Covid-19 Pandemic Situations' Impact on the Relationship Between False Financial Statements and Real Earnings Management: A View from the Fraud Hexagon Theory

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Abstract. Due to the Covid 19 pandemic crisis, many businesses have seen their economic activity diminish, which motivates them to implement actual profits management. Companies may have the possibility to fabricate financial statements to enhance the appearance of their financial reports as a result of this circumstance. This study seeks to ascertain and analyze the impact of the COVID-19 pandemic situations on the relationship between fraudulent financial statements from the perspective of the fraud hexagon theory, which includes stimulus/pressure, capability, opportunity, rationalization, arrogance, and collusion on real earnings management. This research uses quantitative techniques and includes hypothesis testing. The secondary data utilized was obtained from the annual reports of consumer cyclical firms that were listed on the Indonesia Stock Exchange (IDX) before (2019) and during the Covid-19 epidemic (2020). Utilizing the purposive sampling approach, data were gathered. According to the study's findings, actual profits management was positively impacted by financial stability and opportunity, but not by capacity, rationalization, hubris, or collusion. It was discovered that the pandemic scenarios did not exacerbate the impact of false financial statements on the management of profitability. As a result, the firm works to keep its cash flow in good shape so that its finances are solid and its operations are not difficult. The business might make an attempt by appointing an impartial commissioner who has the designation of accountant or CPA and has the capacity to spot financial statement fraud.

Keywords: False Financial Statements, Real Earnings Management, Fraud Hexagon Theory

1 Introduction

Financial reports are the final product of the accounting process and are the main source of financial information for companies. Profit is one of the most widely used financial indicators as a basis for decision making by interested parties (company owners, managers, bankers, creditors, investors). Investors often decide to invest in a company solely on the basis of the large amount of profit the company generates, regardless of

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how those profits are earned. As a result of this situation, managers often try to show their success by showing the amount of profit they have generated. Earnings management is one of the methods used by management to achieve the targets set by the owners/shareholders.

Management cannot only rely on accrual manipulation to affect earnings [1]. If accrual manipulation fails to meet its objectives, management can also manipulate earnings through real activities. Real earnings management is a earnings engineering carried out by managers by manipulating the real activities that exist in the company. Earnings manipulation through real activities tends to be used by management because it is known to be more difficult to detect and can be carried out throughout the period. Earnings management practices will encourage the emergence of information asymmetry in users of financial statements, and allow management to commit more irregularities, including fraud. The pandemic situation that emerged in early 2020 caused almost all companies to experience a decline due to slowing economic activity to a halt. As a result, several sectors are trying their best to remain stable in a situation like this, one of which is by making financial reports that look good (window dressing), that isnt earnings management.

Based on the results of earlier studies [2], [3], and [4], it was determined that there were still discrepancies in the findings and gaps in the literature regarding financial statement fraud from the perspective of the fraud hexagon theory. Additionally, because of the significant number of cases of financial statement fraud discovered, this research is still interesting and deserving of further investigation. This research bases its evaluation of the impact on falsified financial statements on the hexagon fraud hypothesis, which is the most recent fraud theory created from earlier fraud ideas, such as pentagon fraud, diamond fraud, and triangle fraud. This study employs hexagon fraud as a foundation for evaluating its impact on false financial statements since it is the most recent idea created from earlier fraud hypotheses, such as pentagon fraud, diamond fraud, and triangle fraud. It is anticipated that the fraud hexagon, which includes the stimulus/pressure, capability, opportunity, rationalization, arrogance, and collusion variables, will be able to identify fraudulent financial statements using the real earnings management method more thoroughly and with the addition of the Covid-19 pandemic situation as a moderating variable, which was not found in previous studies. The hypotheses of this research are (1) H1: Stimulus/Pressure has a positive effect on real earnings management, (2) H2: Capability has a positive effect on real earnings management, (3) H3: Opportunity has a positive effect on real earnings management, (4) H4: Rationalization has a positive effect on real earnings management, (5) H5 : Arrogance/Ego has a positive effect on real earnings management, (6) H6 : Collusion has a positive effect on real earnings management, (7) H7: The Covid-19 pandemic situation has strengthened the influence of stimulus/pressure on real earnings management, (8) H8 : The Covid-19 pandemic situation strengthens the effect of capability on real earnings management, (9) H9 : The Covid-19 pandemic situation has strengthened the influence of opportunity on real earnings management (10) H10: The Covid-19 pandemic situation strengthens the rationalization effect on real earnings management, (11) H11: The Covid-19 pandemic situation strengthens the effect of arrogance/ego on real earnings management and H12 : The Covid-19 pandemic situation has strengthened the effect of collusion on real earnings management.

