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The Role of the Audit Committee on Determinants Financial Distress with Zmijewski Model

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Abstract

This study is a quantitative study that aims to determine, analyze, prove, and test the company's health status on the effect of Current Ratio, Debt to Equity Ratio, and Return on Assets on financial distress with the Audit Committee as a Moderating Variable. The analysis in this study uses the Zmijewski model. Where the Zmijewski (1984) model uses ratio analysis that measures the performance, leverage, and liquidity of a company for its prediction model. The data used in this study is secondary data originating from the annual reports of state-owned companies listed on the IDX (Indonesian Stock Exchange) for the 2014-2018 period. The results of this study indicate that the effect of the audit committee in moderating return on assets on financial distress is significant. Furthermore, the results of this study debt to equity ratio have a significant effect on financial distress. Meanwhile, the current ratio and return on assets have no significant effect on financial distress. The audit committee does not moderate the effect of the current ratio and debt to equity ratio on financial distress.

Keywords
financial distress; current ratio; debt to equity ratio; return on assets; audit committee

I. Introduction

Financial distress is signal of the coming bankruptcy of a company. if bankruptcy is a failure of a company in carrying out its operational activities in order toproduce profitability For the sustainability of the company's age, financial distress is a situation where there is a stage of decline in the company's financial condition which usually occurs before the company experiences bankruptcy or liquidation. Economic development cannot be separated from investment conditions in a country which are closely related to the capital market. With the capital market, it is easier for a company to obtain funds and raise funds and for investors it will provide additional alternatives to invest the funds they have. The investment of funds will later increase the capital of a company so that it is able to achieve its goals. However, in practice it is often Companies that have been operating for a certain period of time were forced to disband due to financial distress which led to bankruptcy (Rismawati, 2012 in Damayanti, Yuniarta and Sinarwati, 2017). In other words, that financial distress is a signal and as an early warning for a company to go bankrupt if it is not immediately addressed and removed from the liquidation trap, of course the foundations and fortresses of the company that have been built solidly will collapse instantly with only the threat of bankruptcy. *Financial distress* can caused by several factors, both internal and external factors, internal factors can be caused by confusion or mistakes in the allocation of company assets, namely the Neoclassical model (occurs if the allocation of resources within the company is not appropriate. Management is less able to allocate resources (assets) in the company for the company's operational activities.), Financial model (mixing of assets has been done correctly but the financial structure is wrong with liquidity constraints.) and Corporate governance model (mixture of assets and financial structure that has been done correctly but poorly managed.). While the external factors are none other than macroeconomic factors such as fluctuations in inflation, interest rates, audit committees, employee wages and so on which are uncontrollable factors by the company.

The economic condition of the population is a condition that describes human life that has economic score (Shah et al, 2020). Economic growth is still an important goal in a country's economy, especially for developing countries like Indonesia (Magdalena and Suhatman, 2020). According to Tjiptono in Marlizar (2020) marketing performance is a function that has the greatest contact with the external environment, even though the company only has limited control over the company's environment.

The company's performance can be measured by the profit generated, when the company could generate high profits, it is possible that the company has a high cash flow so that it can operate the company smoothly so as to avoid financial difficulties or threaten its business continuity. Companies that are not able to maintain their performance will experience financial difficulties (financial distress) which will result in bankruptcy. Indicators that show whether a company is experiencing financial distress or not can be identified by several phenomena, including those marked by layoffs (mass layoffs), obstructed cash flow due to bad debts, or if for 2 years the net operating profit is negative and for more than 1 year did not pay dividends.

