

## Ownership, Audit Committee, Trigger of Fraud, and Manipulation of Financial Statements

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#### ABSTRACT

Research on financial statements manipulation (MFS) in the construction industry is interesting because this industry is one of the industries that practice fraud the most, reaching 16%. In addition, this research is important because MFS continues to occur with increasing amounts, and has a high risk of loss. This research objectives is to prove the impact of ownership, audit committees, and triggers of fraud on (MFS). The results show that foreign institutional ownership, audit committees, opportunity, and arrogance have a significant negative effect on MFS. The higher the level of ownership of foreign institutions, audit committees, opportunity, and arrogance, the more manipulation of will be prevented. Individual ownership and pressure have a significant positive impact on MFS. The higher the pressure and level of individual shareholders, the greater the potential for MFS. There are several proxies for detecting MFS. This research uses the discretionary accrual Jones modified earnings management proxy. Other research can use other proxies such as MFS through real activities. Further research will be more interesting if it compares the effect of ownership, audit committees, and MFS in the construction industry of ASEAN countries.

**Keywords:** Audit Committees, Manipulation of Financial Statements, Ownership, Triggers of Fraud

## **INTRODUCTION**

The financial report manipulation scandals by Enron, Xerox, and WorldCom in the early 21st century explained that the phenomenon of financial report manipulation can occur anytime, anywhere, and by anyone, even by large, well-known and reputable companies. Enron manipulated its financial statements so that profits appeared bigger and debts could be hidden. The General Electric Technology Company (GE) is suspected of not being transparent and manipulating profits of US\$ 1 billion in 2016/2017 (finance.detik.com, 2020). In 2016 PT Cakra Mineral Tbk harmed shareholders by reporting an overstatement of the value of assets and the value of paid-up capital (beritalima.com, 2016). PT Garuda Indonesia in 2018 also inflated its net profit to US\$ 809 thousand (Nurhayat, 2021). In 2017, PT Tiga Pilar Sejahtera Food Tbk was also suspected of manipulating financial reports by recording excessively high receivables of IDR 1.4 trillion. Apart from that, it is also suspected that there was a flow of funds received by management worth IDR 1.78 trillion from the company (finance.detik.com, 2021). PT Envy Technologies in 2021, is also suspected of committing fraud by manipulating revenue and profits since the company went public on 9 July 2019 (cnbcindonesia.com, 2021).

This study aims to prove of the impact of ownership models, committees of audit, and fraud triggers on the potential for manipulation of financial statements in the construction and infrastructure industries listed on the IDX. Research on this industry is interesting because the construction industry is one of the industries that commits the most fraudulent financial statements, reaching 16%. This research is important because: 1) financial report manipulation continues to occur with an increasing amount of manipulation, 2) the risk of loss due to manipulation of financial statements is getting bigger, and more parties are being harmed.

## **LITERATURE REVIEW**

Theory of agency written by Jensen and Meckling in 1976 is used as the basis for this research, which assumes that humans are selfish and always avoid risks. Agency problems occur because of differences in interests between managers and owners (Nugraha, 2023). Managers will try to present the best financial reports, in order to obtain various benefits from the principal, and avoid the risk of dismissal or poor performance appraisal. Managers often cheat in presenting financial information to cover up poor performance, as in the various cases mentioned above. fraudulent acts are malicious intentions, to deceive and harm other parties, which aim to gain personal benefits by abusing their duties and authority (Suhartono, 2020).

### **Ownership Model and Manipulation of Financial Statements (MFS)**

The ownership model is an attempt to limit conflicts between management and shareholders. The institutional ownership model allows for a degree of oversight and control over management actions thereby limiting the potential for manipulation of financial statements (MFS). Research related to ownership and fraudulent financial reporting found inconsistent results, and the research distinguished ownership into 2, namely managerial and institutional ownership. In this research ownership is divided into four, in order to provide an explanation from a different perspective of ownership. The research hypothesis is:

