

THE ANALYSIS OF FACTORS IN THE FRAUD DIAMOND PERSPECTIVE AS PREDICTORS OF FRAUDULENT FINANCIAL REPORTING IN CONSTRUCTION COMPANIES LISTED ON IDX

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ABSTRACT

Fraudulent financial reporting fraud is a serious problem, especially in the construction sector, which is susceptible to manipulation. The study is intended to analyze the impact of four elements of fraud diamonds on the financial statements of fraud in Indonesia's construction sector (pressure, opportunities, rationalization, and capability). The data were collected from 21 construction companies listed on the Indonesian Stock Exchange (IDX) between 2020 and 2022, and totaled 63 observations. The analysis was conducted using multiple linear regression and the fraud score model (F-Score) as fraud detection tools. The results showed that all independent variables had positive and significant effects on financial fraud. Classical assumption tests ensure the validity of the model and the freedom from autocorrelation, multicollinearity and heteroscedasticity. This model explains 96.6% of changes in fraud in financial statements. The report recommended strengthening internal controls and developing mitigation strategies to reduce the risk of financial statements being forged.

Keywords: *Fraudulent Financial Reporting, Fraud Diamond, Construction Sector.*

INTRODUCTION

Financial statements are an important tool for companies to provide information to external users such as investors and shareholders. In order to ensure the accuracy of the information provided, financial statements must be exempt from material misstatements caused by errors and frauds. According to International Audit Standards (ISA) 240, the main difference between errors and fraud lies in the intention behind the actions, in which fraud is deliberately committed to deceive financial statement users. ISA 240 defines fraudulent financial reports as intentional misstatements or omissions in financial statements, resulting in non-compliance with generally accepted accounting principles (IAASB, 2020). Fraudulent financial reporting is often committed by companies, especially in companies listed on the public stock exchange, to maintaining a positive image. Although authorities such as the Financial Services Authority (OJK) have issued various regulations to protect investors' interests and maintain market integrity, fraud cases still occur frequently. According to data from the Asia Pacific Association of Certified Fraud Examiners (ACFE) for 2022, Indonesia is the fourth largest fraud case country in the Asia Pacific region (ACFE, 2022).

In particular, the construction sector has a particularly high urgency for fraudulent financial reports. This sector is mainly vulnerable to fraud due to its complexity, high volume of transactions and the participation of multiple parties in each project. Among the major cases in which these companies, such as Waskita Karya, was involved in financial statement manipulation in order to decorate their financial situation, suffered significant losses to

investors and undermined Indonesia's public trust in the integrity of construction companies (Wibowo, 2023). These cases highlight the weaknesses of existing control and internal control mechanisms and the high risk of fraud in this sector. With all its challenges, the construction sector requires special attention in fraud detection. It is not only important to maintain the integrity of capital markets, but also to ensure that infrastructure projects that are essential to economic development are not disrupted by harmful practices. Consequently, more in-depth research is needed to understand how the elements of the theory of diamond fraud can be effectively applied to detect fraud in the construction sector. The aim of this study is to examine the four elements of diamond fraud theory on the fraud financial reporting in Indonesian construction. The study uses the Fraud Score Model (F-Score) to detect fraud and expects to contribute significantly to the related literature and to provide practical benefits to auditors in improving their ability to detect fraud.

LITERATURE REVIEW

Agency Theory

Agency Theory explains the agent-principal relationship, where agents often hold more information, leading to information asymmetry (Jensen & Meckling, 2019). This allows agents to act in self-interest. It is based on assumptions of human nature, organizational structure, and information acquisition (Eisenhardt, 1989).

Information Asymmetries

Information asymmetry arises when managers have more information about a company's prospects than shareholders, potentially leading to

conflicts of interest. Scott (2000) identifies two forms: adverse selection, where managers know more than investors, and moral hazard, where managers' actions aren't fully monitored.

