

UNMASKING FINANCIAL DECEPTION: UNRAVELING THE FRAUD HEXAGON'S INFLUENCE ON DETECTING FINANCIAL STATEMENT FRAUD IN INDONESIAN PUBLIC COMPANIES

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ABSTRACT

This study examines the influence of the fraud hexagon on the likelihood of financial statement fraud in Indonesian public companies with stock values below IDR 100 that were listed on the Indonesia Stock Exchange (IDX) from 2018 to 2020. The study population comprises sixty companies with stock values below IDR 100 for three consecutive years listed on the IDX. The objective sampling technique was employed to select a sample of 48 companies that met the research criteria, resulting in 144 observations. Data analysis was performed using logistic regression. The findings reveal that financial stability and change in auditors significantly impact identifying financial statement fraud, while financial targets, changes in directors, collusion, inefficient monitoring, and the frequency of C.E.O. photos show no influence. These results provide valuable insights for detecting and preventing financial statement fraud in Indonesian public companies with low stock values.

Keywords: *Corporate Governance, Fraud Hexagon, Fraud Red Flag, Fraudulent Financial Reporting, Indonesian Public Company*

INTRODUCTION

The financial report contains the company's state from a financial perspective, which is described in detail and reflects what has happened in one year of the accounting cycle published, including a balance sheet report, cash flow statement, and a report on changes in capital. Fundamental analysis is an analytical method that is a tool for investors to measure the level of risk of a stock's value and see how effectively management manages a company in a competitive industry. Thus, this indicator affects the risk level of the stock value. Furthermore, a fundamental analysis was performed to determine whether a stock was overvalued or undervalued.

Several factors can cause the low stock price; this could be because the company's financial performance could be better, so the results of the analysis conducted by potential investors become less attractive. When a stock has a low price, it can be delisted. Example of a stock price below Rp. 100,- is already considered unfavorable because the public thinks the company is less than optimal in carrying out its operations, making potential investors choose to buy shares with good credibility. Thus, companies can commit fraudulent financial statements. According to (Johnstone et al., n.d.) Financial statement fraud involves manipulating, falsifying, or changing the content of accounting books or supporting documents, misrepresenting or omitting events, transactions, or other crucial information.

Moreover, intentionally misuse accounting principles. A survey (2020 A.C.F.E. Report to the Nations, n.d.) in its report entitled report to the Nation 2020 stated that financial statement fraud was ranked third, with a percentage of 10% and a median loss of \$954,000. According to the PwC's Global Economic Crime and Fraud Survey 2020, (2020) there are 14,9% Global Economic Crime and Fraud.

As fraud often occurs, which is detrimental to many parties, Donald Cressey 1950 proposed the existence of a fraud triangle theory that can assist in detecting fraudulent financial statements. (Cressey, 1973) *The fraud triangle theory* has three elements: *pressure, Opportunity, and rationalization*. In his

journal, Vousinas (2019) explains the components of the fraud hexagon, stimulus, which means someone has pressure to commit fraud and has a financial background. Capability refers to the personal characteristics of a person capable of committing fraud. Collusion is a deceptive agreement or cooperation between two or more people to commit malicious acts—the Opportunity where the perpetrators believe the fraudulent acts committed will not be revealed. Rationalization is also an act in which the perpetrator considers what he does daily, like ordinary people. The last component is the ego, where the criminal nature of the perpetrator is the result of the mental process, and thus, fraudulent actions are carried out without any guilt. With the advanced theory and production of the fraud hexagon theory or what can also be referred to as the C. C. C. O. R. In the E Model, the symptoms made by the perpetrators of fraud can be seen clearly and can be a good preventive action. Therefore, this study discusses the elements of the fraud hexagon with financial stability, financial targets, external pressure, changes in directors, cooperation with government projects, ineffective monitoring, changes in auditors, and the frequent number of C.E.O.'s pictures to analyze the factors that influence public companies on the IDX to commit fraudulent financial statements. The company used in this study is a company that has a share price below Rp. 100, where the company has a meager stock price, is seen as underperforming, and could potentially be delisted if it has a price below Rp. 50,-.