H1a: Ownership of domestic has a negative influence on MFS

H1b: Ownership of foreign has a negative influence on MFS

H1c: Ownership of government has a negative influence on MFS

H1d: Ownership of Individual has a negative influence on MFS

### **Audit Committee and MFS**

The task of the committee of audit is to help oversee the board of directors and ensure the application of best practice corporate governance. The audit committee is committed to increasing supervision of management (Kamarudin, Ismail, & Alwi, 2014). The main task of the committee of audit is to ensure that financial reports are relevant and reliable. This important role of the audit committee spurred management to limit for manipulation of financial statements. Thus, the hypothesis two (2) is:

H2: The committee of audit has a negative influence on MFS

### **Triggers of Fraud and MFS**

Someone committing fraud is driven by pressure, opportunity, justification, competence, and arrogance. These five impulses are commonly referred to as the pentagon fraud impulse. Pressure can be both financial and non-financial. Management is required to achieve certain financial targets, thus motivating them to carry out MFS. Opportunity (leeway) is a condition that allows a crime to occur which is difficult to detect. Manipulation occurs due to poor internal supervision and control, as well as light penalties for violations. Rationalizations justification for an action that deviates from the truth. Fraudulent acts by manipulating large numbers and complex techniques would not be possible if the perpetrators did not have the capability and competence to deceive internal controls (Septriani & Handayani, 2018). An arrogant main director will always make financial performance look good, so this will encourage him to manipulate. The research hypothesis are:

H3a: Stress has a positive influence on MFS

H3b: Leeway has a negative influence on MFS

H3c: Rationalization has a positive influence on MFS

H3d: Competence has a positive influence on MFS

H3e: Arrogance has a positive influence on MFS

## **RESEARCH METHOD**

Infrastructure companies on the Stock Exchange of Indonesia are the population of our research, with an observation period of 2017-2021. Samples were selected using certain criteria (purposive sampling method). The data is processed from annual reports and financial reports of infrastructure companies. Data sources come from the IDX website, infrastructure company websites, and the Indonesia Capital Market Directory (ICMD).

### **Variable Operational Definitions**

MFS is variable of dependent, while variables of independent consist of ownership structure, audit committee, and fraud triggers. The control variable is leverage. Financial statement fraud is proxied by the discretionary accrual Jones modified earnings management model as follows:

$$TAcr_{it} = NInc_{it} - OCF_{it}$$

Note:

TAcr = Total Accruals

NInc = Net income

OCF = cash flow from operating activities

It = an entity i, in year t

$$NDAcr_{it} = \beta_1 (1/TA_{it} - 1) + \beta_2 ((Recv_{it}/A_{it} - 1) - (Recv_{it-1}/A_{it} - 1)) + \beta_3 (LTA_{it}/A_{it} - 1)$$

Note:

NDAcr = Non discretionary accruals.  
 $TA_{it-1}$  = Change of assets total an entity i, at the end of year t-1.  
Recv = Receivables.  
 $Recv_{it-1}$  = Receivables of an entity i, in year t-1.  
LTA = long term assets

$$DAcr_{it} = (TAcr_{it} / TA_{it} - 1) - NDAcr_{it}$$

Note:

Dacr = Accruals of Discretionary.  
TAcr = Accruals total of company.  
 $TA_{it-1}$  = Change of total assets.  
NDAcr = Nondiscretionary accruals.

### Independent Variable

The variables of independent in our study are ownership structure, audit committee, and triggers of fraud. Proxy ownership structure consists of ownership by domestic institutions, ownership by foreign institutional, ownership by government and individual ownership. Ownership is measured by the total percentage of shares owned by each ownership model divided by the number of outstanding shares. The calculation of the independent audit committee is carried out by dividing the number of audit committee of independent by total committee of audit members.

### Triggers of Fraud

Pressure is proxied by financial targets. Managers who are highly targeted financially, will tend to cheat. ROA is a proxy for the financial target, which is obtained by dividing net income by total assets. Opportunity is proxied by effective monitoring, which is measured by the number of independent commissioners divided by the number of commissioners. Rationalization is measured by change in auditors, using a dummy variable. A value of 1 will be given if there is a change of auditors, while a value of zero will be given if the auditor does not change. Competence is proxied by the dummy variable changing directors. If there is a change in directors during the observation period, it will be given a value of 1 and if not, it will be given a value of 0. CEO's picture is used as a measure of arrogance. The number of images or photos of CEOs featured in published annual reports as a measure of arrogance. This study measures the number of CEO photos by giving a score of 1 to companies with more than 5 CEO photos, and a score of 0 for companies with less than 5 CEO photos.

