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THE EFFECT OF FRAUD TRIANGLE ON FINANCIAL STATEMENT FRAUD IN BANKING COMPANIES Nikita Stevansyah1, Rousilita Suhendah1* 1Faculty of Economics and Business, Universitas Tarumanagara, Jakarta - Indonesia *Email: rousilitas@fe.untar.ac.id Submitted: 25-05-2023, Revised: 12-07-2023, Accepted: 15-09-2023 ABSTRACT The purpose of this study is to find empirical evidence on the effects of financial stability, external pressure, financial objective, ineffective supervision, and rationality on financial statement fraud. The population of this study are banking companies listed on the Indonesia Stock Exchange (IDX) in 2017-2019. This study uses data from 75 banking companies selected using the purposive sampling method. The data in this study were analyzed using EViews 12 Student Version software and the data analysis method used was multiple linear regression. The results of this study show that financial stability and rationality have a negative and significant impact on financial reporting fraud. On the other hand, the external pressures, the financial objective, and ineffective supervision do not have a significant impact on the fraud of the financial statements. Keywords: Financial stability, external pressure, financial objectives, ineffective supervision, rationality, fraud 1. INTRODUCTION Financial statements show a companys financial position and operations over a period of time. Decisions taken by users of financial statements, such as investors, governments, financial institutions , employees, and the public require a basis in the form of financial statements. Therefore, financial statements must be prepared with accurate and relevant information by applicable accounting rules. Users of financial statements make essential decisions that are very influential and impact a company's survival so that the company tries to show its best condition. However, many companies are dishonest and use irrelevant information to make their financial statements look good. This fraud misleads users of financial statements and creates a bias in decision-making. According to the Association of Certified Fraud Examiners (2022), there are three fraud schemes: corruption, asset misappropriation, and financial statement fraud. Based on research conducted by the Association of Certified Fraud Examiners (2022), the fraud that has the highest frequency is asset misappropiation (86%), following by corruption (50%), and financial statement fraud (9%). However, when viewed from the value of the loss, the most detrimental fraud schemes are financial statement fraud ($593,000), corruption ($150,000), and asset misappropiation ($100,000). Financial statement fraud can be done in various ways and is difficult to detect. However, financial statement fraud is caused by pressure, opportunity, and rationalization, known as the fraud triangle concept (Skousen et al, 2009). According to Statement of Auditing Standards No. 99, four pressure factors that lead to fraud are financial stability, external pressure, personal financial need, and financial target. Statement of Auditing Standards No. 99 (AICPA, 2002) also classifies opportunity factors that may occur in three categories: nature of the industry, inadequate supervision, and organizational structure. At the same time rationality is the third part of the fraud triangle. Financial statement fraud can occur in various sectors, including the banking sector. The banking sector plays a role in supporting national stability in economic growth and improving the living standards of the people through the financial sector and is one of the sectors that plays an important role in national economic development. Banking sector also has business activities that are high risk and vulnerable to fraud that is difficult to detect even though it uses high technology. This study replicates the research of Kayoi and Fuad (2019) which examines factors affecting financial statement fraud reviewed from the fraud triangle. This study has several differences with previous research, namely (1) This study uses banking sector companies listed on the Indonesia Stock Exchange while the sector used in Kayoi and Fuad's (2019) research is the manufacturing sector listed on the Indonesia Stock Exchange, (2) This research uses the 2017-2019 while the research period of Kayoi and Fuad's (2019) is from 2015-2017, and (3) This study does not use personal financial need, nature of industry, and foreign ownership variables. Based on the outline above, it is necessary to reanalyze the effect of fraud tringle on financial statement fraud. The objectives of the research are to obtain empirical evidence of the effects of financial stability, ineffective financial supervision, external pressure, and the accounting objective regarding financial fraud. 