

**FRAUDULENT FINANCIAL REPORTING: FRAUD PENTAGON
ANALYSIS IN BANKING AND FINANCIAL SECTOR
COMPANIES LISTED IN INDONESIA
STOCK EXCHANGE 2016-2018**



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Accounting

Proposed as one of the requirements to achieve:

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UNIVERSITAS SRIWIJAYA

FACULTY OF ECONOMICS

2020

COMPREHENSIVE EXAM APPROVAL LETTER

**FRAUDULENT FINANCIAL REPORTING: FRAUD PENTAGON
ANALYSIS IN BANKING AND FINANCIAL SECTOR
COMPANIES LISTED IN INDONESIA
STOCK EXCHANGE 2016-2018**

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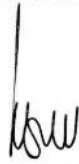
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MOTTO AND DEDICATION

Motto:

“When you want something, all the universe conspires in helping you to
achieve it.”

(Paulo Coelho)

“No retreat. No surrender.”

(Book of Life)

“Life favors the prepared mind.”

(Robin Sharma)

Dedicated to:

- God
- My parent
- My little brother
- My friends
- Universitas Sriwijaya

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Praise to God The Almighty, for the presence of His grace, so that the author can complete the thesis which titled **“Fraudulent Financial Reporting: Fraud Pentagon Analysis In Banking And Financial Sector Companies Listed In Indonesia Stock Exchange 2016-2018”**. This is to fulfill one of the requirements to obtain a Bachelor of Economics degree at Faculty of Economics, Universitas Sriwijaya.

Appreciation and thanks to my beloved parents who have put all their love and positive support during the process of learning. As well as thank you to:

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2. Mr. **Prof. Dr. Taufiq Marwah M.Si**, as Dean of the Faculty of Economics Universitas Sriwijaya;
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4. Mrs. **Emylia Yuniarti, S.E., M.Si., Ak.**, as my Academic Supervisor during my study in Accounting Department Universitas Sriwijaya;
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11. I also place on record, my sense of gratitude to one and all, who directly or indirectly, have lent their hand in this venture that can not be mentioned one by one.

The author realized that in the writing of this thesis is still far from perfection. Therefore, the author is open to any suggestions and constructive criticisms for the sake of improvement in the future.

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ABSTRACT

Fraudulent Financial Reporting: Fraud Pentagon Analysis in Banking and Financial Sector Companies Listed in Indonesia Stock Exchange 2016-2018

By :

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Fraudulent financial statements is a fraud form which is generally difficult to detect. The study was intended to examine the effect of Fraud Pentagon theory in explaining phenomenon fraudulent financial statements. The research population was all financial sector companies listed on the Indonesia Stock Exchange during the 2016-2018 period. This research uses 6 (six) independent variables to achieve this objective, namely: Financial Target, External Pressure, Ineffective Monitoring, Changes in Auditor, Changes in Board of Directors, and Frequent number of CEO picture. The dependent variable was used is fraudulent financial reporting that proxied by F-Score model. Purposive sampling technique was used to determine the research sample and data analysis techniques used multiple regression. Based on the test results, it shows that Financial Target, External Pressure, Ineffective Monitoring, Changes in Auditor, Changes in Board of Directors, and Frequent number of CEO picture have no significant effect on the fraudulent financial reporting.

Keywords : *Fraudulent Financial Statement, Fraud Pentagon, Fraud Score Model*

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ABSTRAK

Fraudulent Financial Reporting: Fraud Pentagon Analysis in Banking and Financial Sector Companies Listed in Indonesia Stock Exchange 2016-2018

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Kecurangan laporan keuangan adalah bentuk kecurangan yang umumnya sulit dideteksi. Penelitian ini dimaksudkan untuk menguji pengaruh teori Pentagon Fraud dalam menjelaskan fenomena kecurangan laporan keuangan. Populasi penelitian adalah semua perusahaan sektor keuangan yang terdaftar di Bursa Efek Indonesia selama periode 2016-2018. Penelitian ini menggunakan 6 (enam) variabel independen untuk mencapai tujuan ini, yaitu: Financial Target, External Pressure, Ineffective Monitoring, Changes in Auditor, Changes in Board of Directors, dan Frequent number of CEO picture. Variabel dependen yang digunakan adalah kecurangan pelaporan keuangan yang diproksi dengan model F-Score. Teknik pengambilan sampel dengan metode purposive sampling digunakan untuk menentukan sampel penelitian dan teknik analisis data menggunakan regresi berganda. Berdasarkan hasil tes, bahwa Financial Target, External Pressure, Ineffective Monitoring, Changes in Auditor, Changes in Board of Directors, dan Frequent number of CEO picture tidak berpengaruh signifikan terhadap kecurangan laporan keuangan.

