

Pentagon Fraud Model and Financial Statement Fraud: The Moderating Role of the Audit Committee

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ABSTRACT

This research aims to analyse and provide empirical evidence on the influence of pentagon fraud indicators and their effect on financial statement fraud, moderated by audit committees, based on phenomena in state-owned enterprises (SOEs) in Indonesia. Research samples were taken from the annual reports of SOEs listed on the Indonesia Stock Exchange from 2019 to 2023. The sampling method used in this study is purposive sampling. This research analysis uses Panel Data Regression. The research results show that pressure, opportunity, and arrogance positively influence financial statement fraud, suggesting that companies continue to engage in such fraud. The audit committee, as a moderating variable, cannot moderate between the fraud pentagon and financial statement fraud.

Keywords:

Fraud Pentagon;
Financial Statement
Fraud; Audit
Committee.

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INTRODUCTION

The Indonesian economy is growing and improving rapidly year after year. Increasing competition in the business world requires company leaders to manage resources effectively. This development encompasses both the private and public sectors. According to the Edelman Trust Barometer (2024), Indonesians' trust in business is 80%, while trust in government-owned companies is 77%. The high level of public trust in the business world and government-owned companies does not always go hand in hand with low levels of fraud (Zariska and Lubis, 2022). Financial statement manipulation remains a serious problem among large companies in Indonesia. According to a survey by the Association of Certified Fraud Examiners (2019), fraud is generally divided into three main categories, one of which is financial statement fraud. There were 22 cases of this type of fraud, accounting for 9% of the total; corruption in 167 cases (70%); and asset misappropriation in 50 cases (21%).

One notable case of financial statement fraud at a state-owned enterprise was uncovered by the Supreme Audit Agency (BPK) in 2023. The BPK identified alleged fraud at PT Indofarma Tbk, including fictitious transactions, use of online loan facilities, and use of tax refund funds for irresponsible purposes. This case resulted in losses of Rp294.77 billion and potential losses of Rp164.83 billion, consisting of uncollectible receivables of Rp122.93 billion, unsold inventory of Rp23.64 billion, and tax expenses on fictitious sales of FMCG products of Rp18.26 billion (kumparan.com, 2024).

The oversight mechanism that plays an important role in this regard is the audit committee, which assists the board of commissioners in overseeing the company's performance (Fitroni and Feliana, 2022). The objectives of the audit committee include maintaining the company's financial performance, evaluating risks, and ensuring compliance with applicable requirements (Rahmawati and Nazir, 2024). The ideal composition of audit committee members, for example, a majority of independent members with specific expertise in finance or accounting, is an important factor in strengthening this oversight function. The audit committee's oversight of the quality of financial statements also helps detect and prevent fraud (Sinaga, 2024).

Fraud can be defined as the opposite of good faith, integrity, and honesty (Susilawati, 2022, p.6). Fraud theory seeks to explain why corporate fraud can occur within a company (Christian et al., 2019). This theory has evolved over the past few decades, including the Fraud Pentagon. Fraud Pentagon is a development of the fraud diamond approach. This theory was put forward by Crowe Howard (2011), who identified five factors that can trigger financial statement fraud. These five factors are pressure, opportunity, rationalization, competence (equivalent to ability), and one additional factor: arrogance (Susilawati, 2022, p.23).

Pressure can come from internal or external factors. People tend to commit fraud or deception when under pressure (Cressey, 1953). Risks arising from management pressure to achieve profit targets based on management regulations are referred to as financial targets (Setiawati et al., 2018).

Opportunity is a condition that allows someone to commit fraud and a situation that opens the way for management or others to commit fraud (Faradiza, 2019). Opportunities are projected based on the industry's nature. The nature of the industry is a condition that optimally reflects the industry (Skousen and Twedt, 2009). Thus, management entities have the opportunity to use subjective accounting estimates to manipulate financial statements (Waqidtun et al., 2021).

Rationalization is the act of justifying fraudulent actions. There are certain characters, attitudes, or ethical values that enable certain parties to commit fraud, or conditions in which individuals who are in a sufficiently stressful environment can rationalize fraudulent actions (Siddiq and Hadinata, 2017). Rationalization is the act of justifying one's own actions and feelings, that what one has done is reasonable. Conditions that facilitate the rationalization of fraud include auditor change, auditor's opinion, and total accruals to total assets.

