPORTUNITY, AND RATIONALIZATION) AND THE LEVEL OF ACCOUNTING IRREGULARITIES IN INDONESIA

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ABSTRACT

Purpose of this research is to find empirical evidence about impact of pressure, opportunity, and rationalization (fraud triangle) to the level of accounting irregularities in Indonesia. The samples are taken from non-financial company that was proven to violate BAPEPAM's rule during 2007-2013. It test all cases of BAPEPAM's rule violation for the first sample and only financial statement's violation cases for the second sample. Ordered logistic regression is used to test the hypothesis. This research found that probability of increasing level of accounting irregularities are affected by financial stability and financial target (pressure), nature of industry and ineffective monitoring (opportunity). The probability of increasing level of accounting irregularities are not affected by rationalization. This research found that investor should choose to invest in a company with good financial stability. Investors should be cautious when going to invest in companies that have high financial targets and ineffective internal controls.

Keywords: Fraud, Accounting Irregularities, Fraud Triangle, BAPEPAM Sanction

1. INTRODUCTION

Many financial scandals that occurred involve accounting irregularities, including the financial statements misleading. As an example, the case of Enron and WorldCom were present misleading financial statements to deceive investors. The case has sparked the approval of the Sarbanes-Oxley Act in the United States. However, this does not stop the occurrence of accounting irregularities. Other case that occurred after the Sarbanes-Oxley Act is Satyam case that occurred in India. There was manipulation of the financial statements of a fictitious bank balances amounting USD1.04 billion and earnings of 20% lower than reported earnings. Scandals mentioned above have many negative impacts and have hurt many people.

As a result of the magnitude of the negative impacts, a lot of research being done to find ways to prevent accounting irregularities occur. Smaili and Labelle (2009) conducted a study to find out how big the role of corporate governance to protect investors from accounting irregularities. They

discovered the probability of accounting irregularities will be reduced when the quality of corporate governance improved. Jaswadi et al. (2012) conducted a similar study in the context of the company in Indonesia. They also discovered the probability of accounting irregularities will be reduced when the quality of corporate governance improved.

In addition to finding ways to prevent accounting irregularities occur, a lot of research done to find the factors that can be used to detect the occurrence of accounting irregularities. Dechow, et al. (1996) sought to identify the causes of earnings manipulation. They found the desire to obtain cheap funding as the main motive companies to manipulate earnings. Beneish (1997) attempted to create a model to detect earnings management. He stated that the ratio of days sales in receivables, the ratio of total accruals to total assets, abnormal return, total positive accruals, cash sales decline and leverage useful for detecting violations of GAAP and aggressive accrual recognition. Skousen et al. (2009) try to detect and predict fraud in the financial statements with the Fraud Triangle and SAS 99 approach. He found that there is influence of financial stability, external pressure, personal needs of directors, ineffective monitoring system (control), and organizational structure of the presence or absence of fraud. Lou and Wang (2009) also use the Fraud Triangle approach to measure the likelihood of fraud in Taiwan. In that study, it was found that there is influence of the company's financial pressures, financial pressures commissioners, complex transactions, weak internal control environment, integrity management, and the relationship between the auditor and management of the presence or absence of fraud in the company of Taiwan.

One of the many studies that contribute to detecting fraud is a study conducted by Cressy (1953). He found three main factors that cause the occurrence of fraud that called Fraud Triangle. The first angle is perceived pressure or incentive fraud perpetrators are regarded as financial needs that cannot be told to others. The second angle is the opportunity to commit fraud perceived by actors (perceived opportunity). The last side is the rationalization that is be justification by actors in doing fraud.

Accounting irregularities actually is an error-fraud continuum (Jaswadi et al., 2012). On one side is a misstatement of accounting irregularities caused by negligence or error. On the other side is

known as a deliberate fraud and an unlawful act. However, previous studies only classify accounting irregularities in the presence or absence of accounting irregularities (Smaili and Labelle, 2009). This can be seen in a study conducted by Dechow, et al. (1996), Skousen et al. (2009), and Lou and Wang (2009). They do not classify companies based on the severity of the accounting irregularities that occurred, but only based on the presence or absence of fraud, which is only one side of the accounting irregularities. On the other hand, research of Smaili and Labelle (2009), which is also replicated by Jaswadi et al. (2012), simply connects accounting irregularities on the mechanisms of corporate governance (Board of Commissioners, Directors, Audit Committee and the External Auditor). They do not account other factors that might have an influence on the occurrence of accounting irregularities.

This study aims to address shortcomings in previous research. This study tried to find factors that can be used to prevent and detect accounting irregularities by using the Fraud Triangle approach. Accounting irregularities will be distinguished by its severity. Stages of this study will follow the stages of research conducted by Skousen et al. (2009) and Lou and Wang (2009) by using an ordered logistic regression method. Fraud Triangle will be proxied by each factors in previous studies and associated with the level of accounting irregularities.

2.PREVIOUS LITERATURE AND HYPHOTHESIS DEVELOPMENT

Stolowy and Breton (2004) states that there is no consensus regard the accounting irregularities. It can be seen from the many definitions of accounting irregularities that were noted. If we look at Oxford Dictionaries, 'irregularities' means something unusual shape or not in accordance with its original properties. So literally, accounting irregularities can be interpreted as accounting practices that is on unusual shape or not as it should be. Schneider (1995) states that the accounting irregularities were a misapplication of accounting principles that is generally accepted. General Accounting Office Report 2002 stated that the aggressive accounting practices, misuse of facts that apply to the financial statements either intentionally or unintentionally, omission or misinterpretation of accounting standards, and fraud fall into the category of accounting irregularities.