### Control Variables

This study uses leverage as a control variable. Companies that often violate debt agreements will tend to manipulate so that the company's profits increase. Leverage will be calculated by dividing total debt to total assets.

### Analysis Techniques and Mathematical Models

Our research uses multiple linear regression for hypothesis test, with the SPSS program. Processing of the SPSS program and interpretation of data originates from Ghazali (2013). Mathematical equation as follows:

$$DAcr_{it} \text{ deposit} = \alpha + \beta_1 DOM\_OWN + \beta_2 FOR\_OWN + \beta_3 GOV\_OWN + \beta_4 IDV\_OWN + \beta_5 AUD\_COM + \beta_6 ROA + \beta_7 COM\_IND + \beta_8 \Delta aud\_ch + \beta_9 \Delta Dir\_CH + \beta_{10} Ceo\_Pic + \beta_{11} Lev + \epsilon$$

Information:

|                 |                                                |
|-----------------|------------------------------------------------|
| $\alpha$        | = constant                                     |
| $\beta$         | = independent variable regression coefficient  |
| DAcrit          | = Directory Accrual of company i in year t     |
| DOM_OWN         | = Domestic institutional ownership             |
| FOR_OWN         | = Ownership of foreign private institutions    |
| GOV_OWN         | = Government ownership.                        |
| IDV_OWN         | = Sole proprietorship.                         |
| AUD_COM         | = Independent Audit Committee.                 |
| ROA             | = Return on Assets.                            |
| COM_IND         | = Ratio of independent commissioners' members. |
| $\Delta$ Aud_Ch | = Change of auditors.                          |
| $\Delta$ Dir_Ch | = Change of leaders / directors.               |
| CEO_Pic         | = Number of photos CEO in annual report        |
| LEV             | = Leverage.                                    |
| $\epsilon$      | = Errors.                                      |

## RESULTS

Study data sourced from statements of financial and annual reports of Infrastructure Sector Companies listed on IDX Indonesia in 2017-2021. This study has population 58 companies, for 5 years. The final sample after deducting outliers and incomplete data, there are 211 samples.

### Descriptive Statistics

Analysis of descriptive statistical in table 1.

**Table 1.** Statistics of Descriptive

|                    | N   | Minimum | Maximum | Mean     | Stdr. Dev. |
|--------------------|-----|---------|---------|----------|------------|
| Dacrit             | 211 | -.3453  | .2818   | -.047130 | .0977940   |
| DOM_OWN            | 211 | .0000   | .9981   | .549852  | .3290402   |
| FOR_OWN            | 211 | .0000   | .9637   | .207550  | .2732302   |
| GOV_OWN            | 211 | .0000   | .6604   | .040277  | .1523544   |
| IDV_OWN            | 211 | .0000   | .8414   | .130090  | .1620481   |
| AUD_COM            | 211 | .3333   | 1.0000  | .916102  | .1984470   |
| ROA                | 211 | -.6312  | .1694   | .009436  | .1009420   |
| COM_IND            | 211 | .1667   | .7500   | .398328  | .1143481   |
| $\Delta$ Aud_Ch    | 211 | 0       | 1       | .09      | .287       |
| $\Delta$ Dir_Ch    | 211 | 0       | 1       | .57      | .496       |
| CEO_Pic            | 211 | 0       | 1       | .43      | .496       |
| LEV                | 211 | .0027   | 2.9148  | .567420  | .3702239   |
| Valid N (listwise) | 211 |         |         |          |            |