2. RESEARCH METHOD Agency Theory Jensen and Meckling (1976) proposed agency theory which contains the relationship between the owner or shareholder (principal) and company management (agent). In this theory, management is a party contracted by shareholders to achieve company goals by optimizing returns or profits from shareholder investments. Therefore, management has the authority to make decisions within the company. Shareholders will also provide compensation or rewards for good performance by company management. Shareholders and company management have different interests that can cause agency problems related to the quality of the company's financial statements. Shareholders want returns, while company management also wants high compensation. In addition, asymmetry information can occur because company management has more information regarding the company than shareholders. As a result, company management can take earnings management actions because management has the opportunity and only wants to show the company's good side. Signalling Theory According to Connelly et al. (2011), there are three main elements in signalling theory: the signal giver, the signal given, and the signal receiver. The signal giver is the company's management who certainly has complete information about the company. The signal can be positive or negative information about the company. The signal giver will undoubtedly be more open to providing positive information than negative information about the company. Meanwhile, signal recipients are external parties such as shareholders or investors with limited access to company information. The signal recipient wants information, especially related to the company's finances and the signal giver will receive a reward for the decision taken from the signal recipient. Signal recipients or external parties of the company expect the signal giver or company management to provide clear and complete information, both positive and negative, to minimize asymmetry information. Asymmetric Information Theory According to Bergh et al. (2019), asymmetry information is when one party has better and more information than the other party. Asymmetry information is always related to two parties. For example, the agent and the principal, whereas the company management knows more information related to the company, especially in financial conditions, and the information owned by company management is different from the information owned by shareholders/investors. The difference in information is called asymmetry information. Asymmetry information can create opportunities for company management to manage earnings by manipulating financial statements. The company management must report all company activities to shareholders/investors as outlined in financial statements. But there is a difference in the information of managers and shareholders can cause company information to be reported inappropriately and result in shareholders being harmed by these actions. Fraud Triangle Theory According to the fraud triangle, there are three causes of fraud: pressure, opportunity, and rationalization. Pressure can occur in an organization as well as in one's individual life. This pressure can come from a lifestyle, economic demands, and financial needs. According to Statement of Auditing Standards No. 99, the pressure factor consists of external and internal pressure. Opportunity is a situation where there is an opportunity that allows fraud to occur. According to research by Dechow et al. (1995), opportunities allow perpetrators to carry out their actions due to weak internal controls, system weaknesses, indiscipline, and weak audit mechanisms. Rationalization is the justification made by the perpetrator for the fraud he committed. According to Skousen et al. (2009), rationalization is the most challenging part of to measure of the fraud triangle theory. Financial Statement Fraud The American Institute of Certified Public Accountants (2002) defines falsification of financial statements whether intentional or negligent that can result in a material misstatement in a company's financial statements that is misleading and detrimental to users of the company's financial statements. Financial statement fraud is an intentional omission or misstatement in certain accounts and amounts in the disclosure of financial statements to manipulate users of financial statements. Financial statements that have been manipulated can decrease the quality of financial statements and harm various parties. Financial Stability Financial stability is one of the conditions included in the pressure factors that can lead to fraudulent financial statements. According to Houben et al. (2004), financial stability is the situation when the financial system is able to: 1. Invest activities and investments efficiently over time. (2) assessing and managing financial risk; (3) Weak against minor offences. According to Norbarani (2012), the company's financial condition can be reflected through the condition of the company's assets. The company does not tamper with the financial statements of the company because the financial performance reflects the current situation when the financial stability of the company is in good condition. However, when the company faces a situation that causes instability in its financial condition, its management as an asset manager gets pressure that encourages them to manipulate financial statements. For this reason, corporate managers use financial statements to hide their companys poor financial standing. H1: Financial stability has a negative effect on financial satement fraud. External Pressure External pressure arises when company management wants to meet the expectations of third parties, such as shareholders or investors. Company management often needs outside funding to grow the company. To fulfil the obligation to return these funds, the company must operate correctly. However, the