

# Investigating Financial Reporting Fraud Using Fraud Pentagon Theory to Strengthen Governance and Transparency

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## **ABSTRACT**

*This study examines fraudulent financial reporting in Indonesia using the Fraud Pentagon Theory, which incorporates financial targets, stability, external pressure, ineffective monitoring, changes in auditors and directors, and CEO photo frequency as determinants. It addresses gaps in prior research that predominantly relied on the Fraud Triangle and Fraud Diamond frameworks, emphasizing large corporations while neglecting small and medium-sized enterprises (SMEs). The study employs a purposive sampling method, selecting 190 State-Owned Enterprises (SOEs) listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022. Multiple linear regression analysis was used to assess the relationship between independent variables and fraudulent financial reporting. The findings confirm that Financial Target, Financial Stability, External Pressure, Ineffective Monitoring, Changes in Auditors, Changes in Directors, and CEO Photo Frequency significantly impact fraudulent financial reporting, whereas firm size does not. These results align with agency theory, highlighting the pressure on management to meet financial goals, leading to fraudulent activities. Thus, strengthening governance structures, enhancing auditor independence, and improving monitoring mechanisms are critical for mitigating fraudulent financial reporting. Future research should explore corporate culture, ethical leadership, and machine learning techniques to enhance fraud detection. Expanding studies across industries and regions can provide a broader understanding of financial fraud dynamics.*

**Keywords:** *Fraud Pentagon Theory, Financial Fraud, Corporate Governance, Fraudulent Financial Reporting, Indonesia.*

## **ABSTRAK**

*Penelitian ini meneliti pelaporan keuangan yang mengandung kecurangan di Indonesia dengan menggunakan Teori Pentagon Kecurangan, yang menggabungkan target keuangan, stabilitas, tekanan eksternal, pemantauan yang tidak efektif, perubahan auditor dan direktur, dan frekuensi foto CEO sebagai faktor penentu. Penelitian ini membahas kesenjangan dalam penelitian*

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sebelumnya yang sebagian besar mengandalkan kerangka kerja Segitiga Kecurangan dan Berlian Kecurangan, yang menekankan perusahaan besar sambil mengabaikan usaha kecil dan menengah (UKM). Penelitian ini menggunakan metode purposive sampling, dengan memilih 190 Badan Usaha Milik Negara (BUMN) yang terdaftar di Bursa Efek Indonesia (BEI) dari tahun 2018 hingga 2022. Analisis regresi linier berganda digunakan untuk menilai hubungan antara variabel independen dan pelaporan keuangan yang mengandung kecurangan. Temuan penelitian ini menegaskan bahwa Target Keuangan, Stabilitas Keuangan, Tekanan Eksternal, Pemantauan yang Tidak Efektif, Perubahan Auditor, Perubahan Direktur, dan Frekuensi Foto CEO berdampak signifikan terhadap pelaporan keuangan yang mengandung kecurangan, sedangkan ukuran perusahaan tidak. Hasil ini sejalan dengan teori keagenan, yang menyoroti tekanan pada manajemen untuk memenuhi tujuan keuangan, yang mengarah pada aktivitas penipuan. Oleh karena itu, memperkuat struktur tata kelola, meningkatkan independensi auditor, dan memperbaiki mekanisme pemantauan sangat penting untuk mengurangi pelaporan keuangan yang mengandung kecurangan. Penelitian di masa mendatang harus mengeksplorasi budaya perusahaan, kepemimpinan yang beretika, dan teknik pembelajaran mesin untuk meningkatkan deteksi kecurangan. Memperluas studi di seluruh industri dan wilayah dapat memberikan pemahaman yang lebih luas tentang dinamika kecurangan keuangan.

**Kata kunci:** Teori Pentagon Fraud, Fraud Keuangan, Tata Kelola Perusahaan, Pelaporan Keuangan yang Curang, Indonesia.

## INTRODUCTION

Financial statements are crucial for organizations (Choi & Gipper, 2024). Every firm listed on the Indonesia Stock Exchange (IDX) is mandated to disclose its financial reports within stipulated deadlines (Maulidiana & Triandi, 2020). These reports serve as critical tools for conveying operational information to both internal and external stakeholders in a timely manner (Apriliana & Agustina, 2017). By presenting a snapshot of a company's financial health at a specific point in time, financial statements enable stakeholders to assess performance and establish benchmarks (Alfian & Tarjo, 2021). They are expected to be clear, reliable, comparable, and relevant (Anisykurlillah et al., 2023), adhering to standardized reporting practices to prevent misinformation (Yulianti et al., 2019; Tarjo et al., 2023).

However, the integrity of these financial statements can be compromised, leading to fraudulent reporting practices aimed at misrepresenting a company's financial position (Abadi et al., 2023). Such misrepresentation not only distorts the true financial picture but also influences managerial decision-making, performance evaluations, and public perception (Dewi & Anisykurlillah, 2021). The implications extend to global financial markets where accurate accounting information is pivotal for informed investment decisions (Akbar, 2017). Despite regulatory efforts, instances of fraudulent financial reporting persist, driven often by managerial motivations to portray favorable company performance (Haqq & Budiwitjaksono, 2019).

