

Analysis of Financial Reporting Fraud with Fraud Hexagon Theory in Financial Companies in the Banking Sub-Sector in 2020-2022

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ABSTRACT

In a situation of economic constraints, the risk of fraudulent financial reporting becomes a major concern. This study examines the Fraud Hexagon Theory in identifying fraudulent financial reporting. It adopts a quantitative approach, focusing on financial companies in the banking subsector listed on the Indonesia Stock Exchange (IDX) from 2020 to 2022, with a total of 47 companies. The sample was selected using purposive sampling, including companies that published complete annual reports and were identified as having committed fraudulent financial reporting at least once during the three-year observation period. The study's results indicate that financial stability and rationalization have a positive effect on fraudulent financial reporting, while ineffective monitoring, capability, arrogance, and collusion have a negative effect. These findings suggest that financial pressure and internal justification increase the risk of fraud, whereas effective supervision and certain individual factors can reduce the tendency to manipulate financial reports. This study provides valuable insights for regulators, auditors, and stakeholders in enhancing supervision and mitigating fraud risks in the banking sector. The resulting policy implications can be used to strengthen internal control systems and reduce the potential for fraudulent financial reporting in the future.

Keywords: Financial Stability, Rationalization, Ineffective Monitoring, Capability, Arrogance, Collusion And Financial Statement Fraud.

ABSTRAK

Dalam situasi ekonomi yang penuh keterbatasan, risiko fraudulent financial reporting menjadi perhatian utama. Studi ini mengkaji Fraud Hexagon Theory dalam mengidentifikasi kecurangan laporan keuangan. Penelitian ini menggunakan pendekatan kuantitatif dengan fokus pada perusahaan keuangan subsektor perbankan yang terdaftar di Bursa Efek Indonesia (BEI) pada 2020–2022, dengan total 47 perusahaan. Sampel dipilih menggunakan purposive sampling, mencakup perusahaan yang menerbitkan laporan tahunan lengkap dan teridentifikasi melakukan kecurangan laporan keuangan minimal satu kali dalam tiga tahun pengamatan. Hasil penelitian menunjukkan bahwa financial stability dan rationalization berpengaruh positif terhadap kecurangan laporan keuangan, sementara ineffective monitoring, capability, arrogance, dan collusion memiliki efek negatif. Temuan ini mengindikasikan bahwa tekanan finansial dan pembenaran internal meningkatkan risiko kecurangan, sedangkan efektivitas pengawasan dan faktor individu tertentu dapat mengurangi kecenderungan manipulasi laporan keuangan. Penelitian ini memberikan wawasan bagi regulator, auditor, dan pemangku kepentingan dalam meningkatkan pengawasan serta mitigasi risiko fraud di sektor perbankan. Implikasi kebijakan

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Kata kunci: Stabilitas Keuangan, Rasionalisasi, Pemantauan Yang Tidak Efektif, Kemampuan, Arogansi, Kolusi Dan Penipuan Laporan Keuangan.

INTRODUCTION

The COVID-19 pandemic, which first emerged at the end of 2019, has fundamentally changed the global paradigm of life. It has not only impacted the health sector but also triggered a wave of domino effects across various sectors, including the financial sector (Clemente-Suárez et al., 2021). The rapid spread of the virus has led to drastic changes in business patterns, economic policies, and corporate strategies. In recent years, financial sector companies listed on the Indonesia Stock Exchange (IDX) have faced significant challenges, particularly from 2020 to 2022. The COVID-19 pandemic, with all its uncertainty and complexity, has had a profound impact on both global and regional economic conditions. Consequently, the risk of fraudulent financial reporting has become an increasing concern amid the prevailing economic uncertainty.

