

## **Analysis of Fraud Pentagon and Good Corporate Governance in Indonesian Financial Companies**

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### **ABSTRACT**

This research will explore the practice of fraud on financial statement and the factors that affect according to Fraud Pentagon Theory using Good Corporate Governance (GCG) as a moderating variable. The research method uses in this study is associative which to examine the relationship to financial statement fraud and the elements that affect fraud are opportunities, pressure, rationalization, competence, and arrogance. Data in the form of secondary datatype obtained from IDX Statistics. Companies specialized in financial sector in which listed on the Indonesia Stock Exchange in 2021 will be used as the study population. The sampling method uses purposive and a sample of 92 companies. The result exhibits the variables of financial stability, external pressure, competence, and arrogance are having a significant effect upon the fraudulent financial reporting. Financial targets, opportunities, and rationalization have a non-significant effect upon the fraudulent financial statement. Good corporate governance does not moderate the relationship between financial targets, opportunities, rationalization, competence, arrogance, and fraudulent financial reporting variables. Good corporate governance moderates the relationship between financial stability, external pressure, and fraudulent financial reporting variables. The outcome from this research can be a recommendation for companies to reduce fraud through implementation strategies and improve the implementation of good corporate governance so that companies can create value and continue to improve their performance.

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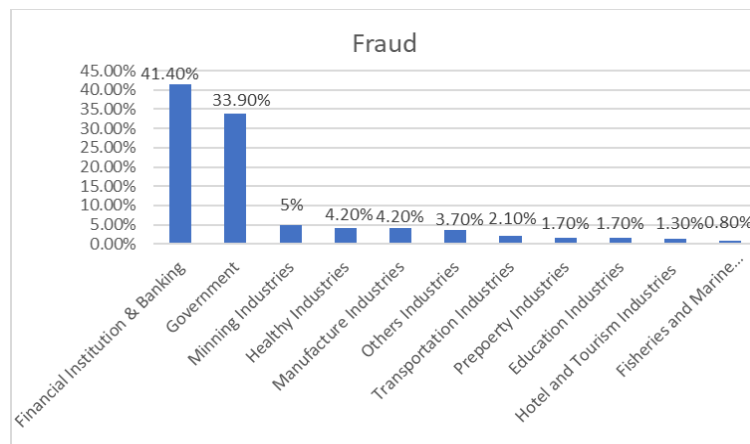
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### **INTRODUCTION**

Financial Accounting Standards (FAS) are used as the guidelines to prepare financial statements, and the data presented are in accordance with the proper rules and minimize fraud. In reality, however, there are many anomalies in the financial statements are presented, such as amounts manipulation, disclosures, mark-ups, and data deletion. Meanwhile, the Association of Certified Fraud Examiners (ACFE) stated that fraud can be divided into three categories: Corruption, Asset Misappropriation as well as Fraudulent Financial Reporting.

Based on the ACFE report, fraud was responsible for the highest losses occurred in fraudulent financial statements (\$593,000), corruption (\$150,000), and asset misappropriation (\$100,000) in 2022 (ACFE Global, 2022).

Financial statement fraud is widely practiced because every company wants its published financial statements to show the best condition of the company. As a result, the company commits fraud or falsifies the financial reports to present the good condition of the company. Thus, the information so the information presented is biased and can misleading stakeholders. The Statement of Auditing Standards No. 70 stated that fraudulent financial reporting is when a company made a misstatement or intentionally conceal some data or information in financial reports which is intended to mislead users. Based ACFE’s research in the Report to The Nations 2019, fraud occurs in almost every industry that produces products and services. Figure 1. Show the data industries that committed fraud in Indonesia.



**Figure 1: Industries that Committed Fraud in Indonesia**  
 Source: ACFE Indonesia, 2019

There are numerous of theories that interpret the logical styles in discover the potential of fraudulent financial statements, the example used is Fraud Pentagon. The Fraud Pentagon is a new way of looking at the fraud miracle proposed by Crowe Horwath in 2011. This extends the Theory of Fraud Triangle preliminarily stated by Cressey in 1953 and the Fraud Diamond which stated by Wolfe and Hermanson in 2004 by adding two motives fraud are competence and arrogance.

