ANALYSIS OF FINANCIAL RATIOS TO PREDICT FINANCIAL DISTRESS CONDITIONS OF MANUFACTURING COMPANIES LISTED ON THE INDONESIAN STOCK EXCHANGE

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\begin{table}[h]
\begin{tabular}{|l|}
\hline
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\end{table}

\textbf{ABSTRACT}

\textbf{Purpose:} This aims of this study is to identify and analyze the effects of liquidity, profitability, and leverage ratio changes to predict financial distress experienced by manufacturing companies listed on the Indonesian stock exchange.

\textbf{Theoretical framework:} The quality of financial reports can improve and enhance a company’s financial performance and confirm the agency theory. The use of financial report quality can help explain relationship conflicts between the principal and the agents and strengthen the explanation of agency theory.

\textbf{Design/Methodology/Approach:} The methodology this study used secondary data from the Indonesian stock exchange website. The research population consisted of all manufacturing companies listed on the Indonesian stock exchange. The sample of this study was chosen based on purposive sampling techniques resulting in 15 manufacturing companies meeting the criteria for analysis using logistic regression. The data were analyzed in a quantitative manner using SPSS version 23.

\textbf{Findings:} The result of this research confirm the notion of agency theory stating that current ratio (CR) and return on assets (ROA) have negative and significant effects on financial distress. However, the debt-to-asset ratio (DAR) variable does not significantly affect financial distress. These findings indicate that a good current ratio and return on assets of a company will affect the company’s financial conditions while the effect of the debt-to-asset ratio (DAR) is not significant because the company is experiencing financial pressure in settling long-term debts.

\textbf{Research, Practical & Social implications:} The study contributes to strengthening previous research findings and helps provide useful information to investors, manufacturing companies, and the business world in general on the Indonesian Stock Exchange in predicting the financial conditions of companies that are experiencing financial distress.

\textbf{Originality/Value:} The value of the study contributes ideas to improve the quality of financial information, especially for accounting professional institutions (standard setters) and regulators to improve the quality of financial accounting standards in order to provide quality information to investors, government, stakeholders, and business society in general.

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ANÁLISE DOS RÁCIOIS FINANCEIROS PARA PREVER AS CONDIÇÕES DE PERTURBAÇÃO FINANCEIRA DAS EMPRESAS INDUSTRIAIS LISTADAS NA BOLSA DE VALORES DA INDONÉSIA

RESUMO
Objetivo: Este estudo tem como objetivo identificar e analisar os efeitos da liquidez, lucratividade e alterações no índice de alavancagem para prever dificuldades financeiras vividas por empresas de manufatura listadas na bolsa de valores da Indonésia.

Estrutura teórica: A qualidade dos relatórios financeiros pode melhorar e aprimorar o desempenho financeiro de uma empresa e confirmar a teoria da agência. O uso da qualidade de relatórios financeiros pode ajudar a explicar conflitos de relacionamento entre o principal e os agentes e fortalecer a explicação da teoria da agência.

Projeto/Metodologia/Abordagem: A metodologia utilizada neste estudo foi a dos dados secundários do sítio da bolsa de valores da Indonésia. A população de pesquisa consistia em todas as empresas de manufatura listadas na bolsa de valores da Indonésia. A amostra deste estudo foi escolhida com base em técnicas de amostragem objetiva, resultando em 15 empresas de fabricação que atendem aos critérios de análise por regressão logística. Os dados foram analisados de forma quantitativa utilizando o SPSS versão 23.

Constatações: O resultado desta pesquisa confirma a noção de teoria da agência afirmando que o rácio atual (CR) e o retorno sobre ativos (ROA) têm efeitos negativos e significativos sobre a angústia financeira. No entanto, a variável do rácio dívida/ativos (RAD) não afeta significativamente as dificuldades financeiras. Estas conclusões indicam que um bom rácio atual e a rendibilidade dos ativos de uma empresa afetarão as condições financeiras da empresa, ao passo que o efeito do rácio dívida/ativos (RAD) não é significativo, uma vez que a empresa está a sofrer pressão financeira para liquidar dívidas a longo prazo.

