

The Influence of Rentability, Current Ratio, Solvency on Bankruptcy Audit Risk in Manufacture Sector

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Abstract:

Manufacturing companies are sector companies that are quite important for the country's development. Overall at mostly Asian developing country, more corporations engaged in public manufacturing the capital market. Manufacture becomes the most population compared to companies engaged in other sectors. This research aims to obtain applied literature outcome about influence source from rentability, current ratio, and solvency on probability of risk of bankruptcy discovered by auditor. Going concern measured and stated by dichotomous factors, namely substantial doubt about going concern or not. There were total of 108 observations used in this research. Hypothesis testing uses logistic regression analysis techniques and is processed using the SPSS 23.0 software. This research conclude that there was no significant effect between profitability also solvency to discovered by auditor of probability of risk of bankruptcy but, there is significant effect between liquidity or current ratio towards the discovered by auditor of probability of risk of bankruptcy.

Keywords: concern, going, opinion, audit, manufacture, sector

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1. Introduction

Manufacturing companies have principles about how companies can carry out operations and company activities with minimum costs but with maximum quality so that companies produce promising profits. Profit earned by the company, costs incurred by the company and capital owned, in the period per year, in general is always used as a standard of survival for the company in the future. With this larger

number of companies, companies engaged in the manufacturing sector have significant industrial influence and stock fluctuations in developing country capital market. To support our research, researchers used manufacture stock published corp. of Indonesian Capital Market (IDX) as research objects [1].

The continuity a corporation must hold became the concern of management and investor within the company; moreover for

shareholders in the company "Continuity means the corporation is continue operate serve customer and provide wealth to employee, management, and shareholders, meaning that no probability nor experience bankruptcy within near future [2]. If the company goes bankrupt, then shareholders and lenders, for example, banks will suffer. The value of shares becomes meaningless, shareholders suffer losses and banks that give credit fail to pay, even though they expect the principal and interest.

Financial auditors have an obligation to protect the interests of those who use financial statements. The parties for example: shareholders and lenders. they are the ones who often use reports as a reference for decision making. So when the auditor knows that the company is on the verge of bankruptcy, the auditor must give a warning to them to be careful not to get caught in a loss. [3] said this is a matter of controversy and debate because the client or company being audited becomes afraid, if the audit report is added an explanatory paragraph which is called the possibility of bankruptcy. So investors and creditors run first, so the state of the company becomes worse. The reason researchers chose manufacturing companies as research objects is because manufacturing companies are the companies with the most business areas that can be analyzed compared to other types of companies. So by taking a sample in a manufacturing company, it is expected that the results of research will be more useful [4].

2. Theoretical Background and Hypothesis Development

2.1. Bankruptcy Risk Audit

Bankruptcy risk audit is conducted in near end of audit engagement. It is stating that in issued by the auditor with explanatory paragraphs [3]. This condition is easily recognized. Invest people who are used to reading independent auditors' reports

will easily find an explanatory paragraph describing the risk of bankruptcy.

They are 4 conditions and events that can be identified and taken into consideration by the auditor, namely:

1. Negative Trends. For example, operational losses that occur repeatedly from period-period, ongoing shortages of working capital, negative operating cash flow, key performance indicators that have a bad score.

2. Indications of Financial Difficulties (Financial Distress). For example, failure to meet debt service obligations, 19 dividend payments arrears, refusal from suppliers to submit requests for ordinary credit purchases, the emergence of the need for debt restructuring, the emergence of the need to find sources or new funding methods, the initiation to sell some of the assets owned quickly.

3. Internal Issues. For example, labor strikes or other labor conflicts, high commitment that is not economical, there is a need to significantly overhaul the company's operations.

4. External Issues. For example, lawsuits or court lawsuits that have the potential to disrupt the survival of the company, the issuance of laws or other problems that have the potential to limit or stop the company's operations in part or in whole, lose management rights, licenses, copyright and important patents, lost customers or major suppliers, losses due to major disasters such as earthquakes, floods, drought, and other force majeure that are not insured or insured but with insufficient coverage.

2.2. Rentability

Rentability analysis measured level of efficiency, effort and profitability achieved by the company concerned. Return on Equity (ROE) is a financial indicator that illustrates a corporation capability to earn an income regarding the utilization of total assets owned by a company. The higher profitability refers to management considered able of managing all existing

capital to generate profits effectively and efficiently so that the auditor has no doubts about the survival of the company [5].

This is supported by research by [6] which proves that profitability influences the bankruptcy audit risk which proxies by going concern. Based on this, the hypothesis proposed is:

H1: Rentability influences bankruptcy risk audit.