In this context, this thesis aims to analyze fraudulent financial reporting in financial companies within the banking sub-sector listed on the Indonesia Stock Exchange during the period 2020–2022. This analysis adopts the perspective of the fraud hexagon theory to obtain empirical evidence that highlights the potential for fraudulent financial reporting and identifies factors that either trigger or mitigate risks within financial sector companies, particularly banking institutions, during the COVID-19 pandemic. Financial reports are documents and/or records of a company's financial information presented to users over a specific accounting period, serving to illustrate the company's performance (Ratnasari & Solikhah, 2019). These reports function as a primary source of information for investors and are a critical factor in capital market investment decisions. Financial performance acts as a key indicator for evaluating how a company utilizes its financial resources (Maryani et al., 2022). To ensure financial reports serve as a reliable benchmark for performance evaluation, they must be prepared with accuracy.

The importance of data in financial reports for stakeholders necessitates a systematic format to ensure accurate financial reporting, which serves as a medium of accountability for a company to specific parties. Management's inability to conceal poor company performance from investors and attract attention often drives them to manipulate or falsify financial reports when company goals are not achieved. This type of fraud occurs when individuals violate laws or regulations to achieve their objectives, as stated in the study by Maryani et al. (2022). Dishonest management may intentionally distort or falsify financial reports to deceive users of these reports. Such behavior is widely recognized by the public and is common in the business world. Fraud involves deliberate deception to obtain unlawful benefits and is considered a crime that can lead to significant financial losses for an organization or company. At the most basic level, there are three main forms of occupational fraud. The first is asset misappropriation, which involves the theft or improper use of a company's resources by its employees. The second is financial statement fraud, the least common but most damaging, where perpetrators intentionally make significant errors or omissions in a company's financial reports. The third is corruption,

which falls in the middle in terms of frequency and financial impact and includes offenses such as bribery, extortion, and conflicts of interest.

Of the three types of fraud mentioned, financial statement fraud is a major concern for stakeholders. Since not all fraud can be prevented, companies must develop rapid fraud detection capabilities to protect themselves from potential damage caused by distorted information in financial statements. Undetected fraud can result in greater financial losses for the company. By designing anti-fraud controls, assessing fraud risks, and implementing proactive measures, it is hoped that companies can better understand and mitigate the potential impact of various types of fraud (Prastika & Sasongko, 2023). According to a survey conducted by the Association of Certified Fraud Examiners (ACFE) Indonesia in 2019, fraud includes corruption, misuse of state and company assets, and financial statement fraud. The survey revealed that the financial and banking sector ranks first, accounting for 41.4% of total fraud cases in Indonesia. The government sector follows in second place with 33.9%, while the fisheries and marine industry ranks last with only 0.8%.

Companies today face a variety of risks, each with its own unique impact. Although just one of many risks, fraud is becoming an increasingly significant problem affecting both public and private organizations across all countries and economic sectors. This is especially true in light of recent global and Indonesian financial crises. The fraud process is dynamic and complex, constantly evolving to adapt to changing circumstances. Due to the varied nature of fraud, several definitions and models have been developed to explain its causes. This study aims to analyze financial reporting fraud using the Fraud Hexagon Theory in financial companies within the banking sub-sector listed on the Indonesia Stock Exchange (IDX) from 2020 to 2022. The researcher applies the Fraud Hexagon Theory proposed by Vousinas (2019) to detect fraudulent financial reporting in Indonesia. This focus is driven by the numerous cases of financial reporting fraud in the country, particularly in the banking and financial sectors. The chosen theory is the most recent and serves as a refinement of several previous models. Through this research, the author hopes to enhance understanding of financial fraud and provide a valuable reference for future studies.

LITERATURE REVIEW

Agency theory explains the existence of a contractual relationship (cooperation) between shareholders (principals) and management (agents), where the principal delegates decision-making authority to the agent, and the agent must be accountable to the principal for their performance (Jensen & Meckling, 2019). This theory focuses on determining the most efficient contract to regulate the relationship between the principal and the agent based on three assumptions (Eisenhardt, 1989): assumptions about human nature, assumptions about organizations, and assumptions about information. Assumptions about human nature suggest that humans act out of self-interest, have bounded rationality, and are generally risk-averse. Organizational assumptions highlight conflicts of interest among organizational members, emphasize efficiency as a measure of effectiveness, and recognize the presence of information asymmetry between principals and agents. Finally, assumptions about information view information as a commodity that can be bought and sold.