Fraudulent financial reporting poses significant risks to stakeholders, undermining trust and potentially leading to financial losses and legal repercussions (Hidayah & Devi Saptarini, 2020). Such fraudulent practices constitute deliberate misrepresentation for personal or collective gain, violating legal and ethical standards (Fitriyah & Novita, 2021). This misconduct not only jeopardizes a company's financial stability and reputation but also threatens broader economic integrity (Utami & Pusparini, 2019). Fraudulent activities encompass various forms including asset misappropriation, corruption, and direct manipulation of financial statements (Marzuki et al., 2024), often resulting in severe consequences such as reduced investor confidence and diminished market credibility (Nanda et al., 2019).

In Indonesia, the prevalence of financial fraud underscores a pressing need for effective detection and prevention mechanisms (Sawaka K., 2020; Wang et al., 2023). The Fraud Pentagon Theory, an extension of the Fraud Diamond Theory, introduces an "arrogance"

dimension alongside traditional elements (Vousinas, 2019). This framework identifies pressure, opportunity, rationalization, capability, and arrogance as critical factors contributing to fraudulent behaviors (Chimonaki et al., 2023). By analyzing these elements, the Fraud Pentagon offers insights into the motivations and circumstances surrounding fraudulent financial reporting, aiding in the development of proactive anti-fraud strategies (Koharudin & Januarti, 2021).

Although previous studies have examined fraudulent financial reporting using the Fraud Triangle and Fraud Diamond frameworks, limited research has been conducted on the applicability of the Fraud Pentagon Theory in Indonesia (Aghghaleh et al., 2016). Many studies focus primarily on the influence of pressure, opportunity, and rationalization, but fail to incorporate the roles of capability and arrogance in financial fraud cases (Vousinas, 2019; Chimonaki et al., 2023). Moreover, existing literature tends to emphasize financial fraud in large corporations, overlooking its occurrence in small and medium-sized enterprises (SMEs) (Sawaka, 2020). Additionally, there is a lack of comprehensive studies integrating qualitative and quantitative approaches to assess the effectiveness of fraud detection mechanisms within the Indonesian regulatory framework (Koharudin & Januarti, 2021). This study seeks to address these gaps by applying the Fraud Pentagon Theory to Indonesian financial fraud cases, providing a more holistic understanding of fraudulent financial behavior and its implications for corporate governance and financial transparency.

## LITERATURE REVIEW & HYPOTHESIS DEVELOPMENT

### Financial Target, Financial Reporting, External Pressure on Financial Reporting

The population for this study was determined using a purposive sampling method based on the following criteria: (1) State-Owned Enterprises (SOEs) listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022; (2) Companies reporting financial data in Rupiah (Rp); and (3) Companies providing relevant research variable data in their annual reports. A total of 190 organizations met these criteria. Financial targets serve as performance benchmarks for companies, influencing managerial decision-making and strategic actions (Antawirya et al., 2019). While achieving these targets signifies strong financial performance (Fathmaningrum & Anggarani, 2021), external factors may hinder their realization (Yulianti et al., 2019). This pressure to meet financial expectations can lead managers to manipulate financial reports, increasing the risk of fraudulent reporting (Fathmaningrum & Anggarani, 2021). Agency theory suggests that conflicts of interest and information asymmetry between managers and stakeholders create incentives for financial misrepresentation (Jensen & Meckling, 1976). Research findings indicate a positive correlation between financial targets and fraudulent financial reporting (Antawirya et al., 2019; Yulianti et al., 2019; Fathmaningrum & Anggarani, 2021). Based on this evidence, the hypothesis proposes that financial targets exert a positive influence on fraudulent financial reporting.

H1a: Financial targets positively influence fraudulent financial reporting.

Pressure is a significant factor contributing to fraudulent financial reporting, as outlined in the fraud pentagon theory (Antawirya et al., 2019). It can be measured using proxies such as financial stability, external pressure, financial targets, and personal financial needs (Nanda et al., 2019). When financial stability is threatened by economic conditions, industry challenges, or operational difficulties, managers may feel compelled to manipulate financial reports to meet expectations (Ozcelik, 2020). Companies often engage in such practices due to shareholder pressure to maintain financial stability. According to agency theory, conflicts of interest between agents and principals lead to information asymmetry, where managers possess more complete financial information (Jensen & Meckling, 1976). Prior studies have reported mixed findings: Antawirya et al. (2019) and Ozcelik (2020) found a positive effect, while Nanda et al. (2019) and Sawaka (2020) found a negative effect. Fitriyah & Novita (2021) found no significant effect.

H1b: Financial stability positively influences fraudulent financial reporting.

External pressure is a key component of the pressure framework within the fraud pentagon theory, introduced by Crowe in 2011. A major challenge for management is the company's dependence on external financing to maintain market competitiveness, making access to funding a critical concern (Sawaka, 2020). External pressure arises when excessive demands are placed on management to meet the expectations of external stakeholders (Omukaga, 2020). This pressure compels companies to prioritize financial performance and profitability to attract investors, thereby increasing the likelihood of earnings manipulation (Ozcelik, 2020). External funding also drives strategic initiatives such as research and development, particularly in industrial enterprises (Akbar, 2017). Agency theory highlights the separation of corporate management functions, ensuring efficiency and effectiveness. However, conflicting interests between principals and agents can lead to financial misrepresentation (Akbar, 2017; Triyanto, 2019). Previous research predominantly supports a positive relationship between external pressure and fraudulent reporting (Akbar, 2017; Antawirya et al., 2019; Omukaga, 2020; Ozcelik, 2020), though Sawaka (2020) suggests a negative impact.

