

Erosion of Company Value: Impact of Financial Statement Fraud in Diamond Theory

SUPRIATININGSIH¹, HIDAYAT DARWIS², NOVA RINI³

^{1, 2, 3} Faculty of Economics and Business, Universitas Teknologi Muhammadiyah Jakarta

Abstract- *Fraud in financial statements can significantly affect the value of a company. The risk that the company must bear if it commits financial statement fraud is that investors and company stakeholders no longer trust the company, so they will withdraw their shares from the company. The purpose of this research is to examine how Diamond theory factors influence financial statement fraud and how they influence company value. The population comes from companies indexed by Sri Kehati shares and listed on the Indonesia Stock Exchange, there are 14 companies, between 2017 and 2021 providing a secondary data sample of 70. Data processing uses the Eviews12 program. Research on the Sri Kehati indexing company revealed that there was no significant relationship between financial target (ROA), change of director and change of audit on financial report fraud. Rationalization has an effect on financial report fraud, while financial report fraud has no impact on company value*

Indexed Terms- *Change of director, Diamond theory, firm value, financial target, Fraudulent financial reporting*

I. INTRODUCTION

Fraud is an act that is intentionally carried out by individuals individually or by one party to gain profits which results in losses to other parties (Tiffani, et al., 2015), in other words if you lie to obtain money or property from their organization. , then you are committing fraud. (Association of Certified Fraud Examiners 2020). The results of a 2022 survey by (Association of Certified Fraud Examiners 2020) in cases of fraud in the world, there were 1,605 cases of the highest misuse of assets with losses of \$1,203,000. and the lowest 150 cases of fraud on financial reports, but this case had the largest loss impact of \$50,482,000 (Association of Certified Fraud Examiners 2020).

Case example: One of the cases that was revealed in April 2019 was the issue of manipulation of PT Garuda Indonesia's financial reporting. Quoted from economy.okezone.com, the PT Garuda Indonesia case began when 2 commissioners - Chaira Tanjung and Dony Oskaria felt that PT Garuda Indonesia's 2018 financial report did not comply with the Statement of Financial Accounting Standards (PSAK). Where in the 2018 financial report, management acknowledged that income from PT Mahta Aero was still in the form of receivables. With the recognition of revenue still in the form of receivables, PT Garuda Indonesia recorded a net profit of \$809.85 thousand. This situation is different from the 2017 financial report, where PT Garuda Indonesia recorded a loss of US\$216.5 million. As a result of this incident, GIAA's share price fell by 2.80% (CNBC Indonesia, 2019). The company will also strengthen their internal monitoring and control system to prevent fraud in the future.

This is possible based on the phenomenon described regarding cases of fraud in index companies on the Indonesia Stock Exchange. It appears that not all companies included in the index on the Indonesia Stock Exchange are free from fraudulent financial reports. The Bevel of Deception is a development of the Triangle and Diamond theories, including the elements of stimulus/pressure, opportunity, rationalization and competence, financial statement fraud gives negative results to company value (Kalbuana et al. 2023, Rukmana 2018). Companies that are indicated to have committed financial report fraud have a negative impact on company value. This research is in accordance with the phenomenon that occurred, where PT Garuda Indonesia, when fraudulent financial reporting was revealed, the company's shares fell by 2.80%.

This study differs from previous studies in terms of the sample used; Researchers chose companies indexed by Sri Kehati shares which were listed on the BEI from

2017 to 2021. The Sri Kehati Index is an Indonesian Biodiversity Foundation and the Indonesian Stock Exchange in 2009. This index evaluates the share price performance of 25 public companies listed on the BEI. This research aims to find out whether companies indexed by Sri Kehati shares have demonstrated a commitment to following the principles of Sustainable and Responsive Investment (SRI) and social environmental and government (ESG) policies, committing fraudulent financial reports, resulting in a decrease in the value of the company's shares.

II. LITERATURE REVIEW

Agency Theory

In the context of agency theory, Kalbuana et al., (2022) fraud in financial reports can have a significant impact on company value. The theory refers to a relationship where the owner (principal) relies on agents (management or company executives) to manage company assets and operations (Ibrahim., et al, 2022, Supriatiningsih, et al., 2023). Agency theory recognizes that there is asymmetric information between the principal and the agent. Agents have greater access to internal company information than principals. This creates opportunities for agents to manipulate or hide information including financial reports without the principal's knowledge or consent (Varghese and Sasidharan 2020).

