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THE EFFECT OF THE FRAUD TRIANGLE IN DETECTING FRAUDULENT FINANCIAL REPORTING IN INDONESIAN BANKING SECTOR COMPANIES Rico Ricardo1, Rousilita Suhendah1* 1Faculty of Economics and Business, Universitas Tarumanagara, Jakarta - Indonesia *Email: rousilitas@fe.untar.ac.id Submitted: 17-04-2023, Revised: 01-06-2023, Accepted: 06-07-2023 ABSTRACT This research aims at finding out the influence of factors in fraud triangle theory towards fraudulent financial reporting in banking companies in Indonesia. Research sample was chosen by using some criteria that consist of banking sector companies registered and listed in Indonesian Stock Exchange & Bank Based on Business Activity II, III, IV group from 2017 to 2019. These criteria chose 37 banks as sample processed by e-Views 12 and Microsoft Excel application. Fraud triangle theory divides three fraud factors: pressure, opportunity, and rationalization. Pressure factor includes external pressure and financial target. Opportunity factor is reflected by monitoring variable, and rationalization factor consists of auditor change and accrual method variable. Research results show that independent variables gave significant impact to dependent variable, except for monitoring and auditor change variable. Keywords: External Pressure, Financial Target, Monitoring, Auditor Change, TATA, Fraudulent Financial Reporting 1. INTRODUCTION We know that every company in Indonesia must arrange a financial statement in line with the financial accounting standard set by IAI. PSAK 1 Number 7 aims to prevent the user of financial statements from getting false information, leading to disadvantages. However, each company's management also wants to have their financial condition in good condition, which is reflected in the financial statement. Because of that, some companies do not doubt falsifying the information stated in their financial report, which has become one of the fraudulent actions in Indonesia. ACFE noted that a significant increase in fraud happened in Indonesia each year. Besides that, it also causes immense loss that disadvantages many people. From that case, the urgency in decreasing fraudulent financial reporting becomes bigger, especially for the banking sector companies that pinpoint the financial sector in Indonesia. UU No. 10 Tahun 1998 defines a bank as a financial institution that collects society's funds in the form of saving and distributes them using credit facilities to increase one's standard of living. It means banks are in charge of managing funds collected from society. If a bank does fraudulent financial reporting, society can not know the bank's financial position in the order. Indirectly, the community will also not know whether banks manage their funds well. The climax is when the bank can not hide its false action anymore, leading to bankruptcy. Many people will not get their money back after that incident happens. After searching the factor of fraud, Cressey (1953) [1] found three fraud factors: pressure, opportunity, and rationalization. The increase in financial targets can cause a pressure factor. Yet, those increases are not necessarily parallel with increased company operations. It can lead to the action of fraud done by managers to uplift their performance. External pressure like loans can also be another fraud factor. Lehman Brothers are one example of companies that does fraud because of debt. Lehman Brothers used the window dressing technique to hide their bad financial position by doing fraudulent financial reporting. Opportunity factors can also cause fraudulent action. An opportunity arises when there is not enough control in a company. A board of commissaries usually does control. However, undetailed and dependent commissaries increase the risk of fraud. The third factor is rationalization, where fraud perpetrator will rationalize his fraudulent action. That kind of perpetrator will cause a big problem because he will not stop to do fraud until their action is found. Because of that, the loss when their fraudulent act is seen has been tremendously significant. Seeing those problems, the researcher finally decided to analyze the factor of fraud triangle factor towards fraudulent financial reporting in Indonesian banking sector companies. Literature Study Agency Theory Jensen and Meckling put forward this theory in 1976. Jensen and Meckling (1976) [2] said there is a separation between principal and agent. A principal is the company's owner, or we usually know it as a shareholder, whereas an agent is a party that manages a company. The problem in this theory arises because the principal and agent have their own goals where the principal, as an investor, wants to get a significant return from their investment, and the agent's goal is to have some incentives from developing the company to a point. In this theory, an agent has more advantages than a principal because agents' role as part of the management team leads them to have more information about the company's economic and financial condition. While investors only get to know the information when exposed by companies' management. An agent can use this advantage to deceive the principal. The agent tends to forge information regarding companies' conditions to not make investors know companies' problems. Management will try to create data like companies' annual financial statements as if they are in good condition, even better situations to get more salaries and incentives. Asymmetric Information Theory Asymmetric information theory is a condition where one party has more information than another. This theory frequently occurs in the business world that companies' management will likely have more information than shareholders. This information inequality regarding companies can affect investors' decision-making quality