Fraud Analysis of Financial Statements Using the Fraud Diamond Theory Perspective Based on ATLAS (An Empirical Study on LPDs in Jembrana Regency)

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***Abstract*— The tendency for accounting fraud to be placed firmly in the context of auditing because fraud continues to be a very serious and costly threat to businesses around the world. This study examines whether there is an effect of the fraud diamond theory variable on the tendency of fraudulent financial statements, using measurements based on ATLAS (Audit Tools and Linked Archive System). The research was carried out at the Jembrana Regency LPD. Respondents in this study were managers and employees who worked at LPD. Data were collected using a questionnaire and analyzed using a variance-based SEM, then processed using Partial Least Square (PLS).**

The results of the study found that opportunity, opportunity, rationalization, and capability have a significant effect on the tendency of fraudulent financial reporting.

Keywords—the tendency of accounting fraud, bysta fraud diamond theory, ATLAS.

I. Introduction

Today's acts of fraud are increasingly complex, and difficult to identify, as a result of technological developments, which have a negative impact on the growth and sustainability of companies. Fraudulent financial reporting by management, such as misusing assets and fraud against businesses, causes a loss of investor confidence in the market [1], and has negative consequences that can cripple economic entities worldwide [2]. The negative publicity by the media of companies that commit fraud is a serious concern for the integrity of the auditing profession and other oversight bodies. The media even puts pressure on researchers about fraud, to be able to provide solutions in dealing with fraud in companies and the public [3], because fraud has implications for investors, company owners, regulators, auditors and the public around the world [4].

The phenomenon of fraud occurring at the Village Credit Institution (LPD), as the only traditional village economic institution in Bali, has received scrutiny from several media, due to the many cases of corruption and other fraud. Tribun Bali.Com writes that around 6% of LPDs in Bali have problems, one of which is because their management has committed acts of corruption [5]. Jembrana Regency, one of the regencies in Bali, faces the same problem, namely two LPD administrators from the Tuwed traditional village, Melaya District, were sentenced to three and two years in prison respectively for committing corruption [6].

The fraud diamond theory, which is a development of the fraud triangle theory, highlights individual capabilities to cooperate in various factors that are suitable for fraud [7]. The fraud triangle framework, popularized by Donald Cressey and W. Steve Albrecht, since the 1940s has been used to explain financial crime. This theory explains that financial crimes and workplace fraud only occur when the perpetrator has sufficient opportunity, pressure, and rationalization to commit fraud. The fraud triangle has also been applied empirically to a range of criminal behavior, and financial crimes, to determine whether the three elements influence the occurrence of fraud [8].

Previous research, such as [1], has used Fraud Diamond Theory variables to test factors suspected of fraud in financial reports, including pressure, opportunity, rationalization, and capability. The results showed that pressure had a significant positive effect on fraudulent financial statements, while opportunity, rationalization and capability had a negative effect on fraudulent financial statements. Different results are shown by research results [9], it turns out that all the variables in the fraud diamond theory have no significant effect on fraudulent financial statements. The results of other studies by [10], [11], and [12], show that all fraud diamond theory variables have a significant negative effect on fraudulent financial statements.

This study aims to examine the effect of the fraud diamond theory elements on the tendency of fraudulent financial statements. The study was conducted at the LPD in Jembrana District. ATLAS (Audit Tools and Linked Archive System) is an audit

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application issued by the Ministry of Finance of the Republic of Indonesia, as a tool that can assist public accountants in understanding and applying auditing standards based on the International Standard on Auditing (ISA) in providing their professional services [13]. ATLAS in analyzing fraud uses fraud triangle variables, such as pressure, opportunity and rationalization, using qualitative indicators. However, the capability variable used by [14] includes its position and function in the organization, intelligence, ego, coercion, deception, and pressure, which are elements that support capability.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

A. Literature Review

States by [4], in general research discussing aspects of fraudulent behavior focuses on various management theories, especially agency theory. Agency theory by Jensen and Meckling (1976), assumes the principle of an agency relationship between shareholders and management, where top managers act as agents whose personal interests are naturally not aligned with the interests of the company and shareholders. On the other hand, according to Davis, et al., in 1997, agency theory assumes that management is usually motivated by self-interest, and self-defense, so that management will commit fraud, because it is best for personal and short-term interests. [4].

