ISSN 2549-6016 (online)
ISSN 1907-7513 (pint)

Analysis Factor Triggers Fraud And Corporate Governance On Indications of Fraudulent Financial Reporting Using the Pentagon Fraud Theory Approach

Sri Astuti[1], Marita[2], Sucahyo Heriningsih[3]
UPN Veteran, Yogyakarta
* Correspondence: astuti2013@gmail.com

Submitted: August 2019, Revised: September 2019, Published: September 2019

Abstract

This study examines the correlation between fraud triggering factors using the Pentagon fraud theory approach and the role of corporate governance on the indication that companies conduct financial statement fraud. The trigger factors for fraud in the Pentagon fraud theory are pressure, opportunity, rationalization, competence and arrogance. The fraud studied in this study is financial report fraud. The financial statements are prepared and accounted for by management. The population in this study are all banking companies listed on the Stock Exchange in 2015-2018. Observation data consisting of 92 companies. The analysis tool used is correlation analysis. Based on the results of testing, the variable that correlates significantly with the indication of the company committing fraud is pressure and corporate governance. Financial statements are a measure of management's performance, so there is pressure from management to deliver their performance information properly. Good corporate governance (GCG) is one of the pillars of the market economic system, closely related to trust in both the companies that implement it and the business climate in a country. Governance mechanisms describe the organizational culture that builds employee ethics and motivates them to uphold ethical values. Inefficiencies in corporate governance will raise the risk of financial report fraud.
Keywords : pentagon fraud , Good corporate governance (GCG) .

A. INTRODUCTION

The financial statements are prepared by management to be held accountable to the owner. In agency theory it is known that there is a separation between company owners and company managers. So that management as a company manager has high control rights over the company. High control rights over the company can lead to abuse of authority in preparing financial statements. *Fraud* is intentional action by company management, governance parties, employees or third parties who commit fraud to obtain unfair or illegal profits (Amiruddin and Sundari, 2012).

According to Hayes (2013),there are two types of *fraud*, namely *misappropriation of assets* and *financial reporting fraud*. *Misappropriation of assets* is a misuse of company assets. While *financial reporting fraud* is an abuse of authority committed to the preparation of financial statements. There are several theories of individual or group motivation for *fraud* . The first theory was the *Fraud Triangle* , coined by Cressey in 1953. The trigger for *fraud* was *pressure* , *opportunity* and *rationalization* . In 2004, *diamond fraud was* developed by Wolfe and Hermanson, triggers of the above *fraud* plus *capability* . In 2011, *Pentagon fraud* theory emerged by Crowe, triggers of the above *fraud* plus *arogancy*. In addition to an independent audit of the financial statements, the company can also make various efforts to minimize the risk of *fraud* . Among others are the application of good corporate governance, risk management, and forming an internal audit unit.

According to IICG (2009) GCG is defined as a structure that is implemented in running a company with the primary goal of increasing shareholder value in the long term while still taking into account the interests of other stakeholders based on laws and regulations and prevailing norms. Based on a survey conducted by the Association of Certified Fraud Examiners (ACFE) in 2014, it showed the fact that the financial and banking sector was the sector that experienced the most cases of *fraud* compared to other sectors. Cases of *fraud* at banking companies in Indonesia involve many management parties and the amount of losses from *fraud* is large.

Research on fraud by using *pentagon fraud* theory has been conducted by several researchers. But the results of previous studies are still not consistent. Various efforts have been made by management to minimize the existence of *fraud* , such as improving company culture through the implementation of the principles of *good corporate governance* (GCG). Because through the implementation of *good corporate governance* (GCG), it is expected to encourage the efficiency of the performance of company resources and produce long-term sustainable economic value.

In theory, the results of previous research, and the background above, the problem in this research is to examine empirically: B How can relationships triggering factor of *fraud* (pressure, opportunity, rationalization, competence and arrogance) on the theory of fraud pentagon , and *good corporate governance* for indications of *fraud* in financial statements?