Wolfe and Hermanson in 2004 explained, those who commit fraud shall be able to recognize as well as take advantage of good opportunities, not just once, but many times. The theory stated that in order to reduce fraud is concentrate on the exact situations which boost pressure, rationalization and a combination of occasion and capability. Horwath in 2011 stated that research commenced by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) believed in up to 70% of fraudsters has a compounded of pressure with arrogance and rapacity. In addition, he stated that arrogance shows superiority and out of mindfulness acquired by rapacity and belief that the internal controls of the firm don’t directly address to them. This fraud pentagon theory provides a framework that can help the management of a company finding solutions to minimize and/or prevent fraud (Thanasak Ruankaew, 2016).

In this study, researchers add GCG as a moderating variable. The implementation of GCG is to give direction and regulate the activities of the company in carrying out its operations, so

GCG is anticipated to elevate the performance of the company. Effective application of GCG is one of the key elements in improving economic efficiency which can help create a conducive and accountable relationship between organs within the company and elevate its performance. Therefore, implementation of GCG may increase discipline and improve the performance of the company, so that GCG is considered to reduce the occurrence of financial statement fraud (Kurniawan, 2019; Rohmatin 2021; Gusti, 2020).

The outcomes of previous studies are out of sync. Norazida et al. (2021) and Devi et al. (2021) show that fraud pentagon has a considerable effect on fraudulent financial reports. The research of Widya (2022) states that the fraud pentagon has no considerable effect on fraudulent financial reports. The aim of this research is to analyze fraud through Fraud Pentagon Theory by making good governance as a moderating variable of companies in financial sector. The financial sector was chosen because the financial sector is the most fraudulent sector (ACFE Report, 2022). The year 2021 was chosen because it was still during the pandemic. Therefore, it is possible for companies to make efforts to manipulate the financial reports which may be improve the economic performance.

Hence, this study aims to examine how does the Fraud Pentagon Theory which the elements are opportunities, rationalization, pressure, competence, as well as arrogance is influence to fraudulent financial statement and how the GCG does moderates fraud through the fraud pentagon of companies in financial sector.

## **LITERATURE RESEARCH**

The theory underlying fraud is agency theory which explains the cooperative relationship within an organization or company between shareholders (principal) and the Company's agents to fulfil contracts that have been agreed upon by both (Meckling, 1976). The Principal gives authority to managers who are representatives or agents of shareholders in managing the Company. The manager will continue to strive to meet the demands of the principle. However, sometimes there are things that are deliberately done by company managers such as providing information that is not the truth, and manipulation of financial statements carried out by managers. This can cause conflict between the two parties. There are differences or discrepancies in information between the principal and the agent, the principal must monitor and control more tightly so as to minimize fraud that will be committed by the company's management. There are three basic types of assumptions of human nature in agency theory: (1) Human beings are generally selfish and do not see the interests of others (self-interest), (2) Man has a limited intellect about understanding the future (bounded rationality), (3) Humans will always avoid risk (risk averse). Looking at the three basic assumptions of human nature in agency theory, managers will always prioritize their personal interests to get profits and bonuses from the company in an incorrect way manipulation of financial statements or not providing actual information to shareholders (Meckling, 1976).

Fraud Pentagon Theory explains the cause of someone committing fraud through five conditions that support each other and form pillars that will cause fraud in a company or organization. The five conditions are pressure, opportunity, rationalization, capability/competence, and arrogance. On the other hand, information asymmetry arising from agency theory can be minimized with good management in the company. GCG will balance the relationship between agents and principals, thus avoiding information asymmetry and minimizing fraud within the company.

## **Agency Theory**

Agency theory is essential in business practices. This describes that the principal or owner and the agent or management are main actors in the contractual relationship (Jensen and Meckling, 1976). The principal as the owner authorizes or mandates the agent (management) to carry out conditioning to manage the company. Although the owner has given the agent a mandate to carry out activities and make decisions on his behalf, the agent also has other interests intended for his own welfare. The difference of the interest between them is appertained to as the agency problem. This allows the managements do not work according to the prosperity of the owner. A management is required to present the report about the state of the company to the owner in form of financial statements. Principals always want a great profitability on their financing activities, while management want a great allowance for his services. This difference in interests can produce pressure on the management, as a result, in order to fulfil these effects, management will act without allowing the owner's interests, one of which is by reporting financial statements which are not stated the existing conditions or can be called financial statement fraud. This clash of interest between the owner and management could happen because management doesn't always act according to the interests of the owner, thus triggering agency costs. This may bring an opportunity for management to cover some data which not known by shareholders. Management will seek its own benefits in numerous acts, such as falsifies the amounts in the financial statements so it presented in biased and may mislead shareholders. When management takes advantage of existing opportunities, they will tend to rationalize, i.e., justify the actions taken and will think that it is reasonable to do so. In addition, the ability factor also affects the ability to manipulate financial reports. The person's position in the company will contribute his or her ability to commit fraud.