Fraud Triangle

The Fraud Triangle identifies three key conditions for fraud: pressure (from financial needs or high targets), opportunity (due to weak monitoring or industry factors), and rationalization, where individuals justify fraudulent actions as acceptable (Cressey Donald, 1953).

Fraud Diamonds

The fraud diamond expands the fraud triangle by adding a fourth element: ability. Wolfe & Hermanson (2004) argue that an individual's ability to recognize and exploit opportunities, combined with pressure and rationalization, is crucial in major fraud cases.

Financial statement fraud

Financial statement fraud involves deliberate actions by management to gain illegal benefits. It includes fraudulent reporting—such as modifying records, making false statements, or using incorrect accounting principles—and asset misuse, like theft or fictitious payments, often concealed through falsified documents (Scott, 2000).

Kultsum & Triyatno (2022) found that the fraud diamond had a positive impact on financial statement fraud in Sri-Kehati index companies (IDX, 2016-2020), but industry characteristics and auditor changes were insignificant. Lionardi & Suhartono (2022) showed that, for banks (IDX, 2017-2020), industry characteristics negatively impacted fraud, while director changes had a positive effect. Abbas & Laksito (2022) confirmed that, for manufacturers (IDX, 2018-2020), director changes positively influenced financial fraud, while financial objectives and industry characteristics had no significant effect. Nor Aini Aprilia & Furqani (2021) found that financial targets negatively impact financial statement fraud, while industry has a positive influence, but capability shows no significant effect. Prakoso & Setiyorini (2021) similarly found that financial targets negatively affect fraud, while management changes have no significant impact.

Research Hypotheses

1. The Effect of Pressure on Financial Statement Fraud

In the context of agency theory, the relationship between the principal and the agent can generate pressure for the agent to commit financial statements fraud (management). The theory of the fraud triangle indicates that this pressure is caused when managers face unrealistic expectations from owners or managers, such as high revenues and

profit goals (Cressey Donald, 1953; Jensen & Meckling, 2019). Furthermore, ISA 240 points out that pressure may also arise from factors such as threats to financial stability, the need for additional external funding and the personal needs of management that are endangered by poor business performance. Some empirical studies support this view, such as Skousen and others. Hanifa and Hery (2015) and Tiffani & Marfuah (2015) found that pressure from management can increase the risk of financial statements fraud. Thus, the first hypothesis is:

H1: Pressure has a positive effect on financial statement fraud.

2. The Effect of Opportunity on Financial Statement Fraud

The theory of the impact of opportunity on financial statement fraud agencies also highlights the possibility of a financial statement being used by management because of information asymmetry and internal control weakness (Jensen & Meckling, 2019). Fraud triangle theory suggests that weaknesses in internal control systems, complexity of accounting rules, and organizational structures can create opportunities for fraud without detection (Albrecht, Turnbull, Zhang, & Skousen, 2010; Cressey Donald, 1953). Previous studies, such as those carried out by Dechow, Sloan, & Sweeney (1996), Dunn (2004), and Skousen, Smith, & Wright (2009) show that fraud opportunities can be reduced through effective supervision, especially through corporate governance mechanisms such as the creation of independent audit committees. Therefore, the second hypothesis is:

H2: Opportunities have a positive impact on financial reporting fraud.

3. The Effect of Rationalization on Financial Statement Fraud

The effect of rationalization on the accounting of fraud in the theory of the triangle of fraud is the process by which the perpetrator merelyifies his or her fraudulent acts (Cressey Donald, 1953). The theory of organizations also supports management's tendency to rationalize its actions in order to maximize the personal value, especially when under high pressure (Jensen & Meckling, 2019). ISA 240 states that companies that frequently change auditors are more likely to commit fraud when management tries to reduce the likelihood of long-term auditors detecting fraud (Lou & Wang, 2009). Consequently, the third hypothesis is

H3: rationalization has a positive impact on fraud in financial statements.