which will become irrelevant. There are two types of asymmetric information: adverse selection and moral hazard (Scott, 2009) [3]. Adverse selection means that a party or more in a business transaction get to know more information than another party because companies' manager has more knowledge in companies' prospect in the past, present, and future. A moral hazard is a type of information where a party in a business transaction or more can observe the action of fulfilling a transaction, but the others can't. These types of asymmetric information are due to the separation between control and ownership. They also cause investors and external parties not to know much about the company's data. As a result, companies' management can carry out fraudulent financial reporting easily so that they can reach their goals which are different from investors' goals, as stated by Jensen and Meckling. Signalling Theory In 1973, Spencer introduced the signaling theory to the public for the first time. Spence (1973) [4] said that the flow of information is similar to the flow of signal sent to be used by its receiver. The implementation in the business world is that managers will strive to give information such as financial statements to investors to consider in making decisions. Then, Ross developed this theory in 1977. Ross (1977) [5] stated that signaling theory is formed due to asymmetric information theory, where companies' management is more knowledgeable than shareholders. Houston et al. (2016) [6] declared that signal is companies' management's action in providing information about how management looks at companies' prospects. Those are carried out by giving financial information that consists of financial notes in the past, present, and future. Investment decision-making will be easier to do by shareholders with financial data. Based on this theory, companies' management is expected to offer companies' information more openly to minimize risk caused by agency and asymmetric information theories. Fraud Triangle Theory Three fraud factors in fraud triangle are introduced by Cressey in 1953. Cressey (1953) [1] stated that there are three factors causing fraud: pressure, opportunity, and rationalization. Pressure The pressure factor is related to someone's motivation to carry out fraud. Cendrowski and Martini (2007) [7] said that three motivations causing someone to commit fraud are lifestyle needs, illegal activities, and daily life pressure. Cendrowski and Martini emphasize personal reasons for committing fraud. While SAS 99 provides the pressure factor of why an organization commits fraud. According to SAS 99, the pressure factor consists of external and internal pressure. External pressure is done by external parties such as creditors. Creditors tend to ensure that a company will fulfill its liabilities without considering the development of its industry. When a company struggles to pay its debt, creditors' actions will become a burden and pressure on the company. To fulfill its obligations, a company will fake its financial statement to get funds from investors. Later, that fund will be used to finish their liabilities to creditors. However, in banking sector companies, most of their assets include liabilities from customer in which the customer's trust on bank increases as the number of liabilities increases. Even, it will increase their revenue and profit as well. H1: External pressure has a significant negative impact on fraudulent financial reporting. While dealing with external pressure, a company will encounter internal pressure, which shareholders cause. As stated before, investors have the return of their shares as their goal. To get a significant return, a company has to be profitable. Because of that, shareholders as companies' owners set some financial standards to be fulfilled by the manager. However, a manager also has his own goal: getting a big salary and incentives. Because of that, a manager must have strived to reach that standard while we can't predict how an industry will develop in the future. If the industry grows, it will be a good chance for the manager to fulfill shareholders' goals. Nevertheless, it will become pressure if something terrible happens to economic conditions. To ensure they reach the financial target, managers will try every way, even if it means fraud. They can do it by forging financial data or even stating false information, causing misinterpretation. Because of that, these two pressure factors can be used to detect fraudulent financial reporting. H2: Financial target has a significant positive impact on fraudulent financial reporting. Opportunity The opportunity factor is related to the possibility of someone committing fraud. Besides that, it also corresponds to control being held in a company. If a company has weak control, then fraud action will be easier. Because of that, a company needs to monitor its control of whether it is strong. SAS 99 also states the same thing that the monitoring variable can be one of the factors in detecting fraudulent financial reporting. A board of general and independent commissioners carries out the act of monitoring a company. In this factor, SAS 99 tend to focus on the percentage of independent commissioners because they don't have any conflict of interest with the company they will work with, as stated in the standard. H3: Monitoring has a significant negative influence on fraudulent financial reporting. Rationalization Rationalization is someone's character and action to justify their mistake. In this case, people with this character will feel that what they do is proper and reasonable. They will take the blame on others. For instance, they might say that other people might do the same thing as they do. The other example is they might say that their company gives a meager salary. As long as their act of