H1c: External pressure positively influences fraudulent financial reporting.

### **Ineffective Monitoring, Change in Auditor on Financial Reporting**

The second component of Crowe's fraud pentagon theory is opportunity, which arises when an organization lacks effective control mechanisms. Weak oversight allows fraudulent financial reporting to occur, particularly in industries with deficiencies in financial reporting processes, such as inadequate supervision or monitoring (Uciati & Mukhibad, 2019). Ineffective monitoring refers to the absence of robust internal control measures within a company, enabling financial misconduct (Antawirya et al., 2019). This situation can stem from concentrated management power, lack of oversight regarding compensation, and insufficient supervision by the board of directors and audit committee in financial reporting processes (Andalia et al., 2021). Strengthening corporate governance through an independent board of commissioners is expected to reduce fraud risks (Fathmaningrum & Anggarani, 2021). Agency theory suggests that shareholders expect accurate financial reporting, but management may manipulate financial statements to secure high salaries and bonuses (Aprilia & Agustina, 2017). Previous research supports a positive relationship between inadequate monitoring and fraudulent financial reporting (Andalia et al., 2021; Antawirya et al., 2019), though Fathmaningrum & Anggarani (2021) found minimal impact.

H2: Ineffective monitoring positively influences fraudulent financial reporting.

In high-pressure work environments, individuals may justify fraudulent activities through rationalization, allowing them to reconcile unethical behavior with personal or professional justifications (Achmad et al., 2022). One mechanism for rationalization is the change of auditors, which may serve as a strategy to eliminate evidence of fraud detected by the previous auditor (Yulianti et al., 2019). A newly appointed external auditor may lack comprehensive knowledge of the company's financial history, creating opportunities for management to conceal fraudulent activities (Utami & Pusparini, 2019). When auditing a new client, auditors must first familiarize themselves with the company's operations, increasing the likelihood that fraudulent activities may go undetected (Hidayah & Devi Saptarini, 2020). Agency theory highlights the conflict of interest between principals and agents, where agents may prioritize personal gains over shareholders' interests (Jensen & Meckling, 1976). Fraudulent financial reporting is often motivated by self-interest (Sawaka K., 2020). Prior research suggests that auditor changes positively influence fraudulent financial reporting (Suryani, 2021; Antawirya et al., 2019;

Haqq & Budiwitjaksono, 2019), while other studies report mixed or insignificant effects (Utami & Pusparini, 2019; Hidayah & Devi Saptarini, 2020; Yulianti et al., 2019).

H3: Change in auditor positively influences fraudulent financial reporting.

### **Change in Director and Higher Frequency of CEO Photograph**

A change in director involves the transfer of leadership from former directors to newly appointed ones, with the goal of improving corporate governance and financial oversight (Hidayah & Devi Saptarini, 2020). The success of this transition is determined by the ability of the new directors to prevent or reduce the occurrence of misleading financial statements (Nanda et al., 2019). If the new directors fail to curb financial misstatements, the transition is deemed ineffective (Haqq & Budiwitjaksono, 2019). Agency theory, as proposed by Jensen & Meckling (1976), emphasizes the need for well-defined performance metrics and incentives to align managerial actions with the interests of stakeholders (Bao et al., 2020). Effective governance mechanisms require an understanding of directors' risk preferences, beliefs, and strategic decisions regarding financial reporting (Haqq & Budiwitjaksono, 2019). Prior studies indicate mixed findings on the impact of director changes on fraudulent financial reporting. While some research suggests a positive relationship (Antawirya et al., 2019; Hidayah & Devi Saptarini, 2020), others indicate a negative effect (Anggraini & Suryani, 2021; Nanda et al., 2019), or no significant impact (Haqq & Budiwitjaksono, 2019).

H4: Change in director positively influences fraudulent financial reporting.

The Pentagon fraud theory suggests that CEO hubris can act as a catalyst for fraudulent financial reporting (Fathmaningrum & Anggarani, 2021). The presence of CEO photographs and biographical details in annual reports reflects the extent of their hubris and self-perceived superiority (Akbar, 2017). A positive correlation exists between arrogance and fraudulent activities, as CEOs with excessive self-confidence may consider themselves above internal regulations and controls (Apriliana & Agustina, 2017; Hidayah & Devi Saptarini, 2020; Maulidiana & Triandi, 2020). Agency theory emphasizes the separation of ownership and management to improve efficiency by employing skilled professionals to oversee the organization. However, this separation may create conflicts of interest between owners and managers (Akbar, 2017). Research findings on the relationship between CEO photographs and fraudulent financial reporting are mixed. Some studies indicate a positive correlation (Akbar, 2017; Antawirya et al., 2019; Apriliana & Agustina, 2017; Nanda et al., 2019), while others suggest no significant impact (Anggraini & Suryani, 2021; Fathmaningrum & Anggarani, 2021; Hidayah & Devi Saptarini, 2020; Sawaka K., 2020; Yulianti et al., 2019).

H5: A higher frequency of CEO photographs positively influences fraudulent financial reporting.

