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THE EFFECT OF *FRAUD DIAMOND THEORY* ON FINANCIAL STATEMENT FRAUD

Geby Tarina Hutagalung[1], Faradiba Azzahra[2], Deliana Deliana[3], Justina Gresya Br Tarigan[4]
Department of Accounting, Politeknik Negeri Medan, Indonesia

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ABSTRACT

This research discusses the phenomenon of financial statement fraud in the context of Fraud Diamond theory. By detailing Pressure, Opportunity, Rationalization, and Capability as the main factors, this study investigates the relationship between these variables and the tendency for financial statement fraud. This research uses a literature review method, this research collects and analyzes nineteen (19) scientific articles related to financial statement fraud and the diamond fraud theory. The results show variations in the influence of each factor on financial statement fraud, with some studies emphasizing the importance of financial stability, regulation, and effective monitoring in preventing this fraud.

Corresponding Author:
Justina Gresya Br Tarigan
Department of Accounting, Politeknik Negeri Medan, Indonesia
justinagresyabrtarigan@students.polmed.ac.id

INTRODUCTION

A company is a place where business processes occur, namely the production and distribution of goods or services with the aim of making a profit. A very important role in a company that is related to company performance is the financial report. Financial reports are a tool for corporate accountability to stakeholders *which* contain financial information and operational activities of the company in a certain period. This information is used for various things, for example for a manager's decision making, assessing management performance, assessing the feasibility of an investment, assessing the feasibility of debt, calculating taxes, and accountability to society.

The characteristics of a good financial report are first, the report must be relevant, when the report presented is able to make decision makers in a company determine new policies. Second, the content of the report must be reliable, to produce good financial reports it must be reliable, meaning it does not mislead readers, therefore there must be no material misstatements (Ulfah *et al,* 2017). Third, financial reports are good and easy to understand, the transactions recorded in them can better understand the strategy used for planning future sales. Lastly, there is an element of comparison in a good financial report, a comparison of what needs to be improved for future reporting, including strategies for product marketing.

Financial Accounting Standards Guidelines (PSAK) no. 1 regarding the purpose of financial reports is to provide information about the financial position, financial performance and cash flows of an entity that is useful for the majority of users of financial reports in making economic decisions. However, sometimes making financial reports has another purpose, namely to get a "good" impression from various parties. The drive or motivation to always look good to various parties often forces companies to manipulate, so that in the end the information provided does not match the actual situation, thus causing harm to many parties. There are many gaps in financial reports that can provide space for management and certain individuals to commit fraud *in* financial reports.

A loophole for committing fraud *on* published financial reports to create a good impression on users. *Fraud* is an illegal act that is deliberately carried out, then hidden to obtain benefits for certain purposes for individuals or other people, thereby causing losses to other parties (Sarpta, 2018). Fraud is designed to directly or indirectly harm another party. The parties most affected by this *fraud* are investors because they have made the wrong decision in investing their capital in the company, resulting in failure to obtain profits from the investments made (Bawakes, 2018).

Fraud is divided into three parts, namely *Asset Misappropriation* , *Corruption* , *Financial Statement Fraud* . Asset misuse is an illegal act in the form of taking, stealing or embezzling assets carried out by someone who has the authority to manage assets. Corruption is an act of abuse of authority committed by someone or more who has a position in an organization which consists of bribery, accepting illegal gifts, personal conflicts of interest and economic extortion.

Financial report fraud is a deliberate action by internal company parties, to deceive and distort information to users of financial reports. Fraud in financial statements can be carried out in various ways, for example by carrying out profit management by increasing/decreasing the value of expenses and income so that it appears as if the company is experiencing a profit/loss in order to attract more investors/creditors to invest or lend their capital to the company and so that the company is not subject to high taxes. Manipulating profits (*earnings manipulation*) is the desire of the company with the motive to ensure that the value of the company's shares remains attractive to investors (Pasaribu & Kharisma, 2018). Failure to achieve targets, thereby endangering management's position, is also one of the reasons why fraud is committed.

