

Fraudulent Financial Reporting Reviewed from The Perspective of Hexagon Fraud Theory: A Study of Companies Received Special Notation from BEI

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ABSTRACT

Fraudulent financial reporting remains a threat to the integrity of global capital markets, undermining investor confidence and causing significant financial losses. This study investigates the factors that influence fraudulent financial reporting using the Hexagon Fraud Theory as a theoretical framework. Data were collected from 138 companies listed on the Indonesia Stock Exchange that received special notation in 2023. The independent variables used are stimulus/pressure, competence/capability, collusion, opportunity, rationalization, and ego/arrogance. This study uses a quantitative approach with multiple regression analysis. The findings show that opportunity is positively correlated with fraudulent financial reporting, stimulus/pressure shows a negative effect. Conversely, competence/capability, collusion, rationalization, and ego/arrogance do not affect fraudulent financial reporting. These results highlight the complex interaction between internal and external pressures in organizations and emphasize the need for strong internal controls to reduce the risk of fraudulent financial reporting.



INTRODUCTION

Fraudulent financial reporting or fraud in financial reporting continues to be a serious threat to the integrity of global capital markets. This fraud undermines investor confidence, affects economic stability, and causes significant financial losses for companies and stakeholders. This fraud can be carried out through manipulation, falsification, or omission of material information in the financial statements, resulting in the report no longer reflecting the true condition of the company. Cases such as Enron and WorldCom involving financial statement manipulation have created a very damaging impact on stakeholders and have caused a crisis of confidence in corporate transparency. The recent phenomenon of financial reporting scandals, such as the fraud case at Luckin Coffee in China in 2020, again highlights the importance of understanding the factors that drive fraud in financial reporting. This case involved fictitious sales reports, which ultimately forced the company to admit losses that were much greater than those disclosed in the initial report (Ludwianto & Fikrie, 2020).

In the Indonesian context, several major cases related to fraudulent financial reporting have affected the integrity of the capital market and investor confidence. One prominent case is the PT Kimia Farma scandal in 2002, where the state-owned pharmaceutical company was involved in financial report manipulation by overstating revenue by up to IDR 32 billion (Sandria, 2021). This case underscores the weak internal supervision in state-owned companies, as well as the important role of external factors such as political and economic pressure in triggering fraud. In addition, the Garuda Indonesia case in 2019 also emerged when financial reports were found containing manipulation related to the recording

of revenue from contract agreements that had not yet been valid. This shows the existence of collusion practices between the company's top management who played a role in the fraud, as well as illustrating the weak internal control system in the company (Dewi & Hardiyanto, 2019). This phenomenon is a reflection that most companies in Indonesia have not fully implemented the principles of transparency and accountability in financial reporting.

According to data from the Financial Services Authority (OJK), fraud in financial reporting is still a significant issue in Indonesia. In recent years, OJK has taken various measures to increase supervision of public companies through stricter regulations on corporate governance and external audits. However, despite tightened regulations, some companies are still able to manipulate due to factors such as pressure to meet financial targets, opportunities through system weaknesses, and justifications made by individuals involved in fraud. Meanwhile, according to data released by the Association of Certified Fraud Examiners (ACFE) 2022, global losses caused by fraud in financial reporting reach billions of dollars each year. ACFE also stated that this type of fraud often occurs due to weak internal supervision and ineffective control systems. Although various efforts have been made to strengthen corporate governance, cases of financial fraud continue to increase.

Research on fraud in financial reporting has grown rapidly along with the emergence of various theories that try to explain this phenomenon. One theory that is often used in understanding the motives and mechanisms behind fraud is the Fraud Triangle Theory, which was first introduced by Cressey (1953). This theory explains that fraud occurs when there are three main elements: pressure, opportunity, and rationalization. This theory was then further developed into the Fraud Diamond Theory by Wolfe and Hermanson (2004), with the addition of the element of ability as a determining factor in committing fraud. However, along with the increasingly complex business environment and the increasing external factors that influence companies, these theories are considered inadequate in explaining all aspects that influence fraud. This theory adds three new elements, namely moral justification, external pressure, and individual capability, in addition to the elements that already exist in the previous theory. Moral justification includes how individuals justify their actions, while external pressure includes environmental factors that influence a person's decision to commit fraud. Individual capability emphasizes that fraud cannot occur without sufficient ability to manipulate the system.