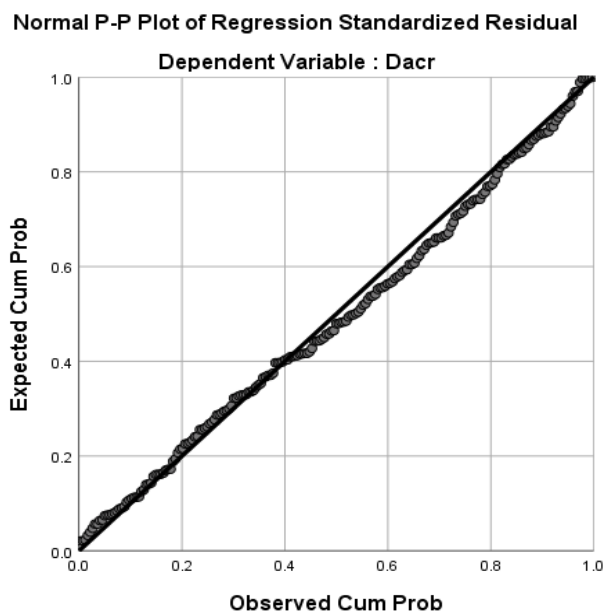
Table 1 show values of the maximum, minimum, standard deviation, and average of all the variables studied. Table 1 shows that the average value of domestic institutional ownership, audit committees, independent commissioners, changes of directors, and leverage is higher than the standard deviation. This means that these variables are homogeneous. Meanwhile, the variable discretionary accruals, foreign ownership, individuals, ROA, auditor turnover, and CEO photos are smaller than the standard deviation. This means that these variables are heterogeneous.

### Classic Assumption Test

The normality test was carried out using a p-plot graph (see figure 1) and non-parametric statistical test, the Kolmogorov-Smirnov. The Kolmogorov-Smirnov test shows Asymp. Sig. (2-tailed) of 0.2, which show the data is normally distributed. The figure 1, P chart, the plot also shows the dots spread around the line and in the direction of the diagonal line, so the residual value is normal.

Multicollinearity test is used to test the correlation between independent variables in a regression model. The independent variables are correlated with each other, causing these variables to be not orthogonal, so the regression model is bad. Orthogonal variables are variables whose correlation values between independent variables are equal to zero (Ghozali, 2013).

**Figure 1.** P-Plot Graph



The Multicollinearity test is carried out by testing Collinearity Statistics and looking at the results of the tolerance and VIF values. the test of multicollinearity (see table 2), it shows that all variables of independent have a value of tolerance  $> 0.1$ , and VIF value  $> 10$ . This means that there are no symptoms of multicollinearity in the variables independent in the regression model.

