PENTAGON FRAUD AFFECT ON FINANCIAL STATEMENT FRAUD AND FIRM VALUE EVIDENCE IN INDONESIA

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ABSTRACT

This study analyzes pentagon fraud in analyzing financial statement fraud which ultimately analyzes the value of the company, so that the limitations of the problem in this study relating to the variables of this study are : financial statements fraud describes by misstatement or earnings manipulation which ultimately results in a misleading annual financial report measured by Benish M and earning management , Pentagon fraud is pressure, opportunity, capability and rationalization and arrogance. Corporate value is measured by price book value and tobins Q.The purpose of this study was to analyze pentagon fraud on financial fraud statement and firm value. This study uses data from 66 manufacturing companies for the period 2012-2016 on the Indonesian stock exchange. The method of data analysis uses partial least square. The results of the study show that the factors of pressure, opportunity, competence, arrogance affect financial report fraud, rationalization does not affect financial report fraud. The financial statement fraud affects the value of the company. The contribution of this research is to provide a basis for the preparation, development of regulations and professional organizations regarding early warning signs, fraud prevention measures, organizational risk management and building public fraud awareness as well as providing a basis for good corporate governance related to internal control so as to provide value enhancement company through fraud control.

Keyword : Pentagon fraud, Financial statement Fraud and Firm Value

INTRODUCTION

1.1 Background Problems

Unsuccessful financial statement fraud can develop into a major scandal that harms many parties (Skousen et al., 2009). Thus, this study is intended to detect financial fraud statements using pentagon fraud analysis with reference to research conducted by Crowe Howarth (2011). The elements in Crow's fraud pentagon theory cannot just be investigated so that it requires variable proxy.

The results of studies conducted by the Association of Certified Fraud ACFE Examiner (2016) show that in practice fraud occurs in banking and manufacturing companies while the lowest is in the religious sector. In Indonesia there have also been various financial scandals in companies / corporations in the financial and non-financial sectors, such as Bank Lippo in 2002, Century Tire in 2008, Kitty Bank and Mega Bank and Bali Bank in 2011 and PT Indoframa in 2004 and PT Agis in 2007

In this study applying research that has been done by Beneish to detect manipulation of financial statements carried out by the company. Detection tools use the Beneish M-Score Model by using 5 variables namely Days' Sales In Receivables Index (DSRI), Gross Margin Index (GMI), Asset Quality Index (AQI), Sales Growth Index (SGI), and Total Accrual To Total Assets Index (TATA) also uses earnings management. Earnings management indicates fraud because it contains intentional elements even in the corridor of accounting principles. Cornett, et al (2006) say earnings management actions have led to several cases of accounting reporting scandals that are widely known. The company's desire for the company's operational activities to be guaranteed sustainability (going concern) by always looking good causes companies to sometimes take shortcuts (illegal), namely by committing fraud. The continuity of the running of this company will lead to an increase in the value of the company which in this study is described by Tobins Q and PBV. Based on these reasons, the authors are interested in compiling a dissertation entitled The Impact of Financial Reporting Fraud Determination with the Pentagon's Fraud Analysis of Company Values.

1.2 Problem Formulation

Based on the explanation above, the research question can be formulated as follows:

1. Are the factors of pressure, opportunity, rationalization, competence, arrogance affecting financial statement fraud?
2. Does financial statement fraud affect the value of the company?

STUDY OF LITERATURE AND HYPOTHESIS FORMULATION

The significance of this study can be explained as follows, namely the need for an empirical study of the results of research that analyzes the effectiveness of fraud risk factors as adopted in SAS No. 99 in predicting financial report fraud. This study uses Cressey's theory, SAS No. 99 and previous studies (such as Skousen et al., (2009), Wolfe and Hermanson (2004), and others) and attempted to develop dimensions and indicators to predict financial statement fraud behavior using fraud diamond factors, namely: 1) pressure (pressure); 2) opportunity (opportunity); 3) rationalization; and 4) capability. Furthermore, coupled with Crowe's researcher (2011) the factors that cause fraud actions consist of five elements, namely: pressure, opportunity, opportunity rationalization, competence, and arrogance. The five elements are more commonly known as Crowe's fraud pentagon theory.

Pressure Factors for Detecting Financial Statement Fraud, illustrated by financial stability, external pressure, personal financial needs and financial targets used to detect fraudulent financial statements. The opportunity factor in this study is illustrated by the nature of industry, and the effective monitoring used to detect fraud. financial statements, Reasonalization Factors with Accrual Total Dimensions As Variables To Detect Fraud Financial Statement, Capability Factors with Majority Ownership Dimensions as Variables for Detecting Fraud Financial Statement, Arrogance Effect with Frequent Number of CEO's picture dimensions in detecting Fraud Financial Statement, Howarth Crowe (2011), Zaki (2017)

