

The Impact of Faud Star on Detecting Fraudulent Financial Statement

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Abstract

Financial statements are least common but can cause most costly compared to corruption and misappropriation of assets. The purpose of this study was to analyze the effect of Fraud Star elements on Fraudulent Financial Statements (FFS) for the period 2018 to 2020. Each element of the Fraud Star are calculated with financial target proxies (ROA) for pressure, ineffective supervision (BDOUT) for Opportunity, total accruals for Rationalization, Direction Change for capabilities. Lack of Integrity it is calculated by real earnings management, and the FFS measurement uses the Beneish M-Score. ACFE, 2020 has released the RTTN which states that the executive level and the accounting department have the 2nd and 3rd highest percentages of fraudsters, respectively 14% and 12%. Banking and financial services are the central public services and are at the heart of economic growth. Therefore the population in this research were banking companies listed on the Indonesia Stock Exchange during the period 2018 - 2020. The research sample was taken using a purposive sampling technique. The data used in this study is secondary data, namely in the form of audited company financial and annual reports and obtained through access to www.idx.co.id and/or the official website of each company. The data analysis method in this study uses panel data regression. The results of the study prove that Opportunity, Rationalization, and Lack of Integrity have a significant positive effect on FFS, while Pressure and Ability, and Internal Audit has not a significant positive effect on FFS

Keywords

fraud star; fraud; fraud financial statement; lack of integrity



I. Introduction

Financial statements have an important function in presenting financial information, namely assets, equity, liabilities, income and expenses of the entity. For users of financial statements, this presentation can be a reflection and assessment of the prospects for future net cash inflows and evaluate the performance of management over the management of the use of the entity's economic resources. Financial statements must have the fundamental qualitative characteristics of useful financial information. These characteristics are relevance, accuracy of representation and materiality. Accuracy of representation means that financial statements are able to represent the substance of economic phenomena in the words to be represented.

FFS is defined by (ACFE, 2020) as a description when employees intentionally err or omit material information in financial statements, for example, improperly recording income and/or expenses, both in terms of time and/or amount, understating reported expenses, and /or inflate artificially reported assets. (Prasmaulida, 2016) is defined as an act of deliberately manipulating a misstatement of nominal value to make it look real with

the aim of deceiving users of financial statements as if they were relevant, accurate, and accountable. As was done by Enron Energy in 2001 with the involvement of Arthur Andersen's Accounting and Tax Consulting fraudulent financial statements worth USD 600 million. The three fraud drafters are the chairman of the financial sector audit, the former chairman and CEO, and the former financial manager (liputan6.com). PT Bank Lippo, Tbk in 2008 with a loss of IDR 5.45 trillion (liputan6.com), Lehman Brothers in 2008, British Telecom in 2017 manipulated a profit of GBP 530 million. Therefore, the conclusion is FFS is defined as fraud model is most costly but the least common. FFS scheme through false statement, manipulating of revenue and/ or expense to make it look real is often called as window dressing

Report to The Nations state fraud financial statements is rare but most costly and the most common industries reported to us were banking and financial services, government and public administration, and manufacturing (ACFE, 2020). Bank and financial services are at the heart of economic growth have 386 fraud cases. The primary reason for fraudsters is because of pressure in the form of fear of being considered to have a bad style, management has a conflict of interest resulting in not being able to maintain the trust. then culminate in cheating and fraud.

Based on research results (Aprilia, 2017; Umar et al., 2020) the pressure has been proven to be a driver of FFS, this is in line with the results of research (Nilzam, 2020). However, this is different from the research results (Dewi, 2021; Rahman et al., 2021). Opportunity is described as a situation that gives rise to the possibility of one or more persons to commit FFS (Akbar, 2017). So fraud can occur if there is the slightest opportunity. The results of the study (Anggraini, W. R. & Suryani, A. W., 2021) stated that Opportunity had no positive effect on FFS. However, the results of these studies are contradictory (Hidayah & Saptarini, 2019; Marheni & Suryati, 2021).