2.3. Current Ratio

Current ratio represent liquidity can be interpreted as the rate of speed of an investment vehicle (asset) to be liquidated into cash funds (money). Liquidity shows the company's capability in order to fulfill nearly matured liability. Current asset is assets that be converted liquid in easy and fast manner. By using current asset and liabilities, companies can calculate liquidity ratios [7]. Liquidity ratio is a form of assessment whether a corporation position of short-term health is normal or not running normally. Therefore, liquidity risk is often referred to as short term liquidity risk.

Research conducted by [8] states that liquidity that uses quick ratio affects the probability of bankruptcy, also supported by study conducted by [9] stating that quick ratio influences this matters. We write second hypothesis proposed is:

H2: Current ratio influences bankruptcy risk audit.

2.4. Solvency

Solvency mean corporations capabilities fulfill their financial obligations when liquidated, both short-term and long-term financial obligations. The solvency ratio does the calculation using the ratio of total debt to total equity. A high solvency ratio can adversely affect a company's financial condition. The higher the solvency ratio, the more it shows the poor financial performance of the company. This condition is causing more bankruptcy risk detected by

auditor and provides opinion. Refers literature [8] that solvency affects the risk of bankruptcy detected by auditor [3] stating that solvency affects this matters. Start from this the following hypothesis is proposed

H3: Solvency affects the acceptance of bankruptcy risk audit

3. Material and Methodology

3.1. Object and Sampling

Objects in this study are profitability, liquidity, and solvency. The object of research was observed from annual report during 2015-2018.

We use nonprobability approach technique with the aim of getting samples that are in accordance with predetermined criteria. These criteria are described:

1. Manufacture sector public corporation, which already public from 2015-2018.
2. Financial statement with independent audit report by each KAP auditing the company in the period 2015 to 2018
3. There are complete data for calculation ratios. There is also report in audited statement.
4. Corporation which suffers loss once in our period of research
5. Presentation of data on all audited financial statements in the study period using the Rupiah currency.

3.2. Data Analysis Method

The data that has been collected will be tested by the specified statistical software. Stages consisted of descriptive analysis, multicollinearity testing, logistic regression analysis and hypothesis testing.

3.3. Measurement Variables

Our research has the variables used consisted of 1 (one) dependent variable and 3 (three) independent variables. Each of the measurement is explained in table:

Table 1. Quantitative Measurement

Variable	Measurement
Going Concern Audit Opinion [4]	This variable uses a dummy with qualifications of companies that receive bankruptcy audit risk (code: 1); no bankruptcy audit risk (code: 0)
Profitability Ratio [10]	This variable uses the calculation of the Return on Equity ratio Net Income / Total Equity
Liquidity [11]	This variable uses the Current ratio calculation Current Asset / Current Liabilities
Solvency [12]	Quantitative measurement uses calculation from Liability divided by Equity

4. Research Result

4.1. Multicollinearity Test

Based on observations, the largest correlation that occurs is between the independent variable profitability which is denoted by (X1) with the independent

solvency variable represented by (X3) which is equal to 0.711. But the biggest correlation that occurs is still lower than 0.9 so it can be said free from multi-collinearity among the independent variables to be examined.

Table 2. Multi-collinearity Test

		Correlation Matrix			
		Constant	X1	X2	X3
Step 1	Constant	1.000	-.173	-.808	-.357
	X1	-.173	1.000	-.010	.711
	X2	-.808	-.010	1.000	.029
	X3	-.357	.711	.029	1.000

4.2. Assessing the Feasibility of the Regression Model

Results conducted by looking at the Hosmer and Lemeshow Test table [13], it can be determined that the score is 7.977 supported p-value 0.436. The value is

greater than α (0.05). So from the results can be concluded that the null hypothesis or (H0) not reject means that our research feasible or fit model thus appropriately interpreted.

Table 3. Feasibility of Research Model

Hosmer and Lemeshow Test			
Step	Chi-square	df	Sig.
1	7.977	8	.436

4.3. Overall Model Fit

The assessment is done by comparison between the value of -2 log likelihood (Block Number = 0) and -2 log likelihood (Block Number = 1) [13]. Refers to the table, we can see it has not included the independent variable the value of -2 log

likelihood is 85,812 when the regression model has entered the independent variable the value of -2 log likelihood has decreased by 10,150 so that it becomes 75,662. This description illustrates a better fit model after the addition of 3 independent variables.