Investigação, implicações práticas e socias: O estudo contribui para reforçar os resultados de investigação anteriores e ajuda a fornecer informações úteis aos investidores, empresas de produção e ao mundo empresarial em geral sobre a Bolsa de Valores da Indonésia na previsão das condições financeiras das empresas que estão a passar por dificuldades financeiras.

Originalidade/Valor: O valor do estudo contribui com ideias para melhorar a qualidade da informação financeira, especialmente para instituições profissionais de contabilidade (normalizadores) e reguladores para melhorar a qualidade das normas de contabilidade financeira, a fim de fornecer informações de qualidade aos investidores, governo, partes interessadas e sociedade empresarial em geral.

Palavras-chave: Rácio Financeiro, Dificuldades Financeiras, Rácio Atual, Retorno sobre o ativo, Rácio Dívida-Ativo.

ANÁLISIS DE LAS RELACIONES FINANCIERAS PARA PREDECIR LAS CONDICIONES DE APUROS FINANCIEROS DE LAS EMPRESAS MANUFACTURERAS QUE COTIZAN EN LA BOLSA DE VALORES DE INDONESIA

RESUMEN
Objetivo: El objetivo de este estudio es identificar y analizar los efectos de los cambios en la liquidez, la rentabilidad y el ratio de apalancamiento para predecir las dificultades financieras experimentadas por las empresas manufactureras que cotizan en la bolsa de valores de Indonesia.

Marco teórico: La calidad de los informes financieros puede mejorar y mejorar el rendimiento financiero de una empresa y confirmar la teoría de la agencia. El uso de la calidad del informe financiero puede ayudar a explicar los conflictos de relación entre el director y los agentes y fortalecer la explicación de la teoría de la agencia.

Diseño/Metodología/Enfoque: La metodología de este estudio utilizó datos secundarios del sitio web de la bolsa de valores de Indonesia. La población investigada estaba compuesta por todas las empresas manufactureras que cotizaban en la bolsa de valores de Indonesia. La muestra de este estudio fue elegida con técnicas de muestreo intencional, resultando 15 empresas manufactureras que cumplen con los criterios para el análisis mediante regresión logística. Los datos se analizaron cuantitativamente con el programa SPSS versión 23.

Resultados: Los resultados de esta investigación confirman la noción de la teoría de agencia afirmando que el ratio de riesgos (RC) actual y el rendimiento de los activos (ROA) tienen efectos negativos y significativos en la dificultad financiera. Sin embargo, la variable de ratio deuda-activos (DAR) no afecta significativamente a las dificultades financieras. Estos hallazgos indican que una buena relación corriente y el rendimiento de los activos de una empresa afectarán a las condiciones financieras de la empresa, mientras que el efecto de la relación deuda-activos (DAR) no es significativo porque la empresa está experimentando una presión financiera para saldar deudas a largo plazo.

Investigación, implicaciones prácticas y sociales: El estudio contribuye a fortalecer los hallazgos de investigaciones anteriores y ayuda a proporcionar información útil a los inversores, las empresas manufactureras.
Abdullah, M., Mirosea, N., Aswati, W. O., Santi. (2023)
Analysis of Financial Ratios to Predict Financial Distress Conditions of Manufacturing Companies Listed on the Indonesian Stock Exchange

INTRODUCTION

The performance of the Indonesian Stock Exchange shows a very positive trend in recent years. The Coronavirus Disease 19 (Covid-19) outbreak in Wuhan, China at the end of 2019 made the Indonesian government implement the Large Scale Social Restriction policy on March 2020. As an implication of the policy, the performance of the Indonesian Stock Exchange plummeted to its lowest level. However, in September 2020, the Indonesian government managed to convince the investors so that the stock exchange began to rise, and the investors began to have confidence in Indonesia’s economic performance. This could be seen from the financial sector’s performance, which was able to survive, and affected the other sectors to rise. The Indonesia Composite Index (ICI) increased within a week. In Friday trading (23/10), the index closed at 5,112.19. The Indonesian stock market recorded the trading data movement closed at the positive zone by the end of October 2020.

The performance of companies in the tourism, transportation, and hospitality sectors tends to experience a serious contraction due to the Covid-19 pandemic. On the other hand, the performance of companies in the financial, mining, and e-commerce sectors shows a relatively positive development. These companies’ performance can be signified by their undisturbed profitability, liquidity, and leverage ratio.