company's development does not always run smoothly or successfully. Hence, difficulties in paying loans to external parties arise. According to Statement of Auditing Standards No. 99, When the companys management is under excessive pressure from outside, there will be a risk that company management will commit fraud against financial fraud. Skousen et al. (2009) state that the pressure experienced by company management is the need to obtain additional sources of external financing or debt to remain competitive. This need is measured using the leverage ratio, which is the ratio that compares total debt to total assets. H2: External pressure has a positive effect on financial satement fraud. Financial Target Company management is required to perform their best in achieving predetermined financial targets. Financial targets can be determined through accounts in the financial statements, one of which is the return on asset ratio. The return on asset ratio is generally used as a measurement of management performance which affects the number of bonuses, salary increases, and others because it can see how efficient the use of assets in a company is. The company's management believes that the better the financial statements, the greater the bonus earned. In this case, financial targets can have a harmful impact which causes company management to do everything possible to make financial reports look good, so they get a significant bonus. According to Statement of Auditing Standards No. 99, a financial target is a risk due to excessive pressure on company management to achieve company’s financial target. The comparison between net income and total company assets, or what is commonly called return on assets, is often used as a measuring tool to see a company's performance. The higher the ROA target of a company, the higher the risk of fraudulent financial statements committed by company management. Achieving financial targets will pressure company management because it is related to the return or bonus they will get. For this reason, company management can manipulate financial statements to achieve predetermined goals H3: Financial target has a positive effect on financial satement fraud. Ineffective Monitoring Ineffective monitoring is one of the conditions included in the opportunity factor. If internal monitoring is not running correctly, chances of fraud in the company. When a company has poor monitoring, fraud will be more significant. According to Dechow et al. (1995), companies that commit fraud usually only have a few members of the board of commissioners and directors from outside the company. In terms of monitoring, the independent board of commissioners has an essential role so that it cannot have conflicts of interest and must be objective in the company. Ineffective monitoring can create a gap for management to commit fraud to maximize profits for themselves. Therefore, parties are needed to minimize the risk of fraud, one of which is an independent commissioner. Independent commissioners are believed to minimize the risk of financial statement fraud in the organization. More independent board members are believed to reduce the risk of fraud in financial statements. H4: Ineffective monitoring has a positive effect on financial satement fraud. Rationalization A rationalization is an act of justification carried out by fraudsters. Discretion is the hardest part of the fraud triangle to measure. Accrual method is used by various companies in presenting financial statements. According to Skousen et al. (2009), the ratio of total accruals to total assets can be used to show rationalization related to the use of accrual principles of a company. The accrual method is considered more appropriate for measuring the company's financial condition because not only cash transactions but also credit transactions are recorded. However, if the customer is unable to pay the credit, the revenue previously recorded by the company's management will become a bad debt expense. The higher the bad debts, the worse it will be for the company's financial condition. The cash flow of operating activities in banking companies often has a negative value due to lending. However, when operating activity cash flow always has a negative value, it can be a sign that the bank has a less liquid financial condition and increasing company management to commit financial statement fraud. H5: Rationalization has a positive effect on financial satement fraud. The following describes this research framework based on the model and explanation provided above: Financial Stability (ACHANGE) Pre ssure H1 (-) External Pressure (LEV) H2 (+) Financial Target (ROA) H3 (+) Financial Opportunity Ineffective Monitoring (BDOUT) H4 (+) Statement Fraud Rationalization (TATA) Rationaliz ation H5 (+) Figure 1 Research Model 3. RESULT AND DISCUSSION The research design used in this study is a descriptive research design with a quantitative approach. The technique used in this research is purposive sampling. This study tested five independent variables against one dependen variable. The five independent variables tested are financial stability as measured by asset change ratio (ACHANGE), external pressure as measured by leverage ratio (LEV), financial target as measured by return on asset ratio (ROA), ineffective monitoring as measured by comparison of total independent commissioners to