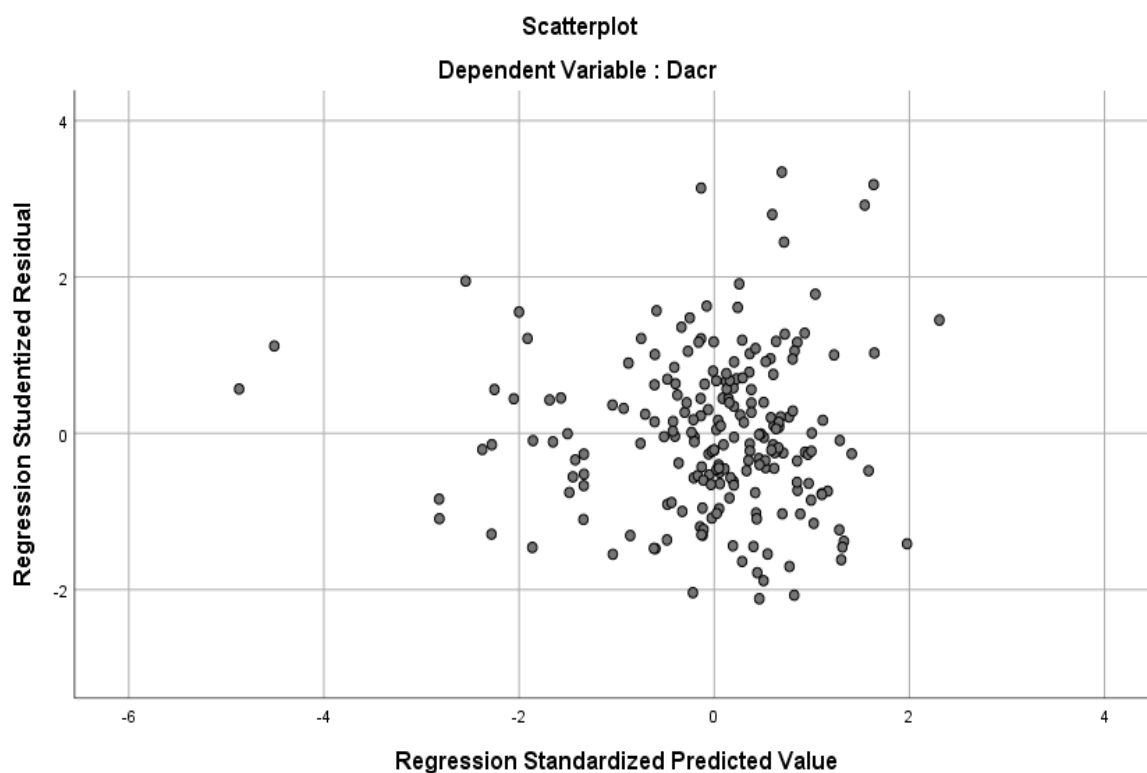
**Table 2.** Test of Multicollinearity

| Coefficients <sup>a</sup> |                         |       |
|---------------------------|-------------------------|-------|
| Model                     | Collinearity Statistics |       |
|                           | Tolerance               | VIF   |
| DOM_OWN                   | .191                    | 5.233 |
| FOR_OWN                   | .229                    | 4.369 |
| GOV_OWN                   | .458                    | 2.185 |
| IDV_OWN                   | .443                    | 2.258 |
| AUD_COM                   | .661                    | 1.514 |
| ROA                       | .724                    | 1.381 |

|                             |      |       |
|-----------------------------|------|-------|
| COM_IND                     | .754 | 1.326 |
| ΔAud_Ch                     | .878 | 1.139 |
| ΔDIR_Ch                     | .875 | 1.143 |
| CEO_Pic                     | .757 | 1.320 |
| LEV                         | .737 | 1.357 |
| a. Dependent Variable: Dacr |      |       |

The heteroscedasticity test uses 2 tests, namely the graphical test with a scatter plot (see Figure 2) and the statistical test. Based on Figure 2, it can be seen that the dots spread above and below the number 0 on the Y axis, and there is no clear pattern of dot distribution. Therefore, there is no heteroscedasticity. The results of the two tests showed that there were no symptoms of heteroscedasticity in the variables studied.

**Figure 2.** Test of Heteroscedasticity



Durbin-Watson numbers and bivariate test are used to test autocorrelation (Table 3). The DW test results showed that the Durbin Watson (DW) value was 1.920. The highest correlation value is 0.479, or less than 95%. From these two tests shows that there is no autocorrelation in the model of regression.

**Table 3.** Bivariate-Test

| Correlations |         |         |         |         |         |         |     |         |         |         |         |     |
|--------------|---------|---------|---------|---------|---------|---------|-----|---------|---------|---------|---------|-----|
|              | DAcrit  | DOM_OWN | FOR_OWN | GOV_OWN | IDV_OWN | AUD_COM | ROA | COM_IND | ΔAud_ch | ΔDIR_Ch | CEO_Pic | LEV |
| Dait         | 1       |         |         |         |         |         |     |         |         |         |         |     |
| DOM_OWN      | .078    | 1       |         |         |         |         |     |         |         |         |         |     |
| FOR_OWN      | -.350** | -.659** | 1       |         |         |         |     |         |         |         |         |     |