## **Fraud Pentagon Theory**

According to the ACFE (2019), fraud is an unlawful act carried out committed designedly for a specific purpose (falsify reports to further parties) and its perpetrators are people from internal or external of the company to gain benefits directly and/or indirectly. Fraudulent financial statement is a fraud that involves actions by officials and/or executives of agency to conceal the real economic condition of agency (ACFE, 2019). The manipulation of financial statements is to obtain benefits from various parties and to conceal the economic condition of the agency from the actual situation. This can be done by financial engineering in presenting financial statements intended to making a profit (window dressing). This type of fraud includes both financial and non-financial fraud. Fraud Pentagon is a theory introduced by Horwath in 2011. This is an evolution of the Fraud Triangle theory developed by Cressey in 1953. This concept enumerates two other components from the three elements in previous concept, which are pressure, opportunity, as well as rationalization and the two more components are capability (individual ability) and arrogance.

## **Pressure and Fraud**

Pressure defined as a motive of a person to engage fraud because it is triggered by a perceived need. Pressure will motivate someone to engage in unethical behavior for various reasons (Ruankaew, 2016). The pressure that causes person to engage this deceitfulness thing perhaps in form of financial stability, external pressure, individual financial needs, and financial targets (Skousen, 2009). Financial stability is a situation that interpret the finances of the agency is in a good state and can be proven by the assets condition (Skousen & Twedt, 2009). External pressure is inordinate tension from management to fit the prospects of

stakeholders. This tension encourages management to seek external sources of financing. The financial target is the position of gains that must be obtained from the assets used to obtain that profit.

The pressure faced by the management ordinarily point out to the decent management of assets with the aim of creating a great return for investors (Tiffani & Marfuah, 2015). This suggest that the increase of the agency's assets may be a way for management to commit fraudulent financial report. Skousen & Twedt in 2009 stated that financial stability shall be measured by the Total Asset Change Ratio and proxied Financial Stability with a ratio of changes in all assets. The result of their research, that the change in total assets (ACHANGE) and fraudulent financial statement having a correlation in a positive direction. The greater ACHANGE, the higher the indication of fraud in financial report. Tiffani & Marfuah in 2015 stated that external pressure is excessive tension faced by the management in meeting third party expectations. SAS No. 99 as well as stated that excessive tension from third parties encourage management to commit fraud in financial report. These are in line with the study aimed by Skousen & Twedt (2009) which explained that the existence of additional funds or debt from third parties will have an impact to pressure on management. According to their research, Skousen & Twedt (2009), they found that leverage ratio which measured by total debt to total assets has a positive effects with fraud in financial report.

Skousen et al. (2009) found that management performance can also be measured by ROA or assets return. The higher the ROA target, the higher management's vulnerability to earnings manipulation (Tiffani & Marfuah, 2015). This shows that financial targets have positive effects with fraudulent reporting.

H1: Financial stability has positive effects on fraud in financial report.

H2: External pressure has positive effects on fraud in financial report.

H3: Financial target has positive effects on fraud in financial report.

### **Opportunities and Fraud**

The individual in engaging fraud must have an ability to seek the opportunity and take advantage of it (Ruankaew, 2016). Opportunities can arise due to weak internal controls, uncontrolled monitoring, or a strategic position. It measured by inefficient of inspection, which defined as the absence of good oversight or internal control to oversee the performance of agency. Strong internal controls will enable companies to identify fraud earlier (Aris, et.al., 2015). This situation may occur when internal parties are dominated by one or a small group of individuals, when there are no compensation controls, and when there is ineffective controls on directors and audit committee controls are not effective. The indicator used is the ratio of independent commissioners (BDOU). The great value on BDOU will increase the effectiveness in monitoring, thereby reducing the possibility of financial statement fraud and vice versa (Maczewski & Akers, 2005).

H4: Ineffective monitoring is proxy opportunities positively effects on fraud in financial report.

