

## Unfolding the Diamond of Fraud: What Drives Financial Statement Manipulation in Indonesia?

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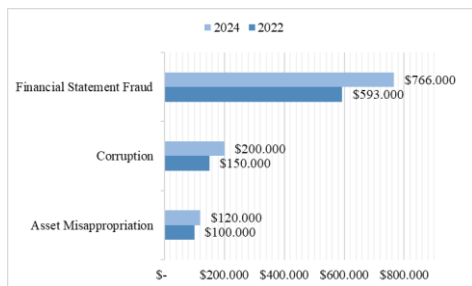
### ABSTRACT

This study investigates the influence of Financial Target, Nature of Industry, Auditor Switching, and Director's Financial Expertise on Fraudulent Financial Statements, with Financial Distress as a moderating variable, based on the Fraud Diamond Theory. The sample consists of 10 pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) during the 2020–2024 period, selected using purposive sampling. The analysis employs multiple linear regression and Moderating Regression Analysis (MRA). The results show that Financial Target and Nature of Industry have a positive effect on fraudulent financial statements, while Director's Financial Expertise has a negative effect. Financial Distress moderates the relationship between Financial Target and fraudulent financial statements but does not moderate the other independent variables.

**Key words:** fraud diamond theory; financial target; nature of industry; auditor switching; director's financial expertise; financial distress; fraudulent financial statements

### INTRODUCTION

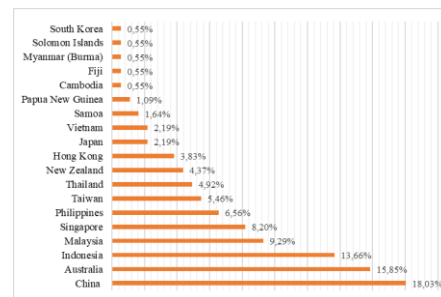
Increasingly fierce global business competition demands that every entity compete to maintain economic sustainability and resilience (Junus et al., 2025), even through manipulation strategies to embellish financial reports as if they have superior performance (Sitoesmi et al., 2024). Association of Certified Fraud Examiners (2024) in their Report to The Nations revealed that global organizations lose approximately 5% of their annual revenue due to fraud, with total losses of USD 3.1 billion from 1,981 cases in 138 countries. 9% of these cases involved financial statement fraud, which caused the greatest losses in the fraud tree, increasing by 29% from 2022, as shown in Figure 1. Figure 2 shows the results of a survey in the Asia-Pacific region with 183 fraud cases and an average loss of USD 200,000. Indonesia recorded 25 cases, ranking third highest. One of these cases occurred at PT Indofarma Global Medika (IGM), where fictitious invoices worth Rp470 billion were discovered. The investigation revealed nine irregularities, including inventory inflation and transaction manipulation (CNN Indonesia, 2024). Total losses reached Rp436.87 billion and state losses Rp371.83 billion.



Sumber : (Association of Certified Fraud Examiners, 2024)

Figure 1

Average Losses in 2022 and 2024 by Fraud Classification



Sumber : (Association of Certified Fraud Examiners, 2024)

Figure 2

Percentage of Fraud Occurring in the Asia-Pacific Region

Association of Certified Fraud Examiners (2024) defining such actions as intentional abuse of power for personal gain, creating ambiguity and misleading users of financial statements (Dwianto et al., 2024). This signals that regulatory compliance has not been fully enforced. Financial statements, which are supposed to be credible information that facilitates users in assessing business performance (Khomariah & Khomsiyah, 2023), are instead manipulated. To this day, fraud remains a critical issue and a challenge in the business world. Therefore, it is necessary to further examine the causes of the increasing number of fraud cases.

This study examines the variables representing each component of the fraud diamond, including financial targets, the nature of the industry, auditor switching, and the director's financial expertise, as previous research results have been inconsistent. Financial targets generally have a significant positive impact on fraud (Anisykurlillah et al., 2022; Bader et al., 2024; Yarana, 2023), but some studies show negative or insignificant results (Harahap et al., 2021; Naldo & Widuri, 2023). The nature of the industry is found to have a significant positive impact (Jati & Anisa Setiyani, 2023; Rianggi & Novita, 2023; Sari et al., 2022) and also negative and insignificant (Junus et al., 2025; Yarana, 2023). Auditor switching also shows varied results, from having a positive impact (Riviera et al., 2024; Setyono et al., 2023) to being insignificant (Achmad, Ghozali, & Pamungkas, 2022; Oktavia & Rinaldo, 2024).