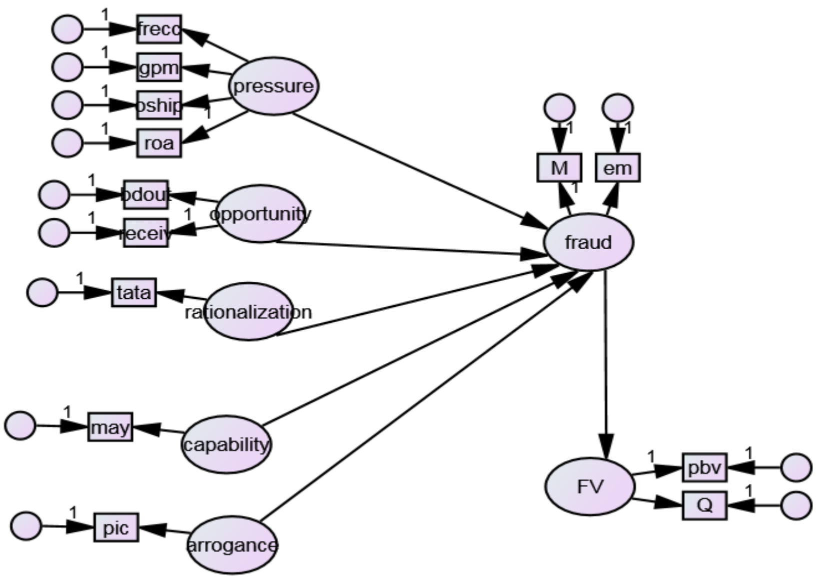

Figure 1 research model

Hypothesis

H1: The pressure factor has a positive effect on financial statement fraud
H2: The opportunity factor has a positive effect on financial statement fraud
H3: The Rationalization factors have a positive effect on financial statement fraud
H4: The Capability factors have a positive effect on financial statement fraud
H5: The Arrogance factors have a positive effect on financial statement fraud
H6: Financial statement fraud has a positive effect on the value of the company

RESEARCH METHODOLOGY

3.1 Introduction
This study aims to analyze the influence between independent variables which are pentagon fraud components and financial statement fraud and their influence on firm value.

Based on data obtained from the 2011-2016 Indonesia Stock Exchange, manufacturing companies listed on the IDX in 2011 were 144 companies. and eliminating outliers, from the number of observation data there are 66 companies. This research uses smart partial least square to obtain accurate and precise results, also data processing is done quickly.

RESULTS AND DISCUSSION

This study analyzes the effect of pentagon fraud in detecting financial statement fraud and its impact on company value. The following is a descriptive description of each variable.

Table 1 Descriptive variables

	Mean	Standard Error
Gpm	1.280	0.177
freec	-0.123	0.242
Oship	0.613	0.004
Roa	0.125	0.007
Receiv	0.013	0.004
Bdout	0.388	0.004
Tata	0.019	0.005
May	0.647	0.970
Dac	0.066	0.005
Pbv	2.341	0.050

Research results show that:
Table 2 research result

		Original Sample (O)	T Statistics (|O/STDEV|)	
H1	**Presure -> fraud**	0.502	9.155	Accepted H1
H2	**opportunity-> fraud**	0.161	4.830	Accepted H2
H3	**rasionalization-> fraud**	0.856	9.164	Accepted H3
H4	**Capability -> fraud**	0.128	1.105	Rejected H4
H5	**Arogance -> fraud**	0.067	3.513	Accepted H5
H6	**fraud -> firm value**	-0.116	3.160	Accepted H6

4.3 Discussion of Research Results
4.3.1 Effect of Pressure on financial statement fraud

1. Effect of financial report targets on financial statement fraud

Agency theory basically explains the relationship between shareholders and management. Shareholders have a goal to get a high return on their investment, while management has an interest in getting a large bonus as a result of their work. Because management is the party contracted by the principal to carry out its obligations, of course management wants to display the company's performance as best as possible. Management does not want to be considered incapable of managing and running a company because it will affect the bonus / compensation that will be received. ROA is often used in assessing manager performance and in determining bonuses, wage increases, etc. (Skousen et. Al., 2009). Therefore, management will try to manipulate, for example by profit manipulation, so that it is considered capable of achieving the predetermined financial targets. Summers and Sweeney (2008),

2. Effect of External Party Pressure on financial statement fraud

Skousen et al. (2008) said that the source of external pressure is the company's ability to pay debts or meet debt requirements. In addition, managers are also possible to have pressure to get additional debt or capital. External Pressure is the ability to fulfill exchange-recording requirements, pay debts, or fulfill debt agreements widely recognized from external parties. External Pressure is calculated using the free cash flow ratio, which is cash flow showing the results of operations whose funds have been received in cash by the company and burdened with cash and actually issued by the company.

3. The influence of Personal Financial Need on financial statement fraud

The results of this study indicate that the greater the ownership of insiders, the higher the financial report fraud. The results of this study support that the higher the percentage of share ownership by insiders, the fraud practices in manipulating financial statements will increase. (Skousen et al., 2009).