Figure 1 research framework that examines factors that influence fraudulent financial reporting. There are seven hypotheses that link independent variables to fraudulent reporting, namely: financial targets (H1a), financial stability (H1b), external pressure (H1c), ineffective monitoring (H2), change in auditor (H3), change in director (H4), and higher frequency of CEO photographs (H5). All factors are assumed to have a positive effect on the likelihood of fraudulent financial reporting. This model can be used to empirically test the influence of internal and external pressures and leadership characteristics on fraudulent behavior in companies.

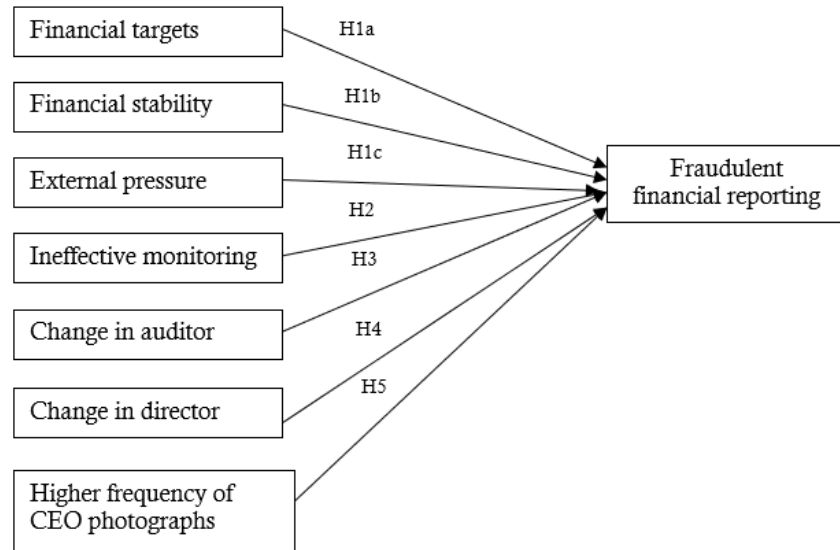


Figure 1. Research Framework

**RESEARCH METHOD**

This study examines fraudulent financial reporting as the dependent variable, measured using the fraud score (f-score) model proposed by Dechow. The f-score comprises accrual quality and financial performance (Skousen et al., 2009), which can be described as follows:

$$F - Score = Accrual Quality + Financial Performance \quad (1)$$

Accrual quality is measured using RSST accruals, named after Richardson, Sloan, Soliman, and Tuna (Richardson et al., 2005). This formula defines accruals as non-cash and non-equity changes in a company's balance sheet, distinguishing the reliability of working capital (WC), non-current operating (NCO), and financial accrual (FIN). It also categorizes accrual types based on asset and liability components (Antawirya et al., 2019) which can be described as follows:

$$RSST \text{ accrual} = \frac{(\Delta WC + \Delta NCO + \Delta FIN)}{\text{Average Total Asset}} \quad (2)$$

Financial performance is reflected in changes in accounts receivable, inventory, cash sales, and earnings before tax and interest, expressed by the following formula:

$$\text{Financial Performance} = \text{change in receivable} + \text{change in inventories} + \text{change in cash sales} + \text{change in earnings} \quad (3)$$

Changes in receivables are calculated as total receivables divided by average total assets. Changes in inventories follow the same method. Changes in cash sales are derived from total sales divided by sales(t) minus total receivables divided by receivables(t). Changes in earnings are earnings(t) divided by average total assets(t) minus earnings(t-1) divided by average total assets(t-1) (Hidayah & Devi Saptarini, 2020). This study examines seven independent variables: pressure (financial targets, stability, external pressure), opportunity (ineffective monitoring), rationalization (auditor opinion),

capability (change in director), and arrogance (CEO frequency). Financial targets, measured by ROA, influence fraud risk (Skousen et al., 2009).

$$ROA = \frac{\text{Net Profit}}{\text{Total of Asset}}$$

Financial stability is measured by the ratio of changes in total assets, where a higher ratio indicates a greater likelihood of financial statement fraud. Research by Yulianti et al. (2019) confirms that financial stability influences fraud occurrence. The asset change ratio (ACHANGE) serves as the financial stability proxy, calculated using the following formula:

$$DACHANGE = \frac{(\text{total asset}_{(t)} - \text{total asset}_{(t-1)})}{\text{total asset}_{(t-1)}}$$

External pressure arises when management faces excessive demands to meet third-party expectations, especially when asset inflows decline while debt obligations persist. This pressure threatens the company's sustainability (Maulidiana & Triandi, 2020). The leverage ratio (LEV) is used as a proxy for external pressure, measured using the debt-to-asset ratio formula:

$$Lev = \frac{\text{Total of liability}}{\text{Total of Assets}}$$

Weak supervision increases the likelihood of management engaging in fraudulent practices. An independent board of commissioners enhances oversight, reducing financial statement fraud risks (Sallal et al., 2021). Research indicates that a higher ratio of independent commissioners positively affects fraud prevention (Haqq & Budiwitjaksono, 2019). The ineffective monitoring proxy is measured using the independent board of commissioners ratio (BDOUT), calculated as the number of independent commissioners divided by the total board of commissioners. The formula is as follows:

$$BDOUT = \frac{\text{Total of Independent Board of Commissioners}}{\text{Total of Board of Commissioners}}$$

The change in auditor proxy indicates potential financial statement issues. A shift in external auditors may signal disputes over accounting policies or undesirable audit findings. Companies may replace strict auditors with more lenient ones, increasing fraud risk. Auditor changes often reflect financial instability when prior auditors refuse an unqualified opinion (Yulianti et al., 2019). This proxy, termed BIG (Big International Group), is a dummy variable: “1” if the company changes auditors (2018–2022) and “0” otherwise.