A company with good, profitability, liquidity, and leverage ratios indicates that the company is not experiencing financial distress. The financial ratio data can be used as a reference in determining whether a company is experiencing financial distress or not. Profitability refers to the ability of a company to generate income through the utilization of its assets (Hoerova, 2018) A company that is able to manage its assets optimally to generate maximum income signifies a financially liquid company. On the other hand, a company that fails to manage its assets to generate maximum income indicates that the company is experiencing financial problems or is in financial distress (Yanuar, 2018)
A company that is facing financial distress is commonly characterized by difficulties in settling short-time debts. If not resolved immediately, this situation may be a signal that the company is heading for bankruptcy or operational failure in the future. Financial distress can be triggered by internal factors, such as liquidity issues, decreasing profitability, and leverage problems experienced by a company, resulting in the company’s difficulties in settling its matured debts.

**LITERATURE REVIEW**

**Agency Theory**

This study refers to the agency theory proposed by Jensen & Meckling (1976) The theory defines an agency relationship as a contract that states that one or more parties (the principals) ask the other parties (the agents) to perform certain services on behalf of the principals by delegating some authority to the agents. In this sense, the company owner (the principal) delegates the management (the agent) to manage the company. A shareholder expects increasing wealth or prosperity but the management as the party who receives the authority to manage the company tends to do something that maximizes their interests and sacrifices the shareholders’. This condition triggers agency conflicts (Bathala et al., 1994). The definition confirms a statement proposed by (Abdullah & Awaluddin, 2016) They define agency theory as a branch of game theory that studies the design of contracts to motivate an agent to act rationally on behalf of the principal. If this is not the case, the interests of the agent will collide with the interests of the principal.

The agency theory is an assumption that explains the relationship between the principal(s) and the agent(s). It defines the best way to manage the relationship between the principal (i.e., the shareholders) and the agent (i.e. the management) in which the principal evaluates the agent’s performance. The theory argues that in conditions of asymmetric information, agency problems are raised (Ahmad et al., 2018). Agency theory has attracted several disciplines: accounting, finance, economics, law, political science, strategy, and organizational psychology. The theory explaining the relationship between company owners and managers needs to be reviewed further in recent debates on company performance (Zogning, 2017).
**Signaling Theory**

The signaling theory was first proposed by Spence (1973) in his research entitled *Job Market Signaling*. According to the signaling theory, a signal giver possesses great internal information that is not publicly known or has not reached its receivers with signal quality that is just as important. According to (Jogiyanto, 2014) information published by a company may serve as a beacon that sends signals to investors in making decisions related to their investment. Shareholders or information givers attract investors to make investments in the company to improve the company’s values in the future. Meanwhile, Eugene F, (2014) perceive the signaling theory as a company management behavior in providing guidance to investors regarding management’s views on the company’s prospects in the future.

The impact of market signaling on financial markets has been extensively researched by utilizing the signaling theory as a strong theoretical foundation and is increasingly used in management research (Bergh et al., 2014). Signaling theory is also widely used in explaining investment decisions (Alsos & Ljunggren, 2017). In their research, Wei & Zhou (2016) found that before the publication of an income statement, bond trading activities tended to increase due to asymmetrical information from new signals.

**Financial Ratio Analysis**

Kasmir (2017) defines financial ratio analysis as an activity of comparing the numbers in a financial statement by dividing one number by another. The comparison can be carried out by comparing a component to other components within the same financial statement or by comparing the components in different financial statements.

Financial ratio analysis refers to activities of analyzing financial statements by comparing one account to another in a financial statement. The comparison can be carried out between accounts in balance sheets or income statements. The analysis aims to identify the correlation between accounts in a balance sheet or an income statement. It describes the correlation and comparison of the number of accounts in a financial statement. The application of ratios as a method of analysis may explain and describe the financial condition of a company (Suajarweni, 2018). Husnan & Pudjiastuti (2015) state that financial ratio analysis is carried out to facilitate the analysts in understanding the financial condition of a company. Financial ratio analysis has been used to determine the health of a company since the 1930s (Ahmad, 2013). Hamid et al, (2023) underscores the importance for businesses to use financial failure models as a means of evaluating their state of financial well-being.
Practically, the financial ratio analysis is categorized into three categories (Kasmir, 2017) namely:

a. Balance ratio, comparison of numbers (accounts) originated from balance sheets
b. Profit ratio, comparison of numbers (accounts) originated from income statements
c. Inter statement ratio, comparison of numbers (accounts) originated from two sources (balance sheets, and income statements).