fraud is not discovered, they will think that their action is all right and should be continued until someone proves their wrong action. Because of that, SAS 99 states that variables that describe the rationalization factor are auditor changes and the accrual method. An auditor is someone who inspects to find a mistake, fraud, or something that deviates from existing standards and regulations. To do that, an auditor must know the condition and collect information about the company he investigates. Hence, an auditor must first adapt to the workflow of the company. They need some time to adjust themselves to the company's environment. In conclusion, it must be hard for a new auditor to get significant findings unless they are lucky enough. The perpetrator will use this moment to commit fraud. The case shows that auditor change can affect the probability of fraudulent financial reporting. H4: Change in auditor has a significant positive impact on fraudulent financial reporting The accrual method proxied by the total accrual to total asset (TATA) ratio can be one thing to determine whether fraudulent financial reporting happens in a company. The law of accrual method said that revenue could be recognized when we have provided service to customers and not when they pay the fee. Because of that, managers can use it to manipulate the company's financial statement by recognizing revenue contrary to the standard. H5: Accrual method has a significant positive impact on fraudulent financial reporting. Fraudulent Financial Reporting ACFE defined fraudulent financial reporting as a scheme where an employee intentionally misstates and eliminates material information from the company's financial statement. When doing financial fraud, the perpetrator must indeed have varied intentions. Like earning management, earnings management's purpose is maximizing the profit so that investors have a good view of the company, minimizing profit to reduce income tax, or carrying out income smoothing to make a stable financial movement. However, the difference between earnings management and fraudulent financial reporting is that earnings management still refers to the prevailing standards. In contrast, financial statement fraud is done by faking data and violating the standard. Yet, these methods will not still reflect the financial condition of the financial statement user, misleading them in making decisions. Therefore, The Treadway Commission (COSO) recommends four ways to mitigate financial statement fraud: establishing an integrated environment in the company, identifying and understanding factors causing fraudulent financial reporting, assessing financial statement fraud risk in the company, as well as designing and implementing an excellent internal control. Figure 1. The Research Model 2. RESEARCH METHOD This research methodology is quantitative descriptive research. A quantitative descriptive study is a descriptive research carried out using data in the form of numbers. In this research, the quantitative data is secondary data collected from companies' financial statements in 2017 – 2019. The data applied in this research is categorized as panel data, combining the time series and cross-section aspects. The time series aspect is from 2017 until 2019, and the cross-section aspect comes from the number of companies. In this research, the writer uses samples chosen by applying the purposive sampling method. The purposive sampling method is a way to determine research samples by using some criteria. The criteria for the sample of this study are 1) Banking sector companies listed on the Indonesian Stock Exchange; 2) Banking sector companies that are not delisted from the Indonesian Stock Exchange (Bursa Efek in 2017 until 2019; 3) Banking sector companies which are listed in Bank Based on Business Activity 2, 3, and 4 categories (have more than 1 trillion rupiahs of core capital). These are some operational variables that is used in this research: Table 1. Operational Variables and Measurement No. Variable 1 External Pressure 2 Financial Target Measurement $Tlral$ $Liaailiriar\ LAT = Tlral\ Arrar\ Nar\ Ilalla\ RNA = Tlral\ Arrar$ Scale Ratio Ratio 3

Monitoring *Tha Nrlaar la Ilaalalaalr Alllirrillarr AANTT* = Ratio *Tlral Alara la Alllirrillarr* 4 Auditor Change AUDCHANGE, dummy variable, Changing Auditor Changing Auditor = 0 = 1; Not 5 Accrual Method *Laaa Aarrih* − *AAN TATA* = *Tlral Arrar* 6 Fraudulent Financial *TAaat* Reporting *AAaat* = (*TAt*−1) − *NAAt* Interval Ratio Ratio 3. RESULT AND DISCUSSION This research has fulfilled three classic assumption tests such as normality test, multicollinearity test, and heteroscedasticity test. Normality test conducted using Jacque Bera has a probability value of 0.755 that is bigger than 0.05 which means the research data has fulfilled normality test. According to multicollinearity test, the centered VIF value of independent variables is lower than 10 which means that the research data has been free from multicollinearity problem. Heteroscedasticity test is conducted by using White test has the probability value of 0.1365 that is higher than 0.05. It means that the research data has also been free from heteroscedasticity problem. The research has also taken Chow test and Hausman test. Based on Chow test, the cross section value is 0.0312 which is lower than 0.05. It means that the chosen model in Chow test is fixed effect model (FEM). Then, the panel data test is continued to Hausman test. According to Hausman test, the cross section value is 0.001 that is lower than 0.05 meaning that the chosen model in Hausman test is fixed effect model (FEM). Hence, the model that is chosen for this research is fixed effect model (FEM). After carrying out panel data test, the descriptive statistic test will be conducted. Here is the result of the descriptive statistic