In this context, the Hexagon Fraud Theory emphasizes that fraudulent financial reporting is not only influenced by individual financial motives, but also by the external and internal environment of the company. This includes external pressure, weak internal controls, the individual's ability to commit fraud, and the moral justification used to justify the action. The results of this study indicate that the higher the management capability, the greater the potential for management to exploit weaknesses in the internal control system. Opportunities to commit fraud arise due to weaknesses in the internal control system. The pressure to achieve financial targets often triggers management to manipulate financial statements. Collusion between management and internal or external parties (auditors) often makes it difficult to uncover fraud cases.

Previous studies have provided a strong theoretical basis, but these studies still tend to focus on only one or two elements. This study will take a more holistic approach by using the Hexagon Fraud Theory to analyze the factors that influence the occurrence of fraudulent financial reporting. By understanding these elements thoroughly, this study is expected to provide an important contribution to efforts to prevent and detect fraud in the future. In addition, this study was conducted on companies that received special notation from the Indonesia Stock Exchange so that it focuses on companies that are having problems in the context of Indonesia as a whole. Thus, this study is expected to provide an understanding of the importance of increasing protection and maintaining transparent and orderly stock trading.

METHODS

In this study, the researcher used a quantitative research method. The researcher collected data sourced from the financial statements of companies that received special notation on the Indonesia Stock Exchange during 2023. Furthermore, the researcher will analyze and interpret the research data. The unit of analysis in this study is companies that received special notation on the Indonesia Stock Exchange. The researcher collected data during the research year with a total of 138 research data samples using the purposive sampling method. Then, the researcher conducted descriptive statistical analysis, frequency analysis, classical assumption tests and multiple regression analysis on the independent variables (stimulus/pressure, competence/capability, collusion, opportunity, rationalization, ego/arrogance) and the dependent variable (fraudulent financial reporting).

Table 1. Measurement of Variables

Information	Measurement	Scale
Fraudulent Financial Reporting(Y)	F-Score model = accrual quality + financial performance	Ratio
Stimulus/Pressure(X1)	Leverage ratio = total liabilities / total assets	Ratio
Competence/Capability(X2)	Change of director = 1 No change of director = 0	Nominal
Collusion(X3)	Government connection = 1 Non-government connection = 0	Nominal
Opportunity(X4)	BDOU ratio= independent commissioners / total commissioners	Ratio
Rationalization(X5)	Auditor change = 1 No change of auditor = 0	Nominal
Ego/Arrogance (X6)	CEO Duality = 1 Non-CEO Duality = 0	Nominal

Source: various references, 2024

RESULTS

Descriptive statistics of the research variables describe the average, minimum, maximum and standard deviation values, as in Table 2.

Table 2. Descriptive Statistics

Variables	Minimum	Maximum	Average	Standard Deviation
Y	-2.045	3.436	0.279	0.791
X ₁	0.000	1.689	0.476	0.323
X ₄	0.000	1.000	0.415	0.172

Source: SPSS Output, 2024

Table 3. Frequency

Variables	Information	Frequency	Percentage	Valid Percentage	Cumulative Percentage
X ₂	No Change of Director (0)	90	65.2	65.2	65.2
	Change of Director (1)	48	34.8	34.8	100
X ₃	Non- Government Connection (0)	50	36.2	36.2	36.2
	Government Connection (1)	88	63.8	63.8	100
X ₅	No Change of Auditor (0)	91	65.9	65.9	65.9
	Change of Auditor (1)	47	34.1	34.1	100
X ₆	Non-CEO Duality (0)	120	87.0	87.0	87.0
	CEO Duality (1)	18	13.0	13.0	100

Source: SPSS Output, 2024

Based on the Tables 2-3, variable X₃ only has a frequency of value 1 which is more than the value 0. This means that many sample companies have cooperation with the government.

The classical assumption tests used are normality, collinearity, and heteroscedasticity. The normality test uses the Kolmogorov-Smirnov test. The collinearity test uses tolerance and VIF values. And heteroscedasticity uses the glejser test. The results of the classical assumption test are presented in Table 4-6.

Table 4. Kolmogorov-Smirnov Test

	Unstandardized Residual
N	138
Test Statistics	0.074
Asymp. Sig. (2-tailed)	0.060c

Source: SPSS Output, 2024

Based on the Table 4, a significance value of 0.060 was obtained, more than 0.05, so it was concluded that the data distribution was normal.

Table 5. Tolerance and VIF Values

Information	Tolerance Value	VIF Value
X1	0.897	1.115
X2	0.702	1.424
X3	0.828	1.207
X4	0.952	1.051
X5	0.763	1.311
X6	0.916	1.092

Source: SPSS Output, 2024

Based on the tolerance value and VIF value (Table 5), all X variables obtain a tolerance value of less than 1 and a VIF value of less than 10. This indicates that there is no perfect collinearity between the X variables.