Kata Kunci: *Fraudulent Financial Statement, Fraud Pentagon, Fraud Score Model*

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CHAPTER I

INTRODUCTION

1.1. Background

Every year cases of fraud always happen and become a problem in the company, and the worse the fraud doers are people who have power in the company. According to the Association of Certified Fraud Examiner, there are 220 cases of fraud in Asia Pacific. Financial statement fraud accounts for 13% of total fraud cases with a median loss of USD 700,000. Fraud, especially on financial statements, occurs because of the motivation and encouragement from various parties, both from within the company, and from outside the company (Septriani & Handayani, 2018). Encouragement and motivation so that the financial statements presented look good and attract the attention of investors or potential investors, so that managers will try to do various ways to present good financial statements. Fraud techniques are varied, ranging from circumventing generally accepted accounting principles (Financial Accounting Standards), conducting aggressive earnings management to carrying out illegal actions which are then hidden, and leading to bankruptcy of the company. Not to mention, the cases of financial reporting fraud that occur, also involve corporate auditors.

Financial statement fraud that is not detected early can develop into a big scandal that is more harmful to many parties. Research conducted by the Association of Certified Fraud Examiners found that 26% of fraud cases with the highest median loss of USD 1,000,000 were carried out by the company owner or

board of directors. In addition, ACFE also found that more than half of the perpetrators of fraud were management.

Major accounting scandals, such as Enron, have proven the serious impact of financial statement fraud on a country's economy and provide enormous lessons for the accounting world. Early detection of fraud in financial statements is a must that must be prioritized. The ability to identify fraud quickly, also develops into a necessity. In addition, demands for financial reporting that are increasingly comprehensive after the enactment of the International Financial Reporting Standards (IFRS) since the last 5 years, also do not guarantee to be able to reduce the opportunity for fraud in financial reporting. With the more comprehensive financial statements that must be presented by management, there are many gaps in the financial statements that open up opportunities for unscrupulous management to commit fraud through earnings management.

In practice, fraud does not only occur in manufacturing companies. Many financial and banking sector companies also experienced it. Based on a survey conducted by the Indonesian Chapter Association of Certified Fraud Examiners (ACFE) in 2016, it shows the fact that the financial and banking sector is the sector that experienced the most cases of fraud after the government sector. Comparison with other sectors affected by fraud can be further seen from the diagram below:

Picture 1.1. Industry victimized by fraud in Indonesia



Source: ACFE Indonesian Chapter 2016

The results of a survey conducted by the Association of Certified Fraud Examiners are also evident from banking and financial companies in Indonesia, which until now are still vulnerable to cases of fraud. Fraud that occurred in the financial and banking sector in Indonesia is also not a new thing anymore. In 1997, Lippo Bank reported that the company was at a loss with assets smaller than the actual value of the asset. An example of a fraud scandal in the Indonesian financial and banking sector which until now has not been completely resolved and is still being discussed is fraud that occurred at Century Bank which was reportedly also dragged the names of executives in Indonesia.

In general, fraud will always happens when there is no prior prevention and detection. In addition, the prevention and detection of fraud in financial statements also often collides with the presence of other factors that motivate the emergence of fraud in various situations, as explained by various theories of fraud such as Cressey's Fraud Triangle Theory, Wolfe's Fraud Diamond Theory and

most recently, Crowe's Pentagon Theory Fraud. According to Crowe (2011), Pentagon Theory has five fraud risk factors that use financial and non financial ratios. Five fraud risk factors consist of pressure, opportunity, rationalization, competence, and arrogance. Pentagon Fraud is a new theory that explores more on the trigger factors of fraud is pentagon fraud.

The competencies described in the pentagon fraud theory have meaning which is similar to capability previously described in the diamond fraud theory by Wolfe and Hermanson (2014). Competence / capability is the ability of employees to ignore internal controls, develop hiding strategies, and control social situations for personal benefit (Crowe, 2011) . According to Crowe, arrogance is an attitude of superiority over the rights held and feels that internal controls or company policies do not apply to him. Moreover, fraud doers now tend to have more independent mindset, more adequate information and access, compared to the era of fraud triangle (Marks, 2012).

The behavior and reasons or motives of management to commit fraud in financial statements are mostly explained in fraud theory. Pressures faced by management as agents for investors (principals) such as pressure to improve performance or increase the value of the company on the stock exchange, for example, can also be used as a kind of rationalization for management to manipulate financial statements. Especially if the opportunity to commit fraud, is also a small risk to be detected or known. Opportunities will be the entry point for fraud, while pressure and rationalization will encourage management to commit fraud. However, fraud with complex techniques and a large nominal is not

possible if there is no particular person with special capabilities in the company. In other words, people who commit fraud must have the capability or competence to fool the internal control, control the situation and develop strategies to disguise fraud. Feelings of superiority and arrogance with positions held, coupled with greed, make the perpetrators confident that internal control does not apply to them.