**Financial Distress**

In their study, Widarjo & Setiawan (2009) explain that a company is considered experiencing financial distress if it experiences losses in two consecutive fiscal years (periods). This variable is measured using dummy variables, namely:

0 = non-financial distress
1 = financial distress

In their study, Sari & Diana (2020) conclude three conditions that may lead to the financial distress of a company. They are financial difficulties, increasing debt and interest rates, and financial losses (Siahaan et al., 2023).

**HYPOTHESES**

**Relationship Liquidity on Financial Distress**

The liquidity of a company is an important indicator when assessing its overall financial health. A higher liquidity level suggests better financial health for the company. Liquidity ratios are closely tied to a company's ability to meet short-term obligations. A higher liquidity ratio indicates a lower likelihood of the company experiencing financial distress (Oktarina, 2018). Additionally, according to Hutauruk et al. (2021) companies with high liquidity ratios are less likely to face bankruptcy threats because good liquidity indicates that the company is financially capable of fulfilling its short-term debts. However, Fitri & Syamwil (2020) found that liquidity does not have an impact on a company's financial distress condition.

H1: Liquidity has significant effects on financial distress

**Relationship Profitability Ratio on Financial Distress**

Profitability serves as an indicator to gauge whether a company's performance is favorable or unfavorable. The performance of a company is reflected in the amount of profit it generates in an accounting period. The higher the profit a company obtains, the more it shows its ability to generate earnings to finance operational activities and provide dividends to shareholders.

Manufacturing companies listed on the Indonesian stock exchange achieve a favorable level of profitability, it can serve as a compelling factor for investors, enticing them to invest in the company with the expectation of future returns. The reported earnings of manufacturing companies always provide interesting information for investors. A strong profitability of manufacturing companies indicates that they are becoming less susceptible to financial pressure or financial distress (Hidayat & Meiranto, 2014). Andre (2013) states that companies facing financial pressure tend to experience declining profits in recent years, indicating that the company is facing financial distress.

H2: Profitability has significant effects on financial distress

**Relationship Leverage Ratio (DAR) on Financial Distress**

Certain companies choose to utilize debt to finance their investments. Investments in a company are expected to generate a good return to cover all of its debts. Companies with significant debt will not be at risk if they can manage their debt to generate higher cash inflows. With increased cash inflows, the company is considered capable of repaying all of its debts (Normiati & Amalia, 2021).

Companies with high leverage levels face risks in meeting their maturing debts because immediate obligations must be fulfilled with available cash funds. The financial ratio commonly used to measure leverage is the total liabilities to total equity ratio (Almilia & Kristijadi, 2003). Yusbardini & Rashid (2019) found that leverage has an impact on financial distress. Based on this explanation, the proposed hypothesis is:

H3: Leverage has significant effects on financial distress

**METHODOLOGY**

This research was carried out on manufacturing companies listed on the Indonesian Stock Exchange during 2014-2018. The data were obtained by accessing the official website of the Indonesian Stock Exchange (www.idx.co.id) and finance.yahoo.com. The objects of this
research consisted of data or information related to current ratios (X1), return on assets (X2), and debt-to-asset ratios (X3) that served as independent variables of this research meanwhile the financial distress experienced by manufacturing companies listed on the Indonesian Stock Exchange (Y) served as the dependent variable of this research.

The population of this research was all manufacturing companies listed on the Indonesian Stock Exchange during the 2014-2018 period consisting of 183 companies. The sampling technique applied in this research was purposive sampling with sampling criteria presented in the following table 1.