Table 6. Glejser test

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
X ₁	-0.106	0.137	-0.071	-0.772	0.442
X ₂	0.061	0.105	0.061	0.585	0.559
X ₃	-0.059	0.095	-0.059	-0.619	0.537
X ₄	0.018	0.250	0.006	0.071	0.944
X ₅	-0.006	0.101	-0.006	-0.062	0.951
X ₆	0.016	0.130	0.011	0.121	0.904

Source: SPSS Output, 2024

Based on Table 6, all X variables obtain a significance value exceeding 0.05. This means that there is no heteroscedasticity but rather homoscedasticity.

Table 7. Hypothesis Testing

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.460	0.224		2.054	0.021
X ₁	-0.725	0.208	-0.296	-3.479	0.000
X ₂	-0.013	0.159	-0.008	-0.084	0.467
X ₃	-0.198	0.145	-0.121	-1.363	0.088
X ₄	0.655	0.380	0.142	1.721	0.044
X ₅	0.003	0.154	0.002	0.016	0.494
X ₆	0.168	0.197	0.072	0.851	0.198

Adjusted R-Square: 0.108
 Significance F: 0.002
 Significance Level: 0.05

Source: SPSS Output, 2024

Based on the hypothesis test (Table 7), the regression equation obtained in this study is:

$$Y = 0.460 - 0.725X_1 - 0.013X_2 - 0.198X_3 + 0.655X_4 + 0.003X_5 + 0.168X_6 + e \dots\dots\dots (1)$$

The equation is explained that Y is fraudulent financial reporting, X₁ is stimulus/pressure, X₂ is competence/capability, X₃ is collusion, X₄ is opportunity, X₅ is rationalization, X₆ is ego/arrogance.

The results of the hypothesis test show that stimulus/pressure has a negative influence on fraudulent financial reporting, opportunity has a positive influence on fraudulent financial reporting and competence/capability, collusion, rationalization, and ego/arrogance have no influence on fraudulent financial reporting.

DISCUSSION

The Influence of Stimulus/Pressure on Fraudulent Financial Reporting

The results of the study show that stimulus/pressure has a negative effect on fraudulent financial reporting. This shows that increasing stimulus/pressure causes a decrease in fraudulent financial reporting. These results support the concept of the Hexagon Fraud Theory that stimulus or pressure is a term that refers to external or internal factors that encourage an individual or group to act fraudulently, such as changing financial reports. Pressure factors, both internal (for example, high performance targets) and external (such as market competition), can encourage individuals or management to commit fraud. This pressure often makes individuals feel forced to find unethical ways to meet existing expectations. Pressure within a company can be in the form of financial pressure such as leverage. Although high

leverage is often associated with the risk of fraud, there are situations where leverage can serve as a driver for transparency and accountability. With tighter supervision and incentives to act ethically, companies with high debt can serve as an example that a stressful environment does not always result in fraud, but can instead encourage better practices in financial reporting. The results of this study are inconsistent with Meidjiati & Amin (2022) which found that stimulus/pressure has a positive effect on fraudulent financial reporting. However, this study is in accordance with of Setyono et al., (2023) that stimulus/pressure has a negative effect on fraudulent financial reporting.

The Influence of Competence/Capability on Fraudulent Financial Reporting

The results of the study show that competence/capability has no positive effect on fraudulent financial reporting. This shows that increasing competence/capability does not affect fraudulent financial reporting. This result is inconsistent with the Hexagon Fraud Theory concept that the ability to commit fraud is an important factor. People who understand accounting systems and internal controls have a greater chance of exploiting weaknesses in those systems. A person's ability or competence in committing fraud is not always a determining factor. Fraud is more often triggered by pressure and opportunities than by a person's technical skills. A person with high competence may choose to act ethically even though that person could commit fraud. Most companies that receive special notation from the Indonesia Stock Exchange do not change directors so they do not have a complex impact on fraudulent financial reporting. This result is inconsistent with Meidjati & Amin (2022) which found a positive relationship between competence and fraudulent financial reporting. However, it is in accordance with Kartikasari et al., (2021) which found that competence/capability has no effect on fraud detection.

The Influence of Collusion on Fraudulent Financial Reporting

The results of the study show that collusion has no positive effect on fraudulent financial reporting. This shows that increasing collusion does not affect fraudulent financial reporting. This result is inconsistent with the concept of the Hexagon Fraud Theory, that collusion can occur within the company or outside the company, such as auditors or suppliers. Because actions taken together are more difficult to find in this situation, collusion can weaken effective internal control. Although collusion can occur and has the potential to increase the risk of fraud, various other factors are often more influential in the context of fraudulent financial reporting. The company environment, individual motivation, and oversight mechanisms play an important role in determining the extent to which collusion affects fraudulent practices. Most companies that receive special notation from the Indonesia Stock Exchange also cooperate with the government, meaning that by carrying out this cooperation the company is trying to improve supervision, transparency, and accountability. The results of this study are inconsistent with Nadziliyah & Primasari (2022) who found that collusion has a positive effect on fraudulent financial reporting. However, it is in line with Meidjati & Amin (2022) which explains that collusion does not affect fraudulent financial reporting.

