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The Fraud Diamond in Action: Predicting Financial Misreporting in Indonesia

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Abstract: Fraudulent financial reporting poses a significant threat to the stability and integrity of financial markets, impacting stakeholders' decisions and eroding investor confidence. This study investigates the influence of factors outlined in the fraud diamond framework on the likelihood of fraudulent financial reporting. Using a sample of 269 data points from 90 consumer cyclical and non-cyclical companies listed on the Indonesia Stock Exchange between 2020 and 2022, we examined the relationship between potential predictors of fraudulent reporting (financial targets, financial stability, external pressure, nature of industry, changes in auditors, audit reports, and changes of directors) and fraudulent financial reporting. Our findings indicate that, among the factors studied, only the presence of challenging financial targets significantly correlates with an increased likelihood of fraudulent financial reporting. Other factors examined did not show a statistically significant association. This study provides empirical evidence that unrealistic financial targets can create an environment conducive to financial statement manipulation. The findings underscore the importance of setting achievable targets and implementing robust internal controls to mitigate the risk of fraudulent financial reporting.

Keywords: fraudulent financial reporting, fraud diamond, beneish m-score model, financial targets

Introduction

Transparent and accurate financial reporting forms the bedrock of a well-functioning capital market. Stakeholders, including investors, creditors, and regulators, rely on reliable financial statements to make informed decisions. However, the integrity of financial reporting is threatened by fraudulent practices, which can have devastating consequences for companies and the broader economy. Fraudulent financial reporting erodes investor confidence, distorts market efficiency, and undermines the credibility of financial information (Ghandur et al., 2019).

The fraud diamond, a widely recognized framework for understanding the factors contributing to fraud, provides a valuable lens for examining fraudulent financial reporting. This framework, an expansion of the fraud triangle, posits that four key elements – pressure, opportunity, rationalization, and capability – converge to enable fraudulent activities. Previous research has linked various factors to an increased risk of fraudulent financial reporting, including financial distress (Ramandy et al. (2021), Rengganis et al. (2019), Putra and Dinarjito (2021), Febriani et al. (2022)), weak internal controls (Maulidiana and Triandi (2020), Achmad et al. (2022)), and management's aggressive pursuit of earnings targets (Utie and Harahap (2022), Ratmono et al. (2020), Puspitha and Yasa (2018), Thamlim and Reskino (2023), Nanda et al. (2019)). However, evidence on the impact of specific factors, such as changes in auditors or board composition have been mixed. (Zakiy et al. (2022), Fathmaningrum and Anggarani (2021), Setiawan and Trisnawati (2022), Dewi (2021), Maulidiana and Triandi (2020), Supri et al. (2018), Koharudin and Januarti (2021), Umar et al. (2020), Utami and Pusparini (2019)).

This study aims to contribute to this body of knowledge by investigating the influence of the fraud diamond framework on fraudulent financial reporting within a sample of Indonesian listed companies. Specifically, we examine the impact of financial targets, financial stability, external pressure, nature of industry, changes in auditors, audit reports by external auditors, and changes of directors on fraudulent financial reporting. While prior research has explored the fraud diamond in various contexts, its application to the Indonesian business environment, particularly within consumer-focused industries, remains relatively underexplored (Umar et al. (2020), Utami and Pusparini (2019)). By shedding light on the factors that contribute to fraudulent reporting in the Indonesian context, this study aims to provide valuable insights for regulators, auditors, and company management in their efforts to mitigate this pervasive problem.

Recent financial difficulties faced by Indonesian companies, such as PT Garuda Indonesia's struggles with profitability and debt, highlight the critical need to understand the drivers of fraudulent financial reporting performed by Garuda Indonesia Tbk (GIAA) in 2018 (Sandria, 2021). The fraudulent financial reporting case committed by PT Garuda Indonesia (GIAA) began when Garuda Indonesia's 2018 financial statements presented a net profit of USD 809.85 thousand, which at that time was equivalent to IDR 11.33 billion. This net profit figure when compared to the previous year, 2017, was very different, in which the financial statements of PT Garuda Indonesia TBK (GIAA) presented a net profit figure of USD 216.5 million, causing many question marks from various parties (Hartomo, 2019). After an investigation, it was found that PT Garuda Indonesia Tbk (GIAA) included revenue gains from PT Mahata Aero Teknologi, even though the profits had not been repaid by PT Mahata Aero Teknologi so that PT Garuda Indonesia Tbk (GIAA) was subject to sanctions from various parties.

