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The Role Of Fraud Pentagon Theory In Detecting Fraudulent Financial Statements In Banking Companies Listed On The Indonesia Stock Exchange In 2017-2019

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ABSTRACT: this study concern of the role of fraud risk factors in the theory of fraud pentagon on detecting fraudulent financial statements. This research was conducted with quantitative methods using secondary data. The instrument used in this research is the published annual report of the company. The sample in this study were 28 banking companies listed on the Indonesia Stock Exchange in 2017-2019. Sample selection using purposive sampling method and analyzed using Sem-Pls, The results show that external pressure, influence monitoring, auditor switch, change of directors, and frequent number of CEO's pictures simultaneously influence detection of fraudulent financial statements. However, partially, the variables of external pressure, auditor switch,influence monitoring and change of directors have a significant influence on detecting fraudulent financial statements. Meanwhile, frequent number of CEO's pictures have no influence on detecting fraudulent financial statements.

KEYWORDS :- *Fraud pentagon theory, fraudulent financial statements, banking companies*

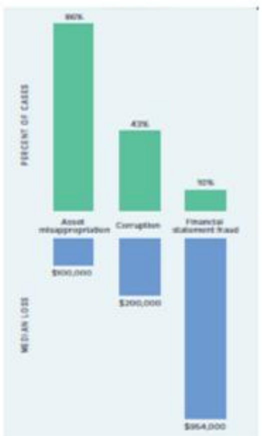
I. INTRODUCTION

Statement of Financial Accounting (SFAC) states that financial statements are a reference for investors and creditors to make rational decisions in investing, credit, and other decisions related to company operations. Therefore, the preparation of these financial report should served based on standar accounting support with real data.

Facts in the field in presenting financial statements, management will try as much as possible to describe the company's performance presented in its financial statements that look good in order to get a "good" impression and assessment from various parties who read it. The act of manipulating financial report doing by management to looked good for user[1]. Fraud by companies to manipulate financial statements is called fraud, and fraudulent practices in financial reporting are called fraudulent financial statements.

Data from ACFE [2] explained that around 125 countries state that fraud of financial statement give biggest impact for company loss.

Figure 1. percentage types of fraud



ACFE Indonesia states that the banking industry [3] occupies the first position of organizations that are disadvantaged due to fraud, with a percentage of 41.4%.

Figure 2. types of industries that are harmed by fraud

The case of manipulation of financial statements by banks in Indonesia is to beautify the financial statements carried out by BTN in 2018, namely in the form of selling the company's non-performing loans to PT Perusahaan Pengelola Aset (PPA).[4]Another case is that PT Bank Bukopin Tbk (BBKP) manipulated financial statement for three years started 2015 until 2017[5]. The manipulation of the financial statements of PT. SNP to obtain investment from Bank NTT so that Bank NTT lost up to Rp50 billion in that investment.[6]

The number of cases of fraudulent financial statements by banking companies in Indonesia is an indication that this topic is interesting to discuss. Fraud can occur in all types of companies, from small companies to publicly listed companies on the IDX. There are still many cases of fraud and manipulation of financial statements by people who have an interest in financial statements, making the role of an auditor in a company very needed. Auditors must be able to consider the possibility of fraud from various points of view [7]. The analytical approach using the fraud pentagon is considered suitable for detecting fraudulent financial statements [8]. This is based on research proposed by Crowe [9] describe that the detection of fraudulent financial statements is measured by five indicator elements in a company; pressure, opportunity, rationalization, competence and arrogance which is then called Crowe's Fraud Pentagon Theory.

II. LITERATURE REVIEW ANDHYPOTHESES

[10] The most action of Fraudulent Financial Statements doing by management by engineering financial statements to be better than the actual (overstatement) or worse than the actual (understatement) to obtain personal gain. The financial report did not show the real number and can make investor and creditors make a loss.

The grand theory in this study is agency theory which, according to Jensen and Meckling, explains the existence of a cooperative relationship between company owners or shareholders as the principle and management as the agent. In this condition, the agent has more information than the principle. This leads to a condition where the information received does not match the truth, agents use information they have to manipulate numbers in financial statements, change information, and present inappropriate financial statements for their personal interests. Meanwhile, on the other hand, shareholders as the principle want financial statements that truly reflect the actual state of the company. This conflict of interest can trigger agency problems. Where the management meet a lot of pressure (Pressure) to increase the company's performance so that the principle gets a higher rate of return on investment, and the agent gets a good appreciation from the principle (Rationalization). Then a high level of arrogance (Arrogance), the opportunity to commit fraud (Opportunity), and having knowledge of how to cover up the fraud (Capability) which makes it easier for agents to commit fraud.[8]

Crowe's Fraud Pentagon Theory consists of five components [9] namely pressure, opportunity, rationalized, capability, and arrogance.