Another phenomenon of financial distress is the occurrence of delisting cases of several public companies on the Indonesia Stock Exchange (IDX) such as PT. Borneo Lumbung Energi & Metal Tbk (20 January 2020), PT. Arpeni Pratama Ocean Line Tbk (06 April 2020), PT. Danayasa Arthatama Tbk (20 April 2020) and PT. Leo Investments Tbk (January 23, 2020) was mostly due to financial difficulties or the company was in a state of financial distress. In addition to delisting cases, many companies tend to experience liquidity, as indicated by the increasing number of companies unable to fulfill their obligations to banks. Therefore, the existence of financial distress can be predicted early by using various methods, among others, by conducting financial statement analysis, cash flow analysis, and so on. The method that is more often used by companies is financial ratio analysis, where companies can predict the possibility of financial distress by performing financial ratios using one of the Z-score methods, Zeta Model, O-Score Model, Grover Model, Springate Model, Zmijewski Model, and Camel Ratio. By using this method, we can easily predict the existence of financial distress for the future period and be able to take decisions to expel the company from the threat of bankruptcy.

According to Muflihah (2017) financial distress is a condition in which the company experiences financial difficulties and the threat of not being able to maintain their business continuity. If the company experiences financial difficulties, it can make investors such as investors (shareholders), potential investors and creditors less interested in investing or lending to the company. And if the company cannot find a solution, it is certain that the company cannot continue its business or go bankrupt.

Research on financial distress has been carried out by several previous researchers using financial ratios. The financial ratios that are often used include analysis that measures performance, leverage and liquidity. In addition to using an analysis that measures performance, leverage and liquidity to predict the possibility of financial distress, there are also external factors that influence the audit committee in a company. In previous studies rarely used the factor external in determining the financial distress of a company. According to the explanation of Article 121 paragraph (1) of Law Number 40 of 2007 concerning Limited Liability Companies (UUPT), the audit committee is one type of committee formed by the board of commissioners. The same thing is stated in Article 1 point 1 of the Financial Services Authority Regulation Number 55/POJK.04/2015 of 2015 concerning the Establishment and Guidelines for the Work Implementation of the Audit Committee (POJK 55/2015), the audit committee is a committee formed by and responsible to the Board of Commissioners in helping carry out the duties and functions of the board of commissioners.

The audit committee has duties and responsibilities including reviewing financial information that will be issued by the issuer to the public and the authorities, including financial reports, projections, and other reports related to the issuer's financial information. In this study, the authors are interested in making the Audit Committee a moderating variable because there is a possible influence on strengthen or weaken financial ratios to Financial Distress. Chosen company BUMN in this study because BUMN companies are companies that have the most influence on the condition of the Indonesian economy. Besides that, state-owned companies also consist of several sectors so that each sector has different characteristics and many people think that state-owned companies have never experienced financial distress, therefore it becomes an attraction for research. The importance of predicting financial distress company used to find out condition current and future companies, the authors are interested in taking the title "The Role of the Audit Committee in Determinants of Financial Distress with the Zmijewski Model (Study of State-Owned Enterprises Listed on the Indonesia Stock Exchange 2014-2018 Period)". This study uses the Zmijewski model, this model used to see the financial distress status of the company with the determinant components of Current Assets, Debt to Equity Ratio and Return on Assets. These determinants are an important component in the company to predict the company's financial distress, so the authors chose the Zmijewski Model in this study.

II. Review of Literature

2.1 Signaling Theory

Signaling theory is a theory that underlies voluntary disclosure where management always wants to show good news to potential investors and shareholders. Management also intends to show news of the company's success with the aim of increasing its credibility even though the information is not mandatory. Signal theory suggests how an entity can provide a signal to users of financial statements, this signal can be in the form of management achievements in realizing owner policies. Companies must present financial statements because the company's financial decision making is based on the disclosure of its financial statements (Muflihah, 2017). Furthermore, the signal theory in the topic of financial distress explains that if the financial condition is good and its existence is still stable, managers will carry out liberal accounting. On the other hand, if the financial condition is bad and its existence is in doubt, the manager will carry out conservative accounting (Muflihah, 2017). Liberal accounting can be interpreted as an optimistic reaction inface uncertainty while conservative accounting can be defined as a prudent reaction in the face of uncertainty that occurs in economic and business activities. The purpose of disclosure is to present information that is considered to be able to influence the decision making of stakeholders (stakeholders) to achieve the objectives of financial reporting. The setting of standards regarding what must be disclosed has been determined by regulatory bodies such as the Securities Exchange Act (SEC) and Market Supervisor Capital (BAPEPAM).