|                             |         |         |         |        |         |        |         |        |       |        |      |   |
|-----------------------------|---------|---------|---------|--------|---------|--------|---------|--------|-------|--------|------|---|
| GOV_OWN                     | .037    | -.330** | -.029   | 1      |         |        |         |        |       |        |      |   |
| IDV_OWN                     | .205**  | -.305** | -.116   | -.104  | 1       |        |         |        |       |        |      |   |
| AUD_COM                     | -.269** | .070    | .237**  | -.067  | .090    | 1      |         |        |       |        |      |   |
| ROA                         | .479**  | -.130   | .088    | .104   | .019    | -.019  | 1       |        |       |        |      |   |
| COM_IND                     | -.228** | .201**  | -.178** | .140*  | -.181** | .024   | -.295** | 1      |       |        |      |   |
| ΔAud_Ch                     | .055    | -.086   | -.092   | .201** | .158*   | -.066  | -.042   | -.065  | 1     |        |      |   |
| ΔDir_Ch                     | -.056   | -.018   | -.028   | .156*  | -.099   | -.131  | -.146*  | .022   | .174* | 1      |      |   |
| CEO_Pic                     | .016    | .029    | -.209** | .307** | .090    | -.069  | -.026   | -.141* | .063  | .190** | 1    |   |
| LEV                         | -.180** | -.192** | .303**  | .069   | -.076   | .189** | -.330** | .043   | -.007 | -.020  | .043 | 1 |
| **. Sign. at the 0.01 level |         |         |         |        |         |        |         |        |       |        |      |   |
| *. Sign. at the 0.05 level  |         |         |         |        |         |        |         |        |       |        |      |   |

### The Results of Hypothesis Test

The results of regression in table 2 show that the adjusted R square is 0.465, which means that 46.5% of the MFS variables can be explained by the independent variables of this research. Meanwhile, 53.5% is another variable that was not examined in our research.

**Table 4.** The Results of Hypothesis test

| Dependent Variable: Discr. Acr   |            |                  |            |                |        |      |
|----------------------------------|------------|------------------|------------|----------------|--------|------|
| Model                            |            | Unstandz. Coeff. |            | Standz. Coeff. | T      | Sig. |
|                                  |            | B                | Std. Error | Beta           |        |      |
| 1                                | (Constant) | .090             | .036       |                | 2.472  | .014 |
|                                  | DOM_OWN    | -.001            | .034       | -.005          | -.041  | .967 |
|                                  | FOR_OWN    | -.158            | .038       | -.442          | -4.186 | .000 |
|                                  | GOV_OWN    | .010             | .048       | .015           | .204   | .839 |
|                                  | IDV_OWN    | .101             | .046       | .167           | 2.204  | .029 |
|                                  | AUD_COM    | -.102            | .031       | -.206          | -3.323 | .001 |
|                                  | ROA        | .513             | .057       | .530           | 8.934  | .000 |
|                                  | COM_IND    | -.123            | .050       | -.144          | -2.470 | .014 |
|                                  | ΔAud_Ch    | -.004            | .018       | -.012          | -.223  | .824 |
|                                  | ΔDir_Ch    | .006             | .011       | .030           | .547   | .585 |
|                                  | CEO_Pic    | -.026            | .011       | -.130          | -2.235 | .027 |
|                                  | LEV        | .050             | .016       | .190           | 3.235  | .001 |
| a. Adj. R Square 0,465 F: 17.584 |            |                  |            |                |        |      |
| b. SEE 0,0715 Sign: 0,000        |            |                  |            |                |        |      |

## DISCUSSION

### Ownership and MFS

Based on hypothesis test, the found of research show that domestic ownership and government ownership have no influence on MFS, so H1a and H1e are rejected. This means that domestic share ownership and government ownership do not affect managers' actions in carrying out MFS practices. This means that the people's representative council is not able to impact the behavior of SOEs managers so they do not cheat. There is a general issue that the Commissioners and managers of SOEs are chosen because they have political connections, not based solely on professionalism, so that commissioners and managers are more committed to certain rulers and political parties than to the interests of the people.

The results state that foreign ownership has a negative impact on MFS, so that the H1b hypothesis is accepted. foreign ownership can improve oversight, limit fraudulent

tendencies, thereby improving the quality of reported earnings. The bigger the ownership of foreign institutions, the lower the risk of MFS occurring. The findings of this research support the research findings of Sule and Monye-Emina (2022).