Literature Review

Agency Theory

(Rankin et al., n.d.) Rankin said that agency theory is one of the theories of positive accounting theory, which means explaining and predicting accounting practices and shaping them. Agency theory is used to understand the relationship between one or more people who employ another person to perform various activities on their behalf. Three costs are associated with trusting agents to make decisions and run the business: monitoring costs, bonding costs, and residual loss.

Financial Statement Fraud

(Johnstone et al., n.d.) Fraud is a deliberate act or behavior involving fraud that results in a misstatement of financial statements. In contrast to human error, there is no intentional misrepresentation. For example, when an accountant makes financial statements and accidentally enters the wrong number, it does not mean the accountant is committing fraud (Albrecht et al., 2012). However, when faced with a similar incident and the accountant intends to intentionally enter the wrong number into the financial statements to make the readers make the wrong decision, it implies fraudulent behavior. Based on Albrecht et al. (2012), fraud is divided into four categories: fraud committed by employees, vendors, customers, and management levels, causing the company or organization to become a victim of fraud.

Occurrence of Financial Statement Fraud

Fraudsters called 'trust violators' caught Cressey's attention. (Cressey, 1973) suggests the fraud triangle, which explains the process of someone committing fraud: financial pressure, Opportunity, and rationalization. For example, (Naqvi 2020), financial stress is usually due to greed, a lavish lifestyle, huge debts, bad credit, personal financial losses, and urgent financial needs. If there is any opportunity to commit fraud, they will hide it or avoid mistakes, which is the second element in the fraud triangle. Rationalization is a justification made by a person or group to commit fraud. However, Vousinas (2019) suggests the Fraud hexagon model, which explains that a person can commit financial statement fraud because of collusion in cooperation with colleagues. Collusion is considered a significant factor in the occurrence of fraud. It is also confirmed by the A.C.F.E. report, which shows that almost half of the cases examined show that the fraud perpetrators colluded with each other to commit fraud.

Hypothesis Development

This section discusses the fraud hexagon elements and hypothesis development. The first element is the stimulus. Stimulus, the first proxy being financial stability, is defined as management's motivation to commit fraud due to an unstable financial situation as a pandemic arises, risk of rapid technological

change, and drop in market demand. Management tends to maintain the stability of a company.

Ahmadiana and Novita (2018) showed that financial stability influences the detection of financial statement fraud. (Chantia et al., 2021) also show that management is pressured to commit fraudulent financial reporting due to unstable financial conditions. This study contradicts the research done by (Anggraini & Suryani, 2021) that stated that financial stability does not affect the detection of financial statement fraud. To proven previous research, this study uses the hypothesis below:

H1: Financial stability negatively influences the detection of financial statement fraud.

The element of the second proxy under the stimulus is the financial target. This situation is driven by principals, such as shareholders, who have pressured management with high expectations to achieve. Investors can gain when a company appears to grow. Management could also achieve better remuneration not only for principal pressure but also for achieving the target.

A study conducted by (Gevanry Sagala & Siagian, 2021) shows that financial targets influence the detection of financial statement fraud. (Achmad & Pamungkas, 2019) It also shows that management will likely make a good representation of return on assets. This study contradicts the research (Handoko & Tandean, 2021) that financial targets do not influence the detection of financial statement fraud. To proven previous research, this study uses the hypothesis below:

H2: Financial targets positively influence detecting financial statement fraud.

The third proxy under the stimulus element was external pressure. This situation arises because of the requirements for listing by the Indonesian Stock Exchange. The company is likely to be lost because of debt repayment. Management should manage its operations to pay the debt.