1. Pressure measured by external pressure

people's motivation to do fraud for theirself is pressure [11]. [12]According to SAS No. One of the conditions that commonly occurs in pressures that lead to fraud is external pressure. If manager get frustrated from environment like industry,economic condition,and operational company's situation, they sometimes get pressure for doing fraud. Company that have more assets they become rich from others[8]. This research supported which shows that external pressure has a significant influencein detection fraudulent financial statements.[13]

2. Opportunity measured by influence monitoring

Opportunity arises due to weak internal control which results in individuals/groups who previously had no intention to commit fraud [14]. [12] SAS No. 99 states that influence monitoring will provide opportunities for fraudulent financial statements. This is appeared by a conflict of interest between principle and agent where there is one person or a small group that dominates the management due to weak supervision or an influence supervisory function within a company. To minimize fraud, companies need influenceive supervision, such as commissioners that not have bonding relationship with company, where the commissioners does not impartiar in internal audit activities. If the board of commissioners loses their independence, then management will dominate the company's internal control so that it can lead to influence monitoring. With the functioning of the board of commissioners, management oversight will be more influenceive. This is supported by research [15] which states that influence monitoring has a significant influence on fraudulent financial statements.

3.Rationalization measured by auditor switch

Auditor switch is a rotation of external auditorfor doing an audit every year. This auditor switch is carried out by the company to cover up its fraud by eliminating the fraud trail found by the previous auditor. This is because the new external auditor does not yet recognize the broad scope of the company so that it cannot indicate the existence of fraudulent financial statements because the audit process time is also limited.Companies that frequently switch auditors, the possibility of cheating is also getting bigger [16].

4. Capability measured by change of directors

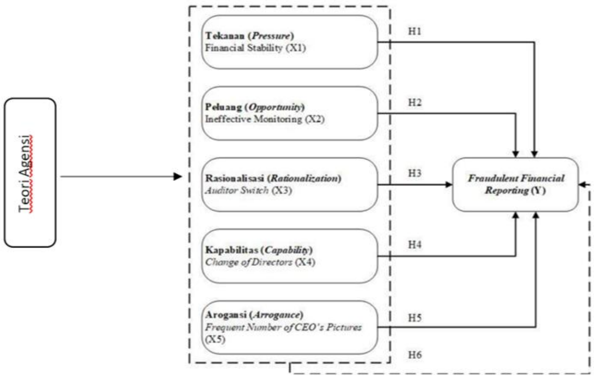
To improve company performance, companies usually make changes to directors who have a better level of expertise and competence. When you know you will take certain actions as you did before and know what happened before. A waiting period will occur as new priorities must adapt and initiate corporate culture and strategies for building the company. [17] During this transition period, it is alleged that this is an opportunity for events to occur. [18] change of directors has a significant influence on fraudulent financial statements.

5. Arrogance measure by the frequent number of CEO's picture

The number figure of leaders that appear in the annual financial statements. The high level of arrogance can be measured by the number of depictions of CEOs that are shown repeatedly because it is considered that the CEO has a desire to be known by the public. CEOs who have this trait will take various ways to maintain their position in various ways, even overcoming internal controls and possibly committing fraudulent actions. [17]. This statement is supported by the results of other studies where the frequent number of CEO's pictures has a significant influence on fraudulent financial statements [19].

The relationship between the variables used is seen as Figure 3

Figure 3 Conceptual Framework



III. RESEARCHMETHODE

This study using a quantitative description approachand using secondary data. Documentary data comes from 28report banking companies. The population of this study were all banking sector companies listed and the sampling method used was purposive sampling.

IV. FINDINGS ANDDISCUSSION

In this study, hypothesis testing using path analysis. Below is a picture of the model research and results obtained from data processing using program tools WarpPLS 7.0 :

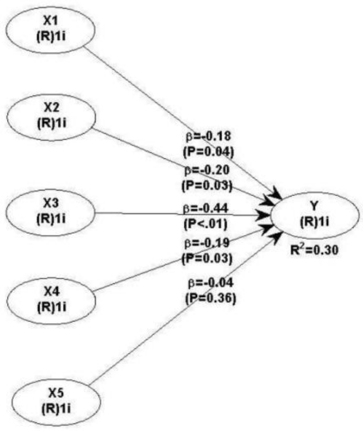


Figure Path Analysis Results shows the results of the path coefficient with a significance level of 5% according to with the calculations that have been done using WarpPLS 7.0 so that obtained the structural equation as follows:

Y = 0,40 + 0,18X1 – 0,20X2 – 0,44X3 – 0,19X4 – 0,04X5 + 0,30

It can be concluded asfollowing:

1. Pressure (External Pressure), Opportunity (Influence Monitoring), Rationalization (Change in Auditor), Competence (Change in Director), and Arrogance (Frequent Number of CEO's Picture) has a high value constant or unchanged by 0.40. So, the amount of fraudulent financial statements is 0.40.
2. Pressure variable is of 0.18. That is, if the Pressure variable increases by 1 unit, then fraudulent financial statements will increase by 0.18
3. opportunity . variable is -0.20. That is, if the opportunity variable increases by 1 unit, then fraudulent financial statements will decrease by 0.20
4. Rationalization variable is -0.44. That is, if the Rationalization variable increases by 1 units, the fraudulent financial statements will decrease by 0.44
5. competence is -0.29. That is, if the competence variable increases by 1 unit, then fraudulent financial statements will decrease by 0.19
6. arrogance variable is -0.04. That is, if the arrogance variable decreases by 1 unit, then fraudulent financial statements will decrease by 0.04