According to the Association of Certified Fraud Examiners (ACFE), fraud is an act of deception or error committed by a person or agency who knows that

the act can result in unjust benefits for the individual, entity, or other parties. In 1953, Cressey Donald identified pressure, opportunity, and rationalization as the three main aspects that influence decision-making. Meanwhile, Wolfe & Hermanson (2004) introduced the Fraud Diamond theory, which expanded on the original framework by adding the element of capability. This fourth component enhances fraud detection and prevention by considering an individual's ability to commit fraud alongside pressure, opportunity, and rationalization. The theory of fraud was further updated by Vousinas (2019), who developed the Fraud Hexagon theory. This model expanded the existing framework to include ego, stimulus, capability, collusion, opportunity, and rationalization as key factors influencing fraudulent behavior. Financial stability describes a company's ability to maintain its financial condition amid various economic threats (Kusumosari & Solikhah, 2020). Syifani (2021) stated that users of financial reports are more confident in companies with stable financial trends. Research by Septiningrum & Mutmainah (2022) shows that financial stability, used as a proxy for pressure, significantly influences indications of financial statement fraud. This finding aligns with studies conducted by (Septriani & Handayani, 2018; Faradiza, 2019; Mukaromah & Budiwitjaksono, 2021).

H1: Financial stability has a significant effect on Financial Statements Fraud

Ineffective monitoring refers to a condition where a company has weak supervision and is less effective in overseeing performance (Adib et al., 2024). If supervision is not carried out optimally, it can create opportunities for fraud. Beasley et al. (2010) stated that supervision by an independent board of commissioners can minimize the occurrence of fraudulent practices. The study by Septriani & Handayani (2018) showed a positive influence of ineffective monitoring on financial statement fraud. This finding aligns with previous research conducted by Skousen et al. (2009) and Agusputri & Sofie (2019), which also stated that ineffective monitoring significantly affects fraud in financial statements.

H2: Ineffective monitoring has a significant effect on Financial Statements Fraud

Rationalization is an effort made by management to justify fraudulent actions in financial reporting. The assessment of rationalization is measured through subjective evaluation (Skousen et al., 2009). Based on research conducted by Novita (2019) and Haryani et al. (2023), the data shows that rationalization has a significant positive effect on the fraudulent presentation of financial reports. This is in line with research conducted by Handayani et al. (2021), which shows similar findings regarding the influence of the rationalization variable on fraudulent financial reporting.

H3: Rationalization has a significant effect on Financial Statements Fraud

Capability is an effort made by an individual to achieve a desired goal by implementing fraudulent practices. According to Wolfe & Hermanson (2004), without capability, fraud will not occur. One form of capability in fraud includes functional authority, confidence, coercion skills, effective lying, and immunity to

stress. Research by Puspitadewi & Sormin (2018) states that the positions of CEO, directors, and division heads are determining factors in the occurrence of fraud, where changes in the composition of the board of directors (change in director) serve as an indication. In line with this, the research by Prastika & Sasongko (2023) also shows that changes in directors have a positive impact on the occurrence of fraud in the presentation of financial statements. Based on this description, the following hypothesis can be formulated:

H4: Capability has a significant effect on Financial Statements Fraud

Arrogance or ego is a greedy attitude that originates within a person. This behavior impacts the occurrence of financial statement fraud. The level of ego possessed by the Chief Executive Officer (CEO) can be illustrated by the number of CEO photos appearing in the annual report. Septiningrum & Mutmainah (2022) found that their research data shows a significant influence of the frequency of CEO photos on financial statement fraud. In previous years, other researchers also conducted studies on forensic themes related to fraudulent financial statement disclosures. Tessa & Harto (2016) similarly demonstrated that the frequent appearance of CEO photos has a positive influence on financial statement fraud. Based on this explanation, the following hypothesis can be concluded:

H5: Arrogance has a significant effect on Financial Statements Fraud

Collusion can be interpreted as an agreement made by two or more people to deceive a third party. The ACFE's Report to the Nations on Occupational Fraud and Abuse states that 51% of fraudulent acts are carried out in collaboration by two or more individuals. Vousinas (2019) confirmed that collusion can have a positive impact on financial statement fraud. Other studies support this finding, including research by Sari & Nugroho (2020) and Prastika & Sasongko (2023), where data shows that collusion, proxied by project cooperation between the private sector and the government, has the potential to influence financial statement fraud.

H6: Collusion has a significant effect on Financial Statements Fraud

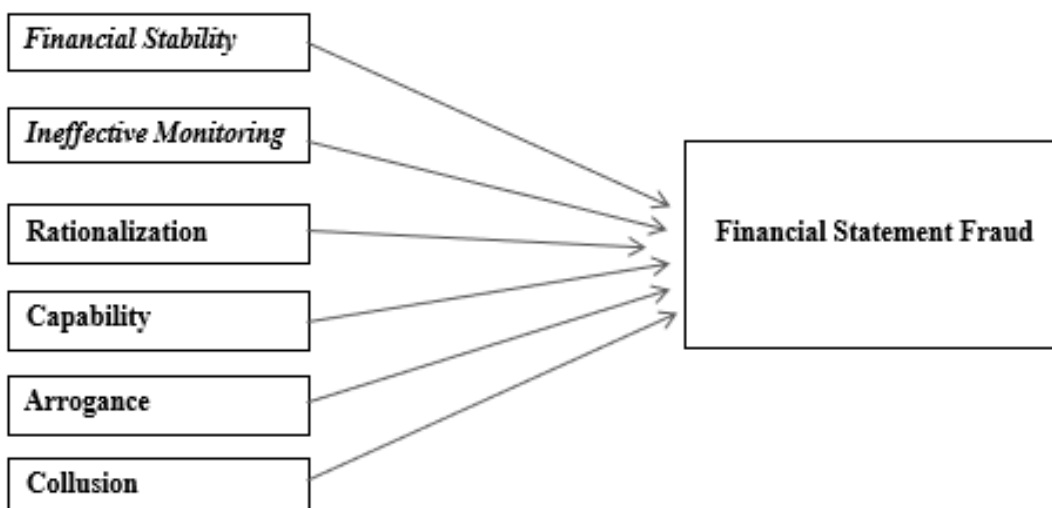


Figure 1. Research Framework

METHODS

This study uses a quantitative approach, focusing on financial companies in the banking sub-sector listed on the Indonesia Stock Exchange (IDX) from 2020 to 2022, totaling 47 companies (Priadana & Sunarsi, 2021). The sample was selected using a purposive sampling method based on the following criteria: companies listed on the IDX during that period, those that published complete annual reports, and those indicated to have committed financial statement fraud at least once during the three-year observation period. After selection, 45 companies met the criteria, resulting in a total of 135 research observations. However, after data processing, one outlier was removed, resulting in a final sample of 134. This study measures the independent variables using the Fraud Hexagon, while the dependent variable—financial statement fraud—is measured using a dummy variable (1 = committed fraud, 0 = did not). The analysis was conducted using logistic regression with SPSS v.23. Fraud identification involves evaluating eight financial ratios to detect indications of financial statement manipulation. These ratios include changes in sales receivables, gross profit margin, asset quality, sales growth, asset depreciation, administrative expenses to sales, leverage level, and total accruals to assets. The analysis results determine whether a company is classified as a manipulator. If the score exceeds a certain threshold, the company can be identified as committing fraud. This model helps assess unfair financial reporting practices, providing insights into the risk of fraud in the banking sector.