2.2 Financial Statements

Harahap (2011:105) for analysts, financial reports are an important medium for assessing performance and condition of the entity. In the first stage an analyst will not be able to directly describe the state of the company and if he could, an analyst will not be able to understand the whole of the company's activities. Therefore, financial statements are the media used as base making a decision.

Financial statements are part of the accounting process of financial reporting. Financial statements describe the financial condition and performance of the company from a certain period. The financial statements that we often encounter include the statement of financial position, profit/loss statement, statement of changes in equity, cash flow statement, balance sheet report and notes to financial statements.

2.3 Financial Distress

Financial distress is a situation where the existence of a company experiences financial difficulties. Muflihah, (2017) defines financial distress as a final process of declining performance before going bankrupt. According to Muflihah, (2017), financial distressoccurs because the company's liabilities are greater than the company's wealth (assets), size and profit. The hampered cash flow makes the company not could maximize the company's operations which result in a decrease in profit or loss so that its existence is threatened. Occurs when the company owes debt to cover the company's operational costs in the transaction period, giving rise to an obligation to pay off debt in future periods. When the bill is due and the company does not have the cash or money to pay it is possible that the creditor will confiscate it to pay off the debt.

Company Loss

Losses in operational activities for several years so that generate negative cash flow. This is because operating expenses are not balanced with revenues. The analysis in this study uses the Zmijewski model. Where the Zmijewski (1984) model uses financial ratios of return on assets (ROA), leverage, and liquidity to get a more precise pattern (Zmijewski, 1984 in Permana, Ahmar, Djaddang, 2017):

Zmijewski models

$X = -4.3 - 4.5X1 + 5.7X2 – 0.004X3$

Where:

X1 = ROA (Return on Assets)

X2 = Leverage (Debt to Equity Ratio)

X3 = Liquidity (Current Ratio)

2.4 Financial Ratio

Muflihah (2017) states that financial ratios are the relationship between one post and another that describes a balance and using this ratio will show the condition of the company. Financial ratios aim to simplify the relationship between items so that it is easier for users of financial statements to understand the relationship. For example, the ratio of current assets, debt to equity ratio, and return on assets.

a. Current Ratio

Muflihah (2017) stated that the liquidity ratio shows the company's ability to pay off its short-term debts/liabilities. This ratio is calculated from working capital, namely current assets and current liabilities. The liquidity ratios include the current ratio, quick ratio and the ratio of cash to current assets. Current ratiodescribe ability the company pays off its short-term debt with current assets. This ratio can be calculated by comparing current assets divided by current liabilities. The greater the value of the current ratio, the less likely the company is to experience financial distress because the company has a number of liquid assets such as cash or money used to pay off its debts and finance its operational activities both during the transaction period so that the company does not experience financial difficulties or threaten its business continuity.

b. Debt to Equity Ratio

Muflihah, (2017) stated that the solvency ratio shows the company's ability to pay off short-term and long-term debt. This ratio can be calculated from long-term items. The solvency ratios include debt-to-equity ratios, debt-to-equity ratios and debt-to-equity ratios. Analysis of this ratio can bedescribe ability the company in paying its debts (short term and long term) if at one time the company is dissolved Muflihah, 2017. This debt to equity ratio can be calculated by comparing the total debt divided by total assets. Companies that have a small debt-to-equity ratio means that the company is not at risk of experiencing financial distress (financial distress) because the smaller the debt ratio value illustrates that the company does not have a lot of debt to outsiders so that the company can use its assets to cover its operational costs and does not result in an obligation to pay off debts that are too large in future periods.

c. Return on Asset

Profitability is the level of success or failure of the company during a certain period. Muflihah (2017) stated that this profitability ratio shows the company's ability to generate profits. This ratio is also often called the operating ratio. Profitability ratios include profit margin, return on assets, return on total assets and return on equity. in this study to measure the profitability ratio using the return on assets ratio as used by Hapsari (2012) and Widarjo and Setiawan (2009). The smaller the return on assets, it is possible that the company's performance is less effective in processing its assets to generate profits so that it can cause losses that result in negative cash flows and the company will experience financial distress if it occurs in several years.