Financial statement fraud or accounting fraud is any intentional act or omission that results in materially misleading financial statements [15]. Cressey in 1953 found three elements of fraud: 1). elements of pressure/motivation arising from financial difficulties; 2). the element of opportunity arising from internal control weaknesses that allow the problem to be carried out and hidden; and 3). rationalization or verbalization that is just a mind game, allowing the fraudster to feel comfortable with his actions, or even as a victim of an unfortunate situation [16]. Wolfe & Hermanson in 2004 developed the fraud diamond theory which believes that the concept of the fraud triangle can be developed for the prevention and detection of fraudulent behavior, by adding one element, namely capability [17]. Wolfe & Hermanson considers that fraud or fraud cannot occur without someone who has the right ability to commit the fraud [18].

B. Hypothesis Development

1) The effect of pressure on fraudulent financial statements: Pressure is a factor that causes unethical behavior. Every perpetrator of fraud, faces some pressure to carry out unethical behavior [19], which can be in the form of financial or non-financial pressure [4]. The pressure to cheat may not be real, but it can be felt. If perpetrators believe that they are being pressured, this belief can lead to fraud [19]. The results of previous research show that pressure has a significant positive effect on fraudulent financial statements [1], [10] and [9]. However, the results of research differ by [11] and [12], indicating that pressure has a significant negative effect on fraudulent financial statements. Research hypothesis:

H1. Pressure has a significant positive effect on fraudulent financial statements.

2) The influence of opportunities on fraudulent financial statements: Fraud will occur if there is an opportunity. Opportunities show that people will take advantage of the circumstances available to them to commit fraud [20]. Opportunities are created by ineffective control or governance systems, which allow someone to commit fraud [19]. Opportunity lies in the perception, and belief of the perpetrator, in most cases, the lower the risk of being caught, the more likely fraud will occur [21]. Research by [9], [1] and [10] shows results, opportunities have a negative effect on fraudulent financial statements. Meanwhile, different results are shown by the results of research by [12], it turns out that opportunity has a significant positive effect on financial statement fraud. The results of a study by [11] show that opportunity has no significant effect on fraudulent financial statements). The hypothesis put forward is:

H2. Opportunity has a significant negative effect on fraudulent financial reporting.

3) The effect of rationalization on fraudulent financial statements: Rationalization is a concept that suggests that the perpetrator must formulate some morally acceptable ideas, before engaging in unethical behavior, referring to justifications and reasons, that immoral acts are different from criminal activities. If someone cannot justify dishonest acts, it is less likely that he will be involved in fraud [19]. Rationalization is the justification of fraudulent behavior, due to lack of personal integrity, or moral reasoning of employees [22]. Research by [11], the results show, rationalization has a significant positive effect on fraudulent financial statements. However, the results of research by [1], show that rationalization has a negative effect on fraudulent financial statements. Different results are shown by the results of research by [12], it turns out that rationalization has no significant effect on fraudulent financial statements. The hypothesis proposed in this study:

H3. Rationalization has a significant positive effect on fraudulent financial statements

4) The effect of capability on fraudulent financial statements: Capability is a situation that has the characteristics or skills and abilities needed to commit fraud [19]. High-level fraud is impossible, without skilled people [1]. Furthermore, [4] believes that only people who have a very high capacity can understand the opportunities that exist, identify their weaknesses, and use them in planning the implementation of fraud. Study by [10], shows the results that capability has a significant effect on fraudulent financial statements. Different results are shown by research results [9], capability does not have a significant effect on financial statement fraud. The results of other studies by [11], and [12], show that capability has a significant negative effect on financial statement fraud. The hypothesis becomes:

H4. Capability has a significant positive effect on fraudulent financial statements

III. RESEARCH METHODS

A. Population and Sample Selection

LPD employees and administrators in Jembrana Regency, became the population in this study. Based on data obtained from the Village Credit Institution Empowerment Institute (LPPLD) of Jembrana Regency, the number of LPDs was 64 LPD units, with a total of 407 employees and 203 of them were taken using a stratified proportional random sampling technique.

