International Journal of Multidisciplinary Research and Publications
ISSN (Online): 2581-6187

Analysis of the Effect of the Fraud Pentagon in Detecting Fraudulent Financial Reporting (Empirical Study of Property, Real Estate and Construction Companies Listed on the IDX in 2019-2021)

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Abstract— *Fraud is an act of fraud or fraud that will result in unfavorable benefits for individuals or entities and external parties to the company, this action is carried out by individuals or entities who are even aware of their actions. This fraud pentagon theory was put forward by Crowe Howarth (2011), namely pressure, opportunity, rationalization, capability and arrogance. The purpose of this study is to determine how the fraud pentagon factors affect financial statement fraud. In this study, fraud pentagon is proxied as, external pressure, financial targets, ineffective monitoring, change of auditor, change of director, and family firms are all independent variables. The data used in this study are secondary data obtained from the company's annual financial reporting. The population used consists of property, real estate and construction companies listed on the Indonesia Stock Exchange in 2019-2021. The purposive sampling technique was used to determine the research sample with the results of 53 companies that met the criteria. Logistic regression method analysis is used as a research method. The results showed that external pressure and financial targets have a significant effect on fraudulent financial reporting. while ineffective monitoring, change of auditor, change of director, and family firms have no significant effect on fraudulent financial reporting.*

Keywords— *Fraud, fraud pentagon, external pressure, financial targets, ineffective monitoring, change of auditor, change of director, family firms.*

I. INTRODUCTION

Economic growth in Indonesia continues to grow over time, of course, having a positive impact on companies to continue to grow. This is evidenced by the number of companies that register themselves in the official capital market so that company information is well recorded. A company's financial information, performance, and operational activities during a certain period of time are contained in the financial statements. In PSAK No. 1 Revised (2014) financial statements are important company performance reports in order to provide information to company parties who have an interest. Financial reporting is used for decision making by management and investors.

The amount of increasingly fierce economic competition requires management to be able to do its job optimally to produce good reports. This encourages management to achieve the targets set by related parties in the company. Targets that are not achieved by management become a big problem so that at the time of publishing the company's financial report is sometimes presented in an inaccurate state. This method is carried out by the company in order to gain profit, but such actions are not justified and include acts of fraud.

According to KUHP Article 378 concerning fraudulent acts, fraudulent acts are acts that aim to benefit themselves or others by unlawful means, by using a false name, a series of lies, ordering others to hand over goods to him or write off receivables and debts. The 2019 Association Of Certified Fraud Examiners (ACFE) survey, fraud that often occurs in Indonesia is corruption, misuse of assets, and financial statement fraud. Corruption cases with survey results of 64.4% show that the most acts of corruption occur in Indonesia, followed by misuse of state and company assets with survey results of 28.9%, and financial statement fraud of 6.7%. Although fraud in financial statements shows low survey results, this does not rule out the possibility of fraud in the company's financial statements.

Fraud cases that occurred in Indonesia are PT Tiga Pilar Food Tbk in 2017 has manipulated the financial statements with the inflation of funds amounting to Rp 4 trillion in accounts receivable, inventory, and fixed assets then in the sales account inflated by Rp 662 billion (accunting.binus.ac.id). PT Kereta Api Indonesia in 2005 also manipulated its financial statements because the state-owned company should have suffered a loss of Rp 63 billion but instead recorded a profit of Rp 6.9 billion (kompasiana.com).

The condition of the company that continues to grow in the future provides opportunities for fraudsters to more easily access various company information. Fraud detection can be done using factors from fraud models. One type of fraud model is the fraud pentagon, the latest fraud model which is a refinement of the previous fraud model. This pentagon fraud theory was proposed by Crowe Howarth (2011), namely pressure, opportunity, rationalization, capability and arrogance. Where the pressure element is proxied by external pressure and financial targets, the opportunity element is proxied by ineffective monitoring. The element of rationalization is proxied by a change of auditor. The element of competence is proxied by change of director and the element of arrogance is proxied by family firms. This research was conducted because of the background of the phenomenon of fraudulent financial reporting practices as described above to further examine and detect how fraudulent financial reporting practices occur in companies somewhere considering the number of cases of fraudulent financial statements in Indonesia.