The Influence of Opportunity on Fraudulent Financial Reporting

The results of the study show that opportunity has a positive effect on fraudulent financial reporting. This shows that an increase in opportunity causes an increase in fraudulent financial reporting. These results support the concept of the Hexagon Fraud Theory that opportunity refers to weaknesses or weaknesses in internal control or oversight systems that allow individuals or groups to commit fraud without being detected. Weaknesses such as weak controls, poor internal audits, or lax supervision processes increase the likelihood of fraud occurring within an organization. The existence of an opportunity to commit fraud, for example, weaknesses in internal control or lack of supervision—provides space for individuals to commit fraudulent financial reporting. When individuals see that they can commit fraud without a high risk of being caught, they are more likely to do so. This is also seen in most companies that receive special notation from the Indonesia Stock Exchange having a low independent commissioner ratio. This means that supervision from independent parties in the company is still lacking, thus potentially increasing the opportunity to commit financial reporting fraud. These results support Sukmadilaga et al., (2022) that an increase in opportunity causes an increase in financial reporting fraud. However, it does not support Situngkir & Triyanto (2020) with the finding that there was no effect of opportunity on financial reporting fraud.

The Influence of Rationalization on Fraudulent Financial Reporting

The results of the study show that rationalization has no positive effect on fraudulent financial reporting. This shows that increasing rationalization does not affect fraudulent financial reporting. This result is inconsistent with the concept of the Hexagon Fraud Theory, that in the rationalization process, individuals who commit fraud build a mental belief that their actions are acceptable or justified. Individuals may think that their actions are reasonable because individuals are done by everyone or because they are done to save the company. By using rationalization, people can commit fraud without feeling guilty. Rationalization is often a mechanism used by individuals to justify fraudulent actions. However, the results of the study show that this does not have a significant effect. This could mean that individuals may act without going through a clear rationalization process, or that other factors are more dominant in driving the action. This is also seen in most companies that receive special notation from the Indonesia Stock Exchange do not change auditors. Although changing auditors can be an important step in increasing transparency and accountability, other factors such as external pressure, internal control quality, and organizational culture may have a greater influence on fraudulent financial statements. Therefore, changing auditors alone may not be enough to effectively address fraud problems. This result is not in accordance with Meidjiati & Amin (2022) who revealed a positive effect of rationalization on financial reporting fraud. However, it is in accordance with Sukmadilaga et al., (2022) with the finding that there is no effect of rationalization on financial reporting fraud.

The Influence of Ego/Arrogance on Fraudulent Financial Reporting

The results of the study show that ego/arrogance has no positive effect on fraudulent financial reporting. This shows that an increase in ego/arrogance does not affect fraudulent financial reporting. This result is inconsistent with the concept of the Hexagon Fraud Theory, that Arrogance occurs when someone, especially in a top management position, feels that they will not be caught or have the right to break the rules for personal or organizational gain. People with big egos often feel exempt from laws and regulations. An egotistical or arrogant attitude can influence a person's behavior, but this result shows that this variable does not have a direct effect on fraud. This may indicate that fraud is driven more by the need to meet external expectations than by personal attitudes. Most companies that receive special notation from the Indonesia Stock Exchange do not have CEOs who hold concurrent positions. This means that the level of arrogance in these companies is still low so that it does not affect fraudulent financial reporting. This result is not the same as the research of Sukmadilaga et al., (2022) which found that ego/arrogance can increase fraudulent financial reporting. However, it supports the research of Nadzilayah & Primasari (2022) which states that ego/arrogance has no influence on financial statement fraud.

CONCLUSION

Based on the research that has been conducted, it can be concluded that stimulus/pressure has a negative effect on fraudulent financial reporting, opportunity has a positive effect on fraudulent financial reporting and competence/capability, collusion, rationalization, and ego/arrogance do not have a positive effect on fraudulent financial reporting. In this study, limitations were found, namely the presence of negative data and a low Adjusted R-Square value of 10.8%. Future research can conduct research in a longer and broader context using companies that have been in trouble for several years in Indonesia. These results imply that companies need to increase supervision within the company to reduce the opportunity for individual companies to commit financial reporting fraud.

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