2.5 Audit Committee

The Audit Committee is an external factor in a company. According to the explanation of Article 121 paragraph (1) of Law Number 40 of 2007 concerning Limited Liability Companies (UUPT), the audit committee is one type of committee formed by the board of commissioners. The same thing is stated in Article 1 point 1 of the Financial Services Authority Regulation Number 55/POJK.04/2015 of 2015 concerning the Establishment and Guidelines for the Implementation of the Audit Committee (POJK 55/2015), the audit committee is a committee formed by and responsible to the Board of Commissioners in assisting in carrying out the duties and functions of the board of commissioners.

2.6 Framework

Based on the theory and previous research, the framework and hypotheses in this study are as follows

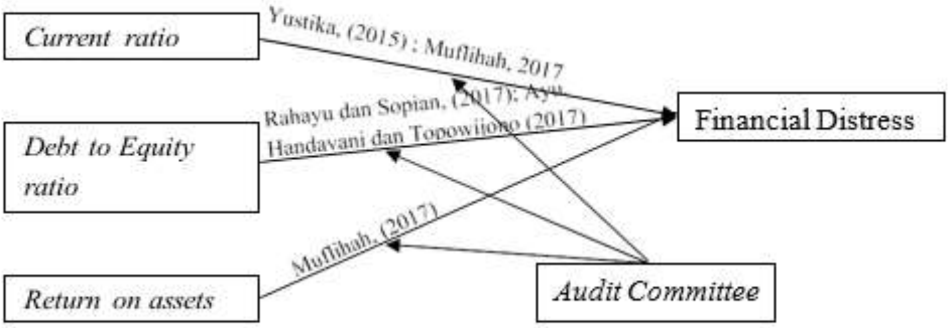

Figure 1. *Framework for Thinking*

Based on Figure 2.2 above, the current ratio, debt to equity ratio and return on assets are the independent variable which has a relationship with the dependent variable is financial distress, while the audit committee is a moderating variable which has a moderating role in the relationship between the independent variables, namely the current ratio, debt to equity ratio and return on assets with the dependent variable being financial distress.

2.7 Research Hypothesis

Formulation of research hypotheses is the next step after researchers put forward a framework of thought, Understanding Hypotheses according to Sugiyono (2009: 51), "The hypothesis is a temporary answer to the formulation of the research problem" In accordance with the formulation of the problem above, the statistical hypothesis in this study is:

H1: There is an effect of current ratio to financial distress
H2: There is an effect of Debt to Equity ratio on financial distress
H3: There is an effect of Return on assets to financial distress
H4: The role of the Audit Committee in moderating the effect of the current ratio on financial distress
H5: The role of the Audit Committee in moderating the effect of the Debt to Equity Ratio on Financial Distress
H6: The role of the Audit Committee in moderating the Effect of Return on Assets on Financial Distress

III. Research Method

This study uses descriptive quantitative methods with the aim of determining the relationship between variables in a population. In quantitative research, data sets are collected, processed and analyzed to find the relationship between the variables studied. Quantitative research method is one type of research whose specifications are systematic, well-planned and clearly structured from the beginning to the making of the research design. According to Sugiyono (2013: 13), quantitative research methods can be interpreted as research methods based on the philosophy of positivism, used to examine certain populations or samples, sampling techniques are generally carried out randomly, data collectionusing research instruments, data analysis character quantitative/statistical with the aim of testing the established hypothesis. The definition of descriptive according to Sugiyono (2012:29) is a method that functions to describe or provide an overview of the object under study through data or samples that have been collected as they are, without analyzing and making generally accepted conclusions. The analysis in this study uses the Zmijewski model. Where the Zmijewski (1984) model uses financial ratios of return on assets (ROA), leverage, and liquidity to get a more precise pattern (Zmijewski, 1984 in Permana, Ahmar, Djaddang, 2017). This study is a quantitative study that aims to determine, analyze, prove, and test the company's health status on the effect of Current Ratio, Debt to Equity Ratio, and Return on Assets on financial distress with the Audit Committee as a Moderating Variable. The analysis in this study uses the Zmijewski model. Where the Zmijewski (1984) model uses the financial ratio of return on assets (ROA), leverage, and liquidity to get a more precise pattern (Zmijewski, 1984 in Permana, Ahmar, Djaddang, 2017). The data used in this study is secondary data originating from the annual reports of state-owned companies listed on the IDX (Indonesian Stock Exchange) for the 2014-2018 period.

