



## LITERATURE REVIEW ON DETECTING FINANCIAL STATEMENT FRAUD USING THE FRAUD DIAMOND THEORY

Arfiansyah Abdillah Manurung<sup>1</sup>, Andhika Chandra<sup>2</sup>, Joy Daniel Purba<sup>3</sup>, Deliana Deliana<sup>4</sup>, Asrin Jazuli<sup>5</sup>

Department of Accounting, Politeknik Negeri Medan, Indonesia

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### ABSTRACT

This study aims to analyse how the Fraud Diamond theory can be used to detect and prevent financial statement fraud in Indonesian companies. Using the Systematic Literature Review (SLR) method, this study reviews 16 relevant journals obtained from databases such as Garuda, Google Scholar, and Sinta. The findings show that the four elements of the Fraud Diamond—pressure, opportunity, rationalisation, and capability—have varying degrees of influence on financial statement fraud. Pressure is identified as the dominant factor that drives management to manipulate financial data, while opportunity arises from weak internal control systems. Rationalisation serves as a psychological justification for unethical actions, and capability reflects the technical skills and authority of perpetrators to effectively conceal fraud. Furthermore, the implementation of Good Corporate Governance (GCG), particularly through the role of independent audit committees, can moderate the risk of fraud and improve detection effectiveness. This study concludes that integrating the elements of the fraud diamond with strong governance practices is essential for establishing a framework for preventing financial statement fraud in Indonesia.

#### Corresponding Author:

Arfiansyah Abdillah Manurung

Department of Accounting, Politeknik Negeri Medan

Medan, Sumatera Utara

[arfiansyahabdillahmanurung@students.polmed.ac.id](mailto:arfiansyahabdillahmanurung@students.polmed.ac.id)

## INTRODUCTION

Current developments show that the economic environment is moving so rapidly that competition between companies is becoming increasingly fierce. This situation is encouraging all companies to maintain and improve their value and quality in order to remain attractive to investors and creditors so that they continue to invest and provide loans, thereby ensuring the sustainability of the company. However, over time, various serious problems have arisen, particularly in the form of financial statement fraud. This is done by irresponsible parties. Manipulation of financial statements by management and employees is often done to present attractive reports, with the aim of encouraging shareholders to continue investing.

Financial statements are a source of financial information presented by a company during a certain period (Furqani & Aprilia, 2021). Financial reports are an indispensable tool in company management, as the information they contain covers various aspects of financial performance such as income, expenses, assets, liabilities, and equity. By utilising financial reports, management

can gain a deeper understanding of the company's financial condition, which can then be used as a basis for making strategic decisions. However, financial statements also have the potential to be used for unethical or illegal actions to conceal fraud or financial manipulation, which ultimately harms stakeholders. (Galih Saputra & Sisdiyanto, 2024)

Fraud in the presentation of financial statements is a very important issue to pay attention to so that such actions can be detected and financial statements remain trusted by stakeholders. Fraud is an act committed by individuals or groups with the aim of obtaining certain benefits through various means, such as deception, abuse of authority, or other actions that harm other parties, whether individuals or business entities. One of the most common forms of fraud occurs in financial statements. Financial statement fraud by management is usually triggered by several factors and conditions that put management under pressure to manipulate. In the current context, there are four main factors that cause fraud, namely pressure, opportunity, rationalisation, and capability, which are referred to as the Fraud Diamond (Wolfe & Hermanson, 2004). (Rahman Abdul et al., 2021)

As theories related to fraud have developed, experts have proposed various additional models such as the Fraud Diamond and Fraud Pentagon to further deepen the identification of fraud risks. The Fraud Diamond is an extension of the Fraud theory.

Triangle, adding a fourth element: capability. This element indicates that in addition to pressure, opportunity, and rationalisation, fraudsters must also possess certain capabilities to carry out fraud effectively, such as a deep understanding of accounting systems or company business processes. Individuals with such capabilities will find it easier to exploit weaknesses in the system for their personal gain. Thus, the Fraud Diamond emphasises that not all individuals who have the opportunity will commit fraud, because only individuals with certain capabilities are able to do so.