Rationalization is the gateway to fraud, the positive effect of rationalization on FFS can be seen in research (Jaunanda & Agoes, 2019; Triyanto, 2019), However, this contradicts the results (Irwandi et al., 2019). Capability is a condition where the fraud perpetrator is supported by a strategic position. The hypothesis that Capability has a positive effect on FFS has been proven by (Demetriades & Owusu-Agyei, 2021; N. Santoso & Surenggo, 2018) different research results are stated by (Aprilia, 2017; Jaunanda & Agoes, 2019). Lack of integrity is novelty on the research. Integrity is the spirit to minimize the risk of fraud. Integrity is a representation of the quality of coverage, responsibility, and honesty. If integrity has been lost in a person, then it is almost certain that that person will act outside the norm, including cheating or fraud. The importance of integrity in fraud prevention has been proven by (Wulandari, D. N., & Nuryanto, 2018) that integrity has a positive effect on preventing fraud. According to differences in the results and the use of models from previous studies, this research is interesting because this research uses the novelty model, namely Fraud Star, which is enhanced by the lack of integrity variable which acts as a quasi-moderating variable, the researcher gives the title "The Effect of Fraud Star on Fraud Financial Statement (Study on Banking Listed on the Indonesia Stock Exchange 2018-2020)".

II. Review of Literature

2.1 Agency Theory

Meckling and Jansen as the inventors of agency theory in 1976 put forward Agency Theory is a theory that describes the close contractual relationship between the agent and the principal. The definition of a contractual relationship is as cooperation based on a

contract between two or more parties. (Aprilia, 2017) describes agency theory based on the following assumptions:

(Aprilia, 2017) describes agency theory based on the following assumptions: Human nature, Organization, Information assumption.

(Meliana & Hartono, 2019) explained that principals always expect high investment returns, while agents have an interest in getting maximum compensation. This illustrates the existence of a conflict of interest (conflict of interest) between the owners of capital and the managers of capital or company management. With the tendency of agents to act no longer to achieve company goals but more motivated towards compensation with illegal schemes such as FFS

The implementation of agency theory in this research is a tangible manifestation of achieving the company's vision and mission. With a mutually agreed contract, the owner of the capital gives confidence to the agent in making decisions.

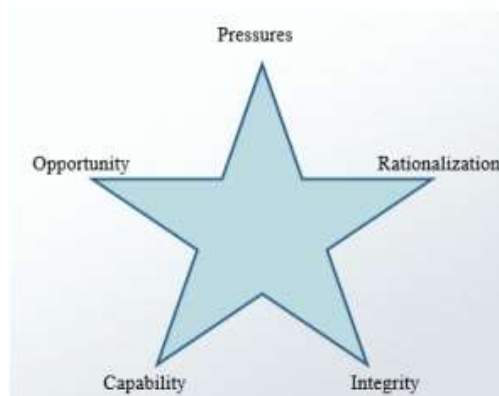
2.2 Fraud Concept

In the English-Indonesian dictionary, fraud means cheating, embezzlement and also deception. Then quoted from kbbi.web.id (KBBI) in a network of fraud is an act of dishonesty. And embezzlement means abuse and corruption, then deception means dishonest behavior with the intention of fooling, outsmarting, misleading, or seeking profit. Based on the existing meaning, there is a difference between fraud and error, an error can turn into an act of fraud if it is done intentionally with the motivation to make a profit.

The three types of fraud according to ACFE are Misappropriation of Assets, Corruption, Fraud Statement

2.3 Fraud Model

(Tuanakotta, 2013), explains the model formed by Crassey, namely the Fraud Triangle that the 3 factors that cause fraud are pressures, opportunity, rationalization. (Wolfe & Hermanson, 2004) reformulated the Triangle of Fraud with the addition of Capability as a driving force in fraud actions. Based on an explanation of the risk of a lack of integrity being toxic, in 2016 Umar updated the existing fraud model. The update is called a fraud star with a variable lack of integrity as an novelty.