total commissioners (BDOUT), and rationalization as measured by total accrual to total asset ratio (TATA). This study uses the dependent variable financial statement fraud as measured by discretionary accrual (DA). This study uses a population of all banking companies that are consistently listed on the Indonesia Stock Exchange during 2017-2019. The criteria for selecting the sample used are: (1) Banking companies listed on the Indonesia Stock Exchange during the 2017-2019, (2) Banking companies that publish audited annual financial statements on the company website or Indonesian Stock Exchange website during 2017-2019, (3) Banking companies that did not experience delisting during the 2017-2019, (4) Banking companies that have complete data for the measurement of independent variables and dependent variable in the study during the 2017-2019, and (5) Banking companies that do not have outliers. Based on these criteria, a sample of 25 companies was obtained from 2017 to 2019, 75 data were obtained. The collected data is then processed using EViews 12. The operationalization of each research variable as presented in Table 1 as follow: Table 1 Operationalization Variables Variables Scale Measurement Financial Statement Fraud Ratio Financial Stability Ratio Ref Kayoi, S. A. & Fuad. (2019). Kayoi, S. A. & Fuad. (2019). External Pressure Ratio Kayoi, S. A. & Fuad. (2019). Financial Target Ratio Kayoi, S. A. & Fuad. (2019). Ineffective Monitoring Ratio Skousen, et al (2009) Rationalization Ratio Skousen, et al (2009) Source: Data Processing Result Financial statement fraud (DA) has the highest value of 0.0255, while the lowest value is - 0 .0381. The average in the financial statement fraud variable is -0.0129 with a standard deviation of 0.0124. Financial stability (ACHANGE) has the highest value of 0.2237, while the lowest value is -0.1160. The average on the financial stability variable is 0.0693 with a standard deviation of 0.0706. External pressure (LEV) has the highest value of 0.9365, while the lowest value is 0.7217. The average external pressure variable is 0.8303 with a standard deviation of 0.0467. Financial target (ROA) has the highest value of 0.0313, while the lowest value is -0.0023. The average financial target variable is 0.0123 with a standard deviation of 0.0084. Ineffective monitoring (BDOUT) has the highest value of 0.8000, while the lowest value is 0.4000. The average in the ineffective monitoring variable is 0.5620 with a standard deviation of 0.0894. Rationalization (TATA) has the highest value of 0.1536, while the lowest value is -0.1303. The average rationalization variable is 0.0106 with a standard deviation of 0.0501. The four types of classical hypothesis tests used in this study are normality, multicollinearity, autocorrelation, and heteroscedasticity. The result of the Jarque-Bera normality test is 0.350114, which is greater than 0.05, so it can be concluded that the date used in the study has a normal distribution. The results of the multicollinearity test show that each correlation value between variables is lower than 0.85 so it can be concluded that the regression model is free from multicollinearity. The autocorrelation test with the Durbin-Watson test is worth 2.036191 indicating that the regression model in the study is free from autocorrelation. The results of the heteroscedasticity test show that the probability value of Obs*R-squared is 0.1604, which is greater than 0.05, so it can be concluded that there are no symptoms of heteroscedasticity in the residual data. This research uses EViews 12 so that it requires panel data selection. panel data testing consists of Chow test, Hausman test, and Lagrange Multiplier test. The results of the Chow test show that the probability value of cross-section Chi-square is 0.0005, which is lower than 0.05, so that the model chosen is the fixed effect model. The results of the Hausman test show that the probability value of cross-section random is 0.1468, or greater than 0.05, so that the model chosen is the random effect model. The results of Lagrange Multiplier test show that the probability value of Breusch-Pagan is 0.0851, which is greater than 0.05, so the model chosen is the common effect model. This study’s correlation value (R) is 0.8357, closer to one than zero, meaning there is a reasonably strong correlation between the independent variables and dependent variable. The value of Adjusted R-squared is 0.8238, so it can be concluded that 82.38% of the financial statement fraud variation can be explained by financial stability, external pressure, financial target, ineffective monitoring, and rationalization, while the remaining 17.62% is influenced by other factors not included in this research model. Table 2 The Results of Multiple Regression Analysis Variable Coefficient Std. Error t-Statistics Prob. C 0.0049 0.0141 0.3444 ACHANGE -0.1780 0.0104 -17.0979 LEV -0.0043 0.0145 -0.2961 ROA -0.0628 0.0827 -0.7595 BDOUT 0.0005 0.0075 0.0684 TATA -0.1262 0.0143 -8.8037 Source: Data Processing Result Based on the data from Table 2, the regression equation is as follows: 0.7316 0.0000 0.7681 0.4501 0.9457 0.0000 DA = 0.0049 – 0.1780 ACHANGE – 0.0043 LEV – 0.0628 ROA + 0.0005 BDOUT – 0.1262 TATA The regression coefficient of financial stability (ACHANGE) on financial statement fraud is - 0.1780 with a prob. value of 0.0000. The coefficient of -0.1780 with a