II. Literature Review

Agency Theory

Agency theory proposed by Jensen and Meckling in 1976 explains that companies can be seen from the relationship between shareholders and company operations. Agency relationships arise when there are one or more individuals called principals, employing one or more individuals called agents to carry out company operations (Haryono et al, 2020). The agent has more company information than the company owner (principal). In practice, management must run the company on behalf of the company owner so that management always maximizes the interests of the company compared to shareholders.

Fraud

According to the ACFE, financial reporting fraud is a crime that causes negligence of information that results in misstatement in the company's financial reports. This negligence can be such as recording fictitious income, reporting expenses that have been understated or deliberately reporting overstated assets (Reynaldi et.al, 2022). There are two forms of financial statement fraud, namely presenting financial statements that are better than the truth (overstatement) or presenting worse than the original (understatement) (Farmashinta and Yudowati 2019).

Pentagon Fraud Theory

Fraud pentagon is a refinement of the two fraud theories, namely fraud triangle and fraud diamond. Donald Cressey (1953), one of the founders of ACFE, concluded that there are three conditions that always exist in fraud, namely pressure, opportunity, and rationalization, which can be referred to as the fraud triangle. In 2004, Wofle (2004: 38) introduced a new model, namely the fraud diamond by adding one element, namely competence. After that, the fraud pentagon theory was proposed by Crowe Howarth (2011) by adding the arrogance element. The addition of this element is a refinement of the fraud pentagon theory which has elements including pressure, opportunity, rationalization, capability, and arrogance.

External Pressure

SAS No. 99, excessive pressure exerted from external parties risks fraud on financial statements. According to Yossi and Desi (2018), the pressure obtained by management is a result of the need to obtain debt or research and capital expenditures so that the company can compete competitively. The debt ratio of a company can describe the comparison of the amount of debt and assets owned by the company. If the company has high leverage, it can be said that the company has high debt and credit risk (Meliana Jaunanda et. al, 2020). The results of research by Meliana (2020) and Nanin (2020) state that external pressure has a significant effect on fraudulent financial reporting.

H1: External pressure affects fraudulent financial reporting.

Financial Targets

Financial targets are the pressure received by management who are led to achieve the company's financial targets in a certain period. According to SAS No. 99 (AICPA, 2002), financial targets set by company directors include receiving bonuses from revenue which causes excessive pressure on management so that it can lead to the possibility of financial statement fraud. Financial targets are shown by the return on assets that have been used in the company. The return of assets ratio is a tool that aims to measure company performance (Yossi and Desi, 2018). The higher the ROA results, the greater the possibility of fraud in the financial statements. The results of research by Yossi (2018) and Nanin (2020) state that financial targets have a significant effect on fraudulent financial reporting.

H2: Financial targets affect fraudulent financial reporting.

Ineffective Monitoring

Ineffective monitoring is an ineffective supervisory system that comes from the company commissioner to monitor company performance and help reduce the occurrence of fraudulent financial statements. SAS No. 99 states that ineffective monitoring can occur because there is a person or group that dominates company management. The supervision of the company commissioners is considered a good company control system. The number of independent commissioners and the number of commissioners with an average of 50% are considered not working effectively and maximally in overseeing management performance, so this comparison can be a potential for fraudulent financial reporting (Yossi and Desi, 2018). The results of research by Meliana (2020) show the results that ineffective monitoring has a significant effect on fraudulent financial reporting.

H3: Ineffective monitoring affects fraudulent financial reporting.

Change Of Auditor

The external auditor audits the financial statement to obtain an opinion on whether the financial statements are fair or not. SAS No. 99 (AICPA, 2002), change of auditor is a change in the company's external auditor which can be an opportunity for fraud in the financial statements. Companies changing external auditors may aim to cover up or erase traces of fraud found by the old auditor. Old auditors are believed to be better able to detect either directly or indirectly the possibility of fraud committed by management in the financial statements (Haryono and Rahma, 2020). The results of research by Alif and Indira (2021) state that the change of auditor has a positive effect on financial reporting fraud.