The Fraud Diamond is an extension of the Fraud Triangle philosophy, which consists of four main elements, namely pressure, opportunity, rationalisation, and capability (Ifazah et al., 2024). One model used to understand and prevent fraudulent acts is the Fraud Diamond theory. This theory identifies four main elements that underlie fraud, and by understanding these factors, auditors and management can raise awareness and take preventive measures early on. Unlike the Fraud Triangle, the Fraud Diamond model adds the aspect of perpetrator capability as an important factor that explains complex and structured fraud.

The relevance of the Fraud Diamond theory is very high in the Indonesian context, given that cases of fraud such as financial statement manipulation, asset manipulation, and fictitious transactions are still frequently found in both public and private companies. By comprehensively understanding and applying the Fraud Diamond, companies and auditors can more easily identify areas that are vulnerable to fraud and assess the effectiveness of internal controls that

have been implemented. Therefore, this study aims to analyse in depth how the Fraud Diamond can be used as a tool to prevent financial statement fraud and provide strategic recommendations for companies and auditors.

However, in practice, not all cases fit the Fraud Diamond theory. A real-life example can be seen in the Bank Jatim case that emerged in the first quarter of 2025. This case became a major financial scandal centred on fictitious credit practices worth Rp569.4 billion at the Jakarta Branch Office. The scandal was classified as creative accounting or serious financial statement manipulation, because it is suspected to have been orchestrated by the Head of the DKI Jakarta Branch together with two private parties who were later named as suspects.

## **THEORETICAL REVIEW**

### **Agency theory**

Theoretical research in agency theory, first introduced by Jensen and Meckling (1976) and later developed by Yulianto and Umam (2025), explains the conflict of interest between owners and managers. Owners expect managers to work in the interests of the company, while managers often have personal goals, such as maintaining their positions or obtaining bonuses. This situation becomes more complex when companies face external pressures, such as declining profits or high financial targets, as these circumstances can encourage managers to 'polish' financial reports to make them look healthy. Thus, external pressure is considered one of the factors that trigger fraud in financial reports. Andrean (2020) states that agency theory describes the relationship between shareholders as principals and management as agents in a cooperation contract. Shareholders tend to want high returns on investment, while management has an obligation to protect the interests of shareholders but still has a personal interest in improving their own welfare. It is this difference in interests that often leads to fraud in the presentation of financial statements.

### **Financial Statements**

Financial statements are a series of information presented by a company during a certain period. These documents serve as a means of communication to convey the company's financial condition and explain how economic activities are carried out and the results are reported to users such as investors and creditors. Financial statements also present the financial position of an entity and the results achieved, while giving an impression of the company's stability and reputation in the eyes of the market (Aprilia, 2021). This encourages every entity to present its financial statements as well as possible in order to maintain its existence.

In a business competition. However, because financial reports are also used by investors and creditors as a basis for decision-making, these reports are

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sometimes manipulated to appear better than they actually are. As a result, this type of manipulation can lead to fraud and damage the integrity of the capital market (Furqani & Aprilia, 2021) (Telugu, 2023) (Yulianto & Umam, 2025).

### **Financial Statement Fraud**

Fraud is a deliberate attempt to obtain illegal profits, which can be done by recording fictitious income, hiding costs, or presenting misleading financial data. Such fraudulent practices not only undermine investor confidence but also weaken the integrity of the capital market. Therefore, detecting financial statement fraud is important so that auditors can analyse the factors causing and indicating fraud. The relationship between external pressure and financial statement fraud is explained by Diliiana (2023), namely when principals demand that companies maintain the stability of profits and assets, thereby encouraging management to manipulate accounts to appear capable of meeting obligations such as debt payments or dividend distributions. (Yulianto & Umam, 2025) (Gunawan & Setya, 2023).

### **Fraud Diamond**

Fraud Diamond is a theory developed by Wolfe and Hermanson (2004) as an extension of the Fraud Triangle proposed by Cressey. This theory adds a fourth element, namely capability (Andrian & Salim, 2020). Fraud Diamond explains that fraud arises due to four main elements, namely pressure, opportunity, rationalisation, and capability. Pressure arises from the urge or need to commit fraud, often stemming from the principal's demand for management to achieve good financial performance. Opportunity arises when monitoring systems are weak and open loopholes for fraudulent acts. Rationalisation explains how individuals try to justify unethical actions. Meanwhile, capability describes the ability perpetrators to recognise opportunities and carry out fraudulent acts effectively without being easily detected..