IV. Results and Discussion

This discussion aims to analyze the results of the research, to explain the results of the research in more detail according to the research objectives and to find out the hypotheses that have been determined based on theory and previous research. Further discussion will be described below:

4.1 Effect of Current Ratio on Financial Distress

Current ratio is a ratio to measure the liquidity of a company that describes the company's ability to fund the company's operations and the ability to meet short-term debt using current assets.

Based on the results of the study, the current ratio has no significant effect on financial distress. This shows that the results of the study are not in line with the logic of the existing theory, namely the greater the level of liquidity required generated by the company, the less likely it is to experience financial distress. In this case, it means that the higher the level of liquidity generated by the company, it will not necessarily avoid financial distress because there are other factors that can affect financial distress.

Research result this contrary to previous research conducted by Ayu, Handayani and Topowijono (2017) which stated that return on assets had a significant negative effect on financial distress, while other factors, namely, current ratio, quick ratio, debt equity ratio equity, and Ln total assets have no significant effect on financial distress.

4.2 Effect of Debt to Equity Ratio against Financial Distress

Debt to Equity ratio is the ratio to measure the solvency of a company that describes the ability company to long-term debt short or long term. The larger the ratio, the greater the risk and the smaller the ratio, the smaller the risk.

Based on the results of the study, the debt to equity ratio has a significant effect on financial distress. This shows that the results of the study are in line with the logic of the existing theory, namely the greater the level of solvability produced by the company, the less likely it is to experience financial distress. In this case, it means that the company's ability to deal with short-term and long-term debt is not a problem or obstacle. So with the high level of solvency, this is good news and of course the company tends to be faster in submitting information in the form of its annual financial reports to the public.

The results of this study do not contradict previous research conducted by Ayu, Handayani and Topowijono (2017) which stated that return on *asset* has a significant negative effect on financial distress, while other factors, namely, current ratio, quick ratio, debt ratio, debt equity ratio, return on equity, and have significant impact

4.3 Effect of Return on Assets against Financial Distress

Return on Asset is the ratio to measure the profitability of a company which describes the company's ability to generate profits over a certain period. The larger the ratio, the smaller the risk and the smaller the ratio, the greater the risk.

Based on the results of the study, that return on assets has no significant effect on financial distress. This shows that the results of the study are not in line with the logic of the existing theory, namely the high profitability of a company will indicate that the company is able to generate high profits high, so that the increase in assets will also occur and will keep the company from the threat of financial distress. In this case, it means that the higher the level of profitability generated by the company, it will not necessarily avoid financial distress because there are other factors that have a greater influence on financial distress.

4.4 The Role of the Audit Committee Moderates the Effect of Current Ratio on Financial Distress

The audit committee is a committee formed by and responsible for responsible to the Board of Commissioners in helping carry out the duties and functions of the board of commissioners. The audit committee has duties and responsibilities including reviewing financial information that will be issued by the issuer to the public and the authorities, including financial reports, projections, and other reports related to the issuer's financial information. In this study, the authors are interested in making the Audit Committee a moderating variable because there is a possible influence on strengthening or weakening financial ratios on Financial Distress.

Based on the results of the study, the role of the audit committee in moderating the effect of the current ratio on financial distress does not have a significant effect, but the value is significantly greater than the effect of the current ratio itself on financial distress. This shows that the research results are in line with the logic of the existing theory, namely that the role of the audit committee in a company can strengthen or weaken financial ratio to Financial Distress. In this case it means that the role of the audit committee can weaken the effect of the current ratio on financial distress.

The results of this study are in line with previous research conducted by Damayanti, Yuniarta and Sinarwati (2017) which stated that the size of the audit committee did not have a significant negative effect on the prediction of financial distress.