Therefore, further exploration is needed regarding the variables that measure fraud. Most studies, such as those in (Achmad, Ghozali, Helmina, et al., 2022; Anisykurlillah et al., 2022; Doan & Ta, 2023; Yarana, 2023) measure the target using ROA, making the ROE proxy for identifying stress intensity in this study a novelty. Furthermore, proportioning the number of directors with financial expertise is rarely done, with some studies (Naldo & Widuri, 2023; Sukmadilaga et al., 2022) only assessing based on education level. Additionally, this study focuses on the pharmaceutical subsector because it is among the top four industries most affected by fraud

(Association of Certified Fraud Examiners, 2024). The complexity of the supply chain and profitability pressures increase the potential for fraud. Society's dependence on JKN also adds pressure, as the BPJS deficit due to a claims ratio of 107.93% (Dewan Jaminan Sosial Nasional (DJSN), 2024), creates liquidity problems and potentially leads to manipulation of financial reports. Thus, this study also considers financial distress as a moderating variable. Previous research has examined it as both an independent variable (Mukhtaruddin et al., 2022; Nugroho & Murtanto, 2024) and a mediating variable (Reskino & Darma, 2023). This study positions financial distress as a moderator, which is also a contribution to novelty.

It can be concluded that this study aims to analyze the influence of financial targets, industry nature, auditor switching, and director's financial expertise on financial statement fraud in pharmaceutical companies in Indonesia. Incentives serve as a benchmark for success, leading to overpressure due to unrealistic target achievement ambitions (Yarana, 2023), the complexity of inventory requiring subjective assessment, kompleksitas persediaan yang memerlukan penilaian subjektif (Kuang & Natalia, 2023), and the justification of dissatisfaction with audit quality thru auditor changes (Jati & Anisa'Setiyani, 2023) creating opportunities for fraud to occur. Meanwhile, financial literacy (Kılılı et al., 2024) can detect irregularities in financial statements, thus preventing deviations (Preicilia et al., 2022). Furthermore, financial distress is believed to be able to validate these conditions in relation to fraud. Based on that statement, the following hypothesis is formulated.

H1 : Financial Target has a positive influence on Fraudulent Financial Statement

H2 : Nature of Industry has a positive influence on Fraudulent Financial Statement

H3 : Auditor Switching has a positive influence on Fraudulent Financial Statement

H4 : Director's Financial Expertise has a negative influence on Fraudulent Financial Statement

H5 : Financial Distress moderates the influence of Financial Targets on Fraudulent Financial Statement

H6 : Financial Distress moderates the influence of Nature of Industry on Fraudulent Financial Statement

H7 : Financial Distress moderates the influence of Auditor Switching on Fraudulent Financial Statement

H8 : Financial Distress moderates the influence of Director's Financial Expertise on Fraudulent Financial Statement

## METHOD

This research uses secondary data from the annual reports of pharmaceutical subsector companies listed on the Indonesia Stock Exchange (IDX) for the period 2020–2024, employing a quantitative approach. The sample was selected using a purposive technique based on specific criteria, resulting in 50 companies that met the research criteria. Fraudulent financial statements are reviewed using the F-Score model (Achmad, Ghozali, Helmina, et al., 2022; Junus et al., 2025; Sari et al., 2022), ROE to measure the intensity of pressure in achieving financial targets, inventory growth as a proxy for the nature of the industry (Bader et al., 2024), dummy variable to indicate auditor change (Doan & Ta, 2023; Setyono et al., 2023; Yarana, 2023), financial expertise based on the directors' financial capabilities (Christian, 2022; Mousavi et al., 2022; Sukmadilaga et al., 2022), and analyzing distress conditions thru Z-Score (Christian, 2022; Nugroho & Murtanto, 2024; Reskino & Darma, 2023).

## RESULTS AND DISCUSSION

The results of the classical assumption tests show that the model is free from multicollinearity problems and the Glejser Test indicates no similarity in residual variance between observations. The model testing procedure revealed that the Fixed Effect Model is the most appropriate model to use for both the regression equations before and after moderation, as shown in Table 2.

Table 2 Panel Regression Coefficients and Statistics (Fixed Effect) before moderation

Multiple linear regression			Moderated Regression Analysis		
Variable	Coefficient	p	Variable	Coefficient	p
C	0.405395	0.0122	C	0.405395	0.3143
FT	0.221601	0.0036*	FT	0.653266	0.0011
NOI	0.535302	<0.001**	NOI	0.499389	0.0001
AS	-0.238041	0.0959	AS	-0.122809	0.4480
DFE	-17.26891	0.0004**	DFE	-15.85200	0.0025
R-squared	0.746468		FT*FD	0.111938	0.0206*
Adjusted R-squared	0.654915		NOI*FD	-0.005304	0.8422
Prob(F-statistic)	0.000000		AS*FD	-0.118078	0.3218
			DFE*FD	0.121425	0.7617