The change in directors proxy reflects leadership transitions that may impact financial reporting integrity. Sudden resignations or replacements can create instability, increasing fraud risk. This proxy, termed CPA (Certified Public Accountant), is measured using a dummy variable (Yulianti et al., 2019). Code “1” indicates a director change between 2018–2022, particularly involving CPA-certified members, while code “0” signifies no change during the period.

Frequent CEO changes are measured using CEOPIC (CEO Pictures), which counts the number of CEO photos in annual reports from 2018–2022. A different CEO photo yearly indicates leadership turnover. Furthermore, the control variable, size, represents a company’s scale and is measured by total assets (Maulidiana & Triandi, 2020). Using size as a control variable helps isolate its impact when analyzing other factors. The formula for size is as follows:

This study employs multiple linear regression since it has one dependent and multiple independent variables (Anggraini & Suryani, 2021). Before regression, a descriptive statistical test is conducted to summarize the data. A classical assumption test ensures unbiased and consistent regression estimates by examining normality, multicollinearity, heteroscedasticity, and autocorrelation. A model suitability test assesses how well the regression model fits the actual data. Hypothesis testing determines whether to accept or reject the proposed hypotheses. The multiple regression equation for this study is as follows:

$$Y = \alpha + \beta_1.X_{1a} + \beta_2.X_{1b} + \beta_3.X_{1c} + \beta_4.X_2 + \beta_5.X_3 + \beta_6.X_4 + \beta_7.X_5 + \beta_8.Z + \varepsilon \quad (4)$$

Information:

- Y = Fraudulent Reporting
- $\alpha$  = Constant
- $\beta_1 - \beta_8$  = Coefficient
- $X_{1a}$  = Financial Target
- $X_{1b}$  = Financial Stability
- $X_{1c}$  = External Pressure
- $X_2$  = Ineffective Monitoring
- $X_3$  = Changes in Auditors
- $X_4$  = Changes in Director
- $X_5$  = CEO photos Frequency
- Z = Size
- $\varepsilon$  = Error

## RESULTS

The descriptive statistics in Table 1 provide an overview of the variables used in this study. Fraudulent reporting, the dependent variable, ranges from -3.51 to 6.25, with a mean of 0.1303 and a standard deviation of 0.8085, indicating variation in financial misreporting among firms. Financial target and financial stability have mean values of 0.0762 and 0.0758, respectively, with relatively low standard deviations, suggesting minor fluctuations across firms. External pressure has a mean of 0.4711 and a standard deviation of 0.1886, showing moderate variation, while ineffective monitoring has a mean of 0.4078, with a lower standard deviation (0.11097), indicating relatively consistent corporate governance practices. Changes in auditors and directors are both binary variables, with mean values of 0.0579 and 0.2211, respectively, indicating that director changes occur more frequently than auditor changes. CEO photo frequency ranges widely from 1 to 35, with a mean of 5.36, suggesting that most firms have stable leadership, though some experience frequent CEO changes. Lastly, firm size varies significantly, ranging from 12.24 to 31.81, with a mean of 19.65, indicating considerable differences in company scale.

Table 1. Descriptive Statistics

Variable	N	Min.	Max.	Median	Mean	Std. Error	Std. Deviation
Fraudulent Reporting	190	-3.51	6.25	0.1150	0.1303	0.05866	0.80850
Financial Target	190	-0.18	0.48	0.0600	0.0762	0.00608	0.08374
Financial Stability	190	-0.40	0.63	0.0700	0.0758	0.00843	0.11617
External Pressure	190	0.11	0.87	0.4750	0.4711	0.01368	0.18859
Ineffective Monitoring	190	0.17	0.75	0.4000	0.4078	0.00805	0.11097
Changes in Auditors	190	0.00	1.00	0.0000	0.0579	0.01699	0.23416
Changes in Director	190	0.00	1.00	0.0000	0.2211	0.03018	0.41605
CEO Photos	190	1.00	35.00	40.0000	5.3632	0.31166	4.29590
Size	190	12.24	31.81	17.4800	19.6517	0.38101	5.25189

The multicollinearity test results (Table 2) indicate that all independent variables have Tolerance Values (TV) above 0.1 and Variance Inflation Factor (VIF) values below 10, confirming the absence of multicollinearity. Financial Target, Financial Stability, and External Pressure have slightly lower tolerance values but remain within acceptable limits. Changes in Auditors and Size show the highest tolerance values, indicating minimal correlation with other predictors. These results suggest that the regression model is reliable, with no significant multicollinearity affecting variable relationships.