### **Rationalization and Fraud**

Rationalization shows that fraudsters must be able to formulate a morally acceptable form of

rationalization before engaging in unethical behavior (Zaki, 2017). Rationalization allows fraudsters to have the perception that their actions are legal and acceptable. The perception that others will do the same and not be sanctioned for the fraud becomes the justification for the fraud (Zulaikha & Hadiprajitno, 2016). Streaming management exposed to fraudulent financial statements that required a change in external auditors.

H5: Change of auditor as rationalization agents positively effects on fraud in financial report.

### **Capability and Fraud**

It focuses on situations in which an individual can exploit circumstances to bypass internal controls in order to legalize what should be prohibited in an organization (Arles, 2014). The person committing the fraud must be able to see the gap that allows them to engage the fraud as an opportunity and take advantage of it. Competence is measured by changes in membership of board's directors. The changes on membership impact stress periods which can increase opportunities for fraud (Wolfe and Hermanson, 2004).

H6: Director turnover is considered a capability indicator positively impact on fraud in financial report.

### **Arrogance and Fraud**

Horwath in 2011 believes that arrogance is a behavior which shows dominance and lack of conscience due to greed and believes that the internal controls of the company do not affect them personally. Crowe (2011) explains that arrogance has 5 (five) the CEO's perspective, which are (1) the high self-pride when the chief is considered as celeb than an entrepreneur, (2) It may penetrate the internal controls system of the company and don't affect them, (3) an arrogance behavior, (4) an arbitrary management style, and (5) the worry of losing their state. The aspects of arrogance mentioned shall develop to the higher arrogance, masking the potential negative effects that can ruin a career or an organization (Horwath, 2011). This phenomenon is best described as an 'iceberg', which looks unthreatening but could be cause a great deal of destruction when it collides with something. (Horwath, 2011). Arrogance is the arrogant attitude of an individual who believes that he is likely to commit fraud due to his level of high self-pride in management that makes the higher and greater the arrogance is. This characteristic will lead people to believe that they will not be detected as fraudsters and the existing sanctions will not affect them (Aprilia, 2017; Pamungkas. 2018).

H7: Arrogance positively effects on fraud in financial report.

### **Good Corporate Governance and Fraud**

GCG defined as a set of laws, regulations and rules that must be adhered to optimize the performance of company resources in order to create value added for stakeholders (Arief, 2020). The effective implementation of GCG is one of the key factors to help increase economic efficiency, helping to create favorable and responsible relationships between business agencies to improve business efficiency. This is why GCG is considered to minimize risk about financial reporting fraud (Kurniawan, 2019; Rohmatin 2021; Gusti, 2020).

H8: GCG moderates fraud in financial report.

**METHODOLOGY**

The study population are coming from 106 financial sector companies which are listed on the IDX in 2021. Secondary data is by obtaining company’s annual report. Out of a total of 106 companies, there are 14 companies that do not publish annual reports and do not fill out complete data, so the total number of companies sampled in this study is 92. The Table 1 below is present operationalization variables:

**Table 1: Operationalization of Variables**

<b>Variables</b>	<b>Indicators</b>	<b>Scales</b>
	F-Score = Accrual Quality + Financial Performance Sources: (Skousen and Twedt, 2009; Rengganis, 2019)	
Fraudulent Financial Reporting (Y)	Dummy variable:  1: for companies that are identified as committing fraud with an F-score value > 1. 0: for companies with an F-score value < 1.	Ratio
Financial Stability (X1)	ACHANGE = $\frac{\text{Total Asset } t - \text{Total Asset } t-1}{\text{Total Asset } t-1}$	Ratio
External Pressure (X2)	Leverage Ratio (LEV) = $\frac{\text{Liabilities}}{\text{Total Assets}}$	Ratio
Financial Target (X3)	ROA= $\frac{\text{Net Income}}{\text{Total Assets}}$	Ratio
Opportunities (X4)	BDOUT = $\frac{\text{Total Independent Commissioners}}{\text{Total Commissioners}}$ Sources: (Wahyuni and Budiwitjaksono, 2017)	Ratio
Rationalization (X5)	Dummy variable: Code 1 is used if the company changes its KAP in 2021 and code 0 is used if the company does not change its KAP in 2021.	Nominal
Capability/Competence (X6)	Dummy variable: Code 1 is used if the company changes its board of directors in 2021 and code 0 is used in case of the company does not change the director’s board in 2021.	Nominal
Arrogance (X7)	Total CEO images in published annual reports Husmawati et al. (2017), Aprilia (2017), and Septriani and Handayani (2018)	Ratio
GCG (Z)	GCG assessment results	Nominal