This research is expected to contribute directly to shareholder, in preventing indications of *fraud* in the company. As well as helping management to be aware of the triggering elements of fraud (pressure, opportunity, rationalization, competence and arrogance) that allows spur indications of *fraud* in financial statements. As for fraud observers, this research is expected to be able to increase reference material in research on the factors triggering indications of fraud in the company's financial statements.

B. RESEARCH METHODS

1. Population and Sample

This research is an empirical study using secondary data. The population in this study are all banking sector companies listed on the Indonesia Stock Exchange in 201 5 -201 8 . The reason for using companies in the banking sector, is because *fraud* in Indonesia is mostly done in the banking industry. The sampling technique used in this study was *purposive sampling*, with the criteria: the company submitted an *annual report* openly and the data were completely available. The data in this study are secondary data. The data needed in this study is company disclosure, corporate governance and financial data of Indonesian banking companies in 201 5 -201 8 . The data will be downloaded from the *annual reports* of companies that are accessed from a web www.idx.co.id . The observation data in this study is 92. The following data table in this study:

Table 1. Data Samples

No	Information	amount
1	Banking company listing in 2018	45
2	No consecutive listings	-8
3	Data incomplete	-15
	Sample company	22
	Observational data 22 x 4 years	92

2. Research variable

The variables in this study consisted of the dependent variable and the independent variable . The dependent variable in this study is *fraud*. This variable is measured using a *dummy* variable . Number 1 indicates that the company is indicated to manipulate financial statements, and number 0 if the company is not indicated to manipulate financial statements. The company is indicated to manipulate the financial statements proxy using the Beneish M-Score model .

While the independent variables in this study are *pentagon fraud* and governance (GCG) components. *Fraud* components include *pressure, opportunity, rationalization, capability* and *arrogance*. *Pressure* variable is measured using financial stability. The *opportunity* variable is measured using audit quality. *Rationalization* variables *are* measured using KAP changes.

Variable *capability* was measured by using a change of directors, and the variable *arrogance* measured using a frequency f oto management in the annual report . Corporate governance variables (GCG) are measured using the IICG index.

3. Basis for Theory and Hypothesis

Fraud according to *International Standards on Auditing number 99* is a deliberate action by company management, governance, employees or third parties who commit fraud to obtain illegal profits. Theory *Fraud Pentagon* is a refinement of the theory of *fraud* that previously existed, namely the theory of *fraud triangle* and theory of *fraud diamond*. The *fraud triangle* theory was first introduced by Donald Cressy in 1953. There are 3 causes of *fraud*, namely pressure; opportunity; justification for *fraud* .

In 2004 this theory was developed into the *Diamond Fraud* Theory by Wolfe and Hermason. Where 3 factors trigger fraud in *Fraud Triangle* theory coupled with individual ability (*capability*). *Capability* factor (ability) is the ability possessed by individuals in committing *fraud*. According to Wolfe and Hermanson (2004), *fraud* occurs mostly because of one's ability to read opportunities, driven by pressure and justification for *fraud*. Along with the development of business and the environment, the diamond fraud theory was developed into a *pentagon fraud* in 2011 by Crowe Howarth.

Pentagon fraud theory is an extension of the previous *fraud* theory . The factors that encourage *fraud to* emerge according to the *Pentagon fraud* theory are pressures, opportunities, justification , competence and arrogance. Arrogance is an attitude of superiority over the rights held and feels that internal control or company policy does not apply to him (Howarth, 2009). Arrogance (*arrogance*) is the nature of a lack of conscience which is an attitude of superiority or the presence of *arrogance* in someone who believes that internal control cannot be enforced personally (Aprilia, 2017).