Imtikhani and Sukirman (2021) showed that external pressure has a positive influence on detecting financial statement fraud. (Achmad & Pamungkas 2019) also stated that external pressure is one factor that positively influences the detection of financial statement fraud. This study contradicts research (Handoko & Tandean, 2021) that external pressure does not influence the detection of financial statement fraud. To proven previous research, this study uses the hypothesis below:

H3: External pressure positively influences the detection of financial statement fraud.

The second element of a fraudulent hexagon is its capability. Someone with the character of fraud is considered a "right person" with a capable ability. When a company is likely to rotate its director, it needs to adapt to the new position and is driven to a "stress period."

A study conducted by (Citra Mulyandani & Rahayu, 2021) shows that the capability proxied in the change in director positively influences the detection of financial statement fraud. In contrast, this study (Chantia et al., 2021) stated that capability does not affect the detection of financial statement fraud. To proven previous research, this study uses the hypothesis below:

H4: Change in directors positively influences the detection of financial statement fraud.

Vousinas (2019) advanced the third element of the fraud hexagon in collusion. Collusion between companies and external parties is a crucial factor in committing fraud. (2020 *A.C.F.E. Report to the Nations*, n.d.) stated that fraud shows that in almost half of the cases investigated, there is collusion to commit fraud.

A study conducted by (Handoko & Tandean, 2021) shows that collusion influences the detection of financial statement fraud. This study contradicts Mukaromah et al. (2021), who stated that collusion does not affect the detection of financial statement fraud. To proven previous research, this study uses the hypothesis below:

H5: Cooperation with government projects positively influences the detection of financial statement fraud.

The fourth element of the fraud hexagon is an opportunity for perpetrators to commit fraud if the company has ineffective monitoring. The Commissioner is one of the boards that should be objectively monitored. If monitoring is ineffective, then management has the Opportunity to commit fraudulent financial statements.

A study by (Rukmana, n.d.) showed that Opportunity influences the detection of financial statement fraud. (Mukaromah et al., 2021) It was also stated that Opportunity also influences the detection of financial statement fraud. In contrast, Achmad and Pamungkas (2019) stated that Opportunity does not influence the detection of fraudulent financial statements. To proven previous research, this study uses the hypothesis below:

H6: Ineffective monitoring positively influences detecting financial statement fraud.

The fifth element of the fraud hexagon is rationalization. Rationalization is the expression in the perpetrator's mind to rationalize the action that they deserve to receive funds due to financial statement fraud. This element is challenging for the auditor to capture financial statement fraud if the company powerfully convinces auditors.

A study conducted by Rukmana (n.d.) showed that rationalization influences the detection of financial statement fraud. Anggraini and Suryani (2021) also stated that rationalization influences the detection of financial statement fraud. Contrary to this research, Imtikhani and Sukirman (2021) stated that rationalization does not influence fraudulent financial statements. To proven previous research, this study uses the hypothesis below:

H7: Changes in auditors positively influence detecting financial statement fraud.

The sixth element of the fraudulent hexagon is ego or arrogance. Arrogance arises from the perspective of the perpetrators who commit f. They are very confident that their actions will not be captured by either internal control or the public, who will be one of the shareholders.

A study (Mukaromah et al., 2021) stated that the ego proxied by the frequent number of C.E.O. picture influence the detection of financial statement fraud. Contrary to this research, Sagala and Siagian (2021) stated that ego does not influence the detection of financial statement fraud. To proven previous research, this study uses the hypothesis below:

H8: The number of C.E.O.s' pictures positively influences financial statement fraud.

