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FINANCE | RESEARCH ARTICLE

The Role of Pentagon Fraud in Detecting Fraudulent Financial Statements

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Abstract: Pentagon fraud is one type of financial fraud that occurs in companies. Pentagon fraud occurs when a company hides or deceives financial statements to reduce the amount of taxes it must withhold or to increase the value of the company for investors report. The purpose of this study was to examine and analyze the effect of the pentagon fraud variable on financial statement fraud with the dependent variable proxy being F-Scores. While the independent variables used in this study are financial stability (ACHANGE), financial target (ROA), nature of industry (RECEIVABLE), ineffective monitoring (BDOUT), change in auditor (CPA), change in directors (DCHANGE), and the frequent number of the CEO's picture (CEOPIC). This research use samples of consumption sector companies listed on the Indonesia Stock Exchange (IDX) for the period 2016–2020. By using purposive sampling, there are 55 samples from 11 companies. The data analysis method used multiple linear regression analysis, with hypothesis testing t-test, f-test, descriptive test, coefficient of determination. The results of this research shows that financial stability, ineffective monitoring, change in auditor, and change in direction have no significant influence on financial fraud statements. But financial target, nature of industry, and frequent number of CEO's picture have significant influence on financial fraud statement.

Keywords: Financial, Fraud, ROA, F-Scores.**JEL Classification Code:** D53, F36, F38

1. INTRODUCTION

Financial statements are an important instrument for a company, it is not uncommon for certain individuals from companies to commit fraud so that the report looks good. This is intended so that users of financial statements assess that the management performance of a company is good. Management will try as much as possible to describe the good condition of the company, this can result in fraudulent financial reporting. Financial statement fraud is a deliberate act of changing or manipulating data because there is a desire to misuse financial statements. The Association of Certified Fraud Examination (ACFE), Indonesia categorizes fraud into three groups: corruption, misappropriation of assets, and fraud in financial statements. In 2019, a survey by ACFE Indonesia revealed 239 fraud cases, 9.2 percent of which were financial statement fraud. The total loss from financial statement fraud is IDR 242,260,000,000. A case of fraudulent financial reporting that occurred in the food and beverage sub-sector consumption sector that recently occurred was PT Tiga Pilar Sejahtera, Tbk (now AISA). In 2017 Joko Mogoginta and Budhi Istanto, as directors who signed the financial statements, manipulated the financial statements with the aim of raising the company's share price. The purpose of this manipulation is to make the financial statements look good and become a reason for investors to buy AISA shares. The manipulation includes six affiliated distributor companies which are written as third parties, and there is an overstatement of receivables from the six companies with a value of Rp. 1.4 trillion, in addition to the alleged flow of funds from the company worth Rp. 1.78 trillion to management. This case shows that the pressure factor from the company's directors is to provide false information so that the company continues to achieve its annual target. The opportunity factor is that company executives are involved in

manipulating financial statements as well as channeling funds to management. The rationalization factor is that company executives assume that the actions taken are correct because it is for the sake of the company's progress. Factors the ability of corporate executives to do whatever they are ordered to do subordinates manipulate data and financial reports. Then the arrogance factor, namely the greed carried out by the board of directors because it has a position to inflate funds and exaggerate receivables just to increase stock prices and achieve company targets.

Based on the theory of Crowe Howard (2011), the causes of fraudulent financial reporting are pressure, opportunity, rationalization, ability, and arrogance, the five factors are called the fraud pentagon. The company's desire to look good in terms of financial performance is what sometimes makes companies take illegal actions, namely fraud. This research was conducted because there are many cases of fraudulent financial reporting in Indonesia, especially in the consumption sector, which tends to be difficult to disclose. Like the AISA case that happened recently. Until now, there are still many studies conducted to explore this case using Crowe's fraud pentagon theory. The purpose of this study is to analyze the effect of financial stability, financial targets, nature of industry, ineffective supervision and auditor turnover on financial statement fraud.