4. The Effect of Capability on Financial Statement Fraud

The effect of capability on the capacity of a financial statement to commit a fraud is an additional element introduced by fraud diamond theory (Wolfe & Hermanson, 2004). The theory of

the agency also recognizes that frequent and irregular changes in directors can lead to fraud opportunities, especially towards the end of their term of office when pressure to demonstrate a good performance increases (Fransiska, 2007; Tiono et al., 2004). Wolfe & Hermanson (2004) point out that the ability of individuals to commit fraud may be influenced by their position, authority, and personal characteristics such as intelligence, confidence, and resistance to stress. Therefore, the fourth hypothesis is

H4: The capability has a positive effect on financial statements fraud.

RESEARCH METHODS

This study investigates financial statement fraud in Indonesian construction companies listed on the IDX from 2020 to 2022, focusing on four key variables: pressure, opportunity, rationalization, and capability. It uses secondary data, including audited financial statements and reports, analyzed through saturated sampling, covering all construction companies on the IDX during the study period. The dependent variable is financial statement fraud, calculated using the F-score model, while independent variables include pressure, opportunities, rationalization, and capability. Data analysis involves classical assumption tests, such as autocorrelation, multi-collinearity, and heteroscedasticity, followed by multiple linear regression using SPSS. The model's accuracy is evaluated through the R^2 coefficient, F-test, and t-test to determine the significance of individual variables, ensuring reliable results in assessing financial fraud in IDX-listed companies.

RESULTS AND DISCUSSIONS

The sampling procedures are described in Table 1.

Table 1. Sample Selection Procedure

No	Information	Total
1	Construction Sector Companies on the IDX for the 2020-2022 period	22
2	Companies whose financial statements were incomplete were found during 2020-2022	(1)
3	Number of samples	21
4	Number of samples in three years of observation	63
5	Number of samples studied	63

Source: www.idx.co.id (Data Processed, 2024)

Table 2 outlines research variables—F-Score (Y), pressure (X1), opportunities (X2), rationalization (X3), and capabilities (X4)—analyzed across 63 observations, detailing their minimum, maximum, average, and standard deviation values.

Table 2. Descriptive Statistics

	N	Min	Max	Mean	Std. Dev
F-Score (Y)	63	-53.57	6.24	-1.1417	7.36836
Pressure (X1)	63	-.79	15.81	.2629	2.00388
External Pressure	63	.04	.89	.5410	.20716
Personal Financial Need	63	.00	.02	.0010	.00429
Financial Target	63	-7.91	.24	-.1256	1.00140
Nature of industry	63	-10.50	2.98	-.1249	1.46911
Ineffective monitoring	63	1.00	1.00	1.0000	.00000
Opportunity (X2)	63	.00	1.00	.4129	.43018
Rationalization (X3)	63	.00	1.00	.0317	.17673
Capability (X4)	63	.00	1.00	.3492	.48055
Valid N (listwise)	63				

Source: Data Processed, 2024

Kaiser Meyer Wolkin (KMO) KMO tests are used to evaluate the appropriateness of samples for factor analysis. The test results show that the KMO value is > 0.5 , indicating that the data has sufficient sample size for factor analysis (Table 3).

Table 3. KMO Test Results

Variable	Kaiser-Meyer-Olkin Measure (KMO)	
	Selection 1	Selection 2
Pressure	0,506	0,511
Opportunity	-	0,500

Source: Data Processed, 2024

The MSA test is used to evaluate the feasibility of each variable factor test model. The MSA analysis results show that all maintained indicators have a MSA value of > 0.5 , i.e. the model is suitable for factor analysis (table 4).