On the other hand, accounting irregularities often associated with fraud. Statement of Auditing Standards No. 53 defines the accounting irregularities as misstatements or deletions value or disclosures in the financial statements are intentional. SAS No. 53 was replaced by SAS No. 82 and replaced again by SAS No. 99. Both replace the word accounting irregularities into fraud. Hennes et. Al. (2008) defines the irregularities as a deliberate misstatement. This definition is similar to the definition of fraud in general. He also stated that the error is different with irregularities because errors are unintentional mistakes.

Explanation of many definitions of accounting irregularities may be seen from the description Jaswadi et al. (2012). He stated that in fact accounting irregularities is an error-fraud continuum. On the other side, accounting irregularities is a misstatement that caused by negligence or error. The other side is known as a deliberate fraud and an unlawful act. Therefore, many parties define accounting irregularities as fraud.

Association of Certified Fraud Examiners (ACFE) defines fraud as a whole act to deceive others for profit. Tuanakotta (2013) mentioned that one definition of fraud is all unlawful act characterized by deceit, concealment, and abuse of trust. This act does not depend on the existence or the physical threat of violence. Fraud committed by individuals or organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal gain or profit business. Meanwhile, SAS No. 99 defines fraud as an intentional act that results in a material misstatement in the financial statements. Of the three definitions, we can conclude that in the accounting context fraud is a material misstatement in the financial statements are intended to deceive others for profit either by individuals or organizations.

Fraud tree is a map of the type of fraud that was developed by the ACFE (1996). This map divides fraud into three. Corruption: According to the ACFE, corruption occurs when someone is abusing its influence in business transactions in a manner that violates the responsibility of the supervisor to benefit either directly or indirectly. Asset Misappropriation: stolen of assets occurs when someone steal or misuse the company resources. Financial Statement Fraud: Financial statement manipulation occurs when someone intentionally make material misstatements or omit material

information in the financial statements of the company. Examples are recorded fictitious revenue, reduce expenses reported, or inflate asset.

Fraud triangle is a concept proposed by Donald Cressey (1953) based on the findings of that research. Cressey interviewed 200 employees who are convicted of theft of money the company (embezzlers). He categorizes the conditions that allow fraud occurred: pressure, opportunities, and rationalization

Pressure and Accounting Irregularities

Cressey (1953) found one of the causes of fraud is pressure. Managers will commit fraud as a result of perceived stress. The pressure will be the reason for the manager when doing fraud. Pressure can come from both internal and external. SAS 99 states that the pressure can be derived from the company's financial stability that is threatened, external pressure as example from lenders, the influence of the company's performance against the wealth management, and difficulties of achieving financial targets. Effect of pressure on fraud evidenced by research that done by Persons (2006). He found that high profitability of the company will reduce the chances of the company to commit fraud. Profitability describes the company's financial stability. When the profitability is good, the company has a good financial stability so that managers' perceived pressure is lighter. Lighter pressure makes the probability of fraud shrink.

External pressure is also a cause of fraud. Dechow et al. (1996) find a company that does more earnings management requires external funding to remain competitive compared to companies that do not perform earnings management. When the rising of external financing needs for the company to remain competitive, managers will experience greater pressure. Greater pressure makes the probability of fraud increases.

Pressure can also be felt when the manager of the company's performance affects the wealth manager. An example is when the manager has significant shares. Skousen et al. (2009) found that managers are more likely to commit fraud if their holdings of company stock to rise. The greater their holdings, the greater the influence of the company's performance over their wealth. Managers will feel

greater stress when they have larger holdings. Greater pressure makes the probability of fraud increases.

In addition, the pressure can also be derived from their financial targets that are difficult to achieve. Summers and Sweeney (1996) found greater financial targets are proxied by return on assets the previous year, the higher the probability the company to commit fraud. When the financial target is greater, managers will experience greater pressure because the target is more difficult to achieve. Greater pressure makes the probability of fraud increases.

We can conclude that when the greater the pressure felt by the individual, the more likely someone is doing fraud. The amount of pressure will be greatly influenced by the magnitude of the perceived financial needs. This makes the greater fraud committed to cover the needs of large financial. Fraud is one of the causes of the accounting irregularities in addition to error (Jaswadi, 2012) so that the higher the level of accounting irregularities.

H1: Pressure has a positive effect on the probability of increasing accounting irregularities.

Opportunities and Accounting Irregularities

One of the causes of fraud is one's perception that there is an opportunity to commit fraud (Cressey, 1953). Although someone has a good reason to commit fraud, he will not be able to do it when there is no chance. SAS No. 99 states that opportunities can be derived from the nature of the industry of the company and the ineffective internal control. The nature of industrial companies sometimes provides opportunities for companies doing fraud. An example is a company that is on the industry which most of the companies has a large inventory. Inventory is an account that is subjective because the company must estimate obsolete inventory (Summers and Sweeney, 1998). This inventory can be manipulated by companies for increasing their profits. Summers and Sweeney (1998) find companies that commit fraud have higher inventory growth than non-fraud companies. The greater growth in inventory, the greater the account must be determined subjectively. This led the company to have a higher chance to commit fraud by making use of this subjective account. Increased opportunities for fraud caused the company to have a higher probability to commit fraud.

Ineffectiveness of internal control is also one of the opportunities the company to commit fraud. It has been proved in a research by Smaili and Labelle (2009) and Jaswadiet al. (2012) that found a negative effect on the quality of corporate governance system of the extent of accounting irregularities. This is because when a company has a system of good corporate governance, the company's opportunity to commit fraud has become fewer. As the result, the probability of the company commit fraud decreased.

It can be concluded that opportunity has a positive influence of fraud. The reason is to do something one must have the ability to do so. When this capability is lost due to lack of opportunities, one cannot do the things he wants. So does fraud. The absence of opportunities will make the company cannot commit fraud and will reduce the level of accounting irregularities.

H2: Opportunity has a positive effect on the probability of increasing accounting irregularities.