<table>
<thead>
<tr>
<th>Sampling Criteria</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing companies listed on the Indonesian Stock Exchange</td>
<td>183 companies</td>
</tr>
<tr>
<td>Exchange 2014-2018 periods</td>
<td></td>
</tr>
<tr>
<td>Manufacturing companies not listed in the Indonesian Stock</td>
<td>(36) companies</td>
</tr>
<tr>
<td>Exchange for two consecutive years 2014-2018</td>
<td></td>
</tr>
<tr>
<td>Manufacturing companies with non-audited financial statements</td>
<td>(6) companies</td>
</tr>
<tr>
<td>in 2014-2018</td>
<td></td>
</tr>
<tr>
<td>Manufacturing companies not publishing financial statements</td>
<td>(35) companies</td>
</tr>
<tr>
<td>in 2014-2018</td>
<td></td>
</tr>
<tr>
<td>Manufacturing companies with fluctuated income in 2014-2018</td>
<td>(91) companies</td>
</tr>
<tr>
<td>Number of research samples</td>
<td>15 companies</td>
</tr>
<tr>
<td>Number of observed financial statements in five years</td>
<td>75 financial statements</td>
</tr>
</tbody>
</table>

Source: Indonesia Stock Exchange (2019)

This research used secondary data obtained from a third party in the form of published financial statements. Data were collected using a documentation technique, by documenting the published financial statements of manufacturing companies listed on the Indonesian Stock Exchange available at its official website.

The analysis tool used in this research was the logistic regression analysis with the help of IBM Statistical Package for Social Sciences (SPSS) version 23 software. This technique was applied to examine the significance of a company’s financial performance effects measured through the current ratio, return on assets, and debt-to-asset ratio variables. The correlation between these three variables is expressed in the following equation:

\[
PFD = B_0 + B_1 \text{LK} + B_2 \text{PROFIT} + B_3 \text{LEVERAGE} + e
\]

Where

P = the probability of a company experiencing financial distress

B_0 = constants

The conceptual framework is presented in the following chart:

![Conceptual Framework](image)

Source: Data processed in 2019

The overall description of the operational definitions of the research variables is presented in the following table 2.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Definition</th>
<th>Formula</th>
<th>Measurement Scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity CR (X1)</td>
<td>A general ratio describing a company’s ability to settle its short-term liabilities or matured debts on time</td>
<td>( CR = \frac{\text{Current Assets}}{\text{Current Liabilities}} ) (Kasmir, 2017: 135)</td>
<td>Ratio</td>
</tr>
<tr>
<td>Profitability ROA (X2)</td>
<td>Profitability describes a company’s ability to generate income from sales, total assets, and capital</td>
<td>( ROA = \frac{\text{EAIT}}{\text{Total Assets}} ) (Kasmir, 2017: 202)</td>
<td>Ratio</td>
</tr>
<tr>
<td>Leverage (X3)</td>
<td>Leverage describes a company’s ability to settle its short-term and long-term liabilities</td>
<td>( DAR = \frac{\text{Total Debts}}{\text{Total Assets}} ) (Kasmir, 2017: 156)</td>
<td>Ratio</td>
</tr>
<tr>
<td>Financial Distress (Y)</td>
<td>Financial distress refers to a condition where a company experiences financial issues, or crises, or is in an unhealthy condition before bankruptcy</td>
<td>0 = Not experiencing financial distress 1 = Experiencing financial distress</td>
<td>Nominal</td>
</tr>
</tbody>
</table>

Source: Data processed in 2019
RESULTS AND DISCUSSION

Descriptive Statistical Results

The result of data processing using IBM SPSS 23 software generates the following descriptive statistical findings:

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR</td>
<td>75</td>
<td>.00</td>
<td>790.00</td>
<td>184.6924</td>
<td>177.22161</td>
</tr>
<tr>
<td>ROA</td>
<td>75</td>
<td>-54.85</td>
<td>7.98</td>
<td>-4.5847</td>
<td>9.58629</td>
</tr>
<tr>
<td>DAR</td>
<td>75</td>
<td>10.00</td>
<td>191.00</td>
<td>63.7067</td>
<td>39.31878</td>
</tr>
<tr>
<td>FD</td>
<td>75</td>
<td>.00</td>
<td>1.00</td>
<td>.4933</td>
<td>.50332</td>
</tr>
</tbody>
</table>

Valid N (listwise) 75

Source: Data processed in 2019

Table 3 above presents the minimum values, maximum values, and average values of all research variables.