Based on the above phenomenon, this study is a development of Utie and Harahap (2022). This research expands the scope of the fraud triangle into a fraud diamond by adding several independent variables taken from the research Zakiy et al. (2022), namely financial stability, changes in auditors, and changes in directors. The purpose of adding financial stability variables, changes in auditors, and changes of directors is to see the development of the company's financial stability, auditor changes and changes in the board of directors whether it will be affected by fraudulent financial reporting.

Literature Review

Agency Theory

Agency theory describes the relationship between one or more people (principal) and another person (agent) in that relationship to perform various services on behalf of the principal by granting and delegating some authority useful in decision making to the agent. In the relationship between the two parties, the principal may have conflicting desires with the agent, giving rise to interest problems (Jensen & Meckling, 1976).

In reality, there are different interests between the management (agent) and the owners of the firm (principal), resulting in asymmetric information, which is the unequal distribution of information between the principal and the agent in the working relationship. According to Akbar (2017), agency theory recognises the importance of separation between principal and agent in order to achieve efficiency and effectiveness. In this case, the agent is a professional hired by the principal to assist in the management of the firm. On the other hand, the existence of this separation can also create problems, namely the inequality of objectives between the principal and the agent.

With several conflict of interests and inequality of objectives that occurs between principal and agent, fraudulent financial reporting could happen with the intention to fulfill the needs and interests. There are several factors that cause fraudulent financial reporting can occur such as pressures felt by the employees that occur from the executives and third parties, capabilities possessed by the executives and arrogances of the executives. The existence of asymmetry between the information held by the agent and the principal, as well as the agent's strong desires, could also increase opportunities and rationalization (Kartikasari et al., 2021).

Fraudulent Financial Reporting

Financial reports not only contain a set of numbers, but become a set of tools to attract the attention of third parties. The importance of financial statements can motivate fraudulent financial reporting if the information in the financial statements is not good (Supri et al. 2018). Companies are motivated to commit fraudulent financial reporting in order to please and gain attention from shareholders, investors, and creditors (Irwandi et al., 2022).

Fraudulent financial reporting is a form of intent or error in reporting financial statements, namely this report is not presented in accorandce with general accounting principles. The deliberation or error is material, which means that it has an impact on the entire financial report so that it can influence the decisions of interested parties (Sudarman et al., 2019).

Fraud Triangle Theory was first proposed in 1953 by Cressey which states that the occurrence of fraudulent financial reporting can be influenced by several things such as opportunity, pressure, and rationalisation. After that, the term fraud diamond was first popularised by Wolfe and Hermanson (2004) who refined the fraud triangle theory. According to the Fraud Diamond theory, there is an additional element that contributes to fraudulent financial reporting, namely competence/ability. Company interest actors who have an advantage (competence/capability) have easy access to company files so that it is easier to manipulate financial reports because company interest actors have much deeper information related to something that might happen in the company and are able to prevent the detection of these manipulation practices.

Financial Targets and Fraudulent Financial Reporting

Financial targets can be defined as a target or achievement of economic profits that must be generated by a company's management. The number of targets or achievements that must be achieved by company management is usually projected in advance so that when the target is not achieved, management will experience unusual pressure (Tjahjani et al., 2022).

Financial targets are targets in the form of returns by executives or management. Management is always required to make the company's performance better than before so that the company succeeds in achieving the predetermined targets. The existence of these expectations, of course, builds its own pressure for management to be in accorandce with the company's expectations (Setiawan & Trisnawati, 2022). With the setting of financial targets, management will always strive to create good corporate financial performance. Pressure can encourage someone to commit fraud in order to fulfil the wishes of the company's internal and external parties (Prayoga & Sudarmaji, 2019).

H_1 There is an influence of financial targets on fraudulent financial reporting.

Financial Stability and Fraudulent Financial Reporting

Financial stability can be defined as companies that have financial performance that tends to be stable will more easily gain the trust of investors and creditors in terms of providing additional capital for the company. When the stability of the company's financial performance is shaken by various conditions that may be faced by the company, company management will experience tremendous pressure and has the potential to commit fraud (Tjahjani et al., 2022).