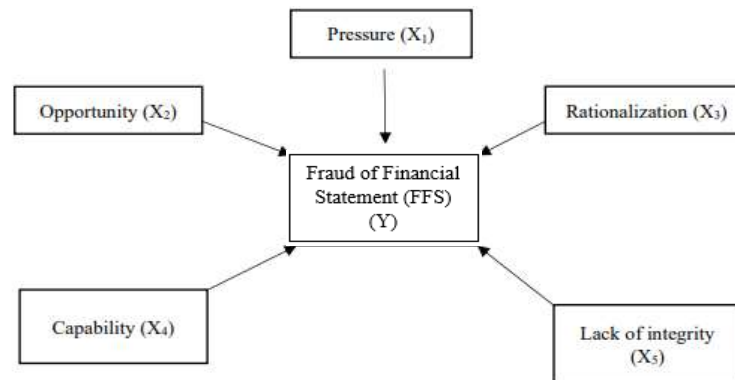


Source: Umar, 2016

Figure 1. Fraud Star

(Siahaan et al., 2019) has proven that the fraud star elements (opportunity, pressures, rationalization, capability, and lack of integrity) have an impact on the fraud occurrence (misappropriation of assets).

2.4 Research Concept Framework



Source: (Umar & Purba, 2020)

Figure 2. Research Concept Framework

Hypothesis

Pressures are a natural urge to commit and hide deception. (Özcan, 2016) empirically states that a decline in financial performance becomes a pressure that encourages financial fraud, it can be understood that when performance is good and growing, it will attract investors. Financial performance is a measuring instrument to know the process of implementing the company's financial resources (Ichsan, R. et al. 2021). The similar statement was also conveyed by (N. Santoso & Surenggo, 2018). According to this exposure the hypotheses proposed as follow:

H1: Pressure has a positive effect on FFS

Opportunity or often known as opportunity is a condition that allows agents to commit fraudulent financial reporting (Akbar, 2017). Refers to the results (Akbar, 2017; Lastanti, 2020; Umar et al., 2020) stated that Opportunity has a positive effect on fraudulent financial reporting. Thus, the opportunity is a golden condition where supervision is minimal. The weaker the supervision, the higher the risk of fraud, and vice versa. According to this exposure the hypotheses proposed as follow:

H2: Opportunity has a positive effect on FFS

Rationalization is an attitude based on the mind, by justifying the crimes, fraud, and fraud committed (Sukirman & Pramono Sari, 2013). Based on the explanation, it can be developed that rationalization is a deviation of thoughts and actions. Fraud perpetrators will never feel guilty and will always look for justification. (Murtanto & Sandra, 2019; A. L. Santoso & Dhiyaul-Haq, 2017; Triyanto, 2019) stated that the role of rationalization is the driven factor fraud of financial statement. According to this exposure the hypotheses proposed as follow:

H3: Rationalization has a positive effect on FFS

(Wolfe and Hemarson, 2004) concluded that the change in directors was the reason behind the fraud. The change of directors is not always good, it could be the change of directors because the previous directors knew and were able to uncover fraud, so that fraud perpetrators considered it a barrier to the next fraud. (Marheni & Suryati, 2021; N. Santoso & Surenggo, 2018) stated that Capability has a positive effect on fraudulent financial reporting. Meanwhile (Akbar, 2017; Lastanti, 2020; Triyanto, 2019) stated otherwise. According to this exposure the hypotheses proposed as follow:

H4: Capability has a positive effect on FFS

According to (BPK, 2017) Integrity is a condition that shows complete unity, honesty, diligence, and adequate competence. From the fraud incident that has been described, the fraud perpetrators are educated people, but the perpetrators lose their integrity (lack, of integrity) (Umar et al., 2020). This is supported by research results (Umar & Purba, 2020) that Lack of Integrity is a variable that has a positive effect on the detection of fraud types of corruption.

H5: Lack of Integrity has a positive effect on FFS

III. Research Method

In this research, the appropriate method to obtain empirical evidence is the quantitative method and panel data regression processing by Eviews 12 software. Conducted through a causality test (Sekaran.et.al., 2020). The sample used is banking companies listed on the Indonesia Stock Exchange for the period 2018-2020. The data sample obtained through idx.co.id and/or each companies website with purposive sampling technique.