H4: Change of auditor affects fraudulent financial reporting.

Change Of Director

International Journal of Multidisciplinary Research and Publications
ISSN (Online): 2581-6187

Law No. 40 of 2007 Article 105 Paragraph 1 regarding Limited Liability Companies contains that the directors of a company can stop or be dismissed at any time in accordance with the GMS regulations and explain the reasons for dismissal. The election of new directors aims to appoint directors who are fit to carry out their duties and improve the performance of the previous directors. The replacement of new directors can cause a stress period. Changing directors is considered an effort to reduce the effectiveness of management performance because it takes time to adapt to the work culture of the new directors (Yossi and Desi, 2018). This allows the change of directors to be one of the causes of fraudulent financial reporting. The results of research by Yosi (2018) and Nanin (2020) state that change of director has a positive effect on financial reporting fraud.

H5: Change of director affects fraudulent financial reporting.

Family Firms

Family firms can be good or bad for the company. Family firms are usually between the main positions in the company such as the position of commissioner occupied by parents and the position of director occupied by their children. Companies that have family firms are considered less effective in overseeing company performance and have strong power for their personal affairs so that opportunities for fraud can occur (Naomi and Dedik, 2020). can be a reason for the board of directors to give the CEO the authority to prioritize personal matters within the company (Naomi and Dedik, 2020). The results of research by Matoussi and Gharbi (2011) state that family firms have a positive effect on financial reporting fraud.

H6: family firms affect fraudulent financial reporting.

III. METHODOLOGY

This research is a quantitative descriptive study. The population used is all property, real estate and construction companies listed on the IDX in 2019-2021. The purposive sampling method was used in selecting samples in the study. So that there are 53 companies used as samples in this study. The data collection technique is carried out by collecting company annual report documents which can be accessed through the IDX website address or the company's official website. The analysis method used in this research is logistic regression analysis.

This study uses two variables, namely the dependent variable and the independent variable. The dependent variable in this study is fraudulent financial reporting. The measurement of fraudulent financial reporting in this study uses the Beneish M-Score (1999). The formulation of the Beneish M-Score formula can be described as follows:

M-Score = -4.84 + 0.920 DSRI + 0.528 GMI + 0.404 AQI + 0.892 SGI + 0.115 DEPI – 0.172 SGAI – 0.327 LVGI + 4.697 TATA

The independent variables in this study use the following measurements:

TABLE I. Operational Measurement

Variable	Indicators	Source
Independent Variable		
External Pressure (LEV)	$LEV = \frac{Total\ Hutang}{Total\ Aset}$	Haryono and Rahima, 2020
Financial Targets (ROA)	$ROA = \frac{Laba\ Bersih\ t}{Total\ Aset\ t}$	Yossi and Desi, 2018
Ineffective Monitoring (BDOUT)	$BDOUT = \frac{Jumlah\ Komisaris\ Independen}{jumlah\ Dewan\ Komisaris}$	Haryono and Rahima, 2020
Change Of Auditor (CPA)	Dummy variable where the external auditor change is given the number 1 and the number 0 for companies that do not change external auditors.	Haryono and Rahima, 2020
Change Of Director (DCHANGE)	A dummy variable where the change of director is given the number 1 and the number 0 for companies that do not change directors.	Haryono and Rahima, 2020
Family Firms (DUAL)	The dummy variable where there is an affiliation relationship between directors and commissioners in the company is given the number 1. number 0 for companies where there is no affiliation relationship between directors and commissioners.	Naomi and Dedik, 2020

IV. RESULT AND DISCUSSION

TABLE II. Descriptive Statistic

Variable	N	Min	Max	Mean	Standard Deviation
M-Score	159	0	1	.35	.479
LEV	159	.0745	1.1080	.445325	.2173141
ROA	159	-.4386	.2774	.001648	.0719589
BDOUT	159	.167	.750	.41663	.101061
CPA	159	0	1	.10	.302
DCHANGE	159	0	1	.48	.501
DUAL	159	0	1	.47	.500
Valid N	159				