result: Table 2. Descriptive Statistics N Mean Max Min Std. Deviation External Pressure 104 0.8099 0.9365 0.0524 0.1205 Financial Target 104 0.0076 0.0313 -0.1123 0.0174 Monitoring 104 0.5817 1.0000 0.4000 0.1125 Auditor Change 104 0.2019 1.0000 0.0000 0.4034 Accrual Method 104 0.0062 0.1633 -0.1422 0.0591 Fraudulent Financial Reporting 104 0.0268 0.2073 -0.1440 0.0655 Table 3. Regression Analysis Variable Coefficient C 0.041650 LEV -0.064881 Prob. 0.0043 0.0000 ROA 0.414645 0.0000 BDOUT 0.045580 0.2001 AUDCHANGE 0.007317 0.0690 TATA 1.060148 0.0000 R-Squared 0.944058 Adjusted R-Squared 0.941204 F-Statistic 330.7642 Prob (F-Statistics) 0.000000 Durbin-Watson Stat 1.642903 Based on the data from Table 3, the regression equation is as follows: (Note: LEV: External Pressure, ROA: Financial Target, BDOUT: Monitoring, AUDCHANGE: Auditor Change, TATA: Accrual Method, DACC: Fraudulent Financial Reporting) The effect of external pressure on fraudulent financial reporting The test results show the coefficient value of -0.065 and the t-test significance value of 0.000. The coefficient value with a negative sign states that the independent variable external pressure has a relationship in the opposite direction to the dependent variable fraudulent financial reporting. If the value of the independent variable external pressure increases, then the value of fraudulent financial reporting variable will decrease. Conversely, if the value of the independent variable decreases, then the value of the dependent variable will increase. The significance value of 0.000 is lower than the 0.05 which means that external pressure variable gives significant negative impact on fraudulent financial reporting (H1 is accepted). A greater number of liabilities to external parties in baking sector companies means a significant trust from society. The increase in their liabilities means that they will get revenues from their service, such as administration fees, mutation printing, interbank transfer, and others. It will only improve their goodwill and help to reach their target faster. Therefore, it will remove the risk and probability of baking sector companies to do financial statement fraud. The research result is similar to the research done by Anjilni (2021) [8]. The effect of financial target on fraudulent financial reporting The test results show the coefficient value of 0.415 and the t-test significance value of 0.000. This means that financial target will give significant positive impact towards fraudulent financial reporting which means that H2 is accepted on this research. Although the external pressure variable will not encourage fraud, we still need to pay attention to the financial target variable because it positively affects the fraudulent financial reporting variable. The financial target is present because of the shareholders' goals of gaining a significant rate of return. At the same time, the rate of return is affected by the amount of the company's profit. So, the manager has to be financially targeted with the amount of profit to enrich the shareholders. At first, the manager had no problem reaching the financial target. Nevertheless, the target keeps increasing each year. In contrast, the industries' condition will not indeed be developed as the increasing target. It will necessarily burden the manager because they must increase the company's profit in recessive conditions. Otherwise, they will not get a good incentive, their own goal. Consequently, the manager will try every way to reach those targets, even if it means to do fraud. In banking sector companies, the manager can record financial transactions contrary to the standard. For instance, they will capitalize operating expense as an asset or recognize service revenue before performing the service to their customers. Consequently, we should pay more attention to financial targets in banking sector companies because it can increase the probability of fraudulent financial reporting. This has been similar to the research result done by Cicillia & Serigus (2015) [9]. The effect of monitoring on fraudulent financial reporting The test results show the coefficient value of 0.046 and the t-test significance value of 0.2001. This means that monitoring variable does not have a significant influence on fraudulent financial reporting, so the hypothesis H3 is rejected. When a company has more portion of independent commissioners, it means that monitoring action will be more effective that it can reduce fraud. However, the research result says it differently. The reason is that the management can still intervene with independent commissioners' work. The management will not cooperate in giving information to the commissioners and will also try to bribe them. Thus, the commissioners' performance will be clouded by those actions and become ineffective, considering that independent commissioners also has personal interest and goals. Prasmaulida (2016) [10] has also stated the same regarding this hypothesis. The effect of auditor change on fraudulent financial reporting The test results show the coefficient value of 0.007 and the t-test significance value of 0.069 which means auditor change variable has no significant impact on fraudulent financial reporting. Hence, the H4 hypothesis is rejected. Besides monitoring, routine examinations can be done to avoid fraudulent action. In this case, Indonesian Bank and Financial Service Authority (OJK) can do inspections on banking sector companies. Yet, the examination held by these two organizations is not routine and has a long period range. However, a fraudulent action can be done at every moment. Therefore, employing an external auditor can be one way to avoid fraud. External auditors will work professionally because they do not have any conflict of interest with the company. However, external auditors need time