Variabel of Operational

3.1 Variabel of Dependent

Variabel of Dependent (Y) is FFS were calculated using the Beneish Model adopted in 1999, As for the formula as follows:

$$\text{M-Score} = -4.84 + 0.920\text{DSRI} + 0.528\text{GMI} + 0.404 \text{AQI} + 0.892 \text{SGI} + 0.11 \text{DEPI} \\ -0.172\text{SGAI} + 4.679\text{TATA} - 0.327 \text{LEVI}$$

With an absolute Beneish M-Score value of -2.22. Value > -2.22 is classified as a manipulator. Each ratio detail as follows:

a. Index of Days Sales in Receivable (IDSR)

IDSR for measuring the ratio of sales receivable days in one year with the comparison of the previous year. The higher the IDSR ratio, the greater the possibility as a manipulator. The formula is:

$$\frac{(\text{Account Receivablest} / \text{Sales t})}{(\text{Account Receivables t-1} / \text{Sales t-1})}$$

b. Index of Asset Quality (IAQ)

IAQ describes changes in asset realization risk. The formula is:

$$\frac{(1 - ((\text{Current Asset t} + \text{PPE t}) / \text{Total Asset t}))}{(1 - ((\text{Current Asset t-1} + \text{PPE t-1}) / \text{Total Asset t-1}))}$$

c. Index of Sales Growth (ISG)

ISG is to measure revenue growth in the current year from year to year. The formula is:

$$\frac{\text{Sales t}}{\text{Sales t-1}}$$

d. Index of Depreciation (IDEP)

IDEP describes the comparison of depreciation and gross value of fixed assets for the current year with the previous year. The formula is:

$$IDEP = \frac{(\text{Depreciation } t-1 / (\text{Depreciation } t-1 + \text{PPE } t-1))}{(\text{Depreciation } t / (\text{Depreciation } t + \text{PPE } t))}$$

e. Index of Sales, General and Administrative Expense (ISGA)

ISGA is to measure the comparison of selling and general administrative expenses in the current and previous years. The formula is:

$$ISGA = \frac{(\text{SGA expenses } t / \text{Sales } t)}{(\text{SGA expenses } t-1 / \text{Sales } t-1)}$$

f. Total Accruals to Total Asset Index (TATA)

TATA explains changes in working capital other than cash minus depreciation on total assets. The formula is:

$$TATA = \frac{\text{Net Income From Continuing Operation}(t) - \text{Cashflow Operating}}{\text{Total Asset } (t)}$$

g. Index of Leverage (ILEV)

ILEV describes changes in the company's financial structure. Increased leverage creates incentives to manipulate earnings.

$$ILEV = \frac{((\text{LTD } t + \text{Current Liabilites } t) / \text{Total Assets } t)}{((\text{LTD } t-1 + \text{Current Liabilites } t-1) / \text{Total Assets } t-1)}$$

3.2 Variabel of Independent

Variable of independent (X) is a variable that has an influence on the dependent variable. Acting as the independent variable is the Fraud Star element. Measurement variabel of Independent variabel are follows:

Variabel	Measurement	Scale	Reference
1. Pressures	$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$	Rasio	(Fajri et al., 2018)
2. Opportunity	$BD\text{-}OUT = \frac{\text{ineffectiveness of supervision}}{\frac{\text{Total Komisari Independen}}{\text{Total Dewan Komisaris}}}$	Rasio	(Skousen et al, 2009)
3. Rationalization	$TATA = \frac{\text{Net income from continuing operation } t - \text{CF From Operation}}{\text{Total Asset } t}$	Rasio	(Skousen et al, 2009)
4. Capability	(D-CHANCE). Variabel dummy Kode 1 = terjadi perubahan direksi kode 0 = tidak terjadi perubahan direksi	Nominal	(Wolfe & Hermanson, 2004)
5. Lack of Integrity	$REM = \text{Abn_CFO} + \text{Abn_Discexp} - \text{Abn_Prod}$	Rasio	(Roychowdhury, 2006; Cohen, (2010)