Donald R. Cressy (1953) explained that there are three factors that cause someone to commit fraud, called the *Fraud Triangle Theory,* including *pressure* , *opportunity* , and *rationalization* . These three factors are based on the results of interviews with embezzlement perpetrators. Furthermore, Wolfe and Hermanson (2004) developed this theory, stating that people who do not have the right abilities and positions will not be able to commit fraud. Therefore, there is the addition of a new variable, namely *Capability* , this means that *the Fraud Triangle Theory* can no longer be used as a guide because the environment and business conditions that influence it continue to change according to the prevailing conditions and circumstances, so Donald R. Cressy calls this a new theory. this is with *Fraud Diamond Theory.*

The first factor is *pressure* , pressure is the encouragement of people to commit *fraud* which is common for companies to manipulate their financial reports so that there is a decline in the company's financial prospects. According to SAS No. 99, there are four types of conditions that generally occur under pressure that can result in fraud, namely, financial stability, external pressure, individual financial needs and financial targets, but many people do it only because of greed. Companies also sometimes feel pressured when their debt ratio or credit ratio is higher, meaning the company is unable to meet or pay investment requirements, thus allowing fraud on financial reports. Personal pressure in the form of a high lifestyle, work in the form of management's financial interests, and external pressure in the form of threats to business or financial system stability.

The second factor is *opportunity* . Opportunities are conditions that provide an opportunity for management or employees to misrepresent financial reports. Perpetrators of fraud feel that the actions they take will not be detected by the parties concerned. Opportunities can occur due to weak internal controls, poor management supervision or through the use of position. The opportunity for someone to commit *fraud* is due to high management turnover, especially management who holds key roles in the company, the absence of *segregation of duties* or separation of duties, and transactions or organizational structures that are too complex. Opportunity factors can also arise as a result of a lack of discipline, weak access to information, absence of an audit mechanism, apathy towards the surrounding environment, and poor organizational governance (Mardatillah *et al.* 2020).

The third factor is *rationalization* , justification is when someone who can commit *fraudulent acts* looks for reasons or justification for the *fraud* and some individuals have attitudes, characters and values that enable them to consciously and deliberately carry out dishonest acts. Perpetrators of fraud will seek justification for their actions, they believe that what they are doing is the right action in accordance with the rights they have to receive. Rationalization is a factor that cannot be observed because rationalization is related to a person's psychological condition when committing *fraud* (Puspasari & Suwardi, 2016).

The fourth factor is *capability* , Sujeewa et al. (2018) defines that a person's traits and abilities are needed to recognize opportunities for fraud and exploit them to gain personal gain.

Fraud is committed when a person's position in a company gives him the ability to carry out actions that benefit personally. Some of the characteristics and capacities that a person has in committing fraud are position in the organization, intelligence to exploit internal control, ego, and the ability to overcome risks resulting from committing fraud (Airlangga, 2020). If a person understands the company's internal controls, he can abuse his position to carry out actions that are detrimental to the company. The ability to understand and exploit internal control weaknesses is a greater influence in a company, so the possibility of committing *fraud* is also greater (Wijayanto, 2020).

One of the cases of financial statement fraud that has occurred in Indonesia is the State Savings Bank case. On Monday 3, February *2020* , BAKN, represented by Commission 2018 is the sale of *cessie,* which is the company's non-performing credit to PT Perusahaan Pengelola Aset (PPA). Then there were allegations of legal violations because BTN was deemed to have disbursed credit not according to its intended purpose in December 2014 worth IDR 100 billion, the credit was used to pay PT Batam Island Marina (BIM)'s debt to shareholders. Then the additional credit worth IDR 200 billion in September 2015 that BTN gave to BIM was not based on accurate credit analysis.