Rationalization and Accounting Irregularities

In addition to the opportunities and pressures, other factor that led to the occurrence of fraud is rationalization (Cressey, 1953). Rationalization is derived from a person and a justification for his actions to commit fraud. SAS No. 99 states that rationalization may be an effort of management to justify the use of improper accounting because the impact is not material.

Management attempts to justify some practice accounting because the impact is not material is a form of rationalization. Management can justify committed fraud because they feel the impact is not material. One example is to utilize accrued in the financial statements. They can recognize revenue that should not be recognized because they feel the impact is not material.

Rationalization is often a plea for someone to justify doing fraud. When someone commits fraud, they will do rationalization to justify fraud committed in order to feel guilty or to be used in court. When there is a rationalization, the probability of the company doing the accounting irregularities and fraud will increase.

H3: Rationalization have a positive effect on the probability of increasing accounting irregularities.

3. RESEARCH METHOD

The samples are non-financial companies who are sanctioned by Securities and Exchange Commission (BAPEPAM) in 2007 through 2013 and listed company. Companies that get sanction because of late submission of annual financial statements are not included. The data is obtained from Komisi Penetapan Sanksi dan Keberatan OJK/BAPEPAM). Paired sample choose from the same industrial code (one and two digit code JASICA), firm size (total assets), and year. Distribution of this sample can be seen in Table 1.

The research model are:

$$\ln \left[\frac{\Pr(Y \leq LAI_k)}{\Pr(Y > LAI_k)} \right] = \alpha_k - \beta' x$$

With:

$$\beta' x = \beta_0 + \beta_1 SALTA + \beta_2 LEV + \beta_3 OSHIP + \beta_4 ROA + \beta_5 INVENTORY + \beta_6 d EXPERT + \beta_7 TACC + \beta_8 LOGSIZE + \varepsilon$$

Description:

K = sanction category-1 (0,1,2); SALTA = *asset turnover ratio*, sales divided by asset; LEV = *leverage*, debt divided by total asset; OSHIP = *insidershareholding*; ROA = *return on asset* at t-1; INVENTORY = growth of inventory ratio to sales at t-1; EXPERT = background or expertise of commissioner of the audit committee, 1 for the commissioner without a background in accounting or finance; TACC = ratio of total accruals to total assets; LOGSIZE = log of the total assets of the company.

Operationalization of Variable

ACCOUNTING IRREGULARITIES

Proxy for the level of accounting irregularities is the level of sanctions (LAI) that given by the BAPEPAM to companies that perform accounting irregularities (Jaswadi, et al., 2012). LAI is an ordinal variable that has a code 1 for companies that obtain the written sanction, code 2 for companies that get fines (penalties), and code 3 for the company under investigation. Sanctions code 0 is given to the companies do not get sanction.

PRESSURE

Under SAS 99, there are four types of pressure that can lead to financial statement manipulation: financial stability, external pressures, personal financial needs and financial targets.

Financial stability

SAS No. 99 states that the manager would have the pressure to manipulate the financial statements as financial stability and / or profitability threatened by economic conditions, industry, or the operating entity. One of the threats that come from industry is competition with a competitor company. Persons (1995) stated asset turnover ratio (SALTA) can describe the ability of the company generate revenue and enterprise management capabilities in the face of competitors. When SALTA is low, the company is not using its assets efficiently and less competitive with other companies. It can disrupt the financial stability of the company because the company cannot compete with other companies. Managers will feel the pressure to cover up or manipulate this information. Consequently, most likely management will conduct accounting irregularities. So, SALTA has a negative effect on accounting irregularities

$${}^1\text{SALTA} = \frac{\text{Sales}}{\text{Total Assets}}$$

External Pressure

SAS No. 99 states that the pressure can be derived from the pressure of a third party (external) to meet their expectations. One of the pressure is to meet debt covenants and pay its debts. This pressure can be seen from the level of corporate debt (leverage). Elayan, et al. (2008) found that leverage has a positive influence on the probability of the company doing the accounting irregularities. Leverage (LEV) is the percentage of the debt on the company's assets. The higher the leverage, the greater the assets derived from loans. As a result, a lot of thing must be followed in order not to violate debt covenants and greater debt to be paid. Managers will experience greater pressures to meet these expectations and more likely to do the accounting irregularities.

$${}^2\text{LEV} = \frac{\text{Total Debt}}{\text{Total Assets}} \times 100$$

Personal Financial Needs

SAS 99 states that the pressure can be felt by management when the company's performance affects their wealth. An example is the equity participation by management so that the performance of the company will determine the rate of return derived from the investment management. Beasley (1996) indicates when management has the company share, their financial wealth will be affected by the company's financial performance. When ownership

increases, managers' wealth will depend on the performance of the company. Management will be more likely to do the accounting irregularities to increase the value of company stock in order to increase their wealth. OSHIP use as a proxy for personal financial needs.

³*OSHIP = the cumulative percentage ownership in the firm held by insiders.*

Financial Target

Return on assets (ROA) is widely used as an indicator of the effectiveness of the use of corporate assets (Skousen, et al., 2009). This study incorporates ROA as a proxy for the company's financial targets because ROA are often used as indicators of the manager's performance assessment and determination of bonuses, salary increases, and other benefits. Summers and Sweeney (1998) reported that the ROA on companies that do not commit and commit fraud has a significant difference.

$${}^4\text{ROA} = \frac{\text{Net Income before Extraordinary Items}_{t-1}}{\text{Total Assets}_t} \times 100$$

OPPORTUNITY

In accordance with SAS No. 99, opportunity is divided into two factors: the nature of the industry and the ineffectiveness of internal control.