Table 1. T-test

Correlation	P-Values	Result
H1 Y →	0,04	significant
H1 → Y	0,03	significant
H3 → Y	0,01	significant
H4 → Y	0,03	significant
H5 Y →	0,36	Not significant

*the role of pressure proxied by external pressure and calculated using the external pressure against the potential for detection fraudulent financial statements showing a significance value of 0.04. [13]which stated that pressure affect the detection of fraudulent financial statements. This is happening because of the ability of companies in the banking sector to repaylong-term debt becomes a pressure for companies to fraud in financial statements. In addition, in this study the sample of companies the banking sector has a fairly large total debt. In line with agency theory, that condition will creates a conflict of interest or a conflict of interest leads to conditions information asymmetry, which is a condition of information imbalance between the principal and the agent. This condition will motivate management (agent) to commit fraudsuch as hiding some financial information to third parties (principal).

*the role of opportunity proxied by influence monitoring of the potential for fraudulent financial statements shows a significance value of 0.03 opportunity has a significant influence on fraudulent financial statements Partial. The results of this study are in line with previous research [15] which states that opportunity has a significant influence on the detection of fraudulent financial statements. errors can be minimized one with a good monitoring mechanism. Influence monitoring is a situation where internal controls are influence or lacking. Based on the results hypothesis testing, the influence of influence monitoring occurs due to an increase in the level of influence supervision by the board of commissioners in banking companies. In this way, the independent commissioners are considered not working optimally and influenceive in supervising management and ensuring accountability, thus opening up opportunities for management to commit fraud in preparing financial reports

*the role of rationalization that is propagated by change in auditors on the potential for fraudulent financial statements shows a significant value of 0.01. It means rationalization has a significant influence on financial statement fraud partially. [16]which states that rationalization has a significant influence against fradulent financial reporting is received.This happened because Changes in auditors or public accounting firms are carried out to cover or eliminate the traces of fraudulent financial statement actions that have been carried out and have been previously known to the auditors.

*the role of capability on the potential for fraudulent reports finance shows a significance value of 0.03.

This means that competence has a significant influence on report fraud partial finance. [17] which states that competence significant influence on the accepted fradulent financial reporting.This happens because during the observation of companies that are under the authority of the United States capital market commit fraud, and it was found that 85% of the cases involved top managers which forced his subordinates to participate in the fraud scheme he planned. change of directors in banking companies during the research year only occurred as much as 87% and director who has good skill than previously or due to the resignation of the board of directors. Change of directors more competent is considered influenceive to enable performance improvement a better company than before so as to prevent fraud on financial reporting.

*the role of the arrogancy variable on the potential for fraud financial statements show a significance value of 0.36. This means that arrogance does not significant influence on report fraud partial finance. [19] arrogancydoes not have a significant influence on the accepted fradulent financial reporting.This happened because the number of CEO images in the company's annual report is not much noticed by financial statement users. Financial statement users mostly only see the results of the company's performance are presented in the annual report.

Table 2. R-squared

	Y	X1	X2	X3	X4	X5
R-squared	0.298					
Adj. R-squared	0.253					
Composite reliab.	1.000	1.000	1.000	1.000	1.000	1.000
Cronbach's alpha	1.000	1.000	1.000	1.000	1.000	1.000
Avg. var. extrac.	1.000	1.000	1.000	1.000	1.000	1.000
Full collin. VIF	1.310	1.047	1.021	1.262	1.057	1.023
Q-squared	0.304					

The table above shows the results that the magnitude of the coefficient determination is 0.298 or 29.8%. This shows that the dependent variable proxied by fraudulent financial statements can be explained at 29.8%. The remaining 70.2% (100%-29.8%) is influence by other aspect that not mention in this research.

V. CONCLUSIONS ANDRECOMMENDATIONS

Pressure,opportunity,capability,rasionalisation and competence has a significant positive influence on fraudulent financial statements on banking companies listed on the Indonesia Stock Exchange period 2017-2019. That is, the greater the external pressure in a the greater the potential for fraudulent financial statements to be carried out by company management. Meanwhile Arrogance has no significant influence on fraudulent financial statements on banking companies registered in Indonesia Stock Exchange for the period 2017-2019. That is, the number of CEO images on the company's annual report can't show the CEO's sense of arrogance but rather to show who is in charge in company and has no influence on the potential for fraudulent financial statements. Recommendation for parties who interested in this case, 1)Public companies and especially banking companies are expected to be more increasing prudence by ensuring that companies implement accountability and transparency that is quite good in presenting financial statements and company annual reports. This is because in line with the times of the stakeholders and third parties are much smarter in detecting fraud financial statements. If fraud is detected in the company then the company's reputation will decline and investors will think again to invest in the company 2) Shareholders and investors are advised to be more careful in determine the choice to invest by doing research first first at the company. This is because to anticipate company fraud. So that shareholders can use detection methods such as those used by researchers in order to detect fraudulent financial statements.

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