PREDICTING MISLEADING FINANCIAL STATEMENT IN MALAYSIA

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ABSTRACT

This study aims to examine the ability of financial ratios in predicting misleading financial statements, specifically in Malaysian environment. This study uses nine financial ratios; seven which are commonly used in previous studies (TLTA, NITA, NIS, CATA, RTA, WCTA & STA) and two additional ratios which have never been tested in previous studies (CFOTA & CFOS). Two time periods were studied to compare the usefulness of financial ratios in predicting misleading financial statements for the first year fraud deem to exist and a year prior it comes out clear. Univariate and multivariate such as independent sample test and logistic regression technique were used to analyze the data. Results from univariate test show six financial ratios are significant while results from logistic regression analysis show that three ratios are significant for the misleading year and two ratios for preceding year. NITA is the only ratio that is significant for all three tests conducted. Thus, it is concluded that financial ratios are able to predict misleading financial statements.

Keywords: Financial ratios, Misleading financial statements

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LIST OF ABBREVIATIONS

TLTA	Total liability over total asset
NITA	Net income over total asset
NIS	Net income over sales
CATA	Current asset over total asset
RTA	Account receivables over total asset
WCTA	Working capital over total asset
STA	Revenue over total asset
CFOTA	Cash from operation over total asset
CFOS	Cash from operation over revenue

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Each year, businesses in the United States suffer more than $600 billion losses due to corporate fraud (Albrecht & Albrecht, 2002). During the years 2000-2002 alone, numerous revelations of corporate wrongdoing, including financial statement fraud, in the United States has resulted in $15 trillion decline in the aggregate market value of all public company stock (Albrecht, Albrecht, Albrecht, & Zimbelman, 2009). As the consequences of the fraudulent activities, investors in the United States lost their confidence in the capital market and most of the fraudulent organizations suffer from bankruptcies and excessive debts. Among the most notable companies bankruptcies due to financial statement frauds are WorldCom ($102 billion), Enron ($64 billion), and Global Crossing ($26 billion). Since then, the Department of Justice (DoJ) has obtained nearly 1,300 fraud convictions (Rezaee & Riley, 2010). The fraud convictions include more than 200 chief executive officers (CEO) and corporate presidents, more than 120 corporate vice presidents and more than 50 chief financial officers (CFO).

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