Regression Equation as follow:

$$FFS = \alpha + \beta_1 \text{ Pressures} + \beta_2 \text{ Opportunity} + \beta_3 \text{ Rationalization} + \beta_4 \text{ Capability} + \beta_5 \text{ Lack of Integrity} + \epsilon$$

Keterangan :

α = Konstanta

β_1 - β_5 = Koefisien Regresi

ϵ = Error

IV. Results and Discussion

Table 1. Purposive Sampling Results

Description	Amount
Companies Listed on the Indonesia Stock Exchange during the 2016-2020 period	49
Companies that do not present a complete annual report during the 2016-2020 period	(0)
Companies that do not present comprehensive data related to the relevance of research variables from 2016-2020	(0)
Number of Company Samples	49
Number of company data processed (3 x 49)	147
<i>Outlier</i>	(44)
Number of samples during research period	103

Source: Data processed (2022)

Table 2. Statistic of Descriptive

Variabel	Observations	Mean	Median	Maximum	Minimum	Std Dev
<i>FFS</i>	103	-2,415	-2,394	0,011	-4,156	0,552
<i>Pressures</i>	103	-0,049	0,015	4,130	-11,270	1,188
<i>Opportunity</i>	103	0,577	0,500	1,000	0,000	0,181
<i>Rationalization</i>	103	-0,002	0,001	0,353	-0,327	0,092
<i>Capability</i>	103	0,689	1,000	1,000	0,000	0,465
<i>Lack of Integrity</i>	103	0,002	0,026	0,958	-0,720	0,183

Source: Data processed by Eviews 12 (2022)

FFS: Mean score -2.415 means that the average banking company that is the sample of this study is not a manipulator.

Pressures: Statistics show that in the time span of the research data the average company experiences pressures, it can be seen from the mean value of -0.049.

Opportunity: Describes that on average the companies have good supervision so that the average risk level of FFS is below 50%, which is 42.23%.

Rationalization: The maximum value of this variable is 0.353 exceeding the threshold of 0.031 indicating the presence of FFS.

Capability: The average company's ability to take FFS actions is 68.9%. 67.96 % or 70 data samples made changes to directors, while 32.04% or 33 data samples did not change directors.

Lack of Integrity: The mean value of 0.002 indicates that the average sample in this study is positively infected with Lack of Integrity

Table 3. FFS Classification

Range FFS	Observations	Percentage	Classification
-4,156 s.d -2,227	70	67,96%	No Manipulator
-2,213 s.d 0,011	33	32,04%	Manipulator

Source: Data processed by Eviews 12 (2022)

Based on table FFS Classification above shows 70 data observations are no manipulator and 33 data observations are manipulator.

4.1 Panel Data Regression

Panel data regression requires the selection of the most appropriate model, the panel data model consists of: Common Effect (CE) Model, Fixed Effect (FE) Model, Random Effect (RE) Model. The model is obtained through testing:

Table 4. Results of Chow Test

<i>Effect Test</i>	<i>Statistic</i>	<i>d.f</i>	<i>Prob</i>	<i>Results</i>
Cross-section F	1.116417	-34,63	0.346	
Cross-section Chi-square	48.571885	34	0.050	FE

Source: Data processed by Eviews 12 (2022)

Table 5. Results of Hausman Test

<i>Test Summary</i>	<i>Chi-Sq. Statistic</i>	<i>Chi-Sq. d.f.</i>	<i>Prob</i>	<i>Results</i>
Cross-section F	20.223	5	0,001	FE

Source: Data processed by Eviews 12 (2022)

Based on the model test, the Hausman Test and Chow Test results show that the selected model is the FE Model. Therefore no longer required LM test.

Table 6. Results of Multicollinearity Test

Variabel	<i>Pressures</i>	<i>Opportunity</i>	<i>Rationalization</i>	<i>Capability</i>	<i>Lof integ</i>
<i>Pressures</i>	1.000	0.024	0.217	-0.042	-0.166
<i>Opportunity</i>	0.024	1.000	-0.125	0.101	0.081
<i>Ratio-nalization</i>	0.217	-0.125	1.000	0.096	-0.314
<i>Capability</i>	-0.042	0.101	0.096	1.000	-0.095
<i>Lofinteg</i>	-0.166	0.081	-0.314	-0.095	1.000

Source: Data processed by Eviews 12 (2022)

Multicollinearity test results show that the independent variables do not exceed 0.9, which means that there are no symptoms of multicollinearity.