**Table 2.** Multicollinearity Test

Variable	Tolerance Value (TV)	Variance Inflation Factor (VIF)	Status
Financial Target (X1a)	0.682	1.467	No Multicollinearity
Financial Stability (X1b)	0.783	1.277	No Multicollinearity
External Pressure (X1c)	0.688	1.454	No Multicollinearity
Ineffective Monitoring (X2)	0.898	1.114	No Multicollinearity
Changes in Auditors (X3)	0.957	1.045	No Multicollinearity
Changes in Director (X4)	0.811	1.232	No Multicollinearity
CEO Photos Frequency (X5)	0.879	1.137	No Multicollinearity
Size (Z)	0.975	1.026	No Multicollinearity

Table 3 confirms that all independent variables have significance values ( $\alpha$ ) above 0.05, indicating no heteroscedasticity in the model. Financial Target has the lowest significance value (0.052), but it remains slightly above the threshold, suggesting minimal risk. Other variables, such as Financial Stability (0.863) and External Pressure (0.944), show high significance values, reinforcing the model's consistency. These results confirm that the regression model meets the assumption of homoscedasticity, ensuring the validity of the coefficient estimates.

**Table 3.** Glejser Test for Heteroscedasticity

Variable	Glejser Test ( $\alpha$ )	Status
Financial Target (X1a)	0.052	No Heteroscedasticity
Financial Stability (X1b)	0.863	No Heteroscedasticity
External Pressure (X1c)	0.944	No Heteroscedasticity
Ineffective Monitoring (X2)	0.934	No Heteroscedasticity
Changes in Auditors (X3)	0.118	No Heteroscedasticity
Changes in Director (X4)	0.596	No Heteroscedasticity
CEO Photos Frequency (X5)	0.900	No Heteroscedasticity
Size (Z)	0.189	No Heteroscedasticity

**Table 4.** Normality and Autocorrelation Test

Test Method	Statistic	p-Value ( $\alpha$ )	Result
Kolmogorov-Smirnov (KS)	Resid1 = 0.000	Resid2 = 0.230	Normal (Meets Assumption)
Durbin-Watson (DW)	1.953	-	No Autocorrelation

**Table 5.** Hypothesis Testing (Regression Test)

Variable	Coefficient ( $\beta$ )	t-Value	p-Value ( $\alpha$ )	Significance
Financial Target (X1a)	4.232	4.232	0.000	Significant
Financial Stability (X1b)	1.078	1.078	0.000	Significant
External Pressure (X1c)	-0.241	-0.241	0.001	Significant
Ineffective Monitoring (X2)	-0.432	-0.432	0.000	Significant
Changes in Auditors (X3)	-0.135	-0.135	0.039	Significant
Changes in Directors (X4)	0.260	0.260	0.000	Significant
CEO Photos Frequency (X5)	0.025	0.025	0.000	Significant
Size (Z)	0.000	0.000	0.930	Not Significant

Table 4 confirms that the regression model meets key assumptions. The Kolmogorov-Smirnov (KS) test shows Resid1 = 0.000 and Resid2 = 0.230, indicating that the residuals follow a normal distribution. The Durbin-Watson (DW) test results in a value of 1.953, which falls within the acceptable range (approximately 1.5 to 2.5), confirming no

autocorrelation. These findings validate the reliability of the regression model, ensuring that statistical inferences drawn from it are robust and unbiased.

The regression test results in Table 5 provide insights into the relationship between various independent variables and Fraudulent Financial Reporting. The H1a hypothesis states that Financial Targets positively influence Fraudulent Financial Reporting. The findings reveal that Financial Target (H1a) has a significant positive effect, as indicated by a coefficient of 4.232 and a t-value of 4.232, with a p-value of 0.000, confirming its strong impact on fraudulent financial activities. Thus, hypothesis H1a is accepted, reinforcing the notion that higher financial targets may drive fraudulent financial practices.

The H1b hypothesis states that Financial Stability positively influences Fraudulent Financial Reporting. The results indicate that Financial Stability (H1b) exhibits a significant positive relationship, with a coefficient of 1.078 and a t-value of 1.078, supported by a p-value of 0.000, emphasizing its role in influencing financial misreporting. Therefore, hypothesis H1b is accepted, suggesting that firms with stable financial conditions may still engage in fraudulent practices to maintain their financial standing.

The H1c hypothesis states that External Pressure significantly influences Fraudulent Financial Reporting. The findings present a significant negative effect, as reflected by its coefficient of -0.241 and a t-value of -0.241, with a p-value of 0.001, suggesting that heightened external pressures may reduce fraudulent reporting tendencies. Consequently, hypothesis H1c is accepted, indicating that firms experiencing greater external scrutiny may be less inclined to engage in fraudulent activities.

The H2 hypothesis states that Ineffective Monitoring significantly influences Fraudulent Financial Reporting. The results reveal a negative coefficient of -0.432, a t-value of -0.432, and a highly significant p-value of 0.000, indicating that strong monitoring mechanisms can mitigate fraudulent financial activities. Thus, hypothesis H2 is accepted, confirming that weak governance structures contribute to increased fraudulent financial behavior.

The H3 hypothesis states that Changes in Auditors significantly influence Fraudulent Financial Reporting. The findings show a significant negative effect, with a coefficient of -0.135, a t-value of -0.135, and a p-value of 0.039, suggesting that auditor changes could act as a deterrent to financial misreporting. As a result, hypothesis H3 is accepted, supporting the argument that frequent changes in auditors may signal increased transparency or regulatory compliance.

The H4 hypothesis states that Changes in Directors significantly influence Fraudulent Financial Reporting. The results demonstrate a positive and significant relationship, with a coefficient of 0.260, a t-value of 0.260, and a p-value of 0.000, implying that shifts in leadership may contribute to increased fraudulent financial behavior. Therefore, hypothesis H4 is accepted, indicating that leadership transitions may create instability or opportunities for financial misrepresentation.