B. Data Collection, Measurement, and Analysis Techniques

Data collection was carried out using a questionnaire, and documentation. The questionnaire contains several questions to respondents related to the indicators measured in the fraud diamond theory variable. Respondents were asked to agree or disagree on each statement, then converted into numbers using a Likert scale with an interval of 5, from 1 strongly disagree to 5 strongly agree. On the other hand, a documentation study is used to collect data on the tendency of financial statement fraud as measured using the Z-score updated by Altman (2000) with the following formula: [1]

$$Z = 0.012X1 + 0.014X2 + 0.033X3 + 0.006X4 + 0.999X5 \quad (1)$$

Where: X1= Working Capital/Total Assets; X2 = Retained Earnings/Total Assets; X3= Profit before Interest and Tax/Total Assets; X4= Market Value of Equity/Book Value of Total Liabilities and X5= Sales/Total Assets.

Validity and reliability tests were conducted using 30 respondents before the questionnaire was distributed. Measuring the validity of the instrument in this study, Pearson correlation was used with Sig. (2-tailed) 0.05, if the correlation value is below 0.05, it means that the data obtained is valid. A reliability test was performed using Cronbach's alpha (α) statistical test. The construct or variable is reliable if the Cronbach's Alpha value is greater than 0.70.

The hypothesis was tested using variant-based SEM, processed using PLS (Partial Least Square) with a significance level of 0.05.

IV. RESULT AND DISCUSSION

A. Test Research Instruments and Models

The validity and reliability of the instrument were tested using 30 respondents. The results of the instrument validity test using 51 indicators show that the Pearson correlation coefficient is greater than 0.30, with the significance value of each indicator being less than 0.05, so all items in the questionnaire are valid. The Cronbach alpha coefficient, for the variable pressure (X1), opportunity (X2), rationalization (X3) and capability (X4), has a value greater than 0.70, thus the questionnaire is reliable.

The indicators used in the research have met convergent validity, because the Smart PLS output shows that each indicator has a loading factor greater than 0.7. The Average Variance Extracted (AVE) value for all constructs is greater than 0.5, so that all constructs are valid or meet convergent validity.

The cross-loading value for all indicators on the variable pressure (X1), opportunity (X2), rationalization (X3) and capability (X4), is greater than 0.70, besides that the correlation coefficient of the latent variable by itself is greater than the correlation coefficient. between itself and other latent variables, then all indicators are valid or meet Discriminant Validity.

The composite reliability value of the pressure (0.972), opportunity (0.918), rationalization (0,970), capability (0,946) and the tendency to financial statement fraud (1,000), as well as the pressure (0.969), opportunity (0.897), rationalization (0,967), capability (0,942) and the tendency to financial statement fraud (1,000), were greater by of 0.7, so the reliability for all constructs is high and reliable.

The R^2 of the tendency of fraudulent financial statements is 0.147 so that the influence models X1 (pressure), X2 (opportunity) X3 (rationalization), and X4 (capability) on the tendency of fraudulent financial statements is 0.147 which can be interpreted that the model is classified as weak. The formula for obtaining predictive-relevant values is: $Q^2 = 1- (1- R1^2)\ (1 - R2^2)\ \ldots(1 - Rp^2)$ is 0.02 greater than 0, meaning the model has predictive relevance. It can be stated that only 14.7% of the variation in accounting fraud variables can be explained by the variables used in the model, while 85.83% is explained by other factors.