2 Research Method

2.1 Population and Research Sample

The population used in this study consists of 57 companies from the non-primary consumer goods (consumer cyclicals) sub-sector that have been registered and published on the Indonesia Stock Exchange (IDX) for the 2019 period prior to the covid-19 pandemic and the 2020 period during the covid-19 pandemic, for a total sample of 114 samples. In order to ensure that the data gathered for this study were more representative and in line with the goals of the research, the sample was determined using a purposive sampling methodology, which involves applying a number of criteria to choose the research sample.

2.2 Variables And Measurement

Table 1 describes the variables and measurements used in this study:

Table 1. Variable and Measurement

Variable	Variable Type	Measurement	Scale
Real Earnings Management [12]	Dependent	REM = (Abnormal CFO*-1) + Abnormal PROD + (Abnormal DISC*-1)	Ratio
Stimulus/ Pressure [5]	Independent	ACHANGE = (Total Asset t − Total Asset t-1)/Total Asset t-1	Ratio
Capability [13]	Independent	DCHANGE : Code 1 if there is a change of directors, and Code 0 if there is no change of directors	Nominal
Opportunity [14]		BDOUT = (Number of Independent Commissioners/Total Board of Commissioners) x -1	Ratio
Rationalization [14]	Independent	CPA = Code 1 if there is a company that replaces public accounting firm, and Code 0 if there is no public accounting firm replacement	Nominal
Arrogance [10]	Independent	CEOPIC = The large number of CEO profiles that appear in the company's annual report	Ratio
Collusion [15]	Independent	POLITICAL : Code 1 if the company has directors or a board of commissioners with dual positions in the government, and Code 0 if the company does not have directors or a board of commissioners with dual positions in the government.	Nominal
Covid 19 Pandemic Situation [16]	Moderating	COV : Code 1 for the state of the company after the covid pandemic, and Code 0 for the state of the company before the covid pandemic.	Nominal
Age [17]	Control	AGE : The age of the company is measured from when the company was founded, to the annual reports used in the research	Ratio

2.3 Data analysis technique

To determine if the independent factors' effects on the dependent variable were significant, this study employed descriptive statistical tests, traditional assumption tests, and hypothesis testing. The following is the research framework.

$$REM = \alpha + \beta 1ACHANGE + \beta 2DCHANGE + \beta 3BDOUT + \beta 4CPA + \beta 5PICT + \beta 6POLITICAL + \beta 7COV + \beta 8ACHANGE.COV + \beta 9DCHANGE.COV + \beta 10BDOUT.COV + \beta 11CPA.COV + \beta 12PICT.COV + \beta 13POLITICAL.COV + \beta 14AGE + \varepsilon \quad (1)$$

Where: REM = Real Earning Management, ACHANGE = Financial Stability (Stimulus/Pressure), DCHANGE = Change in Director (Capability), BDOUT = Ineffective Monitoring (Opportunity), CPA= Change in Auditor (Rationalization, PICT = Frequent Number of CEO's Pictures (Arrogance/ego), POLITICAL = Political Connection (Collusion), COV = Covid-19 Pandemic Situation, AGE = Firm Age

3 Result and Discussion

3.1 Operation Data

Based on predetermined criteria, the sample obtained was 114 samples and table 1 dan Table 2 shows Descriptive Statistics of variables.

Table 2. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
REM	114	0,005	1,118	0,236	0,251
ACHANGE	114	-0,777	0,812	0,029	0,204
BDOUT	114	-0,667	-0,250	-0,436	0,100
PICT	114	0,00	16,00	2,447	1,858
AGE	114	5,000	89,000	33,710	16,446

Source: Processed SPSS output

Table 3. Frequency Table

Variables	N Sample	Dummy = 1		Dummy = 0	
		n	%	n	%
DCHANGE	114	53	46,5	61	53,5
CPA	114	27	23,7	87	76,3
POLITICAL	114	13	11,4	101	88,6
COV	114	57	50,0	57	50,0

Source: Processed SPSS output

3.2 Hypothesis Testing Results

Before testing the hypothesis, the classical assumption test is carried out. The results of the multiple regression model's classical assumption tests showed that the assumptions of normality, heteroscedasticity, autocorrelation, and multicollinearity were all true.