The value of a company from the perspective of the public, investors, and creditors can increase if the company has stable financial performance (Setiawan & Trisnawati, 2022). According to Ratmono et al. (2020), companies with stable financial performance will have more value in the eyes of investors and be able to gain investor confidence so that investors have the desire to invest in the company. Financial stability is closely related to agency theory, namely the principal will reward agents who have optimal performance and achieve the principal's wishes (Sari et al., 2020). Financial stability is an indicator of the company's financial level which is assessed by the level of financial stability of the company (Thamlim & Reskino, 2023).

H_2 There is an effect of financial stability on fraudulent financial reporting.

External Pressure and Fraudulent Financial Reporting

External pressure is excessive pressure obtained by management from outside the company that management must fulfil the wishes and expectations of third parties (Kartikasari et al., 2021). When a company needs additional capital or financing from third parties such as creditors and investors with the aim that the company remains competitive in its field and is able to innovate, the company will face external pressure because the company must be able to improve or maintain financial performance to remain good in the eyes of investors and creditors (Rengganis et al., 2019).

Management has a duty to meet the expectations of external parties (Setiawan & Trisnawati, 2022). Companies are required to always have a competitive nature in the market so that the need for additional financing from external parties is very important. When the company's financial condition is experiencing problems, third parties will hesitate to provide loans or additional funds to the company (Tjahjani et al., 2022).

H_3 There is an effect of external pressure on fraudulent financial reporting.

Nature of Industry and Fraudulent Financial Reporting

Nature of industry is a situation that is considered an ideal position for the company (Tjahjani et al., 2022). According to Zakiy et al. (2022), the nature of industry usually contains numbers that require judgement so that it is easy to commit fraud. Utie and Harahap (2022) argue that inventory is an account that involves estimation and subjectivity, making it prone to fraud.

Nature of industry is an ideal situation in a company or organisation in the industry (Haqq & Budiwitjaksono, 2019). Utie and Harahap (2022) argue that the nature of the industry usually contains numbers that use subjectivity and estimation in financial reports so that they are prone to fraud. According to Puspitha and Yasa (2018), the nature of industry can be a great opportunity for corporate accounting complexity and company estimates that involve subjective judgement. This can occur due to weak internal controls so that companies have the opportunity to carry out these practices.

H_4 There is an effect of nature of industry on fraudulent financial reporting.

Changes in Auditors and Fraudulent Financial Reporting

Changes in auditors is replacement for auditors resulting to adjustment time or a transition period for both auditors and companies. When a transition period occurs, the company will lose supervision or control from the auditors making it easier to commit fraud (Haqq & Budiwitjaksono, 2020).

Auditing is an important part of the process in corporate financial reporting. When there is a disagreement between management in the company and the auditor, the company can change in auditor. Change in auditor may indicate a disagreement in accounting and may be a sign of fraudulent financial reporting (Tjahjani et al., 2022)

The audit aims to provide an opinion and evaluate the fairness of a financial report in the company based on the evidence obtained by the auditor independently (Rinjani, 2022). Companies are able to make changes in auditors when there is disagreement between accounting records (Tjahjani et al., 2022).

Changes in auditors can be an attempt by companies to destroy traces of fraud or the possibility that auditors can detect corporate fraud (Ratmono et al., 2020). Many companies make changes in auditors if the company receives unfavourable results from the previous auditor, thus threatening the company's credibility (Fernandes & Susanto, 2012).

H_5 There is an effect of changes in auditors on fraudulent financial reporting.

The Audit Report by External Auditors and Fraudulent Financial Reporting

The audit report by external auditors is a statement given by the auditor to the company depending on how fair the financial statements are (Fitriyah & Novita, 2021). Audit opinion is a statement or opinion given by an auditor who comes from an independent KAP from the results of an examination or auditing that has been carried out by the auditor (Kartikasari et al., 2021). The auditor will provide an opinion about the company where he audits in accorandce with what happened to the company. When there are differences in results in the financial statements, both material and non-material, this can be seen in the financial statements after the auditing process. Thus, the audit report from the company's external auditor can also be a sign that there are indications of fraudulent financial reporting (Utie & Harahap, 2022).