Logistic Regression Analysis

After all the criteria were examined, the logistic regression equation could be used to analyze the impacts of financial ratios on financial distress. The results of logistic regression are presented in Table 4.

<table>
<thead>
<tr>
<th>Step</th>
<th>B</th>
<th>S.E.</th>
<th>Wald</th>
<th>df</th>
<th>Sig.</th>
<th>Exp(B)</th>
<th>95% C.I.for EXP(B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>X1</td>
<td>-.011</td>
<td>.005</td>
<td>4.378</td>
<td>.036</td>
<td>.989</td>
<td>.979 – .999</td>
</tr>
<tr>
<td></td>
<td>X2</td>
<td>-.672</td>
<td>.182</td>
<td>13.618</td>
<td>.000</td>
<td>.511</td>
<td>.357 – .730</td>
</tr>
<tr>
<td></td>
<td>X3</td>
<td>-.012</td>
<td>.015</td>
<td>.624</td>
<td>.430</td>
<td>.988</td>
<td>.959 – 1.018</td>
</tr>
<tr>
<td></td>
<td>Constant</td>
<td>.607</td>
<td>1.441</td>
<td>.177</td>
<td>.674</td>
<td>1.835</td>
<td></td>
</tr>
</tbody>
</table>

Variable(s) entered on step 1: X1, X2, X3.

Source: Data were processed in 2019

Table 4 above presents the result of the logistic regression analysis that generates the following regression equation:

\[ \text{PFD} = 0.607 - 0.011 \text{CR} - 0.672 \text{ROA} - 0.012 \text{DAR} \]

The values of constants and regression coefficients in the table can be described as:

The value of the constant (\(\alpha\)) in the regression equation above is -0.607. This indicates that if the values of X1, X2, and X3 are 0, the stock price is -0.607.
1. The regression coefficient value of the current ratio (CR) is -0.011 indicating that X1 has a negative regression coefficient direction. This means that if X1 increases by 1%, the stock price will decrease by -0.011 with an assumption that other variables are constant.

2. The regression coefficient of return on assets (ROA) is -0.672 indicating that X2 has a negative regression coefficient direction. This means that if X2 increases by 1%, the stock price will decrease by -0.672 with an assumption that other variables are constant.

3. The regression coefficient value of the debt-to-asset ratio (DAR) is -0.012 indicating that X3 has a negative regression coefficient direction. This means that if X2 increases by 1%, the stock price will decrease by -0.012 with an assumption that other variables are constant.

Hypotheses Examination

The hypotheses examination was carried out to answer the research questions proposed in this study. The result of the hypotheses examination will be presented in Table 10. The impacts of liquidity ratio (CR), profitability ratio (ROA), and leverage ratio (DAR) on financial distress experienced by manufacturing companies listed on the Indonesian Stock Exchange can be described as:

1. The current ratio variable has a significance value of 0.036 < 0.05 so H0 is rejected and H1 is accepted. This means the independent variable provides a significant effect on the dependent variable.

2. The return on asset variable has a significance value of 0.00 < 0.05 so H0 is rejected and H2 is accepted. This means the independent variable provides a significant effect on the dependent variable.

3. The debt-to-asset ratio variable has a significance value of 0.552 > 0.05 so H0 is accepted and H3 is rejected. This means the independent variable provides no significant effect on the dependent variable.

DISCUSSION

The Effect of Liquidity on Financial Distress

The liquidity ratio measured using current ratios indicates a company’s ability to pay off its short-term liabilities. The ratio is calculated from working capital, namely current assets
and current liabilities. The finding of this research indicates that current ratios have negative and significant effects on financial distress.

High liquidity describes a company’s ability to meet its short-term liabilities. This condition indicates that a company is in good health and can avoid financial distresses. From the findings of this study, in terms of signaling theory, the company management tries to send ‘signals’ to investors in the form of good news that the company they manage is financially healthy (Mardani et al., 2023). These results also show that the company's management as an agent of the company owners (principals) has managed the company in accordance with the expectations of the principals.