Table 4. MSA Values

Variable	Indicator	MSA Selection 1	MSA Selection 2
		1	2
Pressure	Financial Stability	0,504	0,507
	External Pressure	0,505	0,508
	Personal Financial Need	0,407	-
	Financial Target	0,582	0,583
	Nature of industry	-	0,501
Opportunity	Ineffective monitoring	-	-
	Organizational Structure	-	0,501

Source: Data Processed, 2024

Communalities

Communalities indicates the amount of variance that can be explained by the factors that are formed. In the communalities test, indicators that did not meet the criteria were eliminated, with the remaining indicators having an extraction value of > 0.5 , indicating validity and reliability (Table 5 and Table 6).

Table 5. Communalities Value of Pressure

	Extraction 1	Extraction 2
Financial Stability	0.585	0.573
External Pressure	0.558	0.548
Personal Financial Need	0.976	-
Financial Target	0.105	0.098

Table 6. Communalities Value of Opportunity

	Communalities	
	Initial	Extraction
Nature of industry	1.000	.501
Organizational Structure	1.000	.501

Sumber: Data Diolah, 2024

Component Matrix

The result of the component matrix shows that each variable contains only one component. The indicator with the highest value in each variable remains an effective and reliable indicator (tables 7 and 8).

Table 7. Component matrix Value of Pressure

	Component 1
Financial Stability	0.757
External Pressure	0.740
Financial Target	0.313

Source: Data Processed, 2024

Table 8. Component matrix Value of Opportunity

	Component 1
Nature of industry	-0.708
Organizational Structure	0.708

Source: Data Processed, 2024

Results of the Classic Assumption Test

Normalization tests were performed using Kolmogorov-Smirnov tests. The results showed that the residual is normally distributed and the Asymp value is the same. Sig (2-tailed) = 0.059 > 0.05 (Table 9).

Table 9. Normality Test

One-Sample Kolmogorov-Smirnov Test			Unstandardized Residual	
N			63 ^c	
Exponential parameter. ^{a,b}	Mean		.1414305	
Most Extreme Differences	Absolute		.212	
	Positive		.082	
	Negative		-.212	
Kolmogorov-Smirnov Z			1.326	
Asymp. Sig. (2-tailed)			.059	

Source: Data Processed, 2024

Multicollinearity tests show that independent variables do not have a correlation, with

VIF values >10 and tolerance >0.1, and models are therefore non-multilinear (Table 10).

Table 10. Multicollinearity Test Results

Variabel	Tolerance	VIF	Description
Pressure (X ₁)	0,812	1,232	Multicollinearity Free
Opportunity (X ₂)	0,291	3,434	Multicollinearity Free
Rationalization (X ₃)	0,234	4,282	Multicollinearity Free
Capability (X ₄)	0,226	4,429	Multicollinearity Free

Source: Data Processed, 2024

Durbin Wattson autocorrelation tests showed that the DW value did not meet the criteria, but follow-up tests showed that the model did not contain autocorrelation with the Aypm value. Sig (2-Tailed) with 0.163 > 0.05 (Table 11).

Table 11. Autocorrelation Test Results with Run Test

	Unstandardized Residual
Test Value ^a	0.06707
Cases < Test Value	31
Cases ≥ Test Value	32
Total Cases	63
Number of Runs	27
Z	-1.396
Asymp. Sig. (2-tailed)	0.163

Source: Data Processed, 2024

Durbin Wattson autocorrelation tests showed that the DW value did not meet the criteria, but follow-up tests showed that the model did not contain autocorrelation with the Aypm value. Sig (2-Tailed) with 0.163 > 0.05 (Table 11).

Table 12. Heteroscedasticity Test Results

Model	Unstd Coefficients		Std Coefficients		t	Sig.
	B	Error	Beta			
1 (Constant)	.276	.051			5.410	.000
Pressure (X ₁)	-.025	.015	-.233		-1.710	.093
Opportunity (X ₂)	-.031	.022	-.320		-1.404	.166
Rationalization (X ₃)	.048	.025	.485		1.906	.062
Capability (X ₄)	-.002	.029	-.020		-.076	.940

^a. Dependent Variable: ABS_RESIDUAL

Source: Data Processed, 2024

Multiple linear regression analysis revealed that pressure (X₁), opportunity (X₂), rationalization (X₃), and capability (X₄) all have a significant positive impact on financial reporting fraud (Y) (Table 15).