Earning management practices are a form of manipulation of financial statements that are often chosen as short-term 'solutions' by management to maintain investor confidence in their performance (Yendrawati et al., 2018). Earning management is a phenomenon that is difficult to avoid because of the use of accrual basis in preparing financial statements. Earnings management can make a company's performance look better than its competitors, so that investors who are not careful (inattentive investors) will be easily deceived by management. It can also be said, earnings management is the beginning of financial statement fraud because financial statement fraud is often preceded by misstatements or earnings management from quarterly financial statements that are considered immaterial, but eventually develop into large-scale fraud and produce reports financially materially misleading (Septriani & Handayani, 2018).

Several studies have been conducted to see how pentagon fraud can detect the fraudulent financial reporting (Antawira, et al. (2019); Apriliana & Agustina, (2017); Septriani & Handayani (2018); Ulfah, Nuraina, & Wijaya (2017). Antawira et al. (2019) found that the financial target can affect the tendency of fraudulent financial reporting. But other studies show different results,

Husmawati et al. (2017) concludes that financial target has not influence on fraudulent financial reporting. Saputra & Kesumaningrum (2017) found that external pressure affect the fraudulent financial reporting, meanwhile Apriliana & Agustina (2017) did not find the relationship between external pressure and fraud. Research conducted by Ulfah et al. (2017) show that auditor opinion has effect on fraudulent financial reporting.

There has been no consistency from the results of the above research caused this research to be still interesting and relevant to be studied. In addition, the opposite results of the variable above give the author attention to reexamine whether the pentagon fraud theory is able to detect fraudulent financial reporting.

This study is different from previous studies, namely in terms of the dependent variable measurement model used. The measurements used for the dependent variable in this study use the measurement model F-score proposed by Dechow et al (2012) for detecting fraudulent financial statements that are analyzed by Pentagon Theory Fraud. This model detect earnings management that simultaneously improves test power and specification (Dechow et al., 2012). The variable component of the F-Score includes two things that can be seen in financial statements, namely accrual quality and financial performance. Based on Kothari & Leone (2001), performance-matched discretionary accruals are more specific and powerful measurements than other discretionary accruals. Kothari & Leone (2001) also explained that performance matching is designed to control the impact of performance in measuring discretionary accruals and performance-matched discretionary accruals can be used as an alternative that can be used in

researching earnings management. Based on the background above, the author finally decided to conduct a research entitled “**Fraudulent Financial Reporting: Fraud Pentagon Analysis in Banking and Financial Sector Companies**”.

1.2. Problems Formulation

Fraudulent financial reporting not only causes the declining in the ethical value of the accounting profession, but also causes financial losses with a sizable amount (Antawira et al., 2019). The role of the auditor profession in this issue is very important for early detection and prevention of the possibility of fraudulent financial reporting so as to minimize the emergence of prolonged problems. According to Crowe (2011) the factors causing fraud acts consist of five elements, namely: Pressure, Opportunity, Rationalization, Competence, and Arrogance. The five elements are more commonly known as Crowe’s fraud pentagon theory. Based on the description above, the following problems can be formulated:

1. Does the financial target (ROA) influence the detection of fraudulent financial reporting?
2. Does the external pressure (LEV) influence the detection of financial reporting fraudulent?
3. Does the ineffective monitoring (BDOUT) influence the detection of fraudulent financial reporting?
4. Does the auditor change (AUDCHANGE) influence the detection of fraudulent financial reporting?

5. Does the change in board of directors (DCHANGE) influence the detection of fraudulent financial reporting?
6. Does the frequent number of CEO's picture (CEOPIC) influence the detection of fraudulent financial reporting?

1.3. Objective of Research

Based on the formulation of the research problems listed above, the objective of this study is to examine empirically:

1. The effect of financial target on the detection of fraudulent financial reporting,
2. The effect of external pressure on the detection of fraudulent financial reporting,
3. The effect of ineffective monitoring on the detection of fraudulent financial reporting,
4. The effect of auditor change on the detection of fraudulent financial reporting,
5. The effect of change in board of directors on the detection of fraudulent financial reporting, and
6. The effect of frequent number of CEO's picture on the detection of fraudulent financial reporting .

1.4. Contribution of Research

This study attempted to contribute as follow.

For companies, to provide views to the management as an agent related to their responsibilities in protecting the interests of the principal in this case investors. Management is expected to be more aware of the long-term impact when conducting fraudulent financial reporting, so that the possibility of bankruptcy or greater bankruptcy due to fraudulent financial reporting can be avoided.

For investors, as a tool for investors in assessing and analyzing their investments in certain companies. With knowledge and insights about fraudulent financial reporting, it is hoped that investors will be more careful and able to detect the possibility of fraudulent financial reporting in certain companies and ultimately be able to provide a guarantee to themselves that the investments made have been in the right hands.

For the literature, contribute to the development of accounting science, especially in the field of forensic accounting regarding factors that can influence companies to carry out fraudulent financial reporting by applying indicator elements from Crowe's fraud pentagon theory.

For other parties, this research can be used as a reference for future research improvements and to add insight.

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