Table 4. Model Fit Test

<i>-2 Log Likelihood</i>	
Block 0	85.812
Block 1	75.662

4.4. Classification Matrix

The classification matrix states in order predict the likelihood of bankruptcy risk opinion. The predictive power of the regression model is used to predict the likelihood of the dependent variable, i.e. going-concern audit opinion in percent [14].

Based on the above table, the results of classification matrix test can be stated as a whole predictive power assumes possibility of acceptance of going concern audit opinion is 80.2%.

Table 5. Classification Matrix
Classification Table^{a,b}

	Observed	Predicted			
		OGC		Percentage Correct	
		Non Going Concern	Going Concern		
Step 1	OGC	Non Going Concern	83	2	98.4
		Going Concern	17	6	16.7
	Overall Percentage				80.2

4.5. Determination of Coefficient

In the test of the coefficient of determination the results show percentage value of 0.180, we can write conclusion all independent variables provide explanation to dependent as much as 18%, which means

that the remaining 78% of the rest factors can be influenced that are not contained in this study. Examples of variables outside of research that can affect the acceptance of going concern audit opinion are audit tenure and company size.

Table 6. Determination of Coefficient

Model Summary			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	75.662 ^a	.118	.180

4.5. Partial Hypothesis

Partial test on our research carried out using logistic regression because the dependent variable namely bankruptcy risk was dummy variable expressed by nominal scale, value 1 or 0 (bankruptcy risk or not). From the results of testing the regression coefficient with logistic regression, the logistic regression equation is obtained as follows:

$$OGC = 0.239 + (-0.871) PROF + (-0.940) LIK + (-0.271) SOLV + \epsilon$$

Information :

OGC: Going concern audit opinion

A: Constant

PROF: Profitability

LIK: Liquidity

SOLV: Solvency

ϵ : Residual

The results show an overview of the hypothesis testing the significance of each independent variable namely profitability, liquidity and solvency under study, so as to produce the following explanation as follows:

Table 6. T Test

Variables in the Equation						
	B	S.E.	Wald	df	Sig.	Exp(B)
St X1	-.871	.732	1.416	1	.234	.418
ep X2	-.940	.446	4.445	1	.035	.391
1 ^a X3	-.217	.149	2.116	1	.146	.805
Constant	.239	.593	.162	1	.687	1.270

1. Profitability. Based on refers at the table, profitability p-value 0.234. Based on value significance of the profitability variable which is greater than the value of α that is equal to 0.05, we are able to say profitability has no influence on bankruptcy risk audit (H1 rejected). Based on table, we have beta -0.871 the independent variable profitability has negative direction to bankruptcy risk audit. Our outcome support previous study by [15] and [16]

2. Liquidity. Based on refers at the results of the table, liquidity p-value: 0.035. Based on p-value liquidity variable which smaller of 0.05, we can say liquidity has influence on bankruptcy risk audit (H2 accepted). On table we can see that beta X2 -0.940 which means that the independent variable liquidity provide negative direction to bankruptcy audit risk. Our outcome supported preliminary research provided [8] and [7].

3. Solvency. Based on refers at table, solvency p-value: 0.146. Based on the significant value of the solvency variable which is greater than the value of α that is equal to 0.05, the solvency has no influence to bankruptcy audit risk (H3 rejected).

5. Conclusion and Suggestion

5.1. Conclusion

First hypothesis did not conclude a high level of profitability in a company would guarantee the company to be free from bankruptcy audit risk. This is probable audit doesn't see company's ability to achieve profits but rather leads to how the company can sort out. The results of this study did not succeed in roving that level the profits obtained to pay off all obligations incurred by the company.

Second hypothesis outcome succeeded in proving that a high level of liquidity in a company would guarantee the company to be free from bankruptcy audit risk. This is probable a corporation that has capability to write off all current liabilities by using all or part of its current assets can avoid bankruptcy audit risk.

Third hypothesis outcome based on statistical process did not agree about a high level of solvency in a company would guarantee the company to be free from going concern audit opinion.

5.2. Suggestion

By considering the results of the analysis, conclusions, and limitations that have been stated above, the improvement recommendation for further research:

1. Academicians researcher expected to be able to use all fields of companies listed on the IDX and a longer research period to provide an overall picture and improve research accuracy.

2. For investors, it is expected to be more aware of the importance of going concern audit opinion in making decisions and

Based on the beta: -0.217, it shows the independent solvency variable provide negative direction to dependent variable of bankruptcy audit risk. Our outcome support preliminary research from [5], [8]

gathering information and considering it before making an investment decision

3. For the auditors, it is hoped that they can further develop consideration of conditions that may affect the continuity corporation operational both financial and non-financial.

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