Competence is the specific knowledge possessed by employees to circumvent internal control systems, devise concealment strategies, and observe social situations in order to achieve their personal interests (Crowe, 2011). Many cases of fraud worth billions can occur because a person recognizes opportunities to commit fraud and takes advantage of them (Wolfe and Hermanson, 2004). In this study, competence is measured by changes in directorship resulting from conditions that could trigger fraud.

Arrogance is an attitude in which a person feels exempt from certain policies and considers that internal rules or company regulations do not apply to them, so they do not feel guilty about the violations they commit (Bawekes et al., 2018). Arrogance is an attitude that shows an individual's sense of superiority and conceit, as well as a condition in which a person considers company policies irrelevant to themselves. Arrogance can be measured by the frequency of the CEO's appearances in the company's financial reports. A high level of arrogance can lead to fraudulent behavior, as CEOs often resort to various means to maintain their position and power (Septriani and Handayani, 2018).

Research on the potential risk of fraud in financial statements continues to yield mixed results, indicating a research gap. Previous research by Septriani and Handayani (2018), Faradiza (2019), and Arifin et al. (2018) suggests that pressure can influence financial statement fraud. However, Elviani et al. (2020), Aprilia (2017), and Emalia et al. (2020) found that pressure does not influence financial statement fraud. Research conducted Putri and Lestari (2021) shows that ability influences financial statement fraud. Research Vivianita and Dian (2019) shows that rationalization factors

influence financial statement fraud, however, in the research conducted Aprilia (2017), Rukmana (2018), and Mardianto and Tiono (2019) stating that rationalization does not affect financial statement fraud. Research results by Sasongko (2019) indicate that competence influences financial statement fraud. Harahap (2017) found that competence does not affect financial statement fraud. Research conducted Tessa (2016) states that arrogance has a significant effect on financial statement fraud. Meanwhile, research Aprilia (2017) declaring that arrogance does not affect financial statement fraud.

This study was conducted to determine the importance of understanding the factors that influence financial statement fraud in Indonesia. By examining the influence of the fraud pentagon, which includes financial targets, ineffective supervision, rationalization, capability, and arrogance, this study can help identify and prevent fraud.

METHOD

The research design is causal. The research object used consists of financial statement fraud variables measured by F-Score = Accrual Quality + Financial Performance (independent variable); independent variable consisting of pressure (X1) measured using ROA = profit after tax/total assets; opportunity (X2) is measured by Nature of Industry, rationalization (X3) is measured using a dummy variable for auditor turnover, competence (X4) is measured by a dummy variable for board turnover, arrogance (X5) is measured by the number of images of the CEO, The audit committee as a moderating variable is measured by the proportion of audit committees to total audit committees divided by the total number of board of commissioners. The sampling technique used in this study is purposive sampling of state-owned enterprises (SOEs) listed on the Indonesia Stock Exchange (IDX) during the period 2019 to 2023. Based on the specified criteria, 16 companies were selected as the sample, yielding 80 observations (annual company data).

RESULTS AND DISCUSSION

Descriptive statistical analysis of each variable is presented to provide a general overview of the research data.

TABLE I: Results of Descriptive Statistical Analysis

Variable	Min	Max	Mean	St. Dev
Pressure	-0.1400	0.2800	0.0318	0.0663
Opportunity	-0.6700	0.9900	0.0405	0.1987
Rationalization	0.0000	1.0000	0.2250	0.4202
Competence	0.0000	1.0000	0.3125	0.4664
Arrogance	0.0000	1.0000	0.9875	0.1118
Financial Statement Fraud	-7.3200	2.1800	0.0270	1.2466
Audit Committee	0.3300	0.3300	0.6470	0.1834

TABLE II: Results of Descriptive Statistical Analysis of Dummy Variables

Variable	Total N = 80			
	Dummy Variable			
	0	1	0	1
Rationalization	62	77,5%	18	22,5%
Competence	55	68,8%	25	31,3%
Arrogance	1	1,3%	79	98,8%

Based on the results of descriptive statistical tests in Table I, the table shows the results for each research variable. The pressure variable has an average of 3.18% (0.0318) and a standard deviation of 0.0663, indicating that the level of pressure

experienced by companies is generally low, with little variation across observations. The minimum and maximum values of this variable are -0.14 and 0.28, indicating a small difference in the pressure level.