Industrial Properties

SAS 99 states that the nature of the industry of the company can provide the opportunity for fraudulent financial reporting. The nature of the industry may be the accounts determined subjective and difficult to be verified. Summers and Sweeney (1998) states that estimated inventory obsolescence is determined subjectively. The common practice is usually utilized an account in the financial statements that relies heavily on estimates and subjective nature such as value of INVENTORY:

$${}^5\text{INVENTORY} = \left(\frac{\text{Inventory}_t}{\text{Sales}_t} - \frac{\text{Inventory}_{t-1}}{\text{Sales}_{t-1}} \right)$$

Ineffectiveness of Internal Oversight

Some organs of internal control are the board of commissioners and the audit committee. Effectiveness of controls may be affected by the quality of the two organs. The quality can be seen in

their background and expertise. Jaswadi, et al. (2012) found that companies that have a financial or accounting expert in the board of directors and audit committees have a lower probability to perform accounting irregularities. Therefore we include EXPERT:

⁶*EXPERT = Indicator variable with the value of 1 if the audit committee does not include at least one commissioner who is (or has been) an accounting or finance graduate, CPA, CFO or controller, or has held senior management position with financial responsibilities; and 0 otherwise.*

RATIONALIZATION

SAS 99 states rationalization can be seen from the repeated attempts by management to justify the use of inappropriate accounting policies with the reason the problem is not material. Beneish (1997) and Francis and Krishnan (1999) states that the accrual (TACC) is a representation of the accounting policies selected by management and can give you an idea of rationalization in the financial statements.

$$\begin{aligned}
 & \text{⁷TACC} \\
 & \Delta \text{ Current Assets} - \Delta \text{ Cash} - \Delta \text{ Current Liabilities} + \Delta \text{ Short term debt} - \\
 & \text{Depreciation Amortization exp.} - \text{Deferred Tax on Earnings} \\
 & \text{+Equity in Earnings} \\
 = & \frac{\hspace{10em}}{\text{Total Assets}}
 \end{aligned}$$

This study included size of the company as a control variable. Elayan, et al. (2008) stated that a company that a larger size company will have more frequent disclosure, better reporting practices, and followed its development by the analyst more. They will be supervised by the public at more closely. As a result, companies that have a larger size will be less likely to do the accounting irregularities than smaller companies. Log of total assets (LOGSIZE) will be a proxy for the size of the company.

$$\text{⁸LOGSIZE} = \log \text{ Total Assets}$$

Because the dependent variables in the study are discrete and ordinal data, the research method used is an ordered logistic regression using STATA 12 software.

4. DATA ANALYSIS AND DISCUSSION

We get 84 companies that were sanctioned by BAPEPAM. There are 14 companies included in category 1 (written sanction), 67 companies included in category 2 (penalties), and the three companies included in the category 3 (investigation). Because of small number of companies included in the category 3, we did not include that samples. Thus, the total sample was 81 company violations. The total sample with a control sample is 162 companies.

Table 2 describes the distribution of samples per year. It can be seen an increase in sanction over the year with the highest case in 2012. The most violations are violations of the VIII.G.7 and UUPM No 69 (presentation of financial statements) with total 34 cases (41.98%). The second most frequent are violations of the rules IX.E.1 (conflicts of interest in certain transactions such as affiliate transactions) with total 16 cases (19.75%). More companies have been subject to a fine (83%) than the written sanction (17%). Written sanction was a slight decrease for 2012 and 2013. There are no companies which violate the financial statements in 2007 and 2008. Company that violate in financial statement get fined (26) more than get written sanction (8).

This study do regression for all sample (81 fraud firm and 81 non fraud firm) and for sample that only violations of the VIII.G.7 and UUPM No 69 about presentation of financial statements (34 fraud and 34 non fraud firm). Table 3 shows the descriptive statistics of the variables. The outlier was overcome by using winsorization at the level of 90%.

The feasibility test of the model is done by looking at the value of $\text{Prob} > \chi^2$. If the value is significant or valued less than 0.05, the model can be declared eligible. Likelihood ratio χ^2 value and the value of the probability $\text{Prob} > \chi^2$ can be seen in Table 5. The test results demonstrate the feasibility of the model that the two models are significant at the 0.01 level which means that the model is considered feasible and can be used for subsequent testing analysis.

To view the ability of independent variables to explain variation in the dependent variable, the researchers will look at the value McFadden Pseudo R². To the entire cases' model, McFadden Pseudo R² value is 0.0968. That is, 9.68% of the variation in the dependent variable can be explained by the independent variables. The remaining 90.32% is explained by other factors outside the model. For

financial statement presentation violation models, the McFadden Pseudo R² value is 0.1588. This indicates that the independent variables in the model can explain 15.88% of the variation in the dependent variable. 74.12% of the variation is explained by other factors outside the model.

Proportional odds model on ordered logistic regression method requires proportional odds assumption is met. It can be seen from the model test and Brant's Wald Test. The results of this test are shown in Table 6. P-value for the model test in all cases model and the model VIII.G.7 & UUPM 69 is greater than 0.1 or insignificant. That is, both the model does not violate the proportional odds assumption. This result is also supported by the results shown by Brant's Wald Test. Pvalue for both models are greater than 0.1 or insignificant. Thus, the models do not violate the proportional odds assumption. Results of an ordered logistic regression models for all cases presented in Table 7.

Influence Of Pressure Factors To The Probability Of Increase Of Accounting Irregularities

For the PRESSURE factor, there are two variables that have significant influence with the dependent variable. These variables are SALTA and ROA. LEV and OSHIP variables showed no significant effect. SALTA variable has probability value 0003, which is lower than 0.01. That is, the variable SALTA has a significant negative effect on the probability of the increase in levels of RSV at 99% confidence level for the model of the entire case. Based on these test results, it can be concluded that the efficient use of assets to generate sales (asset turnover) has a significant negative effect on the probability of the increase in the level of sanctions by BAPEPAM. The higher efficiency of the company in using its assets to generate sales, the less likely the company gets more severe sanctions from BAPEPAM. Conversely, when there is efficient use of assets in generating low sales, the company will be exposed to the probability of more severe sanctions from BAPEPAM is getting big.