The findings of this study confirm the findings of a study conducted by Sulistyani & Ismanto (2017). Liquidity has been proven to provide negative effects on financial distress. However, this finding contradicts the findings of a study conducted by Fitri & Syamwil (2020). They found that liquidity did not have effects on financial distress experienced by a company. The findings of this study contribute to strengthening agency theory.

The Effect of Profitability Ratio on Financial Distress

In this study, profitability was calculated through a comparison of a company’s net profit with its total assets in a certain period. The higher the percentage of this ratio is the better. The second hypothesis states that the profitability variable (ROA) has negative and significant effects on financial distress. This means the increasing profitability of a company can directly reduce the risk of financial distress.

A significant return on assets signifies the company's adeptness in effectively managing its assets to support operational activities. A large return on assets will certainly be beneficial for the company’s sustainability. On the other hand, the increasing return on assets will be indirectly followed by increasing working capital which eventually minimizes the risk of financial distress in the company.

The findings of this study illustrate the company’s management attempts to send signals to investors (stakeholders) and information users in the form of good news. The good news informs the stakeholders that the company is in good condition because it can minimize the risk of financial distress. The findings of this study also illustrated that the company’s management managed the company’s assets in accordance with the shareholders’ expectations. This finding contributes to strengthening signaling theory and agency theory.
The finding of this study is in line with a previous study conducted by Makkulau (2020) stating that profitability has negative and significant effects on financial distress experienced by a company. The higher income gained by a company the lower financial distress experienced by the company. The profitability ratio is the most dominant in predicting financial distress. However, the findings of this study contradicted the findings of a previous study conducted by Wulandari (2019) stating that profitability ratios do not affect financial distress.

The Effects of Leverage Ratio (DAR) on Financial Distress

Leverage can be calculated through Debt-to-Total Asset Ratio (DAR). The ratio refers to the comparison of all assets and all debts that describes a company’s capability to pay off its debts. The higher ratio indicates better prospects in the future. The third hypothesis states that the leverage (DAR) coefficient does not affect financial distress, which means the amount of DAR will not significantly affect the financial distress of a company.

The company’s assets are a combination of all company’s liabilities and equities. Good composition of assets is when the value of equities is larger than liabilities. This condition will minimize the risk of financial distress because most of the company’s operations are borne by its equity.

Company owners (principals) surely want their companies to be able to avoid various kinds of risks, including the risk of financial distress. The owners (principals) always encourage the managers (agents) to work according to the owners’ expectations and in accordance with the companies’ goals so that the company can avoid circumstances that may disrupt the continuity of the company. The findings of this study show that management (as the principal’s agents) has not been able to meet the principal’s expectations to always guarantee that the company can avoid the risk of financial distress.

This research is in line with previous research conducted by Saputri and Asrori (2019) finding that the leverage ratio does not significantly affect the financial distress experienced by a company. On the other hand, a study conducted by Larasati and Wahyudin (2019) stated that the leverage ratio has negative and significant effects on financial distress conditions.

CONCLUSION

Based on the results of the study, the following conclusions can be drawn: (1) Competence affects audit quality for the Government Internal Supervision Apparatus at the Kendari City Inspectorate. (2) Professional attitude affects audit quality for the Government
Internal Supervision Apparatus at the Kendari City Inspectorate. (3) Professional competence and attitude affect the quality of audits for the Government Internal Supervision Apparatus at the Kendari City Inspectorate. Competence greatly affects the quality of the audit.

Auditors who have the ability in the form of knowledge and experience can make it easier for them to complete quality work. Auditors who have a high professional attitude can make decisions that cannot be intervened by other parties so that the resulting audit decisions are of high quality. For the Kendari City Inspectorate to implement several strategies related to the competence and professional attitude of auditors, namely; (a) conduct periodic evaluations of auditors' understanding and knowledge related to inspection and supervision, (b) carry out examinations in different work units and audit objects so as to increase the auditor's experience, (c) conduct training related to inspection and supervision so as to improve professional auditor independence.

This research is still limited to the Kendari City Inspectorate, so the research variables do not have good generalization power. Further researchers are expected to expand the object of research, for example comparing with BPK and BPKP auditors. This study only examines the influence of competence and professional attitudes on audit quality, it is possible that there are many other variables that can affect audit quality.

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