The opportunity variable shows an average of 4.05% (0.0405) with a standard deviation of 0.1987, indicating greater data variation than pressure. The minimum opportunity value is -0.670, while the maximum is 0.990, indicating observations with very low to very high opportunity levels, reflecting significant differences in opportunity levels between companies.

The rationalization variable has an average of 22.5% (0.225) and a standard deviation of 0.4202, indicating significant variation in the data. Based on Table II, the dummy variable value of 0 is 77.5% and the dummy variable value of 1 is 22.5%, indicating that this is a dummy variable: a value of 0 indicates no change, and a value of 1 indicates a change of auditor.

The competency variable has an average of 31.25% (0.3125) with a standard deviation of 0.4664, indicating significant variation between observations. Meanwhile, the minimum and maximum values are 0, indicating that this data is categorical or fixed. Based on Table II, the dummy variable value of 0 is 68.8% and the dummy variable value of 1 is 31.3%, indicating that this variable is a dummy variable, where a value of 0 indicates no change and a value of 1 indicates a change in management.

The arrogance variable has a very high average of 98.75% (0.9875) and a standard deviation of 0.1118, indicating that almost all companies in the sample include a picture of their CEO in their annual reports, while only a few do not. Based on Table II, the dummy variable value of 0 is 1.3% and the dummy variable value of 1 is 98.8%, indicating that this variable is a dummy: a value of 0 indicates the CEO's picture is not displayed, and a value of 1 indicates the opposite.

The financial statement fraud variable shows an average of 2.7% (0.027) but has a high standard deviation of 1.2466, indicating a very large degree of variation between observations. The minimum value of -7.32 and the maximum value of 2.18 reflect quite extreme deviations in the data.

The audit committee variable has an average of 64.7% (0.647) and a standard deviation of 0.1834, indicating that, in general, the companies in the sample have a fairly high level of audit committee existence or effectiveness. The minimum value of 0.33 and the maximum value of 1 indicate differences among companies in the structure and functioning of their audit committees.

TABLE III: Hypothesis Test Results

Variable	Pred.	Coeff.	t-count	t-table	Prob.	Description
C		-0.4048	-2.0380	1.9908	0.0465	
FT	+	8.6900	2.5785	1.9908	0.0127	accepted
NOI	+	5.2252	4.1100	1.9908	0.0001	accepted
AudChange	+	0.2993	0.8012	1.9908	0.4265	rejected
DChange	+	0.2435	0.7052	1.9908	0.4837	rejected
CEO'sPictures	+	1.0113	2.7517	1.9908	0.0081	accepted
FT*AC	+	-8.1616	-1.7517	1.9908	0.0852	rejected
NOI*AC	+	-14.9380	-6.6958	1.9908	0.0000	rejected
AudChange*AC	+	-0.5332	-0.9057	1.9908	0.3686	rejected
DChange*AC	+	-0.6235	-1.2059	1.9908	0.2331	rejected
CEO'sPictures*AC	+	-0.7889	-1.7280	1.9908	0.0897	rejected

Description : Significant at the level 5

Source: data processed by statistical software (2025)

Based on Table III, the regression equation formula for the panel data research model is obtained as follows:

$$\text{FFS} = -0.4048 + 8.6900\text{FT} + 5.2252\text{NOI} + 0.2993\text{AudChange} + 0.2435\text{DChange} + 1.0113\text{CEO's Pictures} - 8.1616\text{FT} \cdot \text{AC} - 14.9380\text{NOI} \cdot \text{AC} - 0.5332\text{AudChange} \cdot \text{AC} - 0.6235\text{DChange} \cdot \text{AC} - 0.7889\text{CEO's Pictures} \cdot \text{AC} + e$$

The results of testing these hypotheses can be analysed as follows:

1. The financial target variable has a coefficient of 8.69, a t-value of 2.5785 > t-table 1.9908, and a probability value of 0.0127 < 0.05 (α level = 5%), indicating a positive effect of financial targets on financial statement fraud.
2. The variable nature of industry has a coefficient value of 5.2252, a t-value of 4.11 > t-table 1.9908, and a probability value of 0.0001 < 0.05 (α level = 5%), indicating a positive influence of industry nature on financial statement fraud.
3. The auditor turnover variable has a coefficient of 0.2993, a t-value of 0.8012 (< t-table 1.9908), and a probability value of 0.4265 (> 0.05), indicating that auditor turnover does not affect financial statement fraud.
4. The variable for board turnover has a coefficient of 0.2435, a t-value of 0.7052 (< t-table 1.9908), and a probability value of 0.4837 (> 0.05), indicating that board turnover does not affect financial statement fraud.
5. The variable number of CEO images has a coefficient value of 1.0113, a t-value of 2.7517 (> t-table 1.9908), and a probability value of 0.0081 (< 0.05), indicating a positive effect of the number of CEO images on financial statement fraud.
6. The financial target variable, moderated by the audit committee, shows a coefficient of -8.1616 with a t-value of -1.7517, which is smaller than the t-table value of 1.9908 and the probability value of 0.0852 > 0.05. These results indicate that the presence of an audit committee does not tend to moderate financial targets in the face of financial statement fraud. Thus, audit committees have not been able to play an effective role in moderating the pressure from financial targets on financial statement fraud.
7. The variable nature of industry, moderated by the audit committee, has a coefficient value of -14.9380 with a t-value of -6.6958 > t-table 1.9908 and a probability of 0.0000 < 0.05, indicating that the audit committee weakens the influence of industry nature on financial statement fraud. This finding indicates that an effective audit committee can reduce the likelihood of fraud arising from a company's industry characteristics.
8. The auditor turnover variable, moderated by the audit committee, has a coefficient of -0.5332 with a t-value of -0.9057 < t-table 1.9908 and a probability of 0.3686 > 0.05. These results indicate that the audit committee weakens the effect of auditor turnover on financial statement fraud. Thus, the audit committee's moderating role in this relationship has not demonstrated any real effectiveness in reducing the potential for fraud.
9. The variable of board turnover moderated by the audit committee has a coefficient value of -0.6235 with a t-value of -1.2059 < t-table 1.9908 and a probability of 0.2331 > 0.05. This finding indicates that the audit committee weakens the effect of director turnover on financial statement fraud. Thus, the audit committee has not been able to effectively moderate the relationship between director turnover and the potential for financial statement fraud.

10. The variable of the number of CEO images moderated by the audit committee has a coefficient value of -0.7889 with a t-value of $-1.7280 < t\text{-table } 1.9908$ and a probability of $0.0897 > 0.05$. These results indicate that the audit committee weakens the influence of the number of CEO images on financial statement fraud. Thus, the audit committee's role in moderating the relationship between managerial arrogance and fraud has not yet demonstrated strong effectiveness.

Discussion

The study's results show that pressure measured through ROA proxies positively affects financial statement fraud. Pressure arising from high financial targets, shareholder demands, and challenging operational conditions forces management to manipulate reporting to maintain its reputation or achieve certain goals (Ratnasari and Rofi, 2020). These findings suggest that companies should improve the efficiency of their monitoring procedures, strengthen their internal control systems, and maximise the function of their audit committees (Sari and Safitri, 2019). These results are consistent with agency theory, which states that conflicts of interest between principals and agents, coupled with information asymmetry, can trigger fraudulent behavior (Jensen and Meckling, 1976). The results of this study are in line with research conducted by Lauwrens and Yanti (2022) and Rifaldi and Indrabudiman (2022) Pressure has a positive and significant effect on financial statement fraud. The results of the opportunity study using NOI as a proxy show that opportunity has a positive impact on financial statement fraud.

Opportunities arising from weak supervision or operational complexity can be exploited by management to manipulate financial statements (Crowe, 2011). This finding underscores the need to strengthen internal control systems to limit management's exploitation of weaknesses within them (Djatmiko et al., 2020). In relation to agency theory, information asymmetry in the industrial environment provides scope for agents to act in ways that deviate from principals' interests, including committing financial statement fraud (Jensen and Meckling, 1976). This requires a robust oversight mechanism to limit opportunistic behavior and maintain the integrity of financial reporting (Yunina and Nisa, 2019). The results of this study are consistent with previous research by Yuniarti et al. (2019), Mohamed et al. (2021), and Elviani et al. (2020): industry nature significantly influences financial statement fraud.