Table 15. Summary of Multiple Linear Regression Analysis Results

Model		Unstd Coeffi- cients	Std Coeffi- cients	t	Sig.
		B	Std. Error Beta		
1	(Constant)	.101	.094	1.072	.288
	Pressure (X1)	.054	.027	2.033	.047
	Opportunity (X2)	.171	.040	4.263	.000
	Rationalization (X3)	.099	.046	2.125	.038
	Capability (X4)	.646	.054	12.058	.000

a. Dependent Variable: Kecurangan Pelaporan Keuangan
Source: Data Processed, 2024

The following equation can be constructed from the results of the above multi-linear regression analysis.

$$Y = 0.101 + 0.054 X_1 + 0.171 X_2 + 0.099 X_3 + 0.646 X_4 + \epsilon \quad (1)$$

According to the determination coefficient (R²), 95.6 per cent of the variation in financial reporting fraud is explained by independent variables and the remaining 4.4 per cent by other factors (table 16).

Table 16. Determination Coefficient Test Results

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.979 ^a	.959	.956	.22432

a. Predictors: (Constant), Capability (X4), Pressure (X1), Opportunity (X2), Rationalization (X3)

Source: Data Processed, 2024

The F test in this study assesses whether the independent variables significantly affect financial reporting fraud, with a 5% significance level. The ANOVA results show an F value of 341.660 and a significance of 0.000, indicating the model is feasible. Independent variables—pressure (X1), opportunities (X2), rationalization (X3), and capabilities (X4)—significantly impact financial reporting fraud, effectively predicting fraud in IDX-listed construction companies (Table 17).

Table 17. Test Result F (ANOVA)

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	68.767	4	17.192	341.660	.000 ^b
Residual	2.918	58	.050		
Total	71.686	62			

a. Dependent Variable: Kecurangan Pelaporan Keuangan

b. Predictors: (Constant), Capability (X4), Pressure (X1), Opportunity (X2), Rationalization (X3)

Source: Data Processed, 2024

Hypotheses test the influence of each independent variable on the dependent variable using a T-test. The results of the t test can be found in table 18.

Table 18. Results of t-Test (Hypothesis Test)

Variable	B	t-count	Sig.	Conclusion
Pressure (X ₁)	0,054	2,033	0,047	Positive Significant
Opportunity (X ₂)	0,171	4,263	0,000	Positive Significant
Rationalization (X ₃)	0,099	2,125	0,038	Positive Significant
Capability (X ₄)	0,646	12,058	0,000	Positive Significant

Source: Data Processed, 2024

The t-test results show a regression coefficient of 0.054 with a significance value of 0.047, indicating that pressure has a positive and significant effect on financial reporting fraud. Therefore, the first hypothesis (H1) is accepted.

The t-test results show a regression coefficient of 0.171 with a significance value of 0.000, indicating that opportunity positively and significantly influences financial reporting fraud. Thus, the second hypothesis (H2) is accepted.

The t-test results show a regression coefficient of 0.099 with a significance value of 0.038, indicating that rationalization has a positive and significant effect on financial reporting fraud. Therefore, the third hypothesis (H3) is accepted.

The t-test results show a regression coefficient of 0.646 with a significance value of 0.000, indicating that capability positively and significantly influences financial reporting fraud. Therefore, the fourth hypothesis (H4) is accepted.