Setiawan and Trisnawati (2022) also argue that audit opinion is a guarantee given by the auditor to a company about the company's own finances. Rengganis et al. (2019) state that the external auditor will later assess the fairness of the company's audited financial statements. In this case, the auditor must express an honest opinion in accorandce with the findings obtained by the auditor.

H_6 There is an effect of the audit report by external auditors on fraudulent financial reporting.

Changes of Directors and Fraudulent Financial Reporting

Changes of directors are the transfer of duties and responsibilities from the management of the old board of directors to the new board of directors so as to improve company performance. Changes of directors can put company management in a period of stress due to differences in performance between the previous and new boards of directors and management (Sari et al., 2020). Changes of directors are efforts made by a company to improve the performance of previous management so that it becomes better and improves the quality of the company (Putra & Dinarjito, 2021).

When companies want to improve management performance, companies can make changes of directors who are considered more credible and have greater potential. Changes of directors can also occur because of the potential for fraudulent financial reporting in the company and the company tries to cover it up (Tjahjani et al., 2022).

H_7 There is an effect of changes of directors on fraudulent financial reporting.

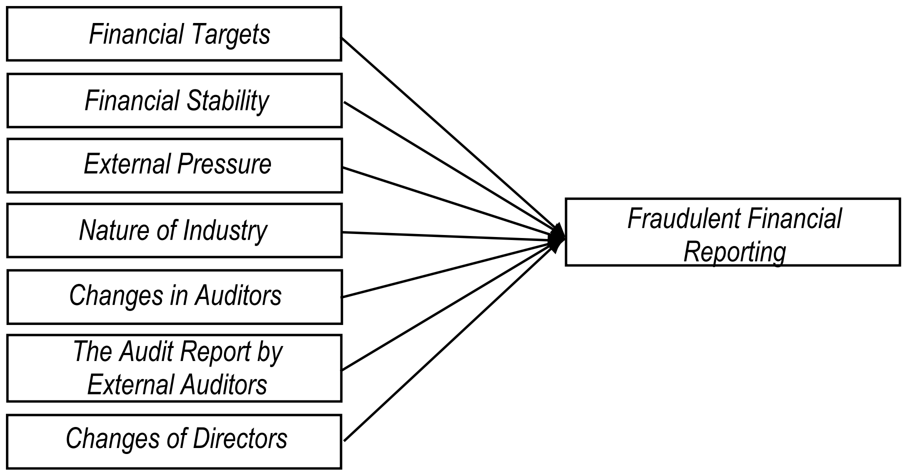

Figure 1 Research Model.

Materials and Methods

The study focuses on consumer cyclical and consumer non-cyclical industrial companies listed on the Indonesia Stock Exchange, *due to consumer cyclical and non-cyclical sectors often constitute a significant portion of emerging economies like Indonesia. Including both provides a more representative sample of the overall market and economic activity.* The method used in selecting samples is purposive sampling method. The sample consists of 269 data points from 90 companies within the specified population. The data covers the period from 2020 to 2022.

Fraudulent financial reporting (FFR) can be a deliberate act when a presented report does not contain general accounting principles (Sudarman et al., 2019). In this study, fraudulent financial reporting is measured using the M-SCORE value developed by Beneish in 1999. The M-Score relies on eight specific financial ratios, making it a quantitative and objective measure of FFR risk. This reduces subjectivity compared to qualitative methods and allows for easier comparison across companies. The M-SCORE model consists of eight financial ratios that are useful for detecting areas of potential fraudulent financial reporting. If the M-SCORE value of a company is greater than -2.22, then there is a high probability of fraudulent financial reporting in the company. The greater the M-SCORE value, the greater the indication of fraudulent financial reporting in the company. The measurement of fraudulent financial reporting is Utie and Harahap (2022) and Zakiy et al. (2022):

$$\text{M-SCORE} = -4{,}84 + 0{,}920\,(DSRI) + 0{,}528\,(GMI) + 0{,}404\,(AQI) + 0{,}892\,(SGI) + 0{,}115\,(DEPI) - 0{,}172\,(SGAI) - 0{,}327\,(LVGI) + 4{,}697\,(TATA)$$

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Table 1 Beneish M-Score Component.