METHODS

This research was conducted at a stock price below Rp.100 for companies listed on the Indonesia Stock Exchange during 2018 – 2020. There are 48 companies selected as research samples. The hypothesis was tested using logistic regression because of the binary number used for the dependent variable with a significance level of 0.05. The independent variables used in this study were binary numbers, ratios, and numerals. Descriptive statistics were used in this study. IBM SPSS version 26 was used for hypothesis testing. The regression formula is as follows:

$$Y_{i,t} = \alpha + \beta_1 X_{1i,t} + \beta_2 X_{2i,t} + \beta_3 X_{3i,t} + \beta_4 X_{4i,t} + \beta_5 X_{5i,t} + \beta_6 X_{6i,t} + \beta_7 X_{7i,t} + \beta_8 X_{8i,t} + \epsilon_{i,t}$$

Explanation :

Y	=	The dependent variable for predicting fraudulent financial statements uses a dummy; if indicated, code '1', and if not indicated, code '0'.
α	=	Constanta
β_1 - β_8	=	The regression coefficient for independent variables
X1	=	<i>Financial Stability (C.A.T.A.)</i>
X2	=	<i>Financial Target (ROA)</i>
X3	=	<i>External Pressure (LEV)</i>
X4	=	<i>Change in Director</i>
X5	=	Governmental Project Cooperation

- X6 = *Ineffective Monitoring (B.D.O.U.T.)*
 X7 = *Change in Auditor*
 X8 = *Frequent number of C.E.O. pictures*
 ε = *Error*
 i = *cross-section*
 t = *time-series*

Descriptive statistics

The result below is a descriptive statistics test for the independent variables, which are financial stability, financial target, external pressure, change in director, cooperation with government projects, ineffective monitoring, change in auditors, and the frequent number of C.E.O.'s pictures and fraud scores as dependent variables:

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
CATA	144	-3.408	5.297	-.06853	.600818
ROA	144	-33.110	8.290	-.27801	2.866899
LEV	144	.006	3461.978	34.20317	308.296783
DCHANGE	144	.000	1.000	.20139	.402438
COL	144	.000	1.000	.21528	.412450
BDOUT	144	.167	1.000	.44439	.140267
AUDCHANGE	144	.000	1.000	.20833	.407534
CEOPIC	144	1.000	24.000	3.33333	3.342877
FSCORE	144	.000	1.000	.31944	.467889
Valid N (listwise)	144				

Source: Author

Overall Model Fit

The table below shows that the -2 log-likelihood was 159.005, below the 163,116 chi-square table. The data fits the model.

Table 2. Overall Model Fit

Iteration		-2 Log likelihood	Coefficients								
			Constant	CATA	ROA	LEV	DCHANGE	COL	BDOUT	AUDCHANGE	CEOPIC
Step 1	1	165.446	-.515	-.582	.146	.001	-.125	-.690	-.934	.668	.058
	2	160.824	-.609	-1.692	.284	.002	-.135	-.992	-1.277	.843	.091
	3	159.429	-.645	-2.649	.798	.006	-.127	-1.091	-1.374	.907	.103
	4	159.041	-.633	-3.222	1.357	.011	-.131	-1.096	-1.412	.925	.104
	5	159.008	-.630	-3.402	1.540	.013	-.130	-1.094	-1.429	.928	.104
	6	159.005	-.630	-3.412	1.551	.013	-.130	-1.094	-1.430	.928	.104
	7	159.004	-.630	-3.413	1.551	.014	-.130	-1.094	-1.430	.928	.104

a. Method: Enter

b. Constant is included in the model.

c. Initial -2 Log Likelihood: 180.418

d. Estimation terminated at iteration number 7 because parameter estimates changed by less than .001.

Source: Author

Hosmer and Lemeshow Test

The feasibility test of the regression model shows that Hosmer and Lemeshow's chi-squared is 5.104, which is still below 14.067, and the significance level above 0.05, which is 0.746, indicates that the model can predict the observation value.

Table 3. Hosmer and Lemeshow Test

Step	Chi-square	df	Sig.
1	5.104	8	.746

Source: Author

Coefficient of Determination Test

Nagelkerke R-Square shows a value of 0.193, which means that the independent variable in this study can explain 19.3% of the dependent variable. Other variables outside of this study explained the remaining 80.7%.

Table 4. Coefficient of Determination test

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	159.004 ^a	.138	.193

a. Estimation terminated at iteration number 7 because parameter estimates changed by less than .001.