Based on the outcomes of the processing of the research model, multiple regression analysis is used to evaluate the hypothesis. As shown below is the multiple regression model:

REM= 0.625+0.325($ACHANGE$) + 0.025($DCHANGE$) + 0.577($BDOUT$) – 0.025(CPA) – 0,018($PICT$) – 0.122($POLITICAL$) – 0.165(ACHANGE.COV) –0.007(DCHANGE.COV) + 0.074(BDOUT.COV) – 0.034(CPA.COV) – 0.014(PICT.COV) + 0.051(POLITICAL.COV) – 0.002 (AGE) (2)

Table 4. Frequency Table

Variable	Prediction	B	Beta	t	Sig. (One Tailed)	Conclusion
(Constant)		0.625		5.059	0.000	
ACHANGE	+	0.325	0.264	2.501	0.007	H_1 accepted
DCHANGE	+	0.025	0.050	0.396	0346	H_2 rejected
BDOUT	+	0.577	0230	2.306	0.012	H_3 accepted
CPA	+	-0.025	-0.043	-0.342	0.366	H_4 rejected
PICT	+	-0.018	-0.130	-1.163	0.124	H_5 rejected
POLITICAL	+	-0.122	-0.155	-1.263	0.105	H_6 rejected
ACHANGE.COV	+	-0.165	-,067	-0.643	0.261	H_7 rejected
DCHANGE.COV	+	-0.007	-0.012	-0.077	0.469	H_8 rejected
BDOUT.COV	+	0.074	0.069	0.389	0.349	H_9 rejected
CPA.COV	+	-0.034	-0.040	-0.312	0.378	H_{10} rejected
PICT.COV	+	-0.014	-0.090	-0.548	0.293	H_{11} rejected
POLITICAL.COV	+	0.051	0.046	0.369	0,357	H_{12} rejected
AGE		-0.002	-0.117	-10.229	0.111	

Source: Processed SPSS output

3.3 Discussions

The stimulus/pressure variable, which is represented by financial stability, has a favorable and strong impact on real earnings management. The findings of this study are corroborated by earlier research [5], which claimed that businesses with stable finances but significant asset fluctuations are likely engaging in dishonest business practices, such as profits manipulation. In an effort to increase the likelihood that it will be a successful business, one way the corporation does this is by falsifying data about the value of the assets it has in order to entice investors to make investments in the business. The findings of this study are also consistent with research by [6], which claims that financial stability serves as a proxy for stimulus or pressure that has a strong favorable impact on financial statement fraud. Earnings management is employed in this study as a measure of financial statement fraud. Conclusion: The demands for financial stability that exist within a company can exert significant pressure on management, motivating management to take actions that company management is not supposed to take, like manipulating real earnings (real earnings management) so that the company can continue to be profitable. demonstrates to investors that the firm is in solid financial position.

Real earnings management is unaffected by the capacity shown by changes in directors (changes in directors). The consumer cyclicals, which are firms in the non-primary consumer goods subsector, are the ones whose companies are used to measuring the change in director variable. The results of this study are at odds with research by [20], [18], and [7], as well as research by which it was concluded that the more frequently directors are replaced, the greater the likelihood that financial reporting is being produced fraudulently. This study's findings, however, are consistent with those of [19], which found that the risk of financial statement fraud is unaffected by changes in a company's board of directors. In this study, earnings management was employed as a proxy for financial statement fraud risk. Thus, it may be said that the firm changed its board of directors in order to boost the company's performance by selecting new directors who are thought to be more qualified than the outgoing directors rather than hide the genuine earnings management practices used by the prior directors.

The management of actual profits is significantly and positively impacted by opportunity as proxied by inefficient monitoring. This is consistent with research by [8], which explains that Opportunity, as represented by inefficient monitoring, has an impact on false financial statements. In this study, the measurement of fraudulent financial statements employed is earnings management. So, it can be inferred that poor monitoring has an impact on actual earnings management, where the chance of earnings management activities occurring increases with the degree of ineffectiveness of internal controls. Because if a corporation has enough control or oversight, there may be openings or chances for internal manipulation of actual earnings (real earnings management). On the other hand, the likelihood of genuine profits management decreases as a company's control increases.

The management of actual earnings is unaffected by rationalization as measured by changes in auditors. To determine if the change in auditors was voluntary and not brought about by orders or rules from the authorities, the change in auditor variable is examined. The findings of this study are at odds with those of previous research [19], which demonstrates a substantial relationship between the auditor turnover variable and earnings management. This research contrasts with that of [9]), who found that the more frequently a company's management changes its public accounting firm, the more signs there are that the business is concealing the fraud that is being perpetrated. This research, however, is consistent with that of [20], which found that switching auditors had little impact on misleading financial reporting. Therefore, it can be concluded that changes in auditors have no impact on real earnings management because the company changed its auditors due to a management change, not because it wanted to hide the practice of manipulating real earnings. there are demands for additional services and needs that develop (other assurance services) at the time of the extraordinary general meeting of shareholders (EGMS) or from shareholders.