RESULTS

Descriptive statistical values for the variables studied include mean, minimum, maximum, and standard deviation values. These results indicate variations in the level of financial statement fraud, financial stability, ineffective supervision, rationalization, capability, arrogance, and collusion in 134 observations. This descriptive statistical analysis provides an initial overview of the characteristics of the data before further testing. By understanding the distribution and tendencies of each variable, this study can explore deeper relationships between the factors studied. These statistical results also play a role in ensuring that the data used is in accordance with the basic assumptions in the analysis to be carried out.

Table 1. Findings of Descriptive Statistical Values

Variables	N	Min	Max	Mean	Std. Dev.
Financial Statement Fraud	134	0.00	1.00	0.6194	0.48736
Financial Stability	134	-0.40	4.65	0.2086	0.49667
Ineffective Monitoring	134	0.33	1.00	0.5903	0.11363
Rationalization	134	-0.47	0.56	0.0034	0.14229
Capability	134	0.00	1.00	0.7164	0.45243
Arrogance	134	1.00	28.00	6.7761	5.26535
Collusion	134	0.00	1.00	0.5149	0.50156

Based on Table 1, in Indonesia, financial reporting fraud in financial companies averaged 0.6194 from 2020-2022, with a standard deviation of 0.48736. This score is higher than the average value, indicating that information about financial reporting fraud is unevenly distributed. The minimum Financial Stability value of -0.40 obtained by PT. Bank Raya Indonesia Tbk. in 2021, so it reflects that the company has the lowest gross profit margin ratio compared to other companies, while the maximum Financial Stability value of 4.65 obtained by PT. Bank Jago, Tbk. in 2021, which means that the company has the highest gross profit margin ratio compared to other companies. The average Financial Stability value for 2020-2022 was 0.2086 with a standard deviation of 0.49667. The average value of Financial Stability in 2020-2022 was 0.2086, which means that the company's ability to manage revenue and cost of goods sold was 20.86%. The minimum value of Ineffective Monitoring was 0.33 obtained by PT. Bank Mayapada, Tbk. in 2021, which means that the company has the lowest proportion of independent board of commissioners compared to other companies, while the maximum value of Ineffective Monitoring was 1.00 obtained by PT. Bank National Nobu, Tbk. in 2021, which means that the company has the highest proportion of independent board of commissioners compared to other companies. The average value of Ineffective Monitoring in 2020-2022 was 0.5903 with a standard deviation of 0.11363. The average value of Ineffective Monitoring in 2020-2022 was 0.5903, this value can be interpreted that the proportion of independent supervision through the board of commissioners of the sample company was 59.03%.

The minimum Rationalization value of -0.47 obtained by PT. Bank Aladin Syariah, Tbk. in 2021, which means that the company has the lowest total accrual total assets ratio compared to other companies, while the maximum Rationalization value of 0.56 obtained by PT. Bank Amar Indonesia, Tbk. in 2022, which means that the company has the highest total accrual total assets ratio compared to other companies. The average Rationalization value for 2020-2022 is 0.0034 with a standard deviation of 0.14229. The average Rationalization value for 2020-2022 is 0.0034, this value can be interpreted that the actual level of discretion in the sample company is 0.34%. While the average Capability value for 2020-2022 is 0.7164 with a standard deviation of 0.45243. The average Capability value for 2020-2022 was 0.7164, this value can be interpreted that the level of change in the composition of directors in the sample companies was 71.64%.

The minimum value of Arrogance is 1.00 which comes from two companies, namely PT. Bank KB Bukopin, Tbk. In 2021, and PT. Bank Mayapada Internasional, Tbk. In 2021 and 2022. which means that the level of Frequent Number of CEO's Picture is the lowest compared to other companies, while the maximum value of Arrogance is 28.00 CEO photos come from PT. Bank Pembangunan Daerah Jawa Barat (BPD) in 2021 which means that the level of Frequent Number of CEO's Picture is the highest compared to other companies. The average value of Arrogance in 2020-2022 is 6.7761 with a standard deviation

of 5.26535. The average value of Arrogance in 2020-2022 is 6.7761, this value can be interpreted that the level of presentation of photos of the president of the board of directors in the annual report of the sample company is equivalent to 6 photos in each annual report. Other findings are stated through the average Collusion Value for 2020-2022 of 0.5149 with a standard deviation of 0.50156. The average Collusion value for 2020-2022 is 0.5149, this value can be interpreted that the level of cooperation between government and banking companies in Indonesia is 51.49%.