Index		Measurement
DSRI	Day's Sales Receivables Index	$\frac{(\text{Net Receivables}_t \,/\, \text{Sales}_t)}{(\text{Net Receivables}_{t-1} / \,\text{Sales}_{t-1})}$
GMI	Gross Margin Index	$\frac{[((\text{Sales}_{t-1})\text{-}(\text{COGS}_{t-1}))\,/\,\text{Sales}_{t-1})]}{((\text{Sales}_t\text{- COGS}_t)\,/\,\text{Sales}_t)}$
AQI	Asset Quality Index	$\frac{(\text{TA}_t\text{ -}(\text{CA}_t\text{+ PPE}_t)\,/\,\text{TA}_t)}{(\text{TA}_{t-1}\text{- }(\text{CA}_{t-1}\text{+ PPE}_{t-1})\,/\,\text{TA}_{t-1})}$ TA = Total Assets CA = Current Assets PPE = Net Property, Plant, and Equipment
SGI	Sales Growth Index	$\frac{(\text{Sales}_t)}{(\text{Sales}_{t-1})}$
DEPI	Depreciation Index	$\frac{(\text{Depreciation}_{t-1})\,/(\text{PPE}_{t-1})\text{+ }(\text{Depreciation}_{t-1})}{(\text{Depreciation}_t)\,/(\text{PPE}_t)\text{+ }(\text{Depreciation}_t)}$ PPE = Net Property, Plant, and Equipment
SGAI	Sales, General, & Administrative Expense Index	$\frac{(\text{SG\&E}_t\,/\,\text{Sales}_t)}{(\text{SG\&E}_{t-1}\,/\,\text{Sales}_{t-1})}$ SG&E = Sales, General, and Administrative Expense
LVGI	Leverage Index	$\frac{[(\text{Currrent Liabilities}_t\text{+ Long Term Debt}_t)\,/\,\text{TA}_t)]}{[(\text{Current Liabilities}_{t-1}\text{+ Long Term Debt}_{t-1})\,/\,\text{TA}_{t-1})]}$
TATA	Total Accruals to Total Assets	$\frac{(\text{Net Income from Operation}_t\text{- Cash Flow from Operation}_t)}{(\text{Total Asset}_t)}$

Table 2 Independent Variables.

Variable	Symbol	Measurement
Financial Target	FT	The ratio of earnings after-tax to total assets (Utie and Harahap 2022).
Financial Stability	FS	The difference between the total assets of the current period and the total assets of the previous period divided by the total assets of the current period (Zakiy et al. 2022).
External Pressure	EP	Leverage is the ratio of total liabilities to total assets (Utie and Harahap 2022).
Nature of Industry	NI	The difference between the ratio of inventory to sales for the current period and the ratio of inventory to sales for the previous period (Utie and Harahap 2022).
Changes in Auditors	CIA	Changes in auditors = 1 No changes in auditors = 0 (Zakiy et al. 2022)
The Audit Report by External Auditors	AUDREPORT	Other than unqualified opinions = 1 Unqualified opinions = 0. (Zakiy et al. 2022)
Changes of Directors	COD	Changes of directors = 1 No changes of directors = 0 (Zakiy et al. 2022)

Source data: IDX

Results

Information regarding the sample selection procedure, descriptive statistics, and t-test results in this study are presented as follows:

Table 3 Sample Selection Procedure.

No.	Criteria	Firms	Data
1.	Consumer cyclicals and consumer non-cyclicals industry companies that are consistently listed on the Indonesia Stock Exchange during 2019 - 2022.	192	576
2.	Consumer cyclicals and consumer non-cyclicals industry companies that are not trading companies.	(51)	(153)
3.	Consumer cyclicals and consumer non-cyclicals industry companies that do not consistently publish annual financial reports with the fiscal year ending on 31 December during 2019 - 2022.	(7)	(21)
4.	Consumer cyclicals and consumer non-cyclicals industry companies that do not present their financial statements in consistent currency units during 2019 - 2022.	(1)	(3)
5.	Consumer cyclicals and consumer non-cyclicals industry companies that do not consistently have data related to research variables during 2019 - 2022.	(2)	(6)
6.	Consumer cyclicals and consumer non-cyclicals industry companies that do not have at least one indication of fraud (M-Score > -2,22) during the three years of observation.	(41)	(123)
	Total	90	270
	Outlier		(1)
	Data after outlier		269

Table 4 Procedure for Sixth Criteria.