The frequent appearance of CEO pictures as a proxy for arrogance/ego has little impact on managing real profitability. The frequency with which corporations include CEO images in their annual reports is used to calculate the frequent number of CEO pictures variable. The findings of this study differ from those of [21]'s research since Howarth included arrogance as one of the factors that contribute to fraud in this study, which focused on earnings management practices. The findings of this study also stand in contrast to research done [8], which found that the quantity of CEO images published on websites is a sign of the arrogance to which CEOs are inclined, as they seek to demonstrate to the public that they hold the greatest position within the organization. This study, however, is consistent with a study by [22] that found that CEOPIC-based measures of arrogance have little impact on managing profitability. Therefore, it can be concluded that the inclusion of a CEO photo in a company's annual report serves as a method of corporate transparency to both investors and the general public by introducing anyone who serves on the board of directors of the company and as a method of accountability for performance and all forms of reporting submitted by the company for a given year.

Political ties are determined by whether or not management at the board of directors or board of commissioners holds several seats in the government. The findings of this study are at odds with those of a study by [11], which claimed that political ties had a considerable favorable impact on earnings management. The research done by [2] also shows that collaboration has a considerable favorable impact on financial statement fraud, although the measurement of financial statement fraud utilized in this study is earnings management. This study supports the findings of a study by [26] that political ties have little impact on managing profits. Therefore, it may be argued that the presence of political connections inside a corporation has little impact on genuine profits management since politically linked organizations are typically subject to public scrutiny, which causes them to scale down on their efforts to control earnings. Companies with political ties actually have lower financial statements in terms of profits quality than comparable businesses without political ties. Poor profitability will have a detrimental effect on the business, such as fewer investors or the possibility of inspection. Companies with political ties, however, don't worry about this since they can mitigate or even completely eradicate the negative effects that are already there.

The Covid-19 pandemic situation did not strengthen the effect of stimulus/pressure which was proxied by financial stability on real earnings management. The Covid-19 pandemic situation variable was measured by looking at non-primary consumer goods (consumer cyclicals) sub-sector companies in the year before the pandemic, namely 2019 and when the Covid-19 pandemic occurred, namely 2020. The Covid-19 pandemic situation that occurred in early 2020 resulted in a decrease in the company's income aspect due to the weakening purchasing power of the people, therefore company productivity decreased, which indeed caused financial instability in a company. However, this is not a pressure or encouragement for the companies used in this study to manipulate real earnings. The condition of the company's financial decline during the Covid-19 pandemic was very reasonable in the eyes of investors, so it was very unlikely for managers to engineer or manipulate earnings, especially since the companies used in this study were not engaged in medical equipment and pharmaceuticals, which at the time Covid-19 is needed by the wider community.

The Covid-19 pandemic situation did not strengthen the effect of capability as a proxy for changes in directors on real earnings management. The Covid-19 Pandemic situation has had an impact on the decline in the national economy. It was written that many companies had stopped their business operations or chose to go out of business because they experienced too great a loss due to this pandemic. Therefore, the company made a change of directors because the company needed more competent directors who could handle a crisis situation during this pandemic so that the company could maintain its company's performance and not suffer losses that led to the termination of its company's operations. So, the company's change of directors during the Covid-19 pandemic was not to cover up the company's real earnings management practices.

The Covid-19 pandemic situation variable does not strengthen the influence of opportunity which is proxied by ineffective monitoring of real earnings management. The policy adopted by the government in order to break the chain of spread of the Covid-19 pandemic is by implementing large-scale restrictions in the form of PSBB and PPKM in all regions of Indonesia as a strategy to inhibit the spread of Covid-19. The PSBB that has been implemented has an impact on all outdoor activities, so that these activities are transferred online, including all office activities are transferred to Work from Home (WFH). This policy resulted in the company not being able to monitor the company's activities and performance directly. However, this is not an obstacle. Companies can still conduct remote monitoring of the performance of their employees by following the guidelines issued by the Ministry of Manpower of the Republic of Indonesia Number 312 of 2020 concerning Guidelines for Preparing Business Continuity Planning in Facing a Disease Pandemic. So, it can be concluded that the existence of the Covid-19 Pandemic did not provide an opportunity for perpetrators to commit acts of fraud through real earnings management practices.