Discussion

1. The Effect of Pressure on Financial Reporting Fraud

This study's first hypothesis posits that pressure positively influences financial reporting fraud, drawing on agency theory and Cressey's 1953 fraud triangle. Agency theory suggests that conflicts of interest arise when agents (managers) face unrealistic expectations from principals (owners), leading to fraud under pressure. The fraud triangle identifies pressure as a key trigger for fraud. Internal pressures, such as high financial targets, and external pressures, such as creditor demands, increase the likelihood of financial fraud. ISA 240 notes that financial stress, especially during negative economic conditions, drives managers to commit fraud. Previous studies, like Skousen et al. (2009), reinforce this, showing that corporate asset growth and high leverage (external pressure) are linked to increased fraud risks. Companies under pressure to demonstrate consistent growth may manipulate financial statements to meet investor expectations.

2. The Effect of Opportunity on Financial Reporting Fraud

The second hypothesis suggests that opportunities positively influence financial reporting fraud. Agency theory highlights that fraud becomes more likely when there is information asymmetry between agents (managers) and principals (owners). The fraud triangle identifies opportunity as a key factor enabling fraud, particularly when internal controls are weak or oversight is lacking. This study shows that poor internal controls and inadequate management supervision increase the risk of fraud. Previous research by Dhow et al. (1996) and Beasley (1996) supports this, demonstrating that strong audit committee oversight reduces fraud risk. Organizational complexity also creates opportunities for fraud, especially when directors hold multiple roles. Haniffa & Hudaib (2006) argue that while external roles can offer information benefits, insufficient supervision in large organizations raises the likelihood of fraud.

3. The Effect of Rationalization on Financial Reporting Fraud

The third hypothesis asserts that rationalization positively influences financial reporting fraud. According to agency theory, agents may justify unethical actions to serve their personal interests. Cressey's fraud triangle explains that fraudsters often rationalize their actions, enabling them to commit fraud without guilt. This study finds that rationalization plays a significant role in financial fraud, especially when management views their actions as justified. For instance, companies may rationalize fraud by changing auditors, hoping new auditors won't detect prior fraud. Research by Lu et al. (2009) and Sorenson, Grove, & Selto (1983) supports this, showing that auditor changes can conceal fraudulent activities.

4. The Effect of Capability on Financial Reporting Fraud

The study's final hypothesis posits that capability positively affects financial reporting fraud. (Wolfe & Hermanson, 2004) fraud diamond adds capability as a fourth element to explain fraud beyond the fraud triangle. Capability refers to an individual's ability to exploit fraud opportunities. The study finds that management changes can increase the likelihood of fraud, especially when politically motivated, leading to conflicts of interest. Research by Wolfe & Hermanson (2004) and Fransiska (2007) supports this, showing that new directors, under pressure to perform well, may commit fraud to secure their positions.

CONCLUSION AND SUGGESTION

The study successfully proved that the four main elements of fraud diamonds, namely pressure, opportunities, rationalization and capabilities, have a positive impact on financial reporting fraud. These

conclusions agree with the basic theories of agency theory, which explains that conflicts of interest between directors and agents can encourage agents to act in ethical ways for their own benefit. Pressure from various sources, such as high financial demands or external pressure, has shown that it increases the risk of fraud in financial reports. In addition, the lack of internal control and complexity of organizational structures create opportunities for management to commit fraud. Rationalization is also an important factor that allows managers to justify their fraud. Finally, management's abilities, especially with regard to the transformation of directors, also facilitate fraud. The benefit of this study is that it strongly correlates the results of research with the theoretical evidence used and supported by the relevant empirical evidence. However, research has limitations, particularly in terms of generalization, as the data used may not reflect the situation of all types of companies or industries. Furthermore, other factors that may affect financial reporting fraud, such as cultural or regulatory factors, have not been discussed in detail.

Further research is required to improve these findings, particularly to extend the scope of the data used to better represent various types of enterprises and industries. Furthermore, follow-up studies are recommended to take into account other factors affecting financial reporting fraud such as organizational culture, government regulations, and information technology. Research can also focus on developing more effective internal control models for preventing fraud and exploring interventions or strategies to reduce pressure and rationalization within management. The results of the study could therefore be more beneficial to companies, auditors and regulators to prevent and detect future financial reporting fraud.

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