This is presumably because the ratio describes the company's ability to utilize their assets to generate sales (capital turnover). When there is an inefficient use of assets, sales will decline. The sales decline will make the company's financial become unstable. Manager's performance will also be assessed on the company's financial stability. This assessment leads to pressure for managers. They will try to make the company has a stable financial in order not to decrease their compensation. As a result, the manager will try to hold or manipulate information regarding this matter. Managers hope

that investors do not know that the company's financial stability is threatened. This is what makes the company will be more likely to commit violations of BAPEPAM regulations than financially stable company.

These findings are consistent with Persons' studies (1995) who found that the ratio of sales to total assets is a factor that affects the probability of fraudulent financial reporting for companies in the United States. By using the stepwise-logistic regression method, Persons (1995) found a negative effect of asset turnover against the probability of fraudulent financial reporting.

The second variable is ROA. ROA has a prob value 0024, this value is lower than 0.05. That is, ROA has a significant negative effect on the probability of the increase in levels of RSV at 95% confidence level. This negative result indicates that when previous year's RNOA is low, the more likely the company to do more serious offenses. The explanation for this result is that if the previous year's RNOA is low, it will be the trigger for the company to determine the target ROA to be higher next year. As a result, managers receive greater pressure to encourage managers to commit violation/accounting irregularities in order to achieve the targeted ROA.

This finding contrasts with the results of research by Summers and Sweeney (1998). They found a positive correlation between financial targets with fraud. This might be due to different samples used in the study Summers and Sweeney (1998), which are companies in the United States. FRAUD scope in research by Summers and Sweeney (1998) is the insider sales transaction. In this study, the scope of accounting irregularities are all cases violation Securities and Exchange Commission, including insider sales, financial misstatement, and conflict of interest in certain transaction.

In addition to the two variables before, there are two other variables in the pressure factor that has no significant relationship with the dependent variable. Both are LEV and OSHIP. LEV has no significant effect on the probability of increasing the sanctions provided by BAPEPAM. These results indicate that the pressure to pay the debt or meet debt covenants not affect the probability of manipulation income (fraud). This finding contrasts with the

findings of Elayan, et al. (2008) but similar to the results of research by Dechow, et al. (2007).

OSHIP variables also did not have a significant effect on the probability of increasing the sanctions provided by BAPEPAM. This finding is in line with the findings in the study Beasley (1996). They also found no significant effect of ownership insiders on the probability of manipulation of financial statements.

Influence of Opportunities Factors on Increasing Accounting Irregularities Probability

For the OPPORTUNITY factor, INVENTORY and EXPERT have a significant effect on the probability of the violation of BAPEPAM occurrence. INVENTORY variable has a p-value of 0.050 that means INVENTORY has a significant positive effect on the probability of LAI levels rise with the level of confidence of 95%. These results prove that the greater the value of the accounts that are subjective as inventory account, the greater the chance of the manager to perform accounting irregularities. These results are consistent with the findings of Summers and Sweeney (1998). They find companies that commit fraud have higher inventory to sales ratio than companies that do not commit fraud in the years prior to the event (t-1). The second is EXPERT, which has a positive coefficient and p value of 0.085, meaning that it has a significant influence on the probability of LAI levels rise with the level of confidence of 90%. The test results prove that if none of the commissioners in audit committee who are experts in finance or accounting, internal controls will weaken, the manager will have greater opportunities to manipulate the financial statements, which resulted in the probability companies get more severe sanctions from BAPEPAM will increase. These results are consistent with studies conducted by Jaswadi et al. (2012) in companies in Indonesia. He found that companies that have a financial expert on the board of directors and audit committees have a lower probability to perform accounting irregularities.

Rationalization Factor Influence on Probability of Accounting Irregularities Increased

Rationalization factor proxied by TACC variables not shown to have a significant

effect on the probability of increasing the sanctions provided by BAPEPAM. That is, the more the accrual in the company, does not affect the probability of the company doing the accounting irregularities heavier. Another possibility is a proxy for rationalization in this study is not appropriate to describe the rationalization factors. This finding is consistent with research results Skousen, et al (2009) in the United States.

Violation on Financial Statements Presentation Only

Table 8 shows the results of an ordered logistic regression models for violation in financial statement presentation only. Same with the regression results of all cases of violations, this model shows the regression results of four independent variables that have a significant relationship to the dependent variable. These variables are SALTA, ROA, INVENTORY, and EXPERT. Rationalization factor represented by TACC also did not show any effect. Direction of the relationship is also same.

Sensitivity Test: All Cases

Sensitivity test is done to look whether the model is robust or not. This test is done by replacing the categories in the dependent variable LAI into two: 0 for the company without sanction and 1 for company that get sanctioned. The method used is a binary logistic regression as the dependent variable consists of two categories (1 and 0). Table 9 shows the sensitivity of the test results for all violation case models. From the results of binary logistic regression above, there are three significant variables. This result differs from the result obtained from an ordered logistic regression results. In these results, EXPERT variable has no significant effect. That is, when the fines are merged with written sanction, the results will be different.

This sensitivity test results indicate the presence of different characteristics at each level of sanctions that make the results of the sensitivity study is different from the initial regression results. The characteristic difference is the reason why each level of sanction must be distinguished by category. The aim is that the results are not biased because it considers all the violations have the same characteristics.

Sensitivity Test: Violation of Financial Statements Presentation

Just like the entire case model, the sensitivity test of violation of financial statement presentation model done by replacing the categories in the dependent variable LAI into two: 0 for the company without sanction and 1 for company sanctioned. Table 10 shows the sensitivity of the test results for the financial statement presentation violation model.