2. Literature Review and Hypothesis Development

2.1. The Effect of Financial Stability on Fraudulent Financial Statements

Financial stability is a condition that describes the company's financial condition in a stable condition. When the company's condition is in a bad condition, the company's management will make every possible effort to restore financial stability so that it looks good. Financial stability is threatened by economic conditions, industry, and the situation of operating entities, managers face pressure to commit financial statement fraud. The company's financial stability is measured based on the number of total assets added from year to year. Total assets that describe the wealth owned by the company. The high assets attract investors. When the total assets are quite large, the company is considered capable of providing maximum returns to investors. The fraud that occurs so that financial stability is good is to manipulate the assets owned by the company. The ratio of changes in total assets can be used to see the increase in the company's asset wealth.

H1: Financial stability has an effect on fraudulent financial statements.

2.2. The Effect of Financial Targets on Fraudulent Financial Statements

Agency theory describes the contract of cooperation between management as agents and shareholders as principals. This contract reflects the different interests between management and shareholders. Therefore, management has pressure to achieve the financial targets that have been planned in advance. Pressure on achieving this target can lead to fraudulent actions by management so that financial targets are achieved and maintain financial performance to look good. The company's financial target is usually a profit that can be seen from the return on assets. ROA is used to show how efficiently assets are used.

H2: Financial targets has an effect on fraudulent financial statements

2.3. The Effect of Nature of Industry on Fraudulent Financial Statements

Nature of industry is the ideal state of a company in the industry. Damayani et al (2017) show that the nature of the industry as proxied by the ratio of changes in accounts receivable has an effect on fraudulent financial statements. They explained that the increase in the company's receivables from the previous year could be an indication that the company's cash turnover was not good. The number of accounts receivable owned by the company will reduce the amount of cash that the company can use for its operational activities. Limited cash can be an impetus for management to manipulate financial statements.

H3: The nature of industry has an effect on fraudulent financial statements.

2.4. The Effect of Ineffective Supervision on Fraudulent Financial Statements

One of the ways to minimize fraud is by means of a good supervisory mechanism within the company. Ineffective control is a condition where the internal control system is not running effectively. According to SAS No. 99, this happens because there is one person or a small group that dominates the management in the company without a compensation supervisor, the ineffective supervision of the board of commissioners, directors, and audit committee over the financial reporting process, causing opportunities for fraudulent actions to open, the company with a large number of commissioners which is less will lead to higher levels of fraud.

H4: Ineffective supervision has an effect on fraudulent financial statements

2.5. The Effect of Auditor Changes on Fraudulent Financial Statements

Loebbecke & Willingham (1989) in Skousen et al (2009) revealed that auditor turnover can be suspected as an attempt by a company to cover up fraud. Rachmania (2017), auditor turnover has an effect on financial statement fraud. The change of auditor used by the company can be considered as a form to eliminate the fraud trail found by the previous auditor.

H5: Changes in auditors has an effect on financial statement fraud

2.6. The Effect of Changes in the Board of Directors on Fraudulent Financial Statements

Changes in the board of directors do not always have a positive impact on a company. The change of directors can be an attempt to get rid of directors who are considered to know the ins and outs of fraud committed by certain elements of the company. In addition, competent directors can make fraud more likely. Employees who have higher intellect or abilities are considered capable of identifying opportunities and committing fraud in accordance with their capabilities. Therefore, the replacement of a new, more competent board of directors does not necessarily mean that there is no fraudulent act.

H6 : Changes in the board of directors has an effect on fraudulent financial statements.

2.7. The Effect of CEO Image Occurrence on Fraudulent Financial Statements

Arrogance is the superior attitude of someone who is dominant with his rights or greed because he feels he has a higher position. Howart (2011) explains that one of the characters in arrogance is having a big ego – the CEO as a celebrity – the arrogance factor. Therefore, the more images of the CEO in making annual reports, it is suspected that the higher his arrogance so that he is able to commit fraud without fear of internal control.

H7: The frequency of the appearance of the CEO image has an effect on financial statement fraud.