The Covid-19 pandemic situation variable does not strengthen the effect of rationalization proxied by changes in auditors on real earnings management. The Covid-19 pandemic situation has not only caused the public's financial condition to deteriorate, but has also had an impact on the decline in income and the economy of all corporate sectors and even the state financial economy. Thus, many companies are trying to reduce costs in order to survive this pandemic. In this study the measurement used is the number of auditor changes made by a company to see whether there is a rationalization effect on real earnings management, but in the conditions of Covid-19, many auditor changes are made by companies not to cover up fraud committed, but it is possible that the replacement was made due to several considerations. One of them is that the possibility of a company changing auditors during a pandemic is because the company wants to find a cheaper auditor/Public Accounting Firm so that it can reduce the costs that the company has to incur for audit fees, auditor transportation costs, and so on.

The Covid-19 pandemic situation variable does not strengthen the effect of arrogance proxied by the frequent number of CEO's pictures on real earnings management. The visible impact of the presence of Covid-19 does not only affect public health, but also affects the economy in various countries and various sectors. In this case, company executives or CEOs are faced with tough challenges that force them to be able to adapt and bring their business through a crisis while still complying with requests from the majority shareholders. However, regardless of the presence or absence of Covid-19, the presence of a CEO photo in a company's annual report is a form of corporate transparency to both investors and the public in introducing anyone who occupies the board of directors in the company and as a form of responsibility for performance and all forms of reporting submitted by the company during one period.

The variable situation of the covid-19 pandemic does not strengthen the effect of collusion proxied by political connections on real earnings management. The COVID-19 pandemic is causing jitters in financial markets. Companies in all sectors without exception are affected by this situation. If there are companies that are affected and then manipulate profits and get protection or are given privileges by their political connections, this will be very obvious/too obvious. So that it will be easy to invite suspicion and questions from various parties resulting in the company and its political connections receiving special attention by the media or legal entities which can then be followed up. Companies that have political connections tend to be more careful in making policies or decisions because if they take the wrong steps, it can be detrimental to both parties. Thus, it can be concluded that the Covid-19 pandemic situation has not strengthened the effect of collusion on real earnings management.

4 Conclusion

Based on the results of the research, it can be said that (1) Stimulus/pressure, which is represented by financial stability, has a positive impact on real earnings management, (2) Capability, represented by changes in directors (changes in directors), has no impact on real earnings management, (3) Opportunity, represented by ineffective monitoring, has a positive impact on real earnings management, and (4) Rationalisation, represented by changes in auditors (changes in auditor (5) The frequency with which CEOs are seen does not indicate arrogance, (6) Political ties do not indicate collusion, and (7) Real earnings management is unaffected by any of these factors. (7) The Covid-19 pandemic scenario did not enhance the impact of stimulus/pressure, which was proxied by financial stability, on real earnings management. (8) The Covid-19 pandemic situation did not strengthen the impact of capacity, which was a proxy for changes in directors, on real earnings management. (9) The Covid-19 pandemic condition does not increase the influence of opportunity, which is indicated by inefficient real earnings management monitoring. (10) The Covid-19 pandemic situation did not strengthen the impact of rationalization on real earnings management as indicated by changes in auditors. (11) The Covid-19 pandemic situation did not strengthen the impact of arrogance as indicated by the frequent use of CEO pictures. (12) The scenario with the COVID-19 epidemic did not exacerbate the impact of political connections-based cooperation on genuine earnings management. This study's shortcomings were discovered by the researchers.

Because not all published yearly reports are comprehensive, not all of the data utilized in this study were able to be used. As a result, the number of samples was constrained. The following study's implications are (1) Real earnings management is proven to rise under pressure or stimulus that is proxied by financial stability. The corporation may thus make an effort to preserve its cash flow so that its finances stay solid and its operational operations are not difficult by doing so, (2) It has been demonstrated that opportunity proxied by ineffective monitoring can increase actual profits management techniques. Consequently, the corporation can try to stop actual earnings management by appointing an impartial commissioner with the status of accountant or CPA who is able to spot fraud in financial statements. According to the most recent sector classification, IDX-IC, the researcher can make the following recommendations for future research: (1) broaden the sample of companies using other sectors; and (2) include additional independent variables that have an impact on real earnings management, such as leverage to withstand external pressure, audit opinion as a proxy for rationalization, and CEO duality as a proxy for arrogance. (3) Conduct study over a longer time span rather than only two years, from 2019 to 2020, the years prior to the covid-19 epidemic, since this would result in different research findings.

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