Based on the explanation above, there is a gap between theory and practice. Based on theory, management is expected to have integrity, honesty and transparency in carrying out its duties so that it can gain the trust of the public. However, in practice, many management elements are easily influenced to commit fraud that only benefits a few people. *Association of Certified Fraud Examiners (ACFE)* entitled *Asia-Pacific Occupational Fraud 2022 : A Report to The Nations,* Indonesia is ranked 4th as a country with the number of *fraud cases* in 2022, with 23 cases recorded. The biggest *fraud* in Indonesia is corruption with a percentage of 64%, misuse of state and company assets/wealth at 28.9% and financial statement *fraud (6.75).*

Based on scientific research conducted by several researchers, financial statement fraud by management has relevance to *the fraud diamond theory. Fraud diamond theory* explains that fraud can occur with several factors including pressure, opportunity, rationalization and ability. Therefore, this research will discuss cases of financial statement fraud, because fraud in financial reports is rampant, so more research is needed into the reasons behind someone committing *fraud* . Based on this background, this research will discuss the phenomenon with the title " The Influence *of Fraud Diamond Theory* on Financial Report Fraud".

RESEARCH METHODS

This study method uses *a literature review. Literature review* is research that examines, examines and collects discussion results from previous research that are relevant to the topic being discussed (Triandini et al., 2019). This research collects scientific articles that have been accredited by Sinta using the *Google Schoolar website,* with the keyword financial statement fraud and there are 19 scientific articles related to financial statement fraud with *the fraud diamond theory variable*. This research stage was carried out by determining the topic of discussion, pre-research, selective literature, processing data to make conclusions (Hidayati et al., 2022). After going through a selective *literature process* from the 19 scientific articles, it was concluded that all of them were relevant to the topic of discussion and could then be processed using *literature rules.*

RESULTS AND DISCUSSION

Fraud is an act carried out intentionally in taking another person's property, property or money through fraud or other unfair means (*Association of Certified Fraud Examiners* in Muziansyah, 2018). *Financial statement fraud* is often carried out in several ways, namely manipulation, falsification, or alteration of financial records and supporting documents for financial statements; intentional errors or omissions from financial reports, whether transactions or other important information; deliberate errors in applying accounting principles relating to amounts, classification, presentation methods or disclosures in financial reports (Widiyanti, 2016 in Yulia, 2018). Fraud triangle theory is a theory that explains the causes of fraud proposed by Donald R. Cressey in 1953.

Fraud diamond theory is *a fraud theory* introduced by Wolfe and Hermanson in 2004 as a refinement of *the fraud triangle theory* by adding another factor that encourages *fraud, namely* capability.
Fraud score model (F-score) is a fraud measurement tool developed by Dechow et al. in 2007, the purpose of which was developed was to establish a measure that can directly calculate a financial report. Based on research conducted by Rianti Tri Annisa, and Halmawati, the results show that financial targets, ineffective monitoring, auditor reports and changes in directors have a simultaneous effect on financial statement fraud. In part, financial targets influence financial statement fraud, while ineffective monitoring, auditor reports and director changes do not influence financial statement fraud. **(The Influence of *Diamond Theory Fraud Elements* on *Financial Statement Fraud*)**