Table 2. Overall Model Feasibility Test

Iteration		-2 Log likelihood	Coefficients Constant
Step 0	1	178.050	0.478
	2	178.047	0.487
	3	178.047	0.487
Step 1	1	132.461	0.210
	2	116.673	0.090
	3	110.227	0.337
	4	109.539	0.434
	5	109.526	0.451
	6	109.526	0.451
	7	109.526	0.451

The initial -2Log likelihood value (block number = 0) before being entered into the independent variable is 178.047 and after the independent variable is entered the -2 Log Likelihood value (Block number 1) is 109.526. This value indicates a decrease in the -2LL value (-2 Log Likelihood) in Block 0 and Block 1 by 68.521. Thus, the regression model is considered appropriate for use in analyzing data. The decrease in this value is due to the addition of independent variables so that it can improve the model. This indicates that the hypothesized model is in accordance (fit) with the data, so that the addition of independent variables to the model shows that the regression model is getting better.

Table 3. Logistic Regression Test Results

Variable	Regression Coefficient	Sig.
Financial Stability	4.352	0.001
Ineffective Monitoring	0.148	0.946
Rationalization	22.070	0.000
Capability	-0.398	0.451
Arrogance	0.045	0.359
Collusion	-0.654	0.203
Nagelkerke R Square		0.545
Chi Square		0.910

The R Square value is 0.545, meaning the independent variable explains 54.5% of the variation in detecting financial statement fraud. The remaining 45.5% is influenced by other variables outside the research model. The chi-square value has a significance level of 0.910. Since $0.910 \geq 0.05$, H_0 is accepted, indicating no statistically significant difference between the model and the data. This result shows that the regression model is feasible and capable of predicting the observation value.

DISCUSSION

The results of statistical tests that have been carried out, it shows that the regression coefficient of the Financial Stability variable is 4.352 with a significance value of 0.001. The significance value of the variable is less than 0.10 so that H1 is accepted. This study proves that Financial Stability has an effect on Financial Report Fraud. The results of this study are in line with research conducted by Septriani & Handayani, (2018); Faradiza (2019); Mukaromah & Budiwitjaksono (2021); Septiningrum & Mutmainah (2022). This study indicates that proper management of income and expenses can encourage stable company finances. The company is likely to have good company management capabilities so that income and expenses can be controlled. In a stable financial condition, management is not under pressure to do things that should not be done so that fraudulent financial reporting practices do not occur. These results are supported by the statement of Skousen et al. (2009), that managers face pressure to commit fraud in financial reports, when financial stability is threatened by the state of the economy, industry, and the situation of the operating entity or in other words the company's financial condition is unstable.

The results of statistical tests that have been carried out, it shows that the regression coefficient of the Ineffective Monitoring variable is 0.148 with a significance value of 0.946. The significance value of this variable is greater than 0.10 so that H2 is rejected. This study proves that Ineffective Monitoring has no effect on Financial Report Fraud. The results of this study are consistent with the research of Sari & Nugroho (2020), but are not in line with the research of Septriani & Handayani (2018), the existence of an independent board of commissioners in a company only provides limited guarantees of objectivity to the results of financial reports. This is because the effectiveness of supervision actually depends on the collective performance of all members of the board of commissioners. In other words, the role of the independent board of commissioners in implementing good corporate governance is still not fully optimal. In addition, the company's supervisory function is also carried out by the audit committee. Through supervision carried out by an independent audit committee, the potential for fraudulent practices can be minimized (Beasley et al., 2010).