B. Hypothesis Testing and Discussion

The bootstrapping procedure was used to test the research hypotheses, with the results of the analysis as shown in Table 1.

TABLE I. PATH COEFFICIENT

Effect	Original Sample	T Statistic	P Values	Significance
X1 → Z	0,172	2,374	0,018	Sig[a]
X2 → Z	-0,261	3,765	0,000	Sig
X3 → Z	0,176	2,345	0,019	Sig
X4 → Z	0,225	2,040	0,042	Sig

Source: Processed data
[a.] Sig = significance

1) The Effect of Pressure on Fraudulent Financial Statements: The results show that pressure has a positive and significant effect on the tendency of fraudulent financial reporting, so that the H1 hypothesis is accepted. That is, the higher the pressure, the higher the tendency to fraudulent financial statements. The results of the study show that the indicator that has the highest loading is on the dimension of financial stability, namely credit disbursement which results in business losses, impacting on the difficulty of returning customer funds. The dimension of excessive pressure on management is the difficulty of obtaining financing through debt, or capital, to survive in competition. If financing with debt, lack of ability to meet debt repayment requirements. Whereas in the personal financial dimension of the board, the board is given excessive financial targets, and also becomes a personal guarantee for the debts of the LPD.

The results of the research are in accordance with an empirical study by [19] that fraud occurs because the perpetrator faces several pressures. The triangle fraud theory by Cressey (1950) cited by [1], states that pressure is an incentive that motivates someone to commit fraud. When the manager's personal interests are not aligned with the company's interests, at that time there will be a tendency to cheat. When there is pressure, both financial and non-financial, it will make it difficult for someone, then trapped in a difficult situation, giving rise to encouragement or motivation to use all means, so that they can be free from difficult situations caused by pressure.

The results of research by [1], [10], [23] and [9], are in line with the results of this study. However, this is not in line with the results of research by [11] and [12], which show that pressure has a significant negative effect on financial statement fraud.

2) The Effect of Opportunity on the Trend of Accounting Fraud: The second hypothesis (H2) is accepted, because opportunity has a significant negative effect on the tendency of fraudulent financial reporting. The tendency for fraudulent financial reporting to occur, based on research results, is due to high opportunities due to the nature of LPD operations, ineffective management oversight procedures, organizational structure complexity and frequent changes, and deficiencies in internal control elements. The results showed that on the dimensions of the operational nature of LPDs, there is uncertainty in estimating assets, debts, income and expenses of LPDs, and there are significant irregular transactions. Meanwhile, from the dimensions of the ineffectiveness of supervision by the management, there are LPD administrators who are dominated by certain groups, and ineffective supervision. The dimension of the complexity of the organizational structure is the difficulty in determining who has the authority to control the LPD. On the other hand, from the dimension of lack of internal control components, there is a fairly high rotation of LPD management.

Triangle fraud theory, is a theory that provides a framework to assist companies in analyzing the company's vulnerability to fraud. Opportunity is one of the factors in the triangle fraud theory, which is a condition that allows someone to cheat [16]. Aspects of fraudulent behavior generally focus on agency theory, which assumes that management is usually motivated by personal interests, so that management will commit fraud, because it is best for personal and short-term interests [4]. Agency conflict occurs, because the LPD management is unable to carry out effective supervision, and there is a deficiency in internal control, so that it is unable to reduce any behavior that deviates from procedures. This creates opportunities for agency conflicts to occur, so that the tendency for fraudulent financial reporting will arise.

The results of this study are in accordance with research by [9], [1] and [10] where opportunity has a negative effect on fraudulent financial statements. Different results are shown by research results [12], where opportunity has a significant positive effect on fraudulent financial statements. The results of research by [11] and [23], show that opportunity has no significant effect on financial statement fraud..