The results of research prove that individual ownership has a positive impact on MFS, so that the H1d hypothesis is rejected. This results means that the higher the level of individual ownership, the higher risk of the MFS. This result is in accordance with Wibowo & Surifah (2022). Individual owners lack mechanisms to control management, so they cannot effectively limit management from carrying out profit manipulation practices (Wibowo & Surifah, 2022).

#### **Audit Committee and MFS**

The results in table 4 show that the committee of audit has a negative impact on the MFS, so hypothesis 2 (H2) is accepted. The Audit Committee was formed to help carry out duty of the Board of Commissioners. The committee of audit helps oversee the Board of Directors and the Management Team and ensures that the company has implemented corporate governance best practices. The findings of this research support the findings of Prasetyo (2014) and Tamalia (2020). The finding of our research contradicts with the finding of Tiapandewi, Suryandari, and Susandya (2020).

#### **Triggers of Fraud and MFS**

The regression test shows that pressure has a positive influence on MFS, so that H3a is accepted. This means that when a manager is targeted with high profits, he will be inclined to fraud. The finding of our research is support with the findings of Faradiza (2019) and Rachmania, Slamet, and Iryani (2017) who found that high performance targets are the main driving force for fraudulent acts.

This research found that opportunity has a negative impact on MFS, so that the hypothesis 3b is supported. Opportunity is an opportunity to cheat without being detected or is unlikely to be detected. Strict supervision by an independent board of commissioners will reduce opportunities for fraud. Managers will be afraid to cheat. This finding is in accordance with Ghandur, Sari, and Anggraini (2019) which shows that an independent board of commissioners is able to reduce the risk of managers cheating on financial reports.

This research found that Rationalization had no effect on MFS, so hypothesis H3c was rejected. These results support the findings of Bayagub, Wafirotin, and Mustoffa (2018) and Sunardi and Amin (2018) which states that the change in auditors has no impact on fraud, because the change in auditors is only to comply with Government Regulations. The results show that competence has no effect on MFS, so the H3d hypothesis is rejected. This result means that the change of directors does not impact managers to do MFS. This is possible because there is good oversight from the independent board of director. Change of directors can also be due to resignation, death, or because the company wants performance improvement. The finding of our results are in line with the findings of Antawirya, Putri, Wirajaya, Suaryana, and Suprasto (2019) and Vivianita and Indudewi (2019).

The results show that arrogance has a significant negative effect on MFS, so the hypothesis H3e is supported. This means that the more CEO photos are displayed, the more pressure the risk of MFS occurs. CEO photos are proxies of arrogance. The more CEO photos are displayed, the CEO will try to present annual reports and financial reports by minimizing acts of fraud. These results are in accordance with Rukmana (2018).

### **Leverage and MFS**

The finding of our research show that leverage has a positive influence on MFS. This means, high leverage, will also have a high FSM risk. The results of research are in support the findings of Christiana (2020) and Melisa (2022).

### **CONCLUSION**

The findings of this study show that ownership of foreign, audit committees, opportunity, and arrogance have a negative significant influence on fraudulent financial statements proxies by earnings management. This means, the bigger level of ownership of foreign institutions, audit committees, opportunity, and arrogance, it will reduce the potential for fraud financial statement in companies.

The other results obtained were individual ownership and stress which had a positive influence on financial statements fraud, were proxied by manipulation of earnings. This means that the higher level of individual ownership and pressure, the greater the potential for fraudulent financial statement. However, there are several independent variables that have no influence on the potential for fraud financial statement, including ownership of domestic institutions, government ownership, rationalization, and competence.

### **LIMITATION**

In our research, financial statement fraud is only proxies by earnings management, which is calculated using the Discretionary Accrual Jones Modified Model. Subsequent research can use other measures, for example real earnings management. The type of share ownership in each of the infrastructure sector companies listed on the Indonesia IDX in 2017-2021 is less spread out, so the data obtained on each ownership structure variable is not balanced. Subsequent research can expand the research population, for example in the construction industry of Asian countries.

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N/A

### **DECLARATION OF CONFLICTING INTERESTS**

The authors declared no potential conflicts of interest.

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