From the results of binary logistic regression above, there are three significant variables. These results are in contrast to what was obtained from the results of an ordered logistic regression. In these results, the variable INVENTORY does not have significant influence. As a sensitivity test in all cases of violations of the model, there are differences between the characteristics of sanctions code 2 (fines) and sanctions code 1 (written sanction). So, it is better to use an ordered logistic regression because this method can capture differences in these characteristics.

5.CONCLUSION AND LIMITATION

This study aims to identify the factors that affect the company doing the accounting irregularities which the accounting irregularities measured into three levels, namely level 1 for companies that obtain the written sanction, level 2 for companies that obtain fines, level 0 is for the companies that not obtain written sanction/fines. This study divides the sample into two groups: group 1 (all cases of violations of the BAPEPAM rules) and group 2 (only violate the presentation of the financial statements rules).

The results found that of the three factors in the fraud triangle, pressure and opportunity factor are proved significant factor to trigger the accounting irregularities. From fourth pressure proxy, only the financial stability (SALTA) and financial targets (ROA) that has significant influence, while interest in the management of the company's performance (OSHIP) and external pressures (LEV) is not proved significant. Research shows that the higher the financial stability (SALTA) and financial targets (ROA) of the company, the lower the probability of companies doing higher level of accounting irregularities. Research was

also found that from the two proxy of opportunity, the influence of the nature of the industry (INVENTORY) and the ineffectiveness of internal control (EXPERT) proved a significant positive effect. That is, companies that have a lot of inventory and ineffective internal controls are more likely to do higher level of accounting irregularities. This study did not find evidence that the rationalization has an effect on the probability of a companies doing accounting irregularities. This result is consistent for both group samples.

There is some limitations and suggestions on the results of this study. First, the number of companies that received written sanctions/penalties from BAPEPAM is very limited, future studies should try to get more data. Second, detailed information on the types of offenses committed company is not obtained thereby affecting the accuracy of grouping levels of sanctions. Future studies are expected to look for the type of offense committed. Third, this study has only one proxy for the rationalization that is accrual, further research can add another proxy of rationalization.

Implications of this research is to maintain the security of the investment, investor should choose to invest in a company with good financial stability. Investors should be cautious when going to invest in companies that have high financial targets, large inventory value, and ineffective internal controls.

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Table 1. Research Sample

Description	2007	2008	2009	2010	2011	2012	2013	Total
Companies that included in KPSK BAPEPAM case	8	8	8	24	18	34	18	118
Companies that excluded from the research sample:								
• Financial Sector	-	(1)	(2)	(3)	(2)	(3)	-	(11)
• Delisting	(1)	(1)	-	(2)	(1)	(3)	(1)	(9)
• Insufficient Data or Data cannot be treated	(2)	(1)	(1)	(4)	(1)	(6)	(2)	(17)
The number of observations with complete data and can be used	5	5	5	15	14	22	15	81
The number of samples (with comparative sample)								162
The number of sample observations violation financial statements	-	-	2	9	11	5	7	34
The number of samples violations financial statements (by comparison)								68

Table 2. Types and Categories of accounting irregularities of all violation cases

Jenis Pelanggaran	2007	2008	2009	2010	2011	2012	2013	Sub Total	Total	%
VIII.G.7 & Pasal 69 UUPM			4	18	22	10	14		34	41.98
Sanksi Tertulis (1)			0	3	4	0	1	8		
Sanksi Denda (2)			2	6	7	5	6	26		
IX.A.2			2						1	1%
Sanksi Tertulis (1)			1					1		
Sanksi Denda (2)			0					0		
IX.A.7		2							1	1%
Sanksi Tertulis (1)		0						0		
Sanksi Denda (2)		1						1		
IX.D.1		2	2						2	2%
Sanksi Tertulis (1)		0	0					0		
Sanksi Denda (2)		1	1					2		
IX.E.1	2			4		14	12		16	20%
Sanksi Tertulis (1)	0			0		0	1	1		
Sanksi Denda (2)	1			2		7	5	15		
IX.E.2	2			6		6	2		8	10%
Sanksi Tertulis (1)	0			0		1	0	1		
Sanksi Denda (2)	1			3		2	1	7		
X.K.1	2		2		4	6			7	9%
Sanksi Tertulis (1)	0		0		0	0		0		
Sanksi Denda (2)	1		1		2	3		7		
X.K.2	2	2							2	2%
Sanksi Tertulis (1)	0	0						0		
Tempa Sanksi (0)	1	1						2		
X.K.4		2				6	2		5	6%
Sanksi Tertulis (1)		0				1	0	1		
Sanksi Denda (2)		1				2	1	4		
X.K.6		2		2					2	2%
Sanksi Tertulis (1)		0		1				1		
Sanksi Denda (2)		1		0				1		
XI.B.2						1			1	1%
Sanksi Tertulis (1)						1		1		
Sanksi Denda (2)						0		0		
Pasal 78 UUPM					2				1	1%
Sanksi Tertulis (1)					0			0		
Sanksi Denda (2)					1			1		
Pasal 93 UUPM	2								1	1%
Sanksi Tertulis (1)	0							0		
Sanksi Denda (2)	1							1		
Total Semua Pelanggaran	5	5	5	15	14	22	15	81	81	100%
Control Sampel	5	5	5	15	14	22	15	81		
Total Sampel	10	10	10	30	28	44	30	162		

Source: modified from BAPEPAM/OJK's data

Rule Number	Regulate About
VIII.G.7 and UUPM Clause 69	Financial Statement Presentation Guidelines
IX.A.2	Registration Procedures for Public Offering
IX.A.7	Responsibilities of Underwriters In Order Booking and Allotment of Securities in a Public Offering
IX.D.1	Right Issue
IX.E.1	Conflict of Interest in Certain Transactions
IX.E.2	Material Transaction and Changes in Core Business
X.K.1	Disclosure of Information that must be made to Public
X.K.2	Obligation to Submit Periodic Financial Statements
X.K.4	Report of Utilization of Proceeds from Public Offering
X.K.6	Obligation to Submit Annual Report for Issuers or Public Company
XI.B.2	Repurchase of Shares Issued by the Issuer or Public Company
UUPM Clause 27	The Information in the Prospectus may not Give any Idea Misguided
UUPM Clause 93	Each Party is prohibited, in any way, make a statement or give information that is materially false or misleading thus affecting the price of the Securities on the Stock Exchange.