Results from rationalisation research using auditor turnover as a proxy indicate that the rationalisation variable has no effect on financial statement fraud. External factors, such as performance pressures or lax oversight mechanisms, have a greater influence on fraud in financial statements than the need to maintain ethical behavior (Engko et al., 2021). This finding is consistent with the view that conflicts of interest between principals (owners or shareholders) and agents (management) create incentives for agents to act in their own interests, especially when oversight systems are not functioning optimally (Jensen and Meckling, 1976). When agents face high external pressure and have access to asymmetric information, they tend to make decisions that benefit themselves without going through a rationalization process (Lanis and Richardson, 2018). The results of this study are in line with research conducted by Faradiza (2019) and Puspitaningrum et al. (2019) Rationalisation does not affect financial statement fraud.

The results of testing competency using board turnover as a proxy for financial statement fraud indicate that the competency variable does not affect financial

statement fraud. According to Yulianti and Cahyonowati (2023), the presence of a new board of directors cannot always prevent or reduce fraudulent acts if it is not supported by a strong internal control system and an incentive structure aligned with the company's objectives. Therefore, changes to the board of directors as a form of management improvement need to be accompanied by strengthening corporate governance to be effective in reducing the risk of fraud. This finding is in line with the view that conflicts of interest between principals and agents cannot be fully minimized solely through improving or replacing the competence of agents (directors) (Jensen and Meckling, 1976). Regardless of their level of expertise, agents may still act in their own best interests and disregard the company's primary objectives when information asymmetry and inadequate oversight procedures are present (Himawan and Karjono, 2019). The results of this study align with previous research by Haqq and Budiwitjaksono (2020), Wibowo and Putra (2023), and Zakiy et al. (2022), which indicate that competence does not affect financial statement fraud.

The results of testing for arrogance using the proxy of the number of CEO images in annual reports show that this variable has a positive effect on financial statement fraud. These results indicate that the higher the level of self-importance displayed by company leaders, the greater the tendency for companies to manipulate their financial reporting (Randi and Faradiza, 2022). This finding reinforces the argument that agents' personal characteristics, such as arrogance, can exacerbate conflicts of interest between management and company owners (Christian and Sulistiawan, 2022). When not balanced by strong oversight mechanisms, arrogant management is more likely to take actions that conflict with shareholders' interests (Jensen and Meckling, 1976). The results of this study are in line with previous research conducted Elviani et al. (2020), Mohamed et al. (2021), and Haqq and Budiwitjaksono (2020), arrogance has a positive effect on financial statement fraud.

Testing the audit committee as a moderating variable in the relationship between pressure and financial statement fraud shows that the audit committee has no influence on this relationship. These results suggest that the existence of an audit committee does not affect the extent to which pressure reduces or strengthens the tendency to commit fraud (Himawan and Karjono, 2019). The supervisory role that the audit committee should carry out has not been optimal in controlling pressure, so it has not been able to reduce the risk of fraud (Rakhmayani and Faisal, 2019). These results indicate that governance mechanisms, such as audit committees, are not yet strong enough to address conflicts of interest between agents and principals, especially when agents are under high pressure (Kardhianti and Srimindarti). When oversight is ineffective, opportunities for agents to act improperly remain open, making it crucial to strengthen audit committees' capacity and independence to prevent fraud (Jensen and Meckling, 1976). The results of this study are consistent with previous research by Yosephine and Marheni (2023), Noch (2019), and Rifaldi and Indrabudiman (2022), which indicate that the audit committee was unable to moderate pressure on the accuracy of financial statements.