Research on *fraud* has been conducted by several researchers. Tessa and Harto (2016) examined *Pentagon fraud* by proxy *Pentagon fraud* factors into several elements, namely *financial targets, financial stability, external pressure, institutional ownership, ineffective monitoring,* external auditor quality, *change in auditor* , change of directors and *frequent numbers of CEO's picture* to detect *fraudulent financial reporting* . The result is that *financial stability* as a proxy for pressure , *external pressure* as a proxy for opportunities , and the *frequent number of CEO images* as an arrogance proxy has a significant effect on *fraud.*

Aprilia (2017) examines *pentagon fraud* with a proxy for CEO politicians, the frequency with which CEO images appear, doubts about the unpublished debt policy, limited access to special purpose entity information, effectiveness of supervision, change of chief auditor, financial stability, external pressure, managerial ownership, change company accounting policies, and auditor's opinion. The result is only managerial ownership variables that have a significant effect on *fraud.*

Skousen *et.al.,* (2009), states that when financial stability is threatened by economic conditions, industry, and the situation of operating entities, managers face pressure to commit *financial statement fraud* , which also states that companies experiencing below-average industry growth , then management tends to manipulate financial statements. While Ulfah research, Nuraina and Lasting (2017) states variable change of auditor and the auditor's opinion which significantly affect the *fraudulent financial repotting.*

4. GCG (*Good Corporate Governance)*

Good corporate governance (GCG) is one of the pillars of a market economic system, closely related to trust both in the companies that implement it and in the business climate in a country. The governance mechanism describes the organizational culture that builds employee code of ethics and motivates it to uphold ethical values. Inefficient corporate governance raises the risk of financial statement *fraud* .

The Internal Audit Function is one of the governance functions, very important in assisting management in monitoring company assets and reducing *fraud* (Hery, 2010). The role of internal auditors is currently very heavy, they are required to conduct evaluations and contribute to improvements in risk management, internal control and governance processes using a systematic approach (Tugiman, 2015).

According to Prihantara in Ulfah and Wijaya (2017) states that *Pressure* is the urge of people to commit *fraud* , this is triggered by financial problems. While the *opportunity* arises because of weak internal control, poor corporate governance, weak sanctions and low performance appraisal (Karyono, 2013). Priantara (2013) argues that *rationalization* occurs because someone seeks justification for their activities that contain *fraud* . Wolfe and Hermanson (2004): *fraud is* committed by people who have the competence to commit fraud. While arrogance according to Horwath (2009) is an attitude of superiority over the rights owned and feels that internal control or company policy does not apply to him.

Fraud can occur in an entity because of the causes. According to *Pentagon's Fraud* theory , the factors driving *fraud* are the presence of pressure, opportunity, rationalization, competence and arrogance. The tendency to commit *fraud* can be reduced by implementing good corporate governance.

Based on the theories that have been put forward, the hypotheses in this study are:

H1: Variables of pressure, opportunity, rationalization, competence and arrogance as well as the role of corporate governance (GCG) are strongly correlated in identifying *fraud* .

Data Analysis Tool

The data in this study will be analyzed using *Pearson correlation* analysis tools . The research hypothesis will be supported if the significance value of t results from processing the correlation value of significance is less than 5%. *Fraud* variable is measured by dummy, if number 1 shows that the company is indicated to manipulate financial statements, and the number 0 if the company is not indicated to manipulate financial statements. To determine the company's manipulator or non-manipulator, identified using Beneish M-Score analysis, with the following equation:

M = -4.84 + 0.92 * DSRI + 0.528 * GMI + 0.404 * AQI + 0.892 * SGI + 0.115 * EDGE - 0.172 * SGAI + 4,679 * PROCEDURES - 0.327 * LVGI

Note: M = Manipulator (1); non-manipulator (0) ; DSRI = Days' Sales in Receivables Index ; GMI = Gross Margin Index ; AQI = Asset Quality Index ; SGI = Sales Growth Index ; DEPI = Depreciation Index ; SGAI = Sales, General and Administrative expenses Index ; LVGI = Leverage Index ; TATA - Total Accruals to Total Assets .