Classification		Frequency	Percentage
Cyclicals Industry	2020	12	32%
	2021	16	43%
	2022	24	65%
Non-Cyclicals Industry	2020	21	40%
	2021	22	42%
	2022	29	55%
Cyclicals and Non-Cyclicals Industry	2020	33	37%
	2021	38	42%
	2022	53	59%

Based on Table 4, in 2020 there were a total of 33 cyclical and non-cyclical industrial companies that had M-SCORE value greater than -2.22 with a total percentage of 37%. In 2021 there were a total of 38 cyclical and non-cyclical industrial companies that had M-SCORE value greater than -2.22 with a total percentage of 42%. In 2022 there were a total of 53 cyclicals and non-cyclicals industrial companies that had M-SCORE value greater than -2.22 with a total percentage of 59%. Finally, after the outlier test was performed, there was one data that was not used in this research sample. The number of companies that meet the criteria in this research is 90 companies with a total of 269 data.

Table 5 Descriptive Statistic.

Variable	N	Minimum	Maximum	Mean	Deviation Standard
FFR	269	-14.3608	66.8875	-1.6479	6.3497
FT	269	-2.4852	4.6933	0.0250	0.3585
FS	269	-0.8189	0.9897	0.0309	0.1584
EP	269	0.0810	44.0973	0.9675	4.3285
NI	269	-1.2266	7.7776	0.0367	0.5076
CIA	269	0	1	0.1300	0.3330
AUDREPORT	269	0	1	0.0100	0.1050
COD	269	0	1	0.3900	0.4880

Table 6 t-test.

Variable	B	Sig.	Result
Constant	-1,251	0,020	
FT	4,346	0,000	H_1 accepted
FS	-2,715	0,307	H_2 not accepted
EP	-0,045	0,613	H_3 not accepted
NI	1,524	0,056	H_4 not accepted
CIA	0,151	0,896	H_5 not accepted
AUDREPORT	-1,404	0,711	H_6 not accepted
COD	-1,131	0,153	H_7 not accepted

Adjusted R^2: 0,053 R: 0,279 Uji F: 0,003

FFR = –1,251 + 4,346 FT – 2,715 FS – 0,045 EP + 1,524 NI + 0,151 CIA – 1,404 AUDREPORT – 1,131 COD + ε

Table 6 shows that the financial target (FT) has a coefficient value of 4.346 and sig. of 0.000. H_1 is supported, this confirm that financial target effects on fraudulent financial reporting. The finding indicates that the size of the financial target in a company will have an effect on fraudulent financial reporting practices. Meanwhile, the coefficient of financial target is positive on fraudulent financial reporting, meaning that financial target has a positive effect on fraudulent financial reporting. The greater the pressure to achieve financial targets, the greater the possibility of fraudulent financial reporting so that it can meet company expectations (Supri et al., 2018). With financial targets, management in the company must strive to realise these targets so that the company's financial performance looks good in the eyes of investors, creditors, and users of financial statements. Fraudulent financial reporting can occur if the company has set targets, but these targets cannot be met by management. Company management will manipulate the company's financial statements in order to achieve the predetermined target (Haqq & Budiwitjaksono, 2020). Empirically, our results support the findings of Utie and Harahap (2022), Zakiy et al. (2022), Ratmono et al. (2020), Supri et al. (2018), Ramandy et al. (2021), Rengganis et al. (2019), Putra and Dinarjito (2021), and Febriani et al. (2022).

Financial stability (FS) has a coefficient value of -2.715 and sig. of 0.307. it shows that H_2 is not supported. There is no effect of financial stability on fraudulent financial reporting. These results indicate that whether or not financial stability in a company will not have an effect on fraudulent financial reporting practices. Financial stability cannot be the reason for fraudulent financial reporting because financial stability can occur for various other reasons that cannot be anticipated such as the covid-19 pandemic and so on (Zakiy et al., 2022). Empirically, the results are in accorandce with Setiawan and Trisnawati (2022), Rengganis et al. (2019), Tjahjani et al. (2022), Ratmono et al. (2020), Utami and Pusparini (2019) in this context.