Table 3 Descriptive Statistics for All Sample

<i>Variable</i>	N	Mean	Median	Minimum	Maximum	Std. Dev.
<i>SALTA</i>	162	0.7971	0.7395	0.0812	2.0934	0.5695
<i>LEV</i>	162	28.6235	26.4150	0.0000	77.4200	22.6009
<i>OSHIP</i>	162	1.9220	0.0001	0.0000	17.5080	4.6831
<i>ROA</i>	162	5.5939	4.7650	-13.5000	25.3000	8.7544
<i>INVENTORY</i>	162	0.0061	0.0000	-0.1820	0.2125	0.0931
<i>EXPERT</i>	162	0.6420	1.0000	0.0000	1.0000	0.4809
<i>TACC</i>	162	-0.0126	-0.0138	-0.2068	0.2353	0.1144
<i>LOGSIZE</i>	162	12.0534	12.1775	10.6791	3.2703	0.7086

Description:

SALTA = asset turnover ratio, sales divided by assets; LEV = leverage, debt divided by total assets; OSHIP = insider stock ownership; ROA = return on asset at t-1; INVENTORY = ratio of inventories to sales growth at t-1; EXPERT = background or expertise in audit committee of commissioners, 1 for the commissioner without a background in accounting or finance; TACC = ratio of total accruals to total assets; LOGSIZE = log of the total assets of the company.

Table 4. Descriptive Statistics of Samples of Financial Statements Violation

<i>Variable</i>	N	Mean	Median	Minimum	Maximum	Std. Dev.
<i>SALTA</i>	68	0.7801	0.7460	0.0973	1.8018	0.4892
<i>LEV</i>	68	29.0421	31.5300	0.0000	65.0700	21.7725
<i>OSHIP</i>	68	2.2154	0.0044	0.0000	17.9705	5.2623
<i>ROA</i>	68	5.9732	5.5050	-13.5900	31.3600	10.5613
<i>INVENTORY</i>	68	0.0041	0.0000	-0.1963	0.2242	0.0985
<i>EXPERT</i>	68	0.5882	1.0000	0.0000	1.0000	0.4958
<i>TACC</i>	68	-0.0170	-0.0136	-0.2257	0.2353	0.1182
<i>LOGSIZE</i>	68	12.1521	12.1970	11.1650	13.3869	0.6260

Description:

SALTA = asset turnover ratio, sales divided by assets; LEV = leverage, debt divided by total assets; OSHIP = insider stock ownership; ROA = return on asset at t-1; INVENTORY = ratio of inventories to sales growth at t-1; EXPERT = background or expertise in audit committee of commissioners, one for the commissioner without a background in accounting or finance; TACC = ratio of total accruals to total assets; LOGSIZE = log of the total assets of the company.

Table 5 Model Eligibility and McFadden Pseudo R² Test Result

Model	LR chi2	Prob chi2 >	McFadden Pseudo R²
All Cases	28.95	0.0003***	0.0968
Financial Statement Presentation Violation	20.86	0.0075***	0.1588

***significant at significant level 0.01

Table 6 Proportional Odds Assumption Test Result

Model	Omodel		Brant's Wald Test	
	Chi2	Prob > chi2	Chi2	Prob > chi2
All Cases	7.14	0.5212	6.86	0.552
Violation of Final Statement Presentation	11.87	0.1570	-85.34	1.000

Table 7 Ordered Logistic Regression of All Violation Cases Result

Iteration 0: log likelihood = -149.57902	N	162
Iteration 1: log likelihood = -135.29700	LR chi2(9)	28.95
Iteration 2: log likelihood = -135.10654	Prob > chi2	0.0003
Iteration 3: log likelihood = -135.10620	Pseudo R2	0.0968
Iteration 4: log likelihood = -135.10620		

Log likelihood = -135.10620

LAI	Coef.	Std. Err.	z	P> z	[90% Conf. Interval]	
SALTA (-)	-0.8958	0.3252	-2.75	0.003***	-1.5332	-0.2584
LEV (+)	-0.0024	0.0079	-0.31	0.380	-0.0179	0.0131
OSHIP (+)	-0.0416	0.0354	-1.18	0.120	-0.1109	0.0277
ROA (+)	-0.0451	0.0227	-1.98	0.024**	-0.0896	-0.0005
INVENTORY (+)	2.9903	1.8115	1.65	0.050**	-0.5601	6.5408
EXPERT (+)	0.4791	0.3480	1.38	0.085*	-0.2030	1.1612
TACC (+)	0.0396	1.5208	0.03	0.490	-2.9412	3.0203
LOGSIZE (-)	-0.1741	0.2462	-0.71	0.240	-0.6567	0.3085
/cut1	-2.9050	3.0006			-8.7859	2.9760
/cut2	-2.4913	2.9981			-8.3674	3.3847

*, **, *** Signifikan pada tingkat signifikansi 0.1, 0.5, 0.01

Description:

SALTA = asset turnover ratio, sales divided by assets; LEV = leverage, debt divided by total assets; OSHIP = insider stock ownership; ROA = return on asset at t-1; INVENTORY = ratio of inventories to sales growth at t-1; EXPERT = background or expertise in audit committee of commissioners, one for the commissioner without a background in accounting or finance; TACC = ratio of total accruals to total assets; LOGSIZE = log of the total assets of the company.