Then from the 8 variables are combined and a score is called an M-Score. If the M-Score is below -2.22 then the possibility of the company is *prudent* , but if the M-Score is greater than -2.22 then the possibility of the company is manipulating its financial statements.

C. RESULTS AND DISCUSSION

1. Descriptive statistics

This research variable consists of pressure variables, measured using a measure of financial stability. The company's financial stability can be seen from changes in its assets. The average change in the assets of the sample companies decreased by 0.0047, this shows that the financial stability of the sample companies tends to be stable. While the average opportunity to commit *fraud* is high, amounting to 0.5761. This indicates that for companies audited by external auditors other than the *Big Four* , there is a tendency for *fraud* . The average opportunity, ability and role of corporate governance is high, which is above 50%. This indicates that if there is an opportunity to commit *fraud* caused by weak internal control by the governance function and is supported by high competence from the perpetrators of *fraud* , *fraud* will emerge . Likewise for the arrogance factor, management has a strong position in the company, so they have the confidence to be arrogant towards all personnel in the company. So that they can act that harms others. The following table 2. descriptive statistics:

Table 2. Descriptive Statistics

Variable	The mean	Standard Deviation
Pressure (X1)	-.0047	.78275
Opportunities (X2)	.5761	.49688
Rationalization (X3)	1848	.39025
Ability (X4)	.6522	47889
Arrogance (X5)	45,6957	29,33690
Governance (X6)	.8010	.11219
Fraud (Y)	.1413	.35024

Source: Data processed in 2019

Table 3. Correlation Results

Variable	Significance Value of Correlation with Y	Direction of Correlation	Strength of Correlation
Pressure (X1)	.858	Positive	Weak
Opportunities (X2)	.135	Negative	Weak
Rationalization (X3)	0.285	Negative	Weak
Ability (X4)	.358	Negative	Weak
Arrogance (X5)	0.239	Negative	Weak
Governance (X6)	0.921	Positive	Weak

Source: Data processed in 2019

Pressure is significantly correlated with *fraud* indication . Pressure is the motivation or motivation of a person (group) to commit fraud. The company as a business entity has the pressure to always show good conditions for the company's performance to interested parties. Financial pressure is a common factor, such as the expectation of excess profits to maintain stock prices. To achieve aggressive profit predictions , management can pressure employees to create unrealistic performance reports by giving bonuses or stock options. So that the greater the management's pressure to show good performance, the higher the probability of *failure to* occur.

Opportunities, rationalization, competence and arrogance correlate insignificantly and negatively towards indications of fraud. Opportunity is a condition that allows someone (management) to commit, hide and convert fraud for their own (group) interests. Rationalization is an act that justifies their illegal actions. Competence is the expertise of employees to ignore internal controls, develop concealment strategies, and observe social conditions to meet their personal interests (Crowe, 2011).

Banking companies are types of industries that have strong regulations in carrying out their activities. So that monitoring of banking activities is very monitored. So that the trigger factors for opportunity *fraud* , rationalization and the ability to commit *fraud* can be detected. Monitoring or monitoring can be done throughout the process or at the end of the process. Throughout the process carried out by internal auditors, while at the end of the process carried out by external auditors.

Arrogance according to Crowe (2011) explains that arrogance is the nature of superiority over the rights held and feels that internal control and company policies do not apply to him. Financial statements are prepared by management and management is responsible for the contents of the financial statements. The nature of this priority will encourage management to act to beautify financial statements that are detrimental to the banking company. This is a type of industry that has strong regulations in carrying out its activities. So that monitoring of banking activities is very monitored. So that the trigger factors for *fraud* : opportunities, rationalization and the ability to commit *fraud* can be detected. Monitoring or monitoring can be done throughout the process or at the end of the process. Throughout the process carried out by internal auditors, while at the end of the process carried out by external auditors with an interest in the financial statements.