### **Pressure**

Pressure is the dominant factor driving financial statement fraud. Financial pressure from profit targets, market competition or investor expectations may increase as the company's financial condition becomes unstable. This situation often leads management to seek quick ways to improve their performance image through financial statement manipulation. Research in various sectors such as manufacturing, insurance, and Islamic banking shows that pressure is positively related to the level of financial statement fraud. state that pressure (Mutiarra et al., 2024) (Isu & Sofie, 2025). Can be measured through a company's financial stability, while adding that significant asset growth reflects stable financial conditions and can reduce the potential for pressure that triggers fraud. (Angelita & Hasnawati, 2023).

### **Opportunity**

According to, opportunities for fraud often arise due to weak internal control systems, ineffective management oversight, and the lack of involvement from the board of commissioners and audit committee. Research shows that companies with high auditor turnover and vulnerable account management, such as accounts receivable, inventory, and total accruals, tend to have greater potential for fraud. Industry complexity also contributes to increased opportunities for fraud, particularly in sectors with high technical characteristics, such as construction and food and beverages. Therefore, strengthening IT audit systems and comprehensive oversight are important steps to reduce these opportunities. (Sinaga & Arief, 2023).

### **Rationalisation**

Amelia et al. (2024) explain that rationalisation is a process of mental justification by perpetrators to make their fraudulent actions seem reasonable. Psychological and organisational cultural factors play a major role in shaping this way of thinking. Individuals in managerial positions who feel they have special privileges or are under moral pressure often seek reasons to justify their actions. However, because rationalisation is difficult to measure empirically, research results on its influence on fraud are still mixed. Auditor turnover sometimes used as an indicator of rationalisation, but it is not always a sure sign of fraud (Rian Abrori et al., 2024).

### **Capability**

According to Intan Octaviani and Kartika Djati (2024), capability is an important element in the Fraud Diamond because it emphasises the perpetrator's intelligence, technical expertise, and strategic position in committing and covering up fraud. Perpetrators who understand accounting systems and organisational structures have greater ability to exploit system weaknesses. However, the influence of capability on fraud is often insignificant in large companies that have strict supervision and good governance.

### **The Role of Good Corporate Governance (GCG)**

Mutiara et al. (2024) explain that the implementation of Good Corporate Governance, particularly through the role of an independent and competent audit committee, can moderate the risk of fraud. Empirical studies of public companies and state-owned enterprises in Indonesia show that the effectiveness of audit committees can reduce the impact of pressure and opportunities for fraud. However, research also reveals that there are still weaknesses in the independence and frequency of audit committee meetings, so their effectiveness is not yet optimal. Farida Nur Fadhilah and Arief Widyananto (2022) emphasise that the Fraud Diamond is a relevant analytical

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tool for detecting potential fraud in Indonesian companies. Therefore, companies need to focus on managing internal and external pressures, improving oversight systems, and fostering a strong ethical culture.

## **RESEARCH METHODS**

This study utilised the Systematic Literature Review (SLR) method. In this study, the researchers selected several findings related to diamond fraud in identifying financial statement fraud obtained from various national journals published in 16 national journals between 2020 and 2025. The sample was selected through four stages. The first step involved analyzing research from journals. The second stage involved collecting literature relevant to the research topic, in the form of journals that could be accessed online. The researchers used the keywords 'diamond fraud' and 'financial statement fraud'. Third, the researchers downloaded every article in the journal. The final step was for the researchers to group the articles based on title, author, and journal name and compile a summary of the literature review results using previous research variables and other related theories with the aim of developing a framework of knowledge and information that is more relevant to the research topic.

## **RESEARCH RESULTS AND DISCUSSION**

### **The Effect of Pressure**

According to Ananda Amillia Mutiara et al. (2024), the majority of studies in their review state that pressure is an important factor in encouraging financial statement fraud. Financial pressure from high profit targets, declining performance, and market competition significantly increase the incentive for management to engage in manipulation. Furthermore, research findings in the Islamic banking sector also indicate that external and internal pressure conditions significantly contribute to increasing the risk of fraud. However, some journals state that intense pressure forces perpetrators to seek shortcuts, such as report manipulation, in order to maintain the company's existence and reputation.