3. Research Method and Materials

The data collection method used in this research is descriptive method with a quantitative approach, which means a method of measuring research variables based on numbers that emphasizes theory testing by analyzing data on the basis of statistical procedures. Secondary data from this study is the financial statements of consumption sector companies listed on the Indonesia Stock Exchange for the period 2016 – 2020. Technical data analysis uses multiple regression, namely data processing

is carried out with the help of the IBM SPSS 25 program. Data sources used in this study This is obtained from the official website of the Indonesia Stock Exchange (IDX) or also known as the Indonesia Stock Exchange (IDX) with the website address www.idx.co.id in the form of annual financial reports. The population of this study are all consumption sector companies listed on the Indonesia Stock Exchange for the 2016-2020 period. The sampling technique used is purposive sampling technique. Based on the sampling criteria, 11 companies were selected. The variables in this study are: (1) Independent variables, namely: financial stability (X1); Financial targets (X2); Nature of Industry (X3); Ineffective supervision (X4); Change of auditor (X5) • Change of board of directors (X6); Frequency of occurrence of CEO image (X7). (2) The dependent variable, namely: fraudulent financial statements (Y). The data analysis technique used descriptive statistical analysis and classical assumption test consisting of: normality test, multicollinearity test, heteroscedasticity test and autocorrelation test. To test the hypothesis, a partial test (t-test) is used.

4. Results and Discussion

4.1. Descriptive Statistical Analysis

Table 1: Descriptive Statistical Analysis

	N	Mean
FSCORES	55	.627013
ACHANGE	55	.102690
ROA	55	.090010
RECEIVABLE	55	.008319
BDOUT	55	401991
CPA	55	.07
DCHANGE	55	.22
CEOPIC	55	1.44
Valid N (listwise)	55	

Based on table 1, it shows and the amount of data observed is 55. The results of descriptive statistical analysis can be seen that the average value of financial statement fraud, as measured by the F-Score is 0.627, indicating the average level of fraud reports that occur in consumption sector companies.

4.2. Normality test

Table 2: Normality Test Results

One-Sample Kolmogorov-Smirnov Test		
		Unstandardized Residual
N		55
Normal Parameters, b	mean	.0000000
	Std. Deviation	.20045121
Most Extreme Differences	Absolute	.114
	Positive	.114
	negative	-.100
Kolmogorov-Smirnov Zc		.114
asympt. Sig. (2-tailed)		.073

The results of the data show that the data is normally distributed. This can be seen from the Asymp value. Sig of 0.073 > 0.05 means that the variable data has been distributed statistically normally.

4.3. Multicollinearity Test

The multicollinearity test was carried out using the VIF (Variance Inflation Factor) value. The test results are obtained as follows:

Table 3: Multicollinearity Test

Model	Tolerance	VIF
ACHANGE	.817	1,224
ROA	.729	1.371
RECEIVABLE	.729	1.372
BDOUT	.923	1.083
CPA	.871	1.148
DCHANGE	.804	1,244
CEOPIC	.734	1.362

The test results show that the VIF value of all independent variables has a value of 1.083 - 1.372 < 10 and a tolerance value of 0.729 - 0.871 > 0.10 meaning that all variables do not show any symptoms of multicollinearity in the regression model.

4.4. Heteroscedasticity Test

Table 4: Heteroscedasticity Test Results

Model	Sig.
ACHANGE	.754
ROA	.487
RECEIVABLE	.983
BDOUT	.754
CPA	.431
DCHANGE	.801
CEOPIC	.931

Based on the table above, the probability value of all independent variables is above 0.05 or none is significant, so there is no heteroscedasticity so that the regression model in this study is feasible to use in predicting financial statement fraud.

4.5. Multiple Regression Analysis

Table 5: Multiple Regression Analysis

Model		Unstandardized Coefficients	
		B	Std. Error
1	(Constant)	.431	.148
	ACHANGE	.138	.240
	ROA	3.167	.458
	RECEIVABLE	-3,011	.891
	BDOUT	.220	.329
	CPA	.100	.120
	DCHANGE	-.139	.078
	CEOPIC	-.100	.032

Based on the results of the multiple linear regression analysis in table 6, the multiple linear regression equation model is obtained:

$$Y = 0.431 + 0.138ACHANGE + 3.167ROA - 3.011RECEIVABLE + 0.220BDOUT + 0.100CPA - 0.139DCHANGE - 0.100CEOPIC$$

From the results of the analysis of multiple linear regression equations, it can be interpreted as follows:

1. The value of each independent variable regression coefficient and the linear regression model. The value of the multiple linear regression coefficient is 0.431. This means that if the independent proxy variable consists of ACHANGE, ROA, RECEIVABLE, BDOUT, CPA, DCHANGE, and CEOPIC has a fixed value or constant, then the magnitude of FSCORES is 0.431.
2. The regression coefficient value of the financial stability variable with the ACHANGE (X1) proxy is 0.138. This means that if the other variables are constant (constant) then every 1 unit increase in the ACHANGE variable causes an increase in financial statement fraud (FSCORES) of 0.138 points.
3. The regression coefficient value of the financial target variable as proxied by ROA (X2) is 3.167. This means that if the other variables are constant, each increase in the ROA variable by 1 unit causes an increase in financial statement fraud (FSCORES) of 3,167 points.
4. The regression coefficient value of the nature of industry variable as proxied by RECEIVABLE (X3) is -3,011. This means that if there is an increase in RECEIVABLE of 1 point, financial statement fraud (FSCORES) will decrease by -3,011 with the assumption that other variables have a fixed value.
5. The regression coefficient value for ineffective supervision proxied by BDOUT (X4) has a value of 0.220. This means that if there is an increase in BDOUT of 1 point, financial statement fraud (FSCORES) will increase by 0.220 with the assumption that other variables have a fixed value.
6. The regression coefficient value of the auditor turnover variable proxied by CPA (X5) is 0.100. This means that if the CPA value increases by 1 point, financial statement fraud (FSCORES) will increase by 0.100 with the assumption that the other variables have a fixed value.
7. The value of the board of directors turnover coefficient as proxied by DCHANGE has a value of -0.139. This means that if DCHANGE has increased by 1 point, financial statement fraud (FSCORES) will experience a decrease in value of 0.139 points assuming the other variables have a fixed value.
8. The coefficient value of the emergence of the CEO image as proxy by CEOPIC has a value of -0.100. This means that if CEOPIC increases by 1 point, financial statement fraud (FSCORES) will decrease by 0.100 points assuming the value of other variables remains.

4.6. T-test

Table 6: t-test

Model		t	Sig.
1	(Constant)	2,915	.005
	ACHANGE	.576	.568
	ROA	6.908	.000
	RECEIVABLE	-3.380	.001
	BDOUT	.668	.507
	CPA	.833	.409
	DCHANGE	-1,778	.082
	CEOPIC	-3.065	.004

Table 6 shows the results of hypothesis testing, namely:

1. The financial stability variable has $t_{count} < t_{table}$ ($0.576 < 2.01174$) with a sig. $0.568 > 0.05$ then H1 is rejected, meaning that financial stability has no effect on fraudulent financial statements.

2. The financial target variable shows the value of $t_{count} > t_{table}$ ($6.908 > 2.01174$) with a sig. $0.00 < 0.05$ then H2 is accepted, meaning that the financial target has an effect on fraudulent financial statements.
3. The nature of industry variable has $-t_{count} < -t_{table}$ ($-3.380 < -2.01174$) with sig. $0.001 < 0.05$ then H3 is accepted, meaning that the nature of the industry has an effect on fraudulent financial statements.
4. The ineffective monitoring variable has a value of $t_{count} < t_{table}$ ($0.668 < 2.01174$) with a value of sig. $0.507 > 0.05$ then H4 is rejected, meaning that ineffective supervision has no effect on fraudulent financial statements.
5. Auditor turnover variable has $t_{count} < t_{table}$ ($0.833 < 2.01174$) and sig. $0.409 > 0.05$ then H5 is rejected, meaning that the change of auditors has no effect on financial statement fraud.
6. The board of directors turnover variable has $-t_{count} > -t_{table}$ ($-1.778 > -2.01174$) with a sig. $0.082 > 0.05$ then H6 is rejected, meaning that the change of the board of directors has no effect on fraudulent financial statements.
7. The variable occurrence of CEO image has $-t_{count} < -t_{table}$ ($-3.065 < -2.01174$) with sig. value. $0.004 < 0.05$ then H7 is accepted, meaning that the appearance of the CEO's image in the annual report has an effect on fraudulent financial statements.