3) The Effect of Rationalization on the Trend of Accounting Fraud: The hypothesis of H3 is accepted because there is a positive influence of rationalization on financial statement fraud. Rational choice theory initiated by [24] is an attempt to reconcile the relationship between the individual and society, and the historical and normative status of rationality. The essence of rationality lies in the human ability to clearly articulate something that is understood so that it is easy to understand how corruption cannot be rational because it requires secrecy and concealment. A rationalization is a form of self-justification, namely an attitude or action taken by a person to justify or convince himself that the action taken is not fraudulent.

The results of the study indicate that the justification for fraudulent financial reporting is due to the use of inappropriate tools in an effort to minimize reported profits for tax purposes, and supervisors are unable to examine those with governance responsibilities, due to access restrictions.

The results of research by [11] and [23] are in line with the results of this study, showing that rationalization has a significant positive effect on fraudulent financial statements. However, this is not in line with the results of research by [1], which shows rationalization has a negative effect on fraudulent financial statements. Different results are also shown by the results of research [12], it turns out that rationalization has no significant effect on fraudulent financial statements.

4) The Effect of Capability on the Trend of Accounting Fraud: Hypothesis H4 is accepted, because the results of the analysis show that capability has a significant positive effect on the tendency of fraudulent financial reporting. The diamond fraud theory by [25] states that most frauds cannot occur without the presence of someone who has great ability in a company. According to [4], only people who have a very high capacity, can understand the opportunities that exist, identify their weaknesses and use them in planning the implementation of fraud. The results of the study show that there is a tendency for financial statement fraud to occur because there are people at the LPD who take advantage of their position, position, or function at the LPD, and the person concerned has the ability to understand and take advantage of internal control weaknesses.

The results of this study are in line with the results of research by [10] showing the results that capability has a significant effect on fraudulent financial statements. However, in contrast to the results of the study [9], it turns out that the variable in capability has no significant effect on fraudulent financial statements. The results of research by [11] and [12], show that capability has a significant negative effect on financial statement fraud, while the results of research by [23] state that capability has no effect on financial statement fraud.

V. Conclusions and Suggestions

A. Conclusions

Pressure has a positive and significant effect on the tendency of fraudulent financial statements because financial stability results from the difficulty in disbursing credit, which causes business losses, making it difficult to return customer funds. There is excessive pressure on management, namely the difficulty of obtaining financing through debt, or equity in order to be competitive. If financing can be through debt, the lack of ability to meet debt repayment requirements. Administrators are subject to excessive financial targets and become personal guarantees for LPD debts.

The opportunity has a negative and significant effect on the tendency of fraudulent financial reporting. Opportunities for financial statement fraud tend to occur as a result of high opportunities due to the increasingly complicated nature of operations, ineffective management monitoring procedures, complex and frequently changing organizational structures, and deficiencies of higher internal control components. There is uncertainty in the estimation of assets, liabilities, income, and expenses, there are unusual and significant transactions. Ineffective management oversight by the existence of administrators who are dominated by certain groups so that oversight is ineffective. It is difficult to determine who has the authority to control the LPD, and the rotation of the board is high.

Rationalization has a significant positive effect on the tendency of fraudulent financial statements. There is justification for fraudulent financial reporting, as there are attempts to use inappropriate tools in an attempt to minimize reported profits for tax purposes, and supervisors are unable to examine those charged with governance due to access restrictions.

The capability has a significant positive effect on the tendency of fraudulent financial statements. The tendency for financial statement fraud to occur because there are people who take advantage of their position, position or function, and have the ability to understand and exploit internal control weaknesses.

B. Suggestions

The LPD in Jembrana District needs to immediately improve the internal control system and monitor the implementation of the system by supervisors. Adequate system implementation and continuous monitoring will prevent opportunities and justifications for committing fraud. Expanding access for supervisors to conduct inspections and not giving excessive targets to administrators so as not to create pressure that triggers fraud.

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