Source: data processed, 2023

Based on the results of descriptive statistical analysis, the amount of data tau N in this study is 159 companies. the minimum value of the m-score variable is 0, the maximum value is 1, has an average value of 0.35, and a standard deviation value of 0.479. The minimum value of the external pressure variable (LEV) is 0.0745, the maximum value is 1.1080, has an average value of 0.445325, and a standard deviation value of 0.2173141. The minimum value of the financial targets variable (ROA) is -0.4386, the maximum value is 0.2774, has an average value of 0.001648, and a standard deviation value of 0.719589. The minimum value of the ineffective monitoring variable (BDOUT) is 0.167, the maximum value is 0.750, has an average value of 0.41663, and a standard deviation value of 0.101061. Then the change of auditor (CPA) variable has a minimum value of 0, a maximum value of 1, has an average of 0.10, and a standard deviation value of 0.302. The change of director variable (DCHANGE) has a minimum value of 0, a maximum value of 1, an average value of 0.48, and a standard deviation of 0.501. The family firms variable (DUAL) has a minimum value of 0,

Anisa Nur Oktaviana and Triyono, "Analysis of the Effect of the Fraud Pentagon in Detecting Fraudulent Financial Reporting (Empirical Study of Property, Real Estate and Construction Companies Listed on the IDX in 2019-2021)," *International Journal of Multidisciplinary Research and Publications (IJMRAP)*, Volume 5, Issue 11, pp. 1-5, 2023.

a maximum value of 1, an average value of 0.47, and a standard deviation value of 0.500.

This study uses a logistic regression model hypothesis analysis test which is tested using the SPSS application. The following is a table of logistic regression analysis test results:

TABLE III. Logistic Regression Test

Variable	B	Sig	Results
LEV	-1.672	.049	H1 Accepted
ROA	6,631	.046	H2 Accepted
BDOUT	.508	.764	H3 Rejected
CPA	.763	.174	H3 Rejected
DCHANGE	.313	.372	H4 Rejected
DUAL	-.544	.128	H5 Rejected
Constant	-.133	.875	H6 Rejected

Source: data processed, 2023

The first step in logistic regression analysis is to assess the overall model. From the results of the table assessing the overall fit of the model at -2 Log Likehood Block Number = 0, it shows a decrease in value at -2 Log Likehood Block Number = 1 of 14.006. The decrease in these results indicates a better regression model or in other words, the hypothesized model fits the data. The NagelKarke R2 value shows 0.116 in the model summary results. This means that the variability of the dependent variable that can be explained by the independent variable is 11.6%, while the remaining 88.4% is explained by other variables not used in this study. The Hosmer and Lameshow test value is 0.246. These results can be interpreted that H0 is accepted because the significance value is greater than 0.05, so the model is able to predict the observation value. Then the classification test results show that the model's ability to predict the occurrence of financial reporting fraud or no financial reporting fraud is 66.7%. The possibility of the company committing financial statement fraud is 23.2% of the total sample data of 159. while the company did not commit financial reporting fraud amounted to 90.3% of the total sample data of 159..

Based on table III, the results of logistic regression analysis of the external pressure variable (LEV) obtained a significant value of 0.049, which means that this value is smaller than 5% or 0.05. This means that the external pressure variable has a significant effect on fraudulent financial reporting. So it can be concluded that H1 is accepted. The leverage ratio makes debt accounts the main source of meeting company financing. The higher the company's credit risk makes creditors worried about lending to the company. The results of this study support agency theory that when management feels that their work has failed, managers are motivated to commit fraud because there is fraud to prove that managers have worked optimally according to the interests of the principal. The results of this study are in accordance with research conducted by Meliana et. al (2020) and Nanin et al (2020) which state that external pressure has a significant effect on fraudulent financial reporting. So it is concluded that the value of external pressure leverage can detect fraudulent financial reporting.