negative sign indicated that the independent variable financial stability has the opposite relationship with the dependent variable financial statement fraud. If the independent varible financial stability’s value decreases, then the value of the dependent variable financial statement fraud will increase, and vice versa. The prob. value of 0.0000 is lower than 0.05 and explains that financial stability has a significant effect on financial statement fraud. This test is the basis for the conclusion that H1 is accepted. H1 states that financial stability has a negative and significant effect on financial statement fraud. The results show that the independent variable of financial stability has a negative and significant effect on the dependent variable of financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019. The results of this study are consistent with the research of Yesiariani and Rahayu (2017), Septriani and Handayani (2018), but not consistent with the research of Kayoi and Fuad (2019). The regression coefficient of external pressure (LEV) on financial statement fraud is -0.0043 with a prob. value of 0.7681. The coefficient of -0.0043 with a negative sign indicated that the independent variable external pressure has the opposite relationship with the dependent variable financial statement fraud. If the independent varible external pressure's value decreases, then the value of the dependent variable financial statement fraud will increase, and vice versa. The prob. value of 0.7681 is greater than 0.05 and explains external pressure also has no significant impact on accounting fraud. This test is the basis for the conclusion that H2 is rejected. H2 states that external pressure has a positive and significant effect on financial statement fraud. The results show that the independent of external pressure has no significant negative effect on the dependent variable of financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019. The results of this study are consistent with the research of Wahyuni and Budiwitjaksono (2017), but not consistent with the research of Kayoi and Fuad (2019). The regression coefficient of financial target (ROA) on financial statement fraud is -0.0628 with a prob. value of 0.4501. The coefficient of -0.0628 with a negative sign indicated that the independent variable financial target has the opposite relationship with the dependent variable financial statement fraud. If the independent variable financial target's value decreases, then the value of the dependent variable financial statement fraud will increase, and vice versa. The prob. value of 0.4501 is greater than 0.05 and explains that financial target has no significant effect on financial statement fraud. This test is the basis for the conclusion that H3 is rejected. H3 states that financial target has a positive and significant effect on financial statement fraud. The results show that the independent variable of financial target has no significant negative effect on the dependent variable of financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019. The results of this study are consistent with the research of Novitasari and Chariri (2018), but inconsistent with the research of Kayoi and Fuad (2019). The regression coefficient of ineffective monitoring (BDOUT) on financial statement fraud is 0.0005 with a prob. value of 0.9457. The coefficient of 0.0005 with a positive sign indicated that the independent variable ineffective monitoring has a direct relationship with the dependent variable financial statement fraud. If the independent variable ineffective monitoring value decreases, then the value of the dependent variable financial statement fraud will decrease, and vice versa. The prob. value of 0.9457 is greater than 0.05 and explains that ineffective monitoring has no significant effect on financial statement fraud. This test is the basis for the conclusion that H4 is rejected. H4 states that ineffective monitoring has a positive and significant effect on financial statement fraud. The results show that the independent variable of ineffective monitoring has no significant positive effect on the dependent variable of financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019. The results of this study are consisten with the research of Sihombing and Rahardjo (2014), Kayoi and Fuad (2019), but not consistent with the research of Agusputri and Sofie (2019). The regression coefficient of rationalization (TATA) on financial statement fraud is -0.1262 with a prob. value of 0.0000. The coefficient of -0.1262 with a negative sign indicated that the independent variable rationalization has the opposite relationship with the dependent variable financial statement fraud . If the value of the independent variable rationalization decrease, then the value of the dependent variable financial statement fraud will increase, and vice versa. The prob. value of 0.0000 is lower than 0.05 and explains that rationalization has a significant effect on financial statement fraud. This test is the basis for the conclusion that H5 is not accepted. H5 states that rationalization has a positive and significant effect on financial statement fraud. The results show that the independent variable of rationalization has a negative and significant effect on the dependent variable of financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019. The results of this study are consistent with the research of Agusputri and Sofie (2019), but not consistent with the research of Septriani and Handayani (2018). 