Fraud Diamond Theory

The Diamond Fraud Theory is a theory developed by Wolfe and Hermanson (2004), developed the Diamond Fraud Theory by adding a fourth factor that can influence fraud, namely capability. The Diamond Fraud Theory was further developed into four components, namely pressure, opportunity, rationalization and capability.

Pressure

Using a financial target proxy is a pressure variable in this research. According to SAS No. 99 (Anindya and Adhariani 2019), financial goals have risks due to the pressure received by management to achieve financial goals which are based on management or board of directors' decisions. This pressure includes determining the bonuses and incentives that management or employees will receive if they exceed the company's financial goals. Company performance

is closely related to financial target measurements; One of the financial target measurements itself is Return on Assets (ROA). Basically, the higher the ROA targeted by the company, the more vulnerable management is to committing fraud (I. Utami et al. 2019), because there is a positive correlation with financial statement fraud. Based on the description above, the hypothesis formulation is made as follows: H1 = Financial targets have a positive effect on fraudulent financial reporting

Capability

One proxy for capability is change of director. According to Wolfe and Hermanson (2004), a person's position or function in an organization can give them the opportunity to commit fraud. Thus, the role of the CEO, directors and division heads can determine the level of fraud. Changes in directors are usually related to political content and the interests of certain parties because the company has targets that are too high or compensation bonuses are large, which causes differences in interests. Studies by Puspitaningrum, et al, (2019), Manurung, (2015) found that changing directors helps financial statement fraud because changing directors is considered an attempt by the company to get rid of directors who are known to have committed fraud. The more frequent changes in directors, the greater the possibility of financial statement fraud. Based on the description above, the hypothesis formulation is made as follows:

H2 = Changing auditors has a negative effect on fraudulent financial reporting

Opportunity

Nature of industry is a proxy for opportunity, which shows the ideal situation where a company has a large financial balance in certain cases based on estimates, such as uncollectible receivables and obsolete goods. The receivables change ratio increases financial statement fraud, according to research (Summers & Sweeney, 1998, Supriatiningsih, et al., 2023). Based on the description above, the hypothesis formulation is made as follows:

H2 = Nature of industry has a positive effect on fraudulent financial reporting

Rationalization

One of the main components of fraud is rationalization, which encourages fraud perpetrators to

seek justification for their actions (Diansari & Wijaya 2019). According to research conducted Tiffani, et al., (2015), companies can change auditors to reduce the possibility of auditors committing fraud in financial reports (Hasnan, et al., 2021). Based on the description above, the hypothesis formulation is made as follows: H4 = Change of auditor has a positive effect on fraudulent financial reporting

Fraudulent financial reporting

The higher the share price of a company, the greater its value. Conversely, if the company shows a negative condition, the greater the decline in profits and the smaller the value. A phenomenon like this would indicate a relationship that is not positive. This research shows that financial report fraud carried out by companies has a negative impact on company value. Elviani, et al (2020) stated that companies that are proven to have committed financial report fraud have a negative impact on company value. Previous research shows that company value is influenced by financial report fraud (Rukmana 2018).

H5 = Fraudulent financial reporting has a positive effect on firm value

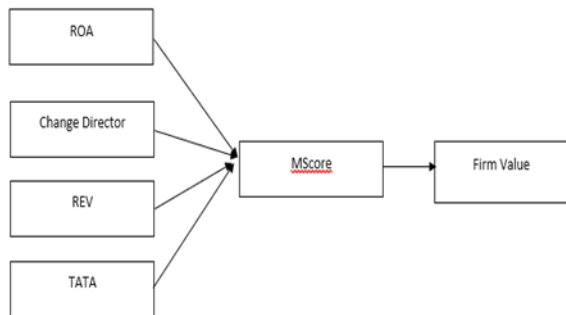


Figure 1. Concept of research model

III. RESEARCH METHODS

The data used are financial reports of manufacturing industry companies indexed by Sri Kehati shares and the Indonesian Stock Exchange for 2017-2021 which were obtained via the official website www.idx.co.id and the company's official website. The Sri Kehati Index is a representation of the share prices of 25 issuers selected based on price earnings ratio (PE), free float and total company assets. The Indonesian Stock Exchange and the Indonesian Biodiversity Foundation (KEHATI) collaborated to create this index. SRI

stands for Sustainable Responsible Investment. The purpose of this index is to provide additional information to investors who wish to invest in issuers that have extraordinary performance in encouraging sustainable business, have good corporate governance and have high environmental awareness.