4.3.2 Effect of Opportunities on financial report fraud

1. Effect of Receivable on financial statement fraud

An increase in the number of corporate receivables from the previous year can be an indication that the company's cash turnover is not good. The number of accounts receivable owned by the company will definitely reduce the amount of cash that the company can use for its operational activities. Limited cash can be an encouragement for management to manipulate financial statements. Significant increase in trade receivables can be a serious indication of a Financial Stability in a company. If the company wants to attract investor interest, then one of the efforts to achieve this goal is by manipulating the amount of accounts receivable either by manipulating the due date to eliminate receivables that have a long collection period (Subramanyam and

Wild, 2008). The results of this study are consistent with Skousen et al. (2009) which states that the nature of industry variable has a significant effect on financial statement fraud.

2. Effect of Ineffective monitoring on financial statement fraud

Furthermore, for Ineffective monitoring is a condition that describes the weak or ineffective supervision of the company in monitoring the company's performance. SO No. 99 says that ineffective supervision is the result of the domination of management by one person or small group without the control of compensation and ineffectiveness of supervision of the financial reporting and internal control processes. Skousen et al. (2009) stated that companies that commit fraud tend to have few commissioners. Therefore, ineffective monitoring is proxied by the ratio of independent board of commissioners (Skousen et al., 2009). The results of the study show that the greater the ratio of independent board of commissioners in the company, the more ineffectiveness of supervision in the company so that the higher the occurrence of financial report fraud.

4.3.3 Effect of rationalization on financial statement fraud

Rationalization as a Variable for Detecting Fraud Financial Statement Francis and Krishnan (1999) and Vermeer (2003) argue that accrual principles relate to management decision making and provide insight into rationalization in financial reporting. According to Skousen (2009) the total accrual ratio variable can be used to describe rationalization related to the use of accrual principles by management. Total accruals will affect financial statement fraud because the accruals are strongly influenced by management decision making in the rationalization of financial statements (Beneish, 1997).

4.3.4. Effect of capability on financial statement fraud

Wolfe and Hermanson (2004) that a person's position in an organization can provide the ability to use opportunities to commit fraud. In this study the capability is proxied by majority ownership. Wolfe and Hermanson (2004) study ability as one of the factors behind cheating. The director's fraud risk concluded that changes could indicate fraud. In SAS No. 99, high turnover from senior management, advisers, or board members can also trigger opportunities that indicate fraud.

Srinivasan (2005) found that outside directors, especially those in charge of audit committees, experienced substantial turnover on the board of companies that restated revenue. (Wolfe and Hermanson, 2004)

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4.3.5 Arrogance to Detect financial statement fraud

This is because, important CEO images are included in the annual report to introduce to the wider community, especially the stakeholders who are the CEO of the company. Photos that are included in the annual report are photos of the activity, if the CEO's photo is displayed in the activity proves that the CEO participated in every activity carried out by the company. So that the community is able to assess the seriousness, tenacity and responsibility of the CEO in leading the company. The results of this study were supported by Tessa and Harto (2016) who said that the frequency of the appearance of CEO images had a positive and significant effect on fraudulent financial reporting.

4.3.6 Effect of financial statement fraud on company value

The results show that earnings management has a negative effect on the value of the company. Earnings management is influenced by conflicts between the interests of shareholders (principals) and agents as managers (company management) that arise because each party tries to achieve or consider the level of prosperity it wants. Agency conflicts that result in false reported profits, resulting in low earnings quality where the impact decreases the value of the company in the future. The low quality of these earnings results in the decision making errors by financial report users such as investors and creditors, so that the value of the company will decrease. This is supported by research conducted by Fernandes and Ferreira (2007) who found that earnings management has a negative effect on firm value, meaning that the use of earnings management will reduce the value of the company.

CONCLUSION

The pressure has a positive effect on financial statement fraud, so the greater the pressure to obtain financial stability, external pressure, the percentage of insider ownership and financial targets, the greater the financial report fraud. Opportunities have a positive effect on financial statement fraud. This shows that the greater the increase in trade receivables and the ineffectiveness of supervision of the independent board of commissioners, the greater the financial report fraud. Rationalization has a positive effect on financial statement fraud, so that the greater the rationalization to get the total accrual to total assets, the greater the financial statement fraud. Capability does not affect financial statement fraud. This shows that majority ownership is not a factor causing financial report fraud. Arrogance has a positive effect on financial statement fraud. This shows that the increasing arrogance, the fraudulent financial statements will increase. Fraud financial statements have a negative effect on financial statement fraud, so that the greater the earnings management, the value of the company will decrease in the long run

Limitation and Implication

For companies in a country management should be careful with the factors of pressure, opportunity and capability because due to pressure factors, opportunities and capabilities are proven to be the motivation of someone in cheating financial statements. Financial report fraud should be avoided by the company because it is proven that it cannot increase the value of the company or is not dominant in determining the value of the company. Financial report fraud can be avoided by the application of risk management through the application of internal control and transparent corporate governance, accountability, responsibility, independence and fairness.

The limitation in this study is to only analyze the manufacturing industry in determining financial statement fraud and not analyze the financial industry, because according to ACFE (2016) the financial industry, especially banking, has a lot of financial statement fraud.

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