4. CONCLUSIONS AND RECOMMENDATIONS This study aims to find empirical evidence on the external pressures, weak control, financial targets and the effect of financial stability on fraud among banking companies listed on the Indonesian Stock Exchange from 2017 to 2019. This study uses secondary data from financial reports published by companies accessed through the Indonesia Stock Exchange website and the company's official website. This study uses purposive sampling data collection techniques with predetermined criteria. Twenty-five companies met all the criteria set and provided 75 data that could be tested. Data processing was carried out with the Microsoft Excel 2022 application while the testing was carried out with the EViews 12. Financial stability is known to have a negative and significant effect on financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019, so H1 which states that financial stability has a negative and significant effect on financial statement fraud is accepted. Company assets indirectly can reflect the condition of the company's financial stability. When the company faces a situation that causes instability in its financial condition, its management as asset managers get the pressure that encourages them to manipulate financial statements. However, when the company's financial stability is in good condition, the company does not manipulate the company's financial statements because the financial performance has shown the actual situation. External pressure is known to have no significant negative effect on financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019, so H2 which states that external pressure has a positive and significant effect on financial statement fraud is rejected. Management is not entirely under external pressure to fulfill its obligations. Company management generally tries to improve company performance to generate profits to fulfil its obligations. Financial target is known to have no significant negative effect on financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019, so H3 which states that financial target has a positive and significant effect on financial statement fraud is rejected. Company management considers that the ROA target that the company must achieve is a reasonable value and can be achieved easily so as not to cause fraudulent financial statements. ROA is a short-term goal of the company that is less able to generate profits. In contrast, company management must establish a long-term program that is useful for the company's sustainability and generates overall profits. Ineffective

monitoring is known to have no significant positive effect on financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019, so H4 which states that ineffective monitoring has a positive and significant effect on financial statement fraud is rejected. Generally, if there is an independent board of commissioners in the company, it will show that the monitoring of a company will be more independent and objective. However, it is different if the independent board of commissioners cannot carry out objective monitoring. In addition, several external parties to banking companies indirectly oversee the company's operations, such as Bank Indonesia and the Otoritas Jasa Keuangan. The lack of effect of this variable can also be caused by the company's appointment of an independent board of commissioners only to fulfill the regulations that have been set. This causes the role of independent commissioners in overseeing company performance not to run optimally. Rationalization is known to have a negative and significant effect on financial statement fraud in banking companies listed on the Indonesia Stock Exchange in 2017-2019, so H5 which states that rationalization has a positive and significant effect on financial statement fraud is rejected. The management of profits in financial statements is explained by total assets net income and operating cash flow. Financial statement fraud committed by increasing company profits can occur because the company is optimistic about reporting its performance. The limitations of this study are: (1) Only uses banking sector companies listed on the Indonesian stock exchange, (2) Limited research period, which is only three years, (3) Only uses five independent variables, and (4) Uses the modified jones model proxy to measure financial statement fraud. Based on the research and limitations, suggestions for further research include: (1) Using samples of other industrial sectors such as transportation, BUMN, and manufacturing other than the banking sector to find out whether there is a failed triangle effect on accounting fraud, (2) Using a longer research period, for example five years, in order to get a more comprehensive picture to make estimates about fraudulent financial statements that result in the future, (3) Using other independent variables such as managerial ownership, firm size, and transparency to see its effect on financial statement fraud, and (4) Using other proxies to measure the components of the fraud triangle and financial statement fraud with fraud diamond or fraud pentagon analysis in detecting financial statement fraud.
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