Table 1. Number of samples that meet the criteria

No.	Remarks	Total
1	companies listed on the Indonesian Stock Exchange in 2017-2021 respectively	25
2	The company does not publish financial reports and does not have complete research data in 2017-2021	15
3	the company has complete data according to the research variables	14
	Number of samples in 5 years	70

Source: www.idx.co.id, 2022

- Operational Definition and measurement
Dependent Variable (Dependent Variable)
Firm Value

Financial ratios can also be used to calculate company value (Kalbuana et al. 2022). Investors use financial ratios to ascertain the value of a company. Management investors can use this ratio to measure a company's past success or predict its future performance. The following financial ratios can be used to determine the value of a company (Ambarwati 2021). The following is the formula for company value:

$$\text{Price to Book Value} = \frac{\text{Share Price}}{\text{Book Value of Shares}}$$

- Variabel Intervening
Fraudulent financial reporting is used as an intervening variable in this research. Measuring fraudulent financial reporting refers to research conducted by (Tiffani, et al., 2015) which used the Beneish M-Score to measure fraudulent financial reporting. The Beneish M-Score is calculated using eight financial ratios and then plugged into its formula:

Beneish M-Score = -4,840 + 0,920 DSRI + 0,528 GMI + 0,404 AQI + 0,892 SGI + 0,115 DEPI – 0,172 SGAI – 0,327 LVGI + 4,697 TATA

- Variable Independent

Financial Target

As a party contracted by shareholders, management must achieve the financial conditions determined by shareholders (Supriatiningsih et al. 2023). Management is required to set a target level of profit obtained for the efforts made to obtain that profit, this condition is called a financial target (Skousen, Smith, and Wright 2008). ROA is a profitability ratio which is usually used to measure a company's operational performance which shows how efficiently assets have been used and often ROA is also used as an indicator determining the size of the bonus that will be given to managers. Based on this, ROA becomes a proxy for financial target variables which can be calculated using the following formula:

$$ROA = \frac{\text{Nett Profit}}{\text{Total Asset}}$$

- Change of Directors

Change of directors refers to the process of replacing or appointing new individuals to the board of directors of a company. Directors are individuals elected by shareholders to oversee the management and direction of the company. Changes in directors can occur for a variety of reasons, including retirement, resignation, dismissal or appointment of new directors to bring particular expertise or viewpoints to the board (Samukri et al. 2022). A person's capacity in an organization will influence their possibility of committing fraud. According to (Siddiq, Achyani, and Zulfikar 2017), (Street and Hermanson 2019) the stressful period after changing the board of directors will increase the possibility of fraud. In this study, dummy variables are used to measure director changes. The value "1" is given if there is a change in directors, and the value "0" is given if there is no change in directors.

- Opportunity

One proxy for opportunity "Nature of Industry" is a term that refers to the ideal state of a company related to the emergence of risks for companies working in industries that require more consideration and

prediction. According to Summers & Sweeney (1998), inventory conditions and accounts receivable differ between companies that commit fraud and companies that do not; they found that both accounts require subjective judgment when estimating unobtainable accounts. Therefore, managers will concentrate on this account if they want to manipulate financial statements. (Khamainy, et al., 2022) So the formula for determining the nature of industry is:

$$\text{Receivable} = \frac{\text{Account receivable}_t - \text{Account receivable}_{t-1}}{\text{Sales}_t - \text{Sales}_{t-1}}$$

- Change of Auditors

The company changes auditors to find the truth so that fraud is not detected. Changing auditors is a way for companies to eliminate traces of fraud discovered by previous auditors (Ibrahim, et al., 2022). In this research, dummy variables are used to measure auditor turnover. If there is a change of auditor from 2017-2021, it is coded 1, 0 if there is no change of auditor.

IV. RESULTS AND DISCUSSION

RESULTS

Descriptive Statistical Test

Table 2. Descriptive statistical test results

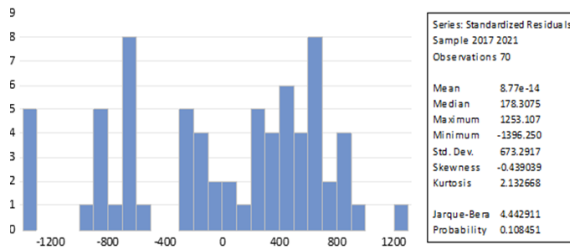
	PBV	MSCORE	ROA	REV	TATA	DCHANGE
Mean	957.0065	878.2525	0.380580	-0.06130	188.2226	0.579710
Median	1.300000	-5.170000	0.080000	0.010000	-0.580000	1.000000
Maximum	16264.43	46393.07	7.500000	0.720000	9915.780	1.000000
Minimum	0.070000	-7.840000	0.000000	-6.230000	-1.060000	0.000000
Std. Dev	3346.412	5678.852	1.243743	-6.230000	-1.060000	0.497222
Skewness	3.833948	7.666676	5.332274	-7.16896	7.666724	-0.322971
Kurtosis	16.47619	61.63644	30.42007	56.87490	61.63703	1.104310