Governance (*good governance*) is manager and board of directors is responsible for preventing and detecting *fraud* (SA 240). They showed a signal to management level on how the organization is committed to the fight against *fraud* . Ethical policies positively influence the existence of *fraud* (Law , 2011). The governance mechanism describes the organizational culture that builds employee code of ethics and motivates it to uphold ethical values. Inefficient corporate governance raises the risk of financial statement fraud (Yucel, 2013). In addition, the audit committee must be alert to the risk of fraud and take immediate action if there is a signal of fraud (Jessup and N oblet , 2012) .

D. CONCLUSION AND RECOMMENDATIONS

This study analyzes the triggering factors of banking companies listed on the Indonesia Stock Exchange (IDX) indicated conducting *fraud* through the Pentagon *fraud* theory approach and the role of corporate governance. Pentagon *fraud* theory states that there are 5 factors triggering fraud, namely pressure, opportunity, rationalization, competence and arrogance. While another variable used to analyze the existence of indications of fraud is the role of corporate governance (*good governance*) .

Based on the correlation analysis, it states that the pressure factor and the role of the governance function correlate significantly with the indication of the company committing *fraud. The fraud* examined in this study is financial statement fraud. Financial statements are prepared and accounted for by management. Financial statements are a measure of management performance, so there is pressure from management to convey information about their performance properly. The mechanism of governance (*good governance*) describe the organizational culture that builds employee code of conduct and motivates him to uphold ethical values. Inefficient corporate governance raises the risk of financial statement *fraud* .

Associated with the significance of the inverse correlation. Then the proposal for the possibility of further research that can be done is by passing different analysis tools such as regression tests or different tests. Likewise, the measurement of independent variables can add a control system (5 components of control). While indicators of fr*aud* pentagon , for component can use the measuring tool management ownership / intern al , and competency management, as happens *fraud* carried out by the manager of finance and accounting.

REFERENCES

Amiruddin and Sundari, 2012, Fraud: How to detect it ?, Unhas repository.

Aprilia, 2017, Analysis of the Effect of the *Pentagon Fraud on* Fraudulent Financial Statements Using the *Beneish Model* for Companies that Implement the *Asean Corporate Governance Scorecard.* Journal of Accounting Research, 6 , 1, 96-126.

Chyntia Tessa and Puji Harto, 2016, *Fraudulent Financial Reporting* : *Testing the Pentagon Fraud Theory in the Financial and Banking Sector in Indonesia* , XIX National Accounting Symposium, Lampung .

Crowe Horwarth, 2012, "The Mind Behind the Crime Fraudsters: Key Behavioral and Environmental Element".

Lie Liana, 2009, The *Use of MRA with SPSS to Test the Effect of Moderating Variables on the Relationship between Independent Variables and Dependent Variables* , DINAMIC Information Technology Journal Volume XIV, No.2, pp. 90-97.

Maria Ulfah, Elva Nuraina and Anggita Lasting Wijaya, 2017, The Effect of *Pentagon Fraud* in Detecting *Financial Reporting Fraudulent* (Empirical Study on Banking in Indonesia Registered on the Indonesia Stock Exchange, Accounting Education Scientific Forum, Vol 5 No 1 October 2017 Page 399-418.

Skousen, CJ, KR Smith, and CJ Wright, 2009, "Detecting and Predecting Financial Statement Fraud: The Effectiveness of the Fraud Triangle and SAS No. 99 . " *Corporate Governance and Firm Performance Advances in Financial Economis* , Vol. 13, h. 53-81.

Suhardjanto Djoko and Dewi Aryane, 2011, Disclosure of Financial Risk and Corporate Governance: Empirical Study of Indonesian Banking, Journal of Finance and Banking Vol. 15 (1): p. 105-118.

Tugiman Hiro, 2015, Development and Claims of the Role of Internal Auditors At present, the National Congress of Accountants XII and the Anniversary of the Indonesian Institute of Accountants.

Wolfe, David T and Dana R. Hermanson, 2004, "The Fraud Diamond: Considering the Four Elements of Fraud". *CPA Journal* . 74.12: 38-42.