The results of statistical tests that have been carried out, it shows that the regression coefficient of the Rationalization variable is 22.070 with a significance value of 0.000. The significance value of this variable is less than 0.10 so that H3 is accepted. This study proves that Rationalization has an effect on Financial Statement Fraud. The results of this study are in line with the research of Yesiariani & Rahayu (2016), Novita (2019) and Handayani et al. (2021). Accrual is an accounting method where revenue or expenses are recognized before money is received or paid (Putri, 2024). The concept of discretionary accrual is often misused by management to manipulate profits without considering accounting limitations. If a company's discretionary accrual level is high, then

there is a high possibility of fraudulent practices in the company's financial reporting. This proves that the accrual model is related to management decision making and is a rationalization of manipulated financial statements (Vermeer et al., 2009; Din et al., 2022).

The results of statistical tests that have been carried out, it shows that the regression coefficient of the Capability variable is -0.398 with a significance value of 0.451. The significance value of this variable is greater than 0.10 so that H4 is rejected. This study proves that Capability has no effect on Financial Statement Fraud. The results of this study are in line with the research of Indarti et al. (2018), Munawar et al. (2021) and Amyar et al. (2023), but not in line with the research of Puspitadewi & Sormin (2018). Changes in the composition of the board of directors carried out by the sample companies are basically not intended to cover up fraudulent practices that may have been carried out by previous directors. Instead, these changes are more driven by the desire of stakeholders to improve company performance or achieve better efficiency compared to the previous period. This is done by dismissing old directors and recruiting new directors who are considered to have higher competence (Yesiariani & Rahayu, 2016).

The results of statistical tests that have been carried out, it shows that the regression coefficient has an Arrogance variable value of 0.045 with a significance value of 0.359. The significance value of this variable is greater than 0.10 so that H5 is rejected. This study proves that Arrogance has no effect on Financial Report Fraud. The results of this study are in line with the research of Novita (2019) and Septiningrum & Mutmainah (2022), but are not in line with the results of research by Tessa and Harto (2016). That the number of CEO photos that appear in the company's annual report cannot present the level of arrogance or superiority of the CEO. The increasing number of CEO photos displayed in a report cannot indicate the high level of CEO arrogance in the company.

The results of statistical tests that have been carried out, it shows that the regression coefficient of the Collusion variable is -0.654 with a significance of 0.203. The significance value of this variable is greater than 0.10 so that H6 is rejected. This study proves that Collusion has no effect on Financial Statement Fraud. The results of this study support the results of research conducted by Akbar et al. (2022), but are not in line with the results of research conducted by Prastika & Sasongko (2023). This, it can be concluded that Collusion cannot fully be a representation that causes fraud in Financial Statements.

CONCLUSION

Financial stability and rationalization significantly impact financial statement fraud. Strong financial stability reduces pressure to commit fraud, while rationalization tends to encourage accounting manipulation. However, ineffective monitoring, capability, arrogance, and collusion negatively affect fraud occurrence, suggesting that supervision effectiveness, management

changes, CEO arrogance, and government collusion do not always heighten fraud risk. These findings indicate that financial statement fraud is influenced by both driving and inhibiting factors. Companies with stable financial conditions are less likely to manipulate financial reports, whereas individuals who justify fraudulent actions may increase fraud risks. Meanwhile, ineffective monitoring and managerial changes do not necessarily facilitate fraudulent activities, emphasizing the complexity of fraud determinants. Future research can explore alternative methods beyond the Beneish M-score to measure financial statement fraud and compare results with prior studies. Additionally, researchers can cross-check data from other sources, such as company projects, to gain a broader perspective. Incorporating new variables that influence fraud risk can enhance understanding and provide deeper insights into corporate financial misconduct. By refining measurement approaches and considering diverse influencing factors, future studies can contribute to more effective fraud prevention strategies.

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