Table 7. Results of Heteroscedasticity

Variabel	<i>Pressures</i>	<i>Opportunity</i>	<i>Rationalization</i>	<i>Capability</i>	<i>Lof integ</i>
<i>Pressures</i>	1.000	0.024	0.217	-0.042	-0.166
<i>Opportunity</i>	0.024	1.000	-0.125	0.101	0.081
<i>Ratio-nalization</i>	0.217	-0.125	1.000	0.096	-0.314
<i>Capability</i>	-0.042	0.101	0.096	1.000	-0.095
<i>Lofinteg</i>	-0.166	0.081	-0.314	-0.095	1.000

Source: Data processed by Eviews 12 (2022)

Table 8. Results of FTest

Model	Prob.	Threshold	Conclusion
<i>Pressures</i>	0.3577	0,05	No Heteroscedasticity
<i>Opportunity</i>	0.6597	0,05	No Heteroscedasticity
<i>Rationalization</i>	0.2843	0,05	No Heteroscedasticity
<i>Capability</i>	0.1937	0,05	No Heteroscedasticity
<i>Lack of Integrity</i>	0.3721	0,05	No Heteroscedasticity

Source: Data processed by Eviews 12 (2022)

From the results of the F test above, it is known that the significance value is < 0.05 . Then H_a is accepted, which means that all the independent variables Fraud Star element can have a positive effect on FFS simultaneously.

Table 9. Coefficient of Determination Results

Model	F	Sig.	Conclusion
Panel Data Regression	17.80	0,000	Significant effect

Source: Data processed by Eviews 12 (2022)

This is very good. It means that 86.5% combination of all independent variables can predict the dependent FFS. While the remaining 13.5% is influenced by other variables out of scope the research.

Table 10. Result of T (Partial) Test

Model	Adjusted R ²	Conclusion
Panel Data Regression	0.865	Describes the variation of the dependent variable of 86.5% has a positive effect on FFS

Source: Data processed by Eviews 12 (2022)

Regression Equation:

$FFS = -2.718 - 0.071 \text{ Pressures} + 0.440 \text{ Opportunity} + 6.074 \text{ Rationalization} + 0.083 \text{ Capability} + 0.723 \text{ Lack of Integrity}$

In table xx above, the results of the 5 hypotheses are as follows:

H1: Pressures have a positive effect on FFS

The influence of the Pressures variable on FFS has a coefficient value of -0.071 with a significance value (prob) of 0.001 <0.05, then this indicates that H1 is rejected.

H2: Opportunity have a positive effect on FFS

The influence of the Opportunity variable on FFS has a coefficient value of 0.440 with a significance value (prob) of 0.005 <0.05, then this indicates that H2 is accepted.

H3: Rationalization have a positive effect on FFS

The influence of the Rationalization variable on FFS has a coefficient value of 6.074 with a significance value (prob) of 0.000 <0.05, then this indicates that H3 is accepted.

H4: Capability have a positive effect on FFS

The influence of the Capability variable on FFS has a coefficient value of 0.083 with a significance value (prob) of 0.171 > 0.05, then this indicates that H4 is rejected.

H5: Opportunity have a positive effect on FFS

The influence of the Pressures variable on FFS has a coefficient value of 0.723 with a significance value (prob) of 0.000 <0.05, then this indicates that H5 is accepted.

V. Conclusion

Based on the results of the analysis and discussion carried out and to answer the research objectives proposed, it can be said as follows:

1. Pressure has not a positive effect on FFR.
2. Opportunity has a have a positive effect on FFR.
3. Rationalization has a positive effect on FFR.
4. Capability has not a positive effect on FFR.
5. Lack of Integrity has a positive effect on FFR.

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