4.7. F-test

Table 7: F-Statistical Test

Model		df	F	Sig.
1	Regression	7	13,630	,000b
	Residual	47		
	Total	54		

Table 7 shows that the results of the F test show that financial stability, financial targets, nature of industry, ineffective supervision, auditor turnover, board of directors turnover, and the frequency of the appearance of the CEO image simultaneously have an effect on financial statement fraud as seen from $F_{count} > F_{table}$ ($13,630 > 2, 21$) with a value of sig. less than 0.05 ($0.000 < 0.05$).

4.8. Coefficient of Determination (R^2)

Table 8: Coefficient of Determination Test

Model	R Square
1	.670

Table 9 shows that the value of R square is 0.670 (67%) which means that financial stability, financial targets, nature of industry, ineffective supervision, auditor turnover, board of directors change, and the frequency of appearance of the CEO image can contribute to financial statement fraud by as much as 67%, while the remaining 33% is influenced by other variables.

4.9. Discussion

The Effect of Financial Stability on Fraudulent Financial Statements

Based on the results of the first hypothesis test (H1) with the results of the t-count value of 0.576 and the value of sig. 0.578 states that the Financial Stability variable has no significant effect on fraud in the company's financial statements. Financial stability is not related to the possibility of a company committing fraudulent financial statements, which means that even though the company has great financial stability or not, it will not affect the company in committing fraudulent actions on financial statements. Companies that have financial stability will not commit fraudulent financial statements. Instability of financial conditions is a pressure for companies that triggers fraudulent actions in financial statements. This test is supported by the company's assets can be

used to see the company's financial condition, because assets can describe the wealth owned by the company. When the company is at a low point or its finances are unstable, it means that the level of supervision is implemented properly by the board of commissioners to maintain the value of the company. PT Indofood CBP Sukses Makmur Tbk in the last two years experienced an increase in assets even during the pandemic, which means the level of company supervision has also improved. Thus, the financial stability of PT Indofood CBP Sukses Makmur Tbk is maintained despite the decline in economic activity in the last two years. Another example is PT Tempo Scan Pacific Tbk, which has increased assets in the last two years. This study supports the research of Damayani., et al. (2017), Prayoga & Sudarmaji (2019).

The Effect of Financial Targets on Fraudulent Financial Statements

Based on the analysis of the hypothesis shows that financial targets have a significant effect on fraudulent acts of financial statements. This can be seen from the results of the t test of 6.098 and the value of sig. 0.000 (sig value < 0.05), then the H4 hypothesis is rejected, meaning that ineffective supervision has no effect on financial statement fraud because the company chooses a competent and reliable board of commissioners. In addition, that many or at least the number of independent commissioners cannot prevent fraudulent financial statements, such as in PT Hanjaya Mandala Sampoerna Tbk, PT Kimia Farma Tbk, PT Chitose Internasional Tbk, which often change the number of independent commissioners and their performance is not stable because the proxy ACHANGE and RECEIVABLE in several years is still a minus. Likewise, PT Indofood CBP Sukses Makmur Tbk and PT Sekar Laut Tbk which changed the number of comparisons between the board of commissioners and the independent board of commissioners also had the same performance, namely there were still minuses from the ACHANGE and RECEIVABLE proxies. This does not rule out the possibility that the number of independent commissioners is only a regulatory requirement in fulfilling good corporate governance, while in practice they can still be influenced by intervention by the company.