The multiple linear regression analysis methods used as the research methods with the following equation:

$$F = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_1 * Z + \dots + \beta_{14} X_7 * Z + \epsilon$$

F = Fraudulent Financial Report; X1 = Financial Stability; X2 = External Pressure; X3= Financial Target; X4 = Opportunities; X5 = Rationalization, X6= Competence; X7= Arrogance, Z = GCG,  $\beta_i$  = Coefficients

## FINDINGS AND DISCUSSIONS

### Descriptive Data of Research Results

Table 2: Descriptive Statistic

	N	Minimum	Maximum	Mean	Std Deviation
X1-Finstab	92	-0.91000	7.120000	0.27817826	0.947387309
X2-LEV	92	0.00000	87.91000	1.51597826	9.110991593
X3-ROA	92	-421.64	68.60	-3.2646	45.08673
X4-BDOUT	92	0.00	1.00	0.5184	0.14473
X5-Rationalization	92	0.00	1.00	0.1630	0.37143
X6-Competency	92	0.00	1.00	0.4783	0.50226
X7-Arrogance	92	0.00	106.00	17.3587	19.72480
Y-Zscore	92	-4.97	21.20	0.4632	2.41092
Z-GCG	92	1.00	3.00	1.7174	0.54118
Valid N(liswise)	92				

Sources: Processed data, 2023

### Classical Assumption Test

This test is carried out before carrying out regression analysis. The results are as follows:

- i. The use of Kolmogorov-Smirnov as a normality test indicates that the data is normally distributed with Asymp values. (2-tailed) is worth 0.200, greater than 0.05.
- ii. Research data shows there is no multicollinearity. This is indicated by the all variables tolerance value being bigger than 0.10 and the Variance Inflation Factor (VIF) value are less than 10,
- iii. The data is spread above or below the number 0 on the Y axis and does not in the form of particular pattern. This indicates that all of data in this study does not have heteroscedasticity.

### Multiple Linear Regression

The equation is as follow:

$$Y = 0.564 + 0.025 X1 - 0.185 X2 + 0.00000058 X3 + 0.500 X4 + 0.043 X5 - 0.133 X6 - 0.281X7 + \epsilon.$$

From this equation, the financial stability, ROA, opportunities and rationalization as a variables have a positive relationship with the occurrence of fraudulent financial reports. The greater value of the variable, the greater the incidence of fraudulent financial reports and vice versa. For external variables, pressure, competence, and arrogance have a negative relationship, meaning that an increase in the value of these variables will reducing the value of fraudulent financial reports significantly. The coefficient of each variable shown in the equation.

From the coefficient of determination test conducted, the adjusted R-square value is 0.325 (32.56%) which means that the possibility that the independent variables of this research affects the dependent variable is 32.56%, while the remaining 67.44% is interpreted by another variables.

**Hypothesis Test**

**Table 3: F Test Results**

ANOVA					
Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	4.468	7	.683	7.181	.000
Residual	7.378	83	.089		
Total	11.846	90			

a. Dependent Variable: Y-ZScore

b. Predittor: Constant, X1-Finstab, X2-LEV, X3-ROA, X4-BDOOUT, X5-Rational, X6-Compet, X7-Arrogance  
 Sources: Result Software Processed data, 2023

From the F-test conducted, the significance value is 0.000, less than 0.05. Therefore, we allowed to conclude that, the model used in the study is appropriate.

**Table 4: t Test Result**

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.564	0.150		3.773	0.000
	X1_FINSTAB	0.025	0.006	0.390	4.067	0.000
	X2_LEV	-0.185	0.057	-0.334	-3.239	0.002
	X3_ROA	5.888E-7	0.000	0.030	0.310	0.757
	X4_BDOOUT	0.500	0.277	0.167	1.809	0.074
	X5_RATIONAL	0.043	0.091	0.043	0.473	0.637
	X6_COMPET	-0.133	0.065	-0.184	-2.037	0.045
	X7_ARROGANCE	-0.281	0.100	-0.277	-2.822	0.006

a. Dependent Variable: Y\_ZSCORE

Sources: Result Software Processed data, 2023

According to Table 4, it shows that the significance values of the financial stability, external pressure, competence, and arrogance variables are all less than 0.05, so we concluded that:

1. Financial stability has a positive significant effect on fraud in financial report.
2. External pressure has a negative significant effect on fraud in financial report.
3. Competence has a negative significant effect on fraud in financial report.
4. Arrogance has a negative significant effect on fraud in financial report.