R-squared	0.797082
Adjusted R-squared	0.689282
Prob(F-statistic)	0.000001

**Notes:**

*Significance level:  $p < 0.05$  (\*),  $p < 0.001$  (\*\*).*

(Source: EViews data processing)

**The Influence of Financial Targets on Fraudulent Financial Statements**

The regression results show that financial targets have a positive and significant influence on fraudulent financial statements ( $\beta = 0.221601$ ;  $p = 0.0036$ ), thus H1 is accepted. The higher the financial target, the higher the profit that must be earned, which stimulates greater pressure to achieve certain projections. Based on agency theory, when the principal sets high performance standards, management's efforts to achieve those results are greater because they serve as the benchmark for success. This pressure allows management to manipulate the data to obtain a good evaluation from the principal regarding their superior performance (Setiawan & Trisnawati, 2022). This result is consistent with (Bader et al., 2024; Sihombing & Eirene Panggulu, 2022; Sudrajat et al., 2023; Yarana, 2023) that there is a positive and significant influence on fraud.

**The Influence of Nature of Industry on Fraudulent Financial Statement**

Based on the regression results, the nature of the industry has a positive and significant effect on fraudulent financial statements ( $\beta = 0.535302$ ;  $p < 0.001$ ), thus H2 is accepted. Companies with high industrial complexity are more likely to engage in manipulation, especially in accounts based on estimates such as inventory. Information asymmetry allows them to leverage reporting flexibility to present better performance (Oktavia & Rinaldo, 2024). Inventory can be recognized as either overstated or understated, inventory timing can be delayed, or even fictitious inventory can be recorded to make profits appear higher. Consistent with (Kuang & Natalia, 2023; Rianggi & Novita, 2023; Sari et al., 2022).

**The Influence of Auditor Switching on Fraudulent Financial Statement**

In the regression, it was shown that auditor switching has a negative but not significant effect on fraudulent financial statements ( $\beta = -0.238041$ ;  $p = 0.0959$ ), so H3 is rejected. This means that the frequency of auditor changes does not have a significant impact, but tends to strengthen independence, audit quality, and the monitoring function to reduce information asymmetry and opportunistic management behavior. This finding is consistent with (Achmad, Ghazali, & Pamungkas, 2022; Jati & Anisa'Setiyani, 2023).

**The Influence of Director's Financial Expertise on Fraudulent Financial Statement**

Regression testing indicates a negative and significant influence of director's financial on fraudulent financial statements ( $\beta = -17.26891$ ;  $p = 0.0004$ ), thus H4 is accepted. More directors with financial expertise will enhance the capability to detect fraud (Killi et al., 2024) and serve as a monitoring mechanism. This competency is also seen as the company's effort to improve governance and eliminate leaders who were previously involved in fraudulent practices. Conversely, a low proportion of directors with financial backgrounds significantly increases the risk of fraud. In line with (Mousavi et al., 2022).

**The Influence of Financial Distress in Moderating Financial Target, Nature of Industry, Auditor Switching, and Director's Financial Expertise on Financial Statement Fraud**

Financial distress is proven to moderate financial target on fraud ( $\beta = 0.111938$ ;  $p = 0.0206$ ). Setting high targets increases the management burden in achieving them. Financial difficulties will hinder resource mobilization, thereby limiting the ability to achieve financial targets. On the other hand, if incentives are not distributed and stakeholder trust decreases, this situation encourages management to manipulate financial statements thru information gaps, as if performance has met expectations (Utie & Harahap, 2025).

Meanwhile, regression shows that financial distress is unable to moderate the nature of industry on fraud ( $\beta = -0.005304$ ;  $p = 0.8422$ ). The complexity of the industry remains a major factor in fraud, regardless of the intensity of pressure due to the company's financial condition. Additionally, financial distress was also unable to moderate auditor switching against fraud ( $\beta = -0.118078$ ;  $p = 0.3218$ ). This indicates that financial pressure did not affect their relationship; auditor turnover was more related to policy factors and internal governance, rather than financial conditions. Finally, financial distress was not able to moderate the influence of director's financial expertise on fraud ( $\beta = 0.121425$ ;  $p = 0.7617$ ). This means that financial pressure does not affect the effectiveness of directors' expertise in minimizing fraud. Their professionalism maintains the integrity of the financial statements independently.

**CONCLUSION**

The research results indicate that financial targets, the nature of the industry, and the expertise of the board of directors significantly influence financial statement fraud, while auditor turnover does not. Financial distress only moderates the relationship between financial targets and fraud. This finding confirms that internal pressure, industry complexity, and managerial competence are more dominant in influencing fraud than external financial

conditions. The limitations of the study include the sample size and one indicator of the fraud diamond. Further research is suggested to include other sectors, consider auditor reputation, and utilize additional indicators.

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