Source: Author

ANALYSIS

Table 5. Logistic Regression Test

Step 1 ^a		B	S.E.	Wald	df	Sig.	Exp(B)	95% C.I. for EXP(B)	
								Lower	Upper
	CATA	-3.413	1.544	4.886	1	.027	.033	.002	.679
	ROA	1.551	1.327	1.366	1	.242	4.716	.350	63.534
	LEV	.014	.014	.978	1	.323	1.014	.987	1.041
	DCHANGE	-.130	.517	.063	1	.801	.878	.319	2.418
	COL	-1.094	.670	2.668	1	.102	.335	.090	1.245
	BDOUT	-1.430	1.516	.889	1	.346	.239	.012	4.672
	AUDCHANGE	.928	.457	4.129	1	.042	2.531	1.033	6.196
	CEOPIC	.104	.069	2.280	1	.131	1.110	.969	1.271
	Constant	-.630	.687	.841	1	.359	.532		

a. Variable(s) entered on step 1: CATA, ROA, LEV, DCHANGE, COL, BDOUT, AUDCHANGE, CEOPIC.

Source: Author

From the logistic regression table, the regression equation used in this study is as follows:

$$\text{Financial Statement Fraud} = -0,630 - 3,413\text{CATA} + 1,551\text{ROA} + 0,014\text{LEV} - 0,130\text{DCHANGE} - 1,094\text{COL} - 1,430\text{BDOUT} + 0,928\text{AUDCHANGE} + 0,104\text{CEOPIC} + \epsilon$$

Influence of financial stability in detecting financial statement fraud

Based on the logistic regression analysis conducted in this study, the researchers found that the financial stability variable, represented by the cash flow ratio to income growth, yielded a regression coefficient of -3.413, with a significance level of 0.027, indicating that the obtained significance value of 0.027 is smaller than the predefined threshold of 0.05 (0.027 < 0.05), leading to the acceptance of the

first hypothesis (H1). Therefore, the interpretation is that financial stability hurts in detecting fraudulent reports. These findings are consistent with the findings of Ahmadiana and Novita (2018), who suggest that the ratio of cash flow to income growth influences financial statement fraud.

Influence of financial target in detecting financial statement fraud

Based on the results of the logistic regression test performed by the researcher, the financial target proxy variable from the stimulus calculated using return on assets (ROA) has a regression coefficient of 1.551 with a significance of 0.242. The significance of 0.241 is more significant than 0.05 ($0.242 > 0.05$) to produce a decision where the second hypothesis (H2) is rejected. This interpretation is that financial targets do not influence the detection of fraudulent financial statements. The results of this study are consistent with those of Handoko and Tandean (2021) and Chantia et al. (2021), Nurardi and Wijayanti (2021), and Handoko (2021)), stated that financial targets do not influence the detection of fraudulent financial statements.

Influence of external pressure in detecting financial statement fraud

Based on the results of the logistic regression test performed by the researcher, the pressure variable outside the proxy of the stimulus calculated using the leverage formula had a regression coefficient of 0.014 with a significance of 0.323. The significance of 0.323 is more significant than 0.05 ($0.323 > 0.05$), resulting in a decision where the third hypothesis (H3) is rejected. This interpretation is that external pressure does not affect the detection of fraudulent financial statements. The results of this study were consistent with those of (Chantia et al., Handoko (2021), Handoko (2021), Handoko and Tandean (2021), Mukaromah et al. (2021), and Utami et al. (2019) state that external pressure does not influence the detection of fraudulent financial statements.

Influence of change in director in detecting financial statement fraud

Based on the results of the logistic regression test performed by the researcher, the proxy change in the director variable from capability had a regression coefficient of -0.130 with a significance of 0.801. The significance of 0.801 is more significant than 0.05 ($0.801 > 0.05$) to produce a decision where the fourth hypothesis (H4) is rejected. The interpretation is that a change in director does not affect detecting fraudulent financial statements. The results of this study are in line with those of (Achmad and Pamungkas (2019) and Gevanry Sagala and Siagian (2021), where it is stated that the change in director does not influence the detection of fraudulent financial statements.