The significance value for the variables of ROA, Opportunities and Rationalization is more than 0.05, so it is concluded that all of these variables have a positive insignificant effect on the fraud in financial report.

**Pressure and Fraud**

The motive for an individual to commit fraud can come from pressures. According to Ruankaew (2016), there are several reasons or motives that motivate an individual to commit fraudulent behavior. The pressures that cause an individual to engage this unethical attitude

include financial stability, external pressures, personal financial needs, and financial targets (Skousen & Twedt, 2009).

The outcomes show the stability on financial has a significantly positive impact upon fraud on financial reporting. Financial stability depicts the agency's financial condition in a good state and could see from state of assets (Skousen & Twedt, 2009). If a company's financial stability is in trouble and/or situation is threatened by changes in conditions of economic, industry, and so on, it will motivate managers to commit fraudulent reports. The pressures that managers face is often related to good assets management to generate great profits and/or returns for investors (Tiffani & Marfuah, 2015). It indicates that gain in an agency's assets is a tool for managers to engage fraud. The outcomes of this research reinforce the findings of Skousen and Tweet in 2009 which suggest that the change in all assets (ACHANGE) have positive correlation to fraudulent financial report. The findings indicate that, larger changes in all assets, the greater the indication of fraudulent reporting. This is consistent with the findings of Devi (2021), Ananda (2019) and Apriliana (2017).

Meanwhile, the pressure that comes from external variable has a significant negative impact on fraudulent reporting. The pressure is excessive tension from management to fulfill the expectations of stakeholders (Tiffani & Marfuah, 2015) as well to encourage management to seek external sources of financing. The presence of external financing (debt) encourages management to implement interactive accounting and management control systems (MACS). In order to reduce debt pressure and lower information asymmetry with lenders, managers will increase the use of interactive MACS (Osma et al., 2018). The use of MACS will minimize the opportunity of managers to engage this unethical attitude, so the relationship between external pressure and fraud is negative (Donning, et.al., 2019). This conclusion is supported by the data in the study, which shows that all sampled companies are in debt.

On other hand, the variable of financial target has insignificant on influencing fraudulent reporting. This is because some expectations for the agency's performance have been achieved. This condition is supported by the research data that seventy-eight (78%) of the sampled companies achieved positive ROA in 2021. According to Wahyuni & Budiwitjaksono (2017), the stock price is closely has correlation with the agency's financial condition. If the agency has great profits, investors will assume that the stock price is also great. However, if it value is low, investors will completely reject it. Thus, management is not attached in engaging fraudulent reporting by falsifies earnings. The outcome of this study is coherent with the outcome of previous researches conducted by Skousen & Tweth (2009), Sihombing (2014), Diary (2014), and Pamungkas (2018), which state that financial targets measured by Return on Assets influence insignificant im on accounting fraud.

### **Opportunities and Fraud**

According to the research results, the opportunity variable shows that the opportunities represented by BDOUT have a positive as well as insignificant impact on fraudulent reporting. The reason for this insignificant effect is not that independent commissioner affects financial reporting fraud, but rather that the quality of the audit committee itself affects fraud on financial statement (Ananda, 2020). OJK (2014) clarifies that Commissioners Board is an organ of an issuer or public agency responsible for carrying out general and/or special supervision which supports the regulations as well as advising the BOD. The research data shows that there is only one company without an independent BOD, PT Pool Advista. Ninety-nine percent (99%) of the sample companies have an independent commissioner's board with the number according to current regulation greater than 30%, which means that

their existence reduces the possibility of fraudulent reporting. In case the board of commissioners does its job well, the risk of fraud is low. This study result confirms the outcomes of a previous study by Ananda et al. (2020), Pamungkas et al. (2018), Sihombing & Rahardjo (2014), and Skousen & Twedt (2009).

### **Rationalization and Fraud**

According to the research results, the rationalization variable influence insignificant on fraudulent financial report. This shows that the greater or lower levels of rationalization not affect the indication of fraud trends. This result reinforces previous research by Skousen & Twedt in 2009, Sihombing & Rahardjo (2014), Rohmatin in 2021, and Pamungkas et al. in 2018 which explained that changing external auditors not impact the likelihood of fraudulent financial reporting. Changing external auditors can happen because the contract with the Public Accountant has ended or it can happen because the agency is not fulfilled with the previous auditors' performances and wants to reduce the audit fee but with better performance results. The research data supports the results of this study as only sixteen percent (16%) of the sample companies changed their external auditors in 2021. However, the outcome of this study does not support the study of Devi (2021) who suggests that this variable is a factor that used to detect fraudulent reporting.