The H5 hypothesis states that CEO Photos Frequency significantly influences Fraudulent Financial Reporting. The findings confirm a positive and significant impact on fraudulent reporting, with a coefficient of 0.025, a t-value of 0.025, and a p-value of 0.000, suggesting that the frequency of CEO photographs in financial reports may correlate with manipulation tendencies. Thus, hypothesis H5 is accepted, highlighting the potential link between CEO prominence in company reports and fraudulent practices.

Meanwhile, the Z hypothesis states that Size significantly influences Fraudulent Financial Reporting. However, the results indicate no significant effect, as reflected by a coefficient and t-value of 0.000, alongside a p-value of 0.930, suggesting that firm size does not play a substantial role in influencing fraudulent financial activities. Given this result, hypothesis Z is rejected due to its lack of significance.

These findings confirm the acceptance of hypotheses H1a, H1b, H1c, H2, H3, H4, and H5, which highlight the significant impact of Financial Target, Financial Stability, External Pressure, Ineffective Monitoring, Changes in Auditors, Changes in Directors, and CEO Photos Frequency on Fraudulent Financial Reporting. However, hypothesis Z

regarding Size is not supported, indicating that firm size does not significantly affect fraudulent financial behavior.

**Table 6.** F-Value and R<sup>2</sup>

Model Fit Indicator	Value	P-value	Interpretation
F-Value	3644	0.000	Model Significant
R <sup>2</sup> (Coefficient of Determination)	0.855		85.5% Variance Explained

The model fit results in Table 6 indicate strong explanatory power. The F-Value of 3644 with a p-value of 0.000 confirms that the model is statistically significant. Additionally, the R<sup>2</sup> value of 0.855 suggests that 85.5% of the variance in Fraudulent Financial Reporting is explained by the independent variables, demonstrating the model's robustness and reliability in predicting fraudulent financial behavior.

## DISCUSSION

The research findings indicate that financial targets exert a powerful and statistically significant impact on fraudulent financial reporting. Consequently, the first hypothesis is confirmed (Ang et al., 2016). The observation above indicates that a corporation's achievement of very ambitious financial objectives would inevitably impact management policies (Chabachib et al., 2019). If the financial objective cannot be attained, it may lead to firm management engaging in fraudulent financial reporting (Andriani et al., 2022). This aligns with agency theory, which posits that agency difficulties emerge when interest gaps and information asymmetry exist, resulting in one side possessing more comprehensive knowledge (Yang et al., 2017). Deceptive activities are influenced by the agent-principal relationship, where management strives to manage confidence, hence being obligated to deliver satisfactory performance outcomes. This situation induces agents to experience pressure and resort to many methods to obtain performance bonuses. Prior research also supports the correlation between financial targets and fraudulent financial reporting (Yulianti et al., 2019; Fathmaningrum & Anggarani, 2021; Antawirya et al., 2019). However, this contradicts findings by Quraini & Rimawati (2019), which indicate that financial circumstances have no impact on fraudulent financial reporting.

Research shows a strong and statistically significant correlation between financial stability and fraudulent financial reporting. Thus, the second hypothesis is supported (Khamainy et al., 2022). These data suggest that a company's financial stability affects its likelihood of fraudulent financial reporting. When a corporation has solid financial resources, its management will seek financial stability, which increases fraudulent financial reporting (Yulianti et al., 2019). Shareholder pressure to maintain financial stability allows management to use fraudulent financial reporting. This finding is consistent with prior research conducted by Achmad, Ghozali et al. (2022), Antawirya et al. (2019), and Ozcelik (2020), which support the notion that financial stability has a beneficial impact. However, studies by Nanda et al. (2019), Sawaka (2020), Fitriyah & Novita (2021), contradict these findings by suggesting that financial stability does not impact fraudulent financial reporting.

This paper disproves the third hypothesis by showing that external pressure negatively impacts fraudulent financial reporting. These results show that external pressure on a company does not necessarily lead to fraudulent financial reporting and vice versa (Quraini & Rimawati, 2018). Agency theory emphasizes the need to segregate functions between corporate management and the interplay between owners and managers. This segregation aims to enhance efficiency and effectiveness by hiring skilled personnel to oversee organizational operations. Nevertheless, this division might give rise to issues, particularly when there is a discrepancy in objectives between the principal and the agent (Akbar, 2017). This finding contradicts prior research conducted by Achmad, Ghozali et al. (2022), Akbar (2017), Antawirya et al. (2019), Omukaga (2020), and Ozcelik (2020), who determined that external pressure positively influences fraudulent financial

reporting. However, it aligns with the findings of Sawaka (2020), which demonstrate that external pressure negatively impacts fraudulent financial reporting.

The research findings indicate that ineffective monitoring has a detrimental and substantial impact on fraudulent financial reporting, thereby leading to the rejection of the fourth hypothesis (Andalia et al., 2021). This phenomenon can arise from the concentration of management power in a single individual or a small group without proper control over compensation, inadequate oversight of the board of directors and audit committee in overseeing the financial reporting process, internal control processes, and similar factors (Toms, 2019). Establishing an autonomous board of commissioners is expected to enhance the oversight of corporate performance, thereby mitigating fraudulent activities (Fathmaningrum & Anggarani, 2021). Prior research also supports the relationship between ineffective monitoring and fraudulent financial reporting (Achmad, Ghazali et al., 2022; Fathmaningrum & Anggarani, 2021). However, these findings contradict research by Antawirya et al. (2019), which demonstrated a positive correlation between ineffective monitoring and fraudulent financial reporting.