External pressure (EP) has a coefficient value of -0.045 and sig. of 0.613. Hypothesis 3 is not supported. The finding indicates that the amount of external pressure in a company will not have an effect on fraudulent financial reporting practices. Companies that have a good or bad financial cycle will still be monitored by creditors and investors so that there is no reason for companies to commit fraudulent financial reporting. Conversely, companies are afraid to commit fraud (Koharudin & Januarti, 2021). Empirically, the results are in accorandce with Utami and Pusparini (2019), Thamlim and Reskino (2023), Kartikasari et al. (2021), and Tjahjani et al. (2022).

Nature of industry (NI) has a coefficient value of 1.524 and sig. of 0.056. H_4 is not supported. These results indicate that whether or not the nature of industry in a company will not have an effect on fraudulent financial reporting practices. Nature of industry cannot predict fraudulent financial reporting. Companies are given their own freedom in determining accounting methods and recording in financial statements, but there are regulations that bind companies regarding how to present some financial accounts that are vulnerable to manipulation so that management is not free to carry out fraudulent financial reporting (Puspitha and Yasa 2018). Empirically, the results are in accorandce with Annisya et al. (2016), Akbar (2017), Anton et al. (2023), Sabatian and Hutabarat (2020), and Irwandi et al. (2022)

Changes in auditors (CIA) has a coefficient value of 0.151 and sig. of 0.896. Hyphotesis 5 is not supported. The finding indicates that the presence or absence of changes in auditors in a company will not have an effect on fraudulent financial reporting practices. According to Fathmaningrum and Anggarani (2021), fraud is able to occur because there are separate opportunities and motivations from management regardless of whether there is a change of auditors or not. Changes in auditors cannot be a benchmark that a company commits fraudulent financial reporting. Empirically, the results are in accorandce with Zakiy et al. (2022), Setiawan and Trisnawati (2022), Dewi (2021), and Maulidiana and Triandi (2020)

The audit report by external auditors (AUDREPORT) has a coefficient value of -1.404 and sig. of 0.711. H_6 is not supported. The finding indicates that whether or not the audit report by external auditors in a company will not have an effect on fraudulent financial reporting practices. According to Fitriyah and Novita (2021), the audit report is a form of statement given by the auditor based on the findings that the auditor has on the company. When the auditor tolerates a financial report, it means that the level of materiality in the financial statements can still be tolerated by an auditor. In many cases, auditors often tolerate but are accompanied by notes or emphasis on a matter so that they do not purely tolerate a company. Empirically, the results are in accorandce with Rengganis et al. (2019), Annisya et al. (2016).

Changes of directors (COD) has a coefficient value of -1.131 and sig. of 0.153. H_7 is not supported. These results indicate that the presence or absence of changes of directors in a company will not have an effect on fraudulent financial reporting practices. Changes of directors cannot be evidence of fraudulent financial reporting because changes of directors can be one of the company's efforts to improve the performance of the board of directors which was previously not optimal. Changes of directors cannot guarantee fraudulent financial reporting (Thamlim & Reskino, 2023). Empirically, the results are in accorandce with Zakiy et al. (2022), Fathmaningrum and Anggarani (2021), Setiawan and Trisnawati (2022), Haqq and Budiwitjaksono (2020), Nanda et al. (2019), and Tjahjani et al. (2022).

Discussion

This study examined the influence of the fraud diamond framework on fraudulent financial reporting within a sample of Indonesian listed companies. Our findings suggest that while various factors outlined in the framework might contribute to fraudulent reporting, the presence of challenging financial targets emerged as a significant predictor. This finding aligns with prior research highlighting the pressure exerted by unrealistic targets on financial reporting practices.

The study contributes to the understanding of fraudulent financial reporting in the Indonesian context, particularly within consumer-focused industries. By identifying financial targets as a key driver of such practices, our findings offer valuable insights for regulators, auditors, and company management.

This study is subject to certain limitations. The sample focused on consumer-related industries in Indonesia, potentially limiting the generalizability of findings to other sectors or geographical regions. Future research could expand the scope to include a wider range of industries and countries to enhance generalizability. Additionally, this study relied on archival data, which may not fully capture the nuances of fraudulent behavior. Future studies could incorporate qualitative methods, such as interviews with company insiders, to gain a deeper understanding of the motivations and rationalizations behind fraudulent financial reporting.

Further investigation into the interplay between the elements of the fraud diamond, particularly the moderating role of internal controls and corporate governance mechanisms, could provide a more comprehensive understanding of how to effectively mitigate fraudulent financial reporting.

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