Influence of cooperation with government projects in detecting financial statement fraud

Based on the results of the logistic regression test that the researcher did, the variable of cooperation with the government project as a proxy for collusion has a regression coefficient of -1.094 with a significance of 0.102. The significance of 0.102 is more significant than 0.05 ($0.102 > 0.05$) to produce a decision where the fifth hypothesis (H5) is rejected. The interpretation is that cooperation with government projects does not affect the detection of fraudulent reports. The results of this study are in line with those of (Gevanry Sagala and Siagian (2021), Mukaromah et al. (2021), and Nurardi and Wijayanti (2021), where it is stated that cooperation with government projects does not influence the detection of fraudulent financial statements.

Influence of ineffective monitoring in detecting financial statement fraud

Based on the logistic regression test results that the researcher did, the ineffective monitoring variable as a proxy for Opportunity calculated using the number of commissioners has a regression coefficient of -1.430 with a significance of 0.346. Thus, the significance of 0.346 is more significant than 0.05 ($0.346 > 0.05$), resulting in a decision where the sixth hypothesis (H6) is rejected. The interpretation is that ineffective monitoring does not affect the detection of fraudulent financial statements. The results of this study are consistent with those of (Achmad and Pamungkas (2019) and Ariyanto et al. (2021), Sagala and Siagian (2021), Handoko (2021), Handoko and Tandean (2021), and Tarjo et al. (2021) stated that ineffective monitoring does not influence the detection of fraudulent financial statements.

Influence of Change in Auditor in detecting financial statement fraud

Based on the logistic regression analysis conducted in this research, it was found that the variable representing a change in the auditor, as a proxy for rationalization, yielded a regression coefficient of 0.928, with a significance level of 0.042, indicating that the obtained significance value of 0.042 is less than the threshold of 0.05 ($0.042 < 0.05$), leading to the acceptance of the seventh hypothesis (H7). A change in the auditor positively impacts the detection of fraudulent financial statements. These findings are consistent with the findings of previous studies by Anggraini and Suryani (2021), Citra Mulyandani and Rahayu (2021), and Utami et al. (2019), which also suggest that changes in auditors positively influence the identification of fraudulent financial statements.

Influence of frequent number of C.E.O.'s pictures in detecting financial statement fraud

Based on the results of the logistic regression test performed by the researcher, the variable number of photos of the President Director in the annual report proxy from ego had a regression coefficient of 0.104 with a significance of 0.131. The significance of 0.131 is more significant than 0.05 ($0.131 > 0.05$), resulting in a decision where the eighth hypothesis (H8) is rejected. The interpretation is that the number of photos of the President Director in the annual report (frequent number of C.E.O.'s pictures) does not detect fraudulent financial statements. The results of this study are in line with those of (Achmad and Pamungkas (2019) and Handoko and Tandean (2021), who stated that the number of C.E.O. photos in the annual report does not influence the detection of fraudulent financial statements.

CONCLUSION

The period from 2018 to 2020 offered a unique opportunity for researchers to conduct tests on whether management would exploit it for their advantage, in this case, by reporting achievements that would, in turn, be welcomed by investors in the form of increased stock prices. The COVID-19 pandemic, as we have come to understand, has led to a decline in stock prices for many issuers, with only a few select issuers able to increase their stock prices.

This research demonstrates that financial stability and auditor turnover are highly relevant in preventing financial reporting fraud. Management understands that financial statements not aligning with economic conditions can raise suspicions of fraudulent activities. Furthermore, if such circumstances are accompanied by auditor turnover, where the new auditor may not yet have established a close relationship compared to the previous auditor, the likelihood of scrutiny and suspicion increases.

We recommend that future researchers further develop their studies on issuers whose stock price changes do not align with the management's presented achievements in the financial statements.

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