According to Wea et al. (2023); Isi & Sofie (2025); Abrori et al. (2024); Andrean & Salim (2021); Fadillah & Widyananto (2022), pressure has a positive and significant influence on financial statement fraud.

### **Influence of Opportunity**

Yessi Doapril Sinaga and Abubakar Arief (2023) in Rian Abrori et al. (2024) reveal that opportunities arise from weaknesses in internal control and supervision. Companies with high auditor turnover and lax supervision allow for the manipulation of vulnerable positions such as inventory and accounts receivable. Additionally, the complexity of the food and beverage and construction industries also creates opportunities for fraud that are difficult to

detect quickly. Thus, strengthening internal audit functions and implementing IT monitoring systems are important mitigation measures.

Research conducted by Mutiara et al. (2024); Yulianto & Umam (2025); Aprilia & Furqani (2021); Carolin et al. (2022); Chandra & Suhartono (2020). Opportunities have an influence on financial statement fraud.

### **The Impact of Rationalisation**

According to Rian Abrori et al. (2024) and Ananda Dwi Amelia et al. (2024), rationalisation is a psychological aspect that plays a role in justifying fraudulent actions by individuals. Managers who feel Those who are entitled or under pressure tend to provide moral justification so that their actions are considered legitimate internally. However, the variability of research results and measurement difficulties indicate that rationalisation is not always a strong indicator for detecting fraud. Auditor turnover related to rationalisation is also not always a sure sign of misconduct.

Research conducted by Michi et al. (2023); Alvionika & Wahyu (2021); Selvia et al. (2021); Arif, Muhammad (2021) shows that rationalisation has a positive and significant effect on financial statement fraud.

### **Capability**

In the journal, Intan Octaviani and Kartika Djati (2024) emphasise that the perpetrator's capabilities, such as technical skills, job position, and ability to conceal crimes, are key factors in the success of fraud. However, the influence of capability tends to be less consistent in some studies due to effective external oversight, especially in large companies with strict governance. This indicates that capability alone is insufficient without supporting opportunities and pressure.

Yulianto & Ikeu (2025) and Chandra & Suhartono (2020) state that capability has an influence on financial statement fraud.

### **Influencing Good Corporate Governance**

(GCG): Farida Nur Fadhilah and Arief Widyananto (2022) conclude that good GCG, particularly the role of a competent and independent audit committee, can reduce the risk of fraud and strengthening fraud detection. However, the effectiveness of audit committees in some Indonesian companies still needs to be improved, particularly in terms of meeting frequency and independence. Improving the capabilities of audit committee personnel and strengthening corporate ethical culture are essential as preventive measures against fraud.

According to Chandra & Suhartono (2020), corporate governance has a positive and significant influence on financial statement fraud. With the increase in fraud incidents, there has been an ineffective approach to preventing financial statement fraud

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## CONCLUSION

Based on a review of literature from various reputable journals, it can be concluded that the Fraud Diamond theory is a relevant and effective framework for detecting financial statement fraud in Indonesia. The four main elements of this theory, namely pressure, opportunity, rationalisation, and capability, contribute differently to influencing fraudulent actions.

Pressure is a major factor that drives management to manipulate financial statements, especially in conditions of high financial targets and intense competitive pressure. Opportunity arises from weaknesses in internal control systems and weak supervision, which are exacerbated by industry complexity, opening up space for fraudulent practices.

Rationalisation serves as a moral justification for fraudsters, although its influence tends to vary and is difficult to measure empirically. The ability or capacity of perpetrators, which includes technical expertise and strategic position, is also important in committing and concealing fraud, but its influence is not always significant, especially if external oversight is effective.

Good corporate governance, particularly the function of a competent and independent audit committee, acts as a moderating variable that can reduce the risk of fraud and improve fraud detection. However, the effectiveness of CG implementation still needs to be improved in various Indonesian companies to support more optimal fraud prevention.

Therefore, integrating the handling of internal and external pressures, strengthening supervision to close opportunities for fraud, understanding the psychological aspects of perpetrators, improving the capabilities of supervisors, and implementing good corporate governance are strategic steps that need to be prioritised in efforts to comprehensively detect and prevent financial statement fraud in Indonesia.

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