Rationalization is a crucial element in fraudulent activities. The paper findings indicate that the phenomenon of change in auditors has a detrimental and statistically significant impact on the occurrence of fraudulent financial reporting. Consequently, the fifth hypothesis is refuted. These findings indicate that when a corporation switches auditors, it becomes impossible to eradicate any evidence of fraud detected by the previous auditor (Puspitha & Yassa, 2018). The primary purpose of the principal's employment as an auditor is to actively identify and assess any fraudulent financial reports submitted by firm management, enhancing the audit findings' overall quality. However, these findings contradict prior studies demonstrating a positive correlation between inadequate monitoring and fraudulent financial reporting (Antawirya et al., 2019; Achmad, Ghazali et al., 2022; Fathmaningrum & Anggarani, 2021).

The analysis shows a strong link between director changes and fraudulent financial reporting. Thus, the sixth hypothesis is supported (Yusrianti et al., 2020). This suggests that when a corporation replaces directors to maximize corporate performance, poor directors will be replaced by more competent and efficient directors (Christian et al., 2019). A change in directors is successful if the new directors can prevent or reduce misleading financial statements (Nanda et al., 2019). Directors retiring or finishing their tenure will maximize profits to increase their pay. Fraudulent activity increases as directors leave or new directors are appointed (Sari et al., 2020). The replacement of a director can be undertaken to enhance the performance of prior management, or it may also mirror a particular political agenda. The appointment of a new director can induce heightened stress, potentially fostering fraudulent conduct (Putra & Dinarjito, 2021). Prior studies also demonstrate a favorable impact of switching directors on fraudulent financial reporting (Antawirya et al., 2019; Hidayah & Devi Saptarini, 2020). However, these findings contradict research by Anggraini & Suryani (2021) and Nanda et al. (2019), which suggest that fraudulent financial reporting decreases with director changes.

The findings highlight the critical role of financial targets, stability, and organizational structure in mitigating fraudulent financial reporting. First, corporate leadership must set realistic financial goals to reduce pressure on management, which may otherwise resort to fraudulent practices. Adopting transparent financial reporting standards and ethical guidelines can prevent deceptive practices driven by ambitious financial objectives. Second, maintaining financial stability should not come at the cost of compromised reporting integrity. Management should focus on sustainable growth strategies rather than manipulating financial statements to meet shareholder expectations. Independent audits and regulatory oversight are essential in ensuring financial transparency. Third, external pressures, including leverage and debt obligations, should be managed through prudent financial planning rather than earnings manipulation. Organizations must enhance risk management frameworks to mitigate the temptation of fraud under financial strain. Fourth, ineffective monitoring remains a key driver of fraudulent reporting. Strengthening governance mechanisms, such as an independent board of commissioners and rigorous

internal audit processes, can enhance oversight and deter financial misrepresentation. Lastly, changes in auditors and directors should be managed with a focus on improving financial integrity. Ensuring smooth leadership transitions and auditor independence will minimize the risk of fraudulent financial reporting, fostering long-term organizational credibility.

## CONCLUSION

The findings of this study reaffirm the critical role of financial and governance factors in influencing fraudulent financial reporting. The regression results confirm that Financial Target, Financial Stability, External Pressure, Ineffective Monitoring, Changes in Auditors, Changes in Directors, and CEO Photos Frequency significantly affect fraudulent financial reporting. Conversely, firm size does not exhibit a significant relationship with fraudulent reporting. These results align with agency theory, emphasizing the pressure on management to meet financial targets and maintain stability, potentially leading to fraudulent activities. The study highlights that ambitious financial targets and the need for financial stability serve as key drivers of fraudulent financial reporting. Additionally, external pressure has a significant negative effect, indicating that increased scrutiny may deter fraudulent behavior. The findings also reveal that ineffective monitoring exacerbates the risk of fraudulent reporting, while frequent changes in auditors and directors contribute to variations in financial misrepresentation. Notably, the prominence of CEO photos in financial reports correlates positively with fraudulent tendencies, suggesting a possible link between executive visibility and misreporting.

These findings hold significant implications for corporate governance and regulatory policies. Strengthening monitoring mechanisms, improving auditor independence, and reinforcing governance structures can serve as deterrents to fraudulent financial reporting. Regulatory bodies and policymakers should focus on enhancing transparency and implementing stringent oversight measures to mitigate fraudulent practices within firms. Despite the robustness of the model, this study has certain limitations. The dataset is confined to a specific period and geographic context, which may affect the generalizability of the findings. Additionally, unobserved variables and qualitative factors, such as corporate culture and ethical leadership, were not considered, which could influence fraudulent behavior. Future research should explore the role of ethical leadership, corporate culture, and technological advancements in fraud detection. Expanding the study across different industries and regions would provide a broader perspective on fraudulent financial reporting dynamics. Furthermore, incorporating machine learning techniques could enhance the predictive accuracy of fraud detection models, offering more effective preventive measures.

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