The Effect of Auditor Change on Financial Statement Fraud

The change of auditors can be referred to as track-off for companies where fraud may be discovered by the old auditors. But based on the results of the study, the change in auditors does not justify the actions taken (rationalization) which can be used as an excuse for the perpetrators to commit fraudulent acts. In addition, the change of the old auditor to the new auditor cannot be concluded that the replacement auditor has no experience in the field of auditing. There are several other reasons why companies change their auditors because of the company's dissatisfaction with the auditor's opinion, a change in company management occurs if the company changes its board of directors so it will change company policies, companies that are conducting funding activities in the development of new business segments (expansion) of course expect to get a positive reaction. Positively by changing auditors, because of the high level of profitability, companies will be able to hire larger KAPs so that the quality of financial reports can be improved. Financial difficulties also affect auditor turnover. Companies will hire audits that have low fees. Based on the results of hypothesis testing H5 is rejected with a t-count value of 0.833 and a sig value. of 0.409 (sig.>0.05), then the change of auditors has no effect on fraudulent financial statements. Some companies do change auditors, but not because they want to eliminate the detection of fraudulent acts in financial statements by the old auditors. This is because the company complies with Government Regulation Number 20 of 2015 concerning the practice of public accountants providing services to a company entity, which is limited to a maximum of 5 (five) consecutive financial years. The reason the next company does not change its external auditor is because it is likely that the previous auditors agreed more on the practice of accounting methods used by the company and had understood the financial aspects and how they worked with each other and the company felt the results of the external auditor's opinion.

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The Effect of Changes in the Board of Directors on Fraudulent Financial Statements

Based on the results of the t-test hypothesis test, the t-count result is -1.778 and the value of sig. 0.082, (sig.> 0.05) indicates that H6 is rejected because it means that the change of the board of directors has no significant effect on financial statement fraud. This can happen because when viewed from the descriptive table of the capability variable, it shows that the average is 0.22. The average results tend to be low because they are below. Therefore, the sample companies used in this study tend not to change directors too often. In addition, if the highest stakeholders in the company want an improvement in the company's performance by recruiting directors who are considered more competent than the previous directors. The change of directors was not because the old directors used their abilities to commit fraud but because of other reasons. In addition, the company wants to improve the company's performance by replacing the previous directors with directors who are considered better and more competent. The change of directors was successful because the new directors were able to use their position to further advance the company and prevent fraud. What the company has to do if it is going to replace the old directors to the new directors is to select the best possible new director candidates, see their performance in their previous positions, and see what vision and mission he will do to advance the company. PT Hanjaya Mandala Sampoerna Tbk made changes to the board of directors for three consecutive years, but its ROA performance remained stable and there was no drastic decline. So, in conclusion, the change in the board of directors is not caused by the old board of directors taking advantage of their ability to commit fraud, but the company replacing the more competent directors.

The Effect of CEO Image Frequency on Financial Statement Fraud

From the results of the analysis of the hypothesis test t obtained t count -3.065 sig value. 0.004 (sig value < 0.05), then H7 is accepted. This means that the frequency of the appearance of the CEO image has a significant effect on financial statement fraud. This happens because usually CEOs tend to be arrogant towards their positions and positions so that with these positions it will

be easier for the CEO to commit fraudulent actions. The frequency of the appearance of the CEO's image in the annual report of consumption sector companies for the 2016-2020 period shows a fairly high frequency, as in PT Hanjaya Mandala Sampoerna Tbk which shows more than 1 photo of the CEO's image in its annual report.

5. Conclusion

Financial stability, ineffective supervision, change of auditors and change of board of directors have no effect on fraudulent financial statements. For, financial targets, the nature of the industry and the frequency of the appearance of the CEO image have an effect on fraudulent actions in financial statements. Beside that, as suggestions for future implications and limitations this study addresses: (1). For the Company to further improve corporate control through the fraud pentagon model and detect fraud as early as possible. In addition, the company must also supervise more in detail so that management does not justify fraudulent actions or manipulate the annual financial statements. (2). For potential investors, they can understand the variables that cause financial statement fraud, so that it can be the initial detection to find out fraudulent financial statements in a company and can make the right decisions before investing in the company. This research is only limited to secondary data in the form of audited financial statements as a data source, so it is not sufficient to reveal any variables that affect financial statement fraud. Beside that, as suggestions for future research agenda this study addresses: (1). Adding variables or using different proxies from the fraud pentagon variable in order to get a more accurate model in detecting fraudulent financial statements; (2). Expanding the sample data used, is not limited to consumption sector companies; (3). Using other proxies for fraudulent financial statements other than F-SCORES

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