According to (ACFE Indonesia, 2020), financial statement fraud is a deliberate misrepresentation or presentation of an organization's financial condition or disclosures in financial reports with the intention of eliminating obstacles to achieving existing financial goals and deceiving users of financial statements. Based on research conducted by Adam Maulana Prastyo, Aris Eddy Sarwono, Dewi Saptanitinah Puji Astuti, the findings of this research show that the *Fraud Diamond element* can help identify fraudulent financial statements. The higher the application of *fraud diamond analysis* , the reduced the risk of financial statement fraud occurring in the company. Internal control can anticipate fraudulent financial reports in companies by using fraud diamond analysis. The possibility of financial statement fraud in a company can be reduced by increasing the quality of *fraud diamond analysis.* **(The Influence of *Fraud Diamond* in Detecting *Fraudulent Financial Statements*)**
According to the GONE theory created by G. Jack Bologna in Priantara (2013, 48), there are four factors that encourage someone to commit fraud: Greed , Opportunity , Need , Exposure . Based on research conducted by Riaqa Syahria, Fariyana Kusumawati, Adi Darmawan Ervanto, research results showed that financial stability and changing auditors had an effect on financial statement fraud. However, external pressure, financial targets *(pressure)* , quality of external auditors *(opportunity)* , and change of directors *(capability)* have no effect on financial statement fraud. **Detecting Financial Report Fraud Using *Fraud Diamond* (Study of Banking Companies Listed on the Indonesian Stock Exchange for the 2012-2016 Period)**
Wolfe and Hermanson in 2004 stated that there are four factors that underlie someone committing fraud, namely *pressure* , *opportunity* , *rationalization* and *capability* which is called *the Fraud Diamond Theory.* Based on research conducted by Wilhelmina Mitan, Siktania Maria Dilliana, Robertho Tomy Meyer, the results of this research show that pressure, opportunity, rationalization and ability do not have a significant effect on the tendency to fraudulent financial statements either partially or simultaneously. **The Influence of *Diamond Fraud* on Financial Report Trends at the Sube Huter Credit Cooperative**
Statement of Auditing Standards (SAS) No. 99 entitled Fraud Considerations in Financial Statement Audits reveals that there are two types of misstatements that are relevant to financial statement audits and the auditor's consideration of fraud. The first type is misstatement originating from fraudulent financial statements, namely deliberate misstatement or omission of amounts or disclosures in financial reports designed to deceive users of financial statements. The second type is misstatement that arises from misuse of assets, commonly referred to as theft or abuse of trust. Based on research conducted by Wilhelmina Mitan, Siktania Maria Dilliana, Robertho Tomy Meyet, the research results show that external pressure and the nature of the industry have a significant positive effect on financial statement fraud. Meanwhile, financial stability, ineffective monitoring, rationalization and positioning have no effect on financial statement fraud.

According to the Association of Certified Fraud Examiners (ACFE, 2016) defines fraud as unlawful acts carried out intentionally for certain purposes (manipulation or giving false reports to other parties) carried out by people from inside or outside the organization to obtain personal or group benefits that directly or indirectly harm other parties. **The Influence of *Fraud Diamond Theory* on Fraud *in* the Pintu Air Credit Cooperative**

Based on previous research, there are several theories used to analyze the effect of fraudulent financial statements, for example the *Fraud Diamond Theory. Fraud Diamond Theory is* a perfecting theory of *Fraud Triangle Theory,* in this theory there are 4 factors of fraud, including

: pressure , *opportunity* , *rationalization* and *capability* . The management is of course very close to these four conditions. Example 1) pressure , management has encouragement from their superiors to commit fraudulent acts. 2) opportunity , conditions where management has the opportunity to commit fraud. 3) rationalization , ambitious personalities often make management think that everything they do is correct and does not violate the law. 4) capability , if you have a high position/position it will be easier for management to commit fraud.

The current phenomenon in companies proves that for personal gain, management is willing to commit fraud that can threaten their position in the company. An example is employees who do not have a choice so they have to commit fraud because of pressure from their superiors. Actions that are considered normal in a company environment, without realizing it, create a person who relies more on others and does not believe in himself. Logically, when management fulfills the four main aspects in the *Fraud Diamond Theory dimensions* (pressure, opportunity, rationalization and capability) then fraud will quickly occur. However, when good internal control is carried out, there will be minimal fraud within the company, so it is hoped that management can reduce acts of fraud on financial reports.

CONCLUSION

Based on the results of the literature study, it can be concluded that *Fraud Diamond Theory* is relevant in analyzing the influence of financial conditions. Factors such as *Pressure, Opportunity, Rationalization* , and Capability plays an important role in determining the likelihood of fraud in financial statements . Several studies show that variables such as financial stability, auditor changes, and regulations can also influence the condition of financial reports. Some management feel that they have power over a company so they dare to commit fraud. Personal needs are also very influential in fraudulent financial reports, wanting to keep up with the times so relying on all means to follow *trends.* Therefore, understanding the company's internal and external conditions and applying *Fraud Diamond analysis* can help detect and prevent potential financial report fraud.

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