### **Capability and Fraud**

This research shows that capability or competence has significantly negative impact on the detecting fraudulent on financial report. Therefore, it means that change in the company's director board have less risk of fraud in the agency's financial statements. In case of no change in board of directors in agency would motivate them to cooperate in committing financial statement fraud using their own capacity. This result negative impact because the new director's boards needs time to adapting suboptimal operating condition (Tessa & Hsrto, 2016). The outcome from this research reinforces Pamungkas et al. (2018) research. However, this contradicts with the findings of Devi (2021) and Rohmatin (2014).

### **Arrogance and Fraud**

According to the output of this study, it indicates that arrogance has a significantly negative in influencing fraudulent financial reporting. Arrogance defined as an arrogant attitude of an individual causing fraud and creates the belief that he will not be caught and that the existing sanctions will not affect him. In this study, arrogance is expressed through the quantity of photos from CEO shown in the annual report published by management shows a negative relationship, meaning that the more CEO photos were, the higher the index of fraud in the report the weaker the financial statement and vice versa. The outcome of this analysis is inconsistency with the hypothesis; that arrogance will have a positive impact in the detection of fraudulent financial report. The negative impact of the quantity of photos from CEO shown in the yearly report means that the CEO use them to build his or her prestige (Al-Shammari, Rasheed, & Al-Shammari, 2019). CEO does not want to lower their prestige by falsifying economic report. Therefore, more photos of the CEO, the less indications of fraudulent financial report. The data in this study shows that 28 or 96.6% of the companies sample data with an above-average number of CEO photos do not indicate fraudulent in financial report, also 50 which 79.4% of the companies sample data that have a certain quantity of CEO photos below the average also does not fraudulent in financial reporting. It could means that the mass of companies in financial sector with above-average CEO photo requirements. The outcome from this study is in line with Triyanto (2020), whom found that arrogance has a significant

negative effect in detecting fraud. However, it does not support findings from Devi in 2021, Ananda et al.(2021), and Pamungkas et al. in 2018 in which they found that there is significant positive impact on arrogance in the detection of fraudulent financial reporting.

**Moderation Test Results**

**Table 5: Moderation Test Results**

Model		Coefficients <sup>a</sup>			t	Sig.
		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta		
1	(Constant)	.320	.092		3.483	.001
	X1Z	.019	.005	.375	4.109	.000
	X2Z	-.094	.030	-.344	-3.192	.002
	X3Z	6.111E-7	.000	.063	.626	.533
	X4Z	.207	.143	.149	1.450	.151
	X5Z	-.020	.012	-.162	-1.710	.091
	X6Z	-.061	.036	-.160	-1.664	.100
	X7Z	-.055	.042	-.135	-1.300	.197

a. Dependent Variable: Y\_ZSCORE

Sources: Result Software Processed data, 2023

As seen in Table 5, it may concluded that GCG moderates financial stability and external pressure variables on fraudulent financial statements.

**Good Governance and Fraud**

The outcome of research hypotheses tested as presented in Table 4 show that financial stability and external pressure, moderated by GCG, have an important impact upon detection of reporting financial fraud. At the same time, GCG is not the moderating variable of financial targets, opportunities, rationalization, competence as well as arrogance in fraudulent financial report. Overall, this allow to conclude that GCG is not a moderating variable in detecting financial reporting fraud. This happens because companies realized that GCG must be implemented not only to reduce fraud, but also to enhancing company performance so the value may be increased.

**CONCLUSION**

In conclusion, financial stability, external pressure, competence, as well as arrogance are having a significant effect upon fraudulent financial reporting. Financial targets, opportunities, as well as rationalization variables are having a non-significant effect on fraudulent financial reporting. GCG not moderates the correlation between financial targets, opportunities and rationalization, competence, arrogance, and financial statement fraud. GCG moderates the relationship between stability on stability in financial, external pressure, and fraud on financial reporting variables. The outcome of this research is to give recommendations for agencies to reduce fraud and improve GCG practices so that companies can create value and improve their performance.

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