to adjust to the company's environment and situation to collect data and information. So, the auditor tends to find significant findings and fraud in the second year they examine. The management will use this situation to hide their fraudulent action. One of the ways is changing their auditor every year. Every new auditor will surely need time to adapt, which will complicate them in the examination. When they have adapted to the situation and succeeded in collecting information, their examination period has come to an end. Finally, they will make the report based on their findings which are not detailed. The fraudulent action is most likely not to be found. Nevertheless, auditor change does not significantly influence fraudulent financial reporting. A new auditor can also find fraud easily. It depends on their luck, skill, and experience in the auditing field. New auditors also tend to have a different perspective from past auditors in carrying out an audit. Therefore, there is still a significant chance of finding the fraud. In addition, we cannot ensure that the company changing auditor is committing fraud because there is also a regulation from the Indonesian financial ministry that a company has to change its auditors every three years. This is stated on Article 3 Paragraph

3 in The Rule of Indonesian Finance Minister Number 17/PMK.01/2008. The effect of accrual method on fraudulent financial reporting The last variable, the accrual method, proxied by the total accrual to total asset (TATA) ratio, affects the fraudulent financial reporting variable positively and significantly which means the hypothesis H5 is accepted. This was also stated by Iqbal & Murtanto (2016) [11]. An example of the accrual method implementation is recognizing revenue from customers after providing them services, although the company has not received any payment yet. This is stated in PSAK 72 regarding revenues. However, this term is often misused by the organization's personnel. They will try to use it to increase the company's revenue and profit. An example in banking sector companies is the recognition of electronic data capture (EDC) machine installation revenue that is recorded when the customers do not even use the machine. This contradicts PSAK 72 regulation because the customers have not received any benefit from the company. Nevertheless, it will increase the total accrual to total asset ratio because the company will not receive any payment until the customer uses the service. This situation will make a more significant difference between net profit and cash from operating activities, increasing the TATA ratio. Therefore, the total accrual to total asset ratio can be one factor in determining the level of fraudulent financial reporting. Besides the revenue recognition, it can also be caused by issuing credit with a loose condition. Giving credit without following the standard will provide a higher risk to the bank's liquidity because the chance of unpaid debt will be more significant. When banking companies' credit has come to the non-performing loan (NPL) stage, the banking company has to reserve funds for uncollectible receivables. Consequently, it will reduce the company's profit while shareholders want it to increase. Otherwise, it will impact managers' incentives and bonuses. To avoid that, the manager will still use the unpaid receivables as revenue, so they do not have to reserve the loss from uncollectible receivables. However, they will receive any cash from those revenues because they are not collectible. Ultimately, it will only give a greater difference between the revenue and cash from operating activities. Therefore, the total accrual to total revenue ratio will also be higher. 4. CONCLUSION AND SUGGESTION Conclusion The external pressure has a significant negative impact on fraudulent financial reporting. This can happen because the bigger liabilities a banking sector company has means that there is a bigger trust from the customer. Indirectly, it will increase the company’s revenue from administration fee, provision, and other fees. The study shows that there is a significant positive influence from financial target towards fraudulent financial statement because managers have their own goals to increase their bonus and incentive which is valued by their ability to reach the financial target. If the financial target increases each year, it will be harder for managers which will lead them to do fraud. The monitoring variable and the auditor change variable does not significantly impact fraudulent financial reporting because the company’s management can intervene independent commissioners’ work that makes their performance become ineffective. While, new auditor can have their own judgement so that there will be still probabilities for them to find fraudulent financial reporting. While accrual method has a significant influence on fraudulent financial reporting. It can be caused by false recognition of revenue in the financial statement to make company’s profit become higher. Besides that, it can be done by the relaxation of credit terms. They will be likely to face non performing loan that the company need to reserve receivables’ balance. In order not to decrease their profit, they will not disclose it which turns into fraudulent financial reporting. Suggestion The suggestion for the next research is to find a different proxies for independent variables that do not influence the dependent variable which is fraudulent financial reporting. For monitoring variable, the next researcher can use IND proxy which is the size of audit committee. While, auditor change can be changed into auditor opinion in financial statement. As well, the dependent variable, fraudulent financial

reporting proxy can be alternated using beneish model.

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