Source: output eviws-12 result

Based on the results of descriptive statistical tests from table 1, it can be seen that there are 70 observations of data on each variable. This number comes from 14 sample companies and 5 annual reporting periods of banking services sector companies listed on the Indonesia Stock Exchange in 2017-2021.

Uji Normalitas

Figure 2: Normality test results



Based on the diagram above, it shows that the probability is 0.108451 above 0.05, the data is normally distributed with a total of 70 data.

Panel Data Regression Selection Method

The results of the chow test model can be seen in table 2 as follows:

Table 3. Chow test results

Effects test	Statistic	d.f	Prob
Cross-section F	16.426872	(25,100)	0.0000
Cross-Section Chi-square	211.972398	25	0.0000

Source: (Output results from e-Views v.12, 2024)

Based on the Eviews output results above, it is known that the cross section probability value F is 0.0000. With a cross-section probability value F smaller than 0.05, it can be concluded that the appropriate model based on the results of the Chow test is the fixed effect model.

Hausman test

Table 4. Hausman test result

Test summary	Chi-Sq Statistic	Chi-Sq d.f	Prob
Cross-section random	0,649405	4	0,9574

Source: Output results from e-Views v.12, 2024

Based on the Eviews output results above, it is known that the random cross section probability value is 0.9574. With a cross section probability value F greater than 0.05, it can be concluded that the appropriate model based on the Hausman test results is the random effect model.

Langrange Multiplier test

Table 5. Result from Lagrange Muliplier Test Model

Cross section	
Breusch-Pagan	146,9851
	(0,0000)

Source: (Output results from e-Views v.12, 2024)

Based on the Eviews output results above, it is known that the Breusch pagan cross section probability value is 0.0000. With the probability value of the Breusch pagan cross section being smaller than 0.05, it is concluded that the appropriate model based on the results of the Lagrange multiplier test is the random effect model.

Panel Data Regression Model

Random Effect Model Test (REM)

Tabel 6. Random effect model test result

Variable	Coefficien	Std. Error	t-Statistic	Prob.
C	1.461.527	1.090.684	1.352.409	0.1787
ROA	-0,076323	0.417579	-0.19277	0.8553
REV	0.155079	0.867620	0.179741	0.8584
TATA	4.678.325	0.007248	6.454.974	0.0000
DChange	-1.582.371	1.352.597	-116.885	0.2443
Adjusted R-squared	0.998682			

Source: (Output results from e-Views v.12, 2024)

Results of the Random Effect Model Test (REM) ROA, REV, TATA and Dchange on MSocre

- The ROA variable (X1) has a t-statistical value of -0.192 with a Prob value. (significance) of 0.8553 > 0.05, H1 is rejected. So it can be concluded that the ROA variable (X1) has no significant effect on the M-SCORE variable (Z).
- The variable REV (X2) has a t-statistic value of 0.179 with a Prob value. (significance) of 0.8584 > 0.05, H2 is rejected. So it can be concluded that the REV variable (X2) has no significant effect on the M-SCORE variable (Z).
- The TATA variable (X3) has a t-statistics value of 645.48 with a Prob value. (significance) of 0.0000 < 0.05, H3 is accepted. So it can be concluded that the TATA variable (X3) has a significant effect on the M-SCORE variable (Z).

- The variable Change Director (X4) has a t-statistical value of -1.169 with a Prob value. (significance) of $0.2443 < 0.05$, H4 is rejected. So it can be concluded that the Change of Director variable (X4) has no significant effect on the M-SCORE variable (Z).
- The Adjusted R-Square value is 0.9996, so it can be interpreted that the contribution of the ROA (X1), REV (X2), TATA (X3) and Change Director (X4) variables to the M-SCORE (Z) variable is 99.86%.