Financial Targets (ROA) obtained a significant value of 0.046, which means that this value is smaller than 5% or 0.05. This means that the external pressure variable has a significant effect on fraudulent financial reporting. So it can be concluded that H2 is accepted. Financial targets can be utilized by third parties to practice fraudulent financial statements. The company's financial report on the asset and profit account can be used as a gap for management in committing fraudulent acts. The results of this study are in accordance with research conducted by Yosi (2018) and Nanin (2020) which states that financial targets have a significant effect on fraudulent financial reporting. The higher the ROA results, the greater the possibility of fraudulent financial reporting of the company.

Ineffective monitoring (BDOUT) obtained a significant value of 0.764, which means that this value is greater than 5% or 0.05. This means that the ineffective monitoring variable has no significant effect on fraudulent financial reporting. So it can be concluded that H3 is rejected. This happens because the supervision carried out by the company is effective, indicating that the control system is working well. Even though the number of independent commissioners and all commissioners is small, it will not affect the occurrence of fraudulent financial reporting. The results of this study are not in accordance with research conducted by Meliana et. al (2020). However, it is supported by research conducted by Ajeng et. al (2022) and Ayu et. al (2021), which states that the supervision carried out by the company aims to prevent and will detect fraud even though the number of independent commissioners and company commissioners is small.

Change of auditor (CPA) obtained a significant value of 0.174 which means that the value is greater than 5% or 0.05. This means that the change of auditor variable has no significant effect on fraudulent financial reporting. it can be concluded that H4 is rejected. The company made a change of auditor due to the company's dissatisfaction with its external auditor. The company changes the external auditor (change of auditor) aims to improve or improve the quality of the company's financial statements so that auditor changes are not always related to fraudulent financial reporting. The results of this study are not in accordance with research conducted by Alif and Indira (2021). However, it is supported by research conducted by Ajeng et. al (2022) and Armya et. al (2019), which states that the task of external auditors is not only to find fraud but also to supervise and provide opinions on financial statements in accordance with applicable regulations.

Change of director (DCHANGE) obtained a significant result of 0.372 which means that this value is greater than 5% or 0.05. This means that the change of director variable has no significant effect on fraudulent financial reporting. So it can be concluded that H5 is rejected. The change of company directors is always related to the existence of fraudulent financial reporting. The change of the board of directors is because the old directors are considered unable to carry out their duties so that the change of directors is expected to be able to improve or improve the quality of performance which is considered more competent and able to contribute more optimally to company performance. The results of this study are not in accordance with research conducted by Yosi (2018) and Nanin (2020). However, it is supported by research conducted by Armya et. al (2019) and Ajeng et. al (2022) which provides empirical evidence that change of director has no significant effect on financial reporting fraud.

Family firms (DUAL) obtained a significant result of 0.128 which means that the value is greater than 5% or 0.05. This means that the family firms variable has no significant effect on fraudulent financial reporting. So it can be concluded that H6 is rejected. Family firms have a long-term vision that aims to maintain the image of the company's value and good name in the eyes of the public. By maintaining the control system by family members, it is considered that the company is more consistent in its performance. So that family firms are not always associated with fraudulent financial reporting. The results of this study are not in accordance with research conducted by Matoussi and Gharbi (2011). However, it is supported by research conducted by Ayu et. al (2021) which provides empirical evidence that family firms have no significant effect on financial reporting fraud.

V. CONCLUSION

This study is used to examine the fraud pentagon factors that can influence the detection of fraudulent financial reporting in property, real estate and construction companies on the Indonesia Stock Exchange (IDX) in 2019-2021. Based on the results of data processing in this study, it is concluded that external pressure and financial targets have a significant effect on fraudulent financial reporting. while other variables such as ineffective monitoring, change of auditor, change of director, and family firms have no significant effect on fraudulent financial reporting.

Based on the conclusions of this study, the researcher provides the following suggestions: first, future researchers can use the population of other company sectors. Second, researchers can extend the research period in order to get more accurate results, for example five years to ten years. Thirth, urther research is expected to conduct a study by including the impact during the covid-19 pandemic situation.

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