4.5 The Role of the Audit Committee in Moderating the Effect of Debt to Equity Ratio on Financial Distress

The audit committee is a committee formed by and responsible to the Board of Commissioners in assisting in carrying out the duties and functions of the board of commissioners. The audit committee has duties and responsibilities including reviewing financial information that will be issued by the issuer to the public and the authorities, including financial reports, projections, and other reports related to the issuer's financial information. In this study the authors are interested into make the Audit Committee a moderating variable because there is a possibility of influence to strengthen or weaken financial ratios to Financial Distress.

Based on the results of the study, the role of the audit committee in moderating the effect of the debt to equity ratio on financial distress is not significant, but the value is significantly greater than the effect of the debt to equity ratio itself on financial distress. This shows that the results of the study are in line with the logic of the existing theory, namely that the role of the audit committee in a company can strengthen or weaken the financial ratio to Financial Distress. In this case, it means that the role of the audit committee can weaken the influence of the debt to equity ratio on financial distress.

The results of this study are in line with previous research conducted by Damayanti, Yuniarta and Sinarwati (2017) which stated that the size of the audit committee had no negative effect significant to the prediction of financial distress.

4.6 The Role of the Audit Committee in Moderating the Effect of Return on Assets on Financial Distress

The audit committee is a committee formed by and responsible to the Board of Commissioners in assisting in carrying out the duties and functions of the board of commissioners. The audit committee has duties and responsibilities including reviewing financial information that will be issued by the issuer to the public and the authorities, including financial reports, projections, and other reports related to the issuer's financial information. In this study, the authors are interested in making the Audit Committee a moderating variable because there is a possible influence on strengthening or weakening financial ratios on Financial Distress.

Based on the results of the study, the role of the audit committee in moderating the effect of return on assets on financial distress has a significant effect on the value of significantly smaller than the effect of return on assets itself on financial distress. This shows that the results of the study are in line with the logic of the existing theory, namely that the role of the audit committee in a company can strengthen or weaken financial ratios to Financial Distress. In this case it means that the role of the audit committee can strengthen the effect of return on assets on financial distress.

The results of this study are not in line with previous research conducted by Damayanti, Yuniarta and Sinarwati (2017) which stated that the size of the audit committee did not have a significant negative effect on the prediction of financial distress.

V. Conclusion

Based on research conducted on 16 state-owned companies that aim to know the role of the audit committee on the determinants of financial distress, namely:

1. Based on the research conducted, there is an effect of the audit committee moderating return on assets on financial distress. The significant value (sig) of 0.026 is much smaller than 0.05, so the effect of the audit committee in moderating return on assets on financial distress is significant. Based on the SPSS calculation, the t value is -2.283, while the p value is 0.026, so that the p value is <5% (0.026 <0.05), meaning that there is a significant effect for the audit committee variable to moderate return on assets on financial distress. These results indicate that the higher the audit committee moderating return on assets, the better the financial distress, and vice versa.
2. Furthermore, in this study there is no effect of the audit committee moderating the debt to equity ratio on financial distress. the significant value (sig) of 0.192 is much greater than 0.05, so the influence of the audit committee moderates the debt to equity ratio to financial distress is not significant. Based on the SPSS calculation, the t-count is -1.320, while the p-value is 0.192, so that the p-value is >5% (0.192>0.05), meaning that there

is no significant effect for the audit committee variable to moderate the debt to equity ratio on financial distress. These results indicate that the higher the audit committee moderating debt to equity ratio, the better the financial distress, and vice versa.

3. Furthermore, in this study there is no effect of the audit committee moderating the current ratio on financial distress. the significant value (sig) of 0.320 is much greater than 0.05, so the effect of the audit committee moderating the current ratio on financial distress is not significant. Based on the SPSS calculation, the t-count value is 1.003, while the p-value is 0.320, so that the p-value is >5% (0.320>0.05), meaning that there is no significant effect for the audit committee variable moderating the current ratio on financial distress. This result shows that the higher the audit committee moderating the current ratio, the better the financial distress, and vice versa.

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