Table 8 Ordered Logistic Regression of Financial Statement Presentation Violation

Iteration 0: log likelihood = -65.684224	N	68
Iteration 1: log likelihood = -55.337586	LR chi2(7)	20.86
Iteration 2: log likelihood = -55.253050	Prob > chi2	0.0075
Iteration 3: log likelihood = -55.252851	Pseudo R2	0.1588
Iteration 4: log likelihood = -55.252851		

Log likelihood = -55.252851

LAI	Coef.	Std. Err.	z	P>z	[90% Conf. Interval]
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SALTA (-)	-1.1237	0.6454	-1.74	0.041**	-2.3886	0.1412
LEV (+)	-0.0084	0.0140	-0.60	0.275	-0.0359	0.0191
OSHIP (+)	-0.0147	0.0503	-0.29	0.386	-0.1133	0.0839
ROA (+)	-0.0713	0.0361	-1.98	0.024**	0.1420	-0.0006
INVENTORY (+)	-3.7272	2.9408	1.27	0.103*	-2.0367	9.4911
EXPERT (+)	1.0683	0.5907	1.81	0.036**	-0.0894	2.2260
TACC (+)	-0.1254	2.9546	-0.04	0.483	-5.9163	5.6656
LOGSIZE (-)	-0.2361	0.4904	-0.48	0.315	-1.1973	0.7250
/cut1	-3.8531	5.8923			-15.4017	7.6955
/cut2	-3.2201	5.8879			-14.7601	8.3199
*, **, *** Signifikan pada tingkat signifikansi 0.1, 0.5, 0.01						

Description:

SALTA = asset turnover ratio, sales divided by assets; LEV = leverage, debt divided by total assets; OSHIP = insider stock ownership; ROA = return on asset at t-1; INVENTORY = ratio of inventories to sales growth at t-1; EXPERT = background or expertise in audit committee of commissioners, one for the commissioner without a background in accounting or finance; TACC = ratio of total accruals to total assets; LOGSIZE = log of the total assets of the company.

Table 9 Model Sensitivity for All Cases Test Result

Iteration 0: log likelihood = -112.28984	N	162
Iteration 1: log likelihood = -99.31743	LR chi2(8)	25.97
Iteration 2: log likelihood = -99.30428	Prob > chi2	0.0011

Iteration 3: log likelihood = -99.30428

Pseudo R2 0.1156

Log likelihood = -99.30428

LAI	Coef.	Std. Err.	z	P>z	[90% Conf. Interval]	
SALTA (-)	-0.8465	0.3334	-2.54	0.006***	-1.5000	-0.1931
LEV (+)	-0.0002	0.0081	-0.02	0.492	-0.0159	0.0157
OSHIP (+)	-0.0314	0.0374	-0.84	0.201	-0.1048	0.0420
ROA (+)	-0.0435	0.0232	-1.87	0.031**	-0.0890	0.0020
INVENTORY (+)	3.9112	1.9655	1.99	0.024**	0.0589	7.7635
EXPERT (+)	0.4525	0.3642	1.24	0.107	-0.2613	1.1663
TACC (+)	-0.1838	1.5732	-0.12	0.454	-3.2672	2.8997
LOGSIZE (-)	-0.1486	0.2571	-0.58	0.282	-0.6525	0.3553
_cons	2.4570	3.1315	0.78	0.217	-3.6806	8.5946
*, **, *** Signifikan pada tingkat signifikansi 0.1, 0.5, 0.01						

Description:

SALTA = asset turnover ratio, sales divided by assets; LEV = leverage, debt divided by total assets; OSHIP = insider stock ownership; ROA = return on asset at t-1; INVENTORY = ratio of inventories to sales growth at t-1; EXPERT = background or expertise in audit committee of commissioners, one for the commissioner without a background in accounting or finance; TACC = ratio of total accruals to total assets; LOGSIZE = log of the total assets of the company.

Table 10. Sensitivity of Violation of Financial Statement Presentation Test Result

Iteration 0: log likelihood = -47.134008	N	68
Iteration 1: log likelihood = -39.354795	LR chi2(6)	15.68
Iteration 2: log likelihood = -39.292375	Prob > chi2	0.0471
Iteration 3: log likelihood = -39.292193	Pseudo R2	0.1664
Iteration 4: log likelihood = -39.292193		

Log likelihood = -39.292193

LAI	Coef.	Std. Err.	z	P>z	[90% Conf. Interval]	
SALTA (-)	-0.9582	0.6306	-1.52	0.065*	-2.1941	0.2778
LEV (+)	-0.0032	0.0143	-0.22	0.412	-0.0311	0.0248
OSHIP (+)	1.0269	0.0557	0.48	0.315	-0.0823	0.1361
ROA (+)	-0.0586	0.0347	-1.69	0.046**	-0.1266	0.0094
INVENTORY (+)	2.8925	3.1136	0.93	0.177	-3.2102	8.9950
EXPERT (+)	0.9670	0.6184	1.56	0.059*	-0.2451	2.1792
TACC (+)	-1.4015	3.0520	-0.46	0.323	-7.3832	4.5802
LOGSIZE (-)	-0.1773	0.5227	-0.34	0.368	-1.2018	0.8472
_cons	2.6703	6.2489	0.43	0.335	-9.5773	14.9179
*, **, *** Signifikan pada tingkat signifikansi 0.1, 0.5, 0.01						

Description:

GPM = gross profit margins; ACHANGE = percentage of asset growth; CATA = ratio of the ability to generate positive cash flow; SALAR = withdrawal efficiency ratio of receivables; SALTA = asset turnover ratio, sales divided by assets; FINANCEt = ex-ante demand for funding; ROA = return on assets; EXPERT = background or expertise commissioners, one for the commissioner without a background in accounting or finance.