The results of the audit committee testing, which moderates the effect of opportunity on financial statement fraud, show that the audit committee, as a moderating variable, hurts the influence of opportunity on financial statement fraud. The audit committee plays an important role as a corporate governance mechanism that can close control gaps and limit the room for agents to commit fraud (Tambunan,

2021). A competent, independent, and active audit committee that performs its oversight function can serve as an effective monitoring tool to prevent management from abusing authority and manipulating financial information (Abdullah et al. 2019). These results support the assumption that oversight mechanisms, such as audit committees, can reduce the risk of opportunistic behavior by agents (management) arising from information asymmetry and a lack of oversight by principals or shareholders (Jensen and Meckling, 1976). The existence of an audit committee helps reduce information gaps and improve accountability, thereby mitigating the conflicts of interest inherent in agency relationships by increasing the effectiveness of internal oversight. The results of this study are in line with research conducted by Setyono et al. (2023), which found that the audit committee, as a moderating variable, has a significant negative effect on the influence of opportunity on financial statement fraud.

The test results show that the audit committee, as a moderating variable, is unable to moderate the effect of rationalisation on financial statement fraud. This means that the existence of an audit committee, as measured in this study, cannot weaken or strengthen the impact of rationalization on the occurrence of financial statement fraud (Nurhasanah et al., 2022). This indicates that the audit committee's role in preventing the rationalization of fraudulent acts remains ineffective, as rationalization is a psychological factor rooted in the perpetrator's internal motives and moral justifications, making it difficult to detect through external supervision (Asni and Heniwati, 2022). These findings confirm that oversight mechanisms, such as audit committees, are more effective at controlling structural and external factors, such as pressure and opportunity, than internal factors, such as moral values and individual cognitive processes (Jensen and Meckling, 1976). The results of this study are in line with the research by Rifaldi and Indrabudiman (2022), Yosephine and Marheni (2023), Asni and Heniwati (2022), which state that audit committees are unable to moderate the influence of rationalization on financial statement fraud.

The test results show that the audit committee has not been able to effectively moderate the impact of management turnover on financial statement fraud. This indicates that changes in top management structure do not necessarily lead to increases or decreases in the tendency to commit fraud (Dwianto et al., 2024). Within the agency theory framework, the relationship between owners (principals) and management (agents) is prone to conflicts of interest, especially when there is information asymmetry and weak supervision (Jensen and Meckling, 1976). However, the results of this study show that changing agents (directors) does not always increase the risk of opportunistic fraud. On the other hand, oversight mechanisms such as audit committees have not been fully able to intervene effectively in this context. This reflects that in order to reduce agency risk, a combination of structural oversight and a coherent incentive system is needed, so that management has the motivation to act in the interests of owners, rather than relying solely on changes in leadership structure (Silvera et al., 2024) The results of this study are in line with previous research conducted Yosephine and Marheni (2023) and Noch (2019), indicates that the audit committee is unable to moderate competence in financial statement fraud.

The results of audit committee testing as a moderating variable did not affect the relationship between arrogance and financial statement fraud. The weakness of the audit committee's role in moderating the influence of arrogance indicates the need for supervisory reform that emphasizes not only structure, but also the effectiveness

of audit functions, internal reporting, and active involvement in assessing leadership quality (Asni and Heniwati, 2022). These findings indicate that controlling fraud risk requires more than identifying management personality traits; it must be accompanied by an effective governance system (Ulum and Suryatimur, 2022). Companies need to ensure that accountability systems, transparency, and the supervisory role of boards and audit committees function optimally to prevent potential abuse of power due to individual arrogance (Wahyuni et al., 2024). In agency theory, arrogance can exacerbate conflicts of interest between management (agents) and owners (principals), because agents who feel dominant and less supervised tend to act in their own interests (Jensen and Meckling, 1976). However, the results of this study show that these risks can be mitigated with adequate supervision and control, so that even if arrogance is present, it does not necessarily lead to fraud. The results of this study are in line with research conducted by Yosephine and Marheni (2023), Amalia and Annisa (2023), and Noch (2019), indicates that the audit committee is unable to moderate arrogance towards the accuracy of financial reports.

CONCLUSION

The results of the study show that high pressure and management arrogance increase the risk of fraud in financial reports, while rationalization and competence have no significant effect. Opportunities arising from weak supervision also trigger fraud, making it very important to strengthen internal control systems. Audit committees have been proven effective in mitigating the influence of opportunity, but ineffective in mitigating the relationship between pressure, rationalization, competence, and arrogance in relation to fraud. These findings emphasize the importance of strengthening audit committees' structure, independence, and competence, alongside oversight reforms that address structural, ethical, and leadership character aspects.

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