Table 7. Random effect model test results

Variable	Coefficien t	Std. Error	t- Statisti c	Prob.
C	1.243.082	3.711.27	0.3394	0.738
ROA	-141.697	1.423.85	0,9951	0.321
REV	3.145.939	2.958.38	0.1063	0.915
TATA	1.274.052	1.426.82	0.0891	0.929
DChange	6.775.619	4.636.59	1.461	0.929
MScore	-0,21479	4.636.59	1.461.	0.146
Adjusted R- squared	0.006340			

Source: (Output results from e-Views v.12, 2024)

Random effect test results of the Mscore model on Firm value

- The M-SCORE (Z) Intervening variable has a t-statistic value of -0.3398 with a Prob value. (significance) of $0.7382 > 0.05$, rejected. So it can be concluded that the Intervening M-SCORE (Z) variable has no significant effect on the PBV (Y) variable.
- The Adjusted R-Squared value is -0.006340, so it can be interpreted that the contribution of the influence of the ROA (X1), REV (X2), TATA (X3), Change Director (X4) and M-SCORE (Z) Intervening variables to the PBV (Y) variable) of 6.34%.

DISCUSSION

- The influence of financial targets on financial statement fraud

Based on the research results, it can be concluded that companies will not be affected by low or high ROA

levels to commit financial statement fraud. Companies indexed by Sri Kehati have gone through a strict selection process based on criteria that include their company's financial practices and risk management. This is because management does not consider the specified ROA goals to be difficult to achieve, because they feel these goals are still reasonable and achievable. Therefore, a high level of ROA cannot be a reason for management to commit financial statement fraud. This is in line with research results from (Kurniati, et al., 2020, Diansari & Wijaya 2019). This is different from the results of research from Utami, et al., (2022) which states that financial targets have an influence on financial report fraud.

- The effect of changing audits on financial statement fraud

Based on the research results, the conclusion is drawn that rationalization has no effect on financial statement fraud. The auditor is one of the supervisors who provides information regarding findings in the company's financial statements that there are material misstatements or indications of fraud. A company that frequently changes auditors allows the company to commit fraud. This is in line with research results from (Oktaviany & Reskino, 2023, Luvita, 2021). Companies indexed by Sri Kehati shares have carried out good corporate governance, so they carry out audit changes in accordance with Government Regulation 423/KMK.06/2002 article 6 which states that the provision of general audit services for the financial statements of an entity can be carried out by KAP no later than for 5 (five) consecutive financial years and by a Public Accountant for a maximum of 3 (three) consecutive financial years, namely three years (Salsabila 2018). However, research results from (Rizkiawan & Subagio, 2023, Lastanti, et al., 2022, Utami, et al., 2022) state that changing audits has an effect on financial statement fraud.

- The influence of the nature of industry on financial statement fraud.

Based on the research results, it can be concluded that the nature of industry influences financial report fraud. The subjective assessment carried out by the company on inventory accounts, the size of which is determined by the estimates of each company manager, therefore cannot indicate that companies in an industry have the possibility of having financial report fraud. This is in

line with the results of research from (Wahyuni, et al., 2019). The results differ from research from (Khamainy, et al., 2022), (Taqi, et al., 2024) that the nature of industry influences financial report fraud. The large number of trade receivables a company has will of course reduce the amount of cash that the company can use for its operational activities. Limited cash can be an incentive for management to manipulate financial reports.

- The effect of Change of Director on financial statement fraud

Based on the research results, it can be concluded that changing directors has an effect on financial statement fraud. In line with research results from (Yanti & Munari 2021). This is different from research from Drice & Nuryani (2022), Purwaningtyas & Ayem (2021), Ijudien (2018), which states that changing directors has no effect on financial statement fraud. Under the supervision of the board of commissioners, who are representatives of the shareholders, this is done to ensure that shareholders are not harmed. Directors who do not do a good job will immediately be replaced with new, better directors.

- The influence of financial report fraud on company value

Based on the research results, the conclusion is drawn that financial statement fraud has no effect on company value, because Sri Kehati is a form of investment that considers social, environmental and corporate governance aspects apart from only focusing on financial profits alone. Investors who are members of Sri Kehati choose to invest in companies that pay attention to responsible and sustainable business practices. This is in line with research results from (Purwitasasi 2020, Purnama & Astika 2022). In contrast to research results from (Rukmana, 2018) which states that financial statement fraud has an effect on company value.

V. CONCLUSION AND SUGGESTION

CONCLUSION

Based on the results of research conducted on companies indexed by Sri Kehati, the conclusion is drawn that ROA, nature of industry, and director turnover have no effect on financial statement fraud. Meanwhile, rationalization using the nature of

industry proxy has an effect on financial report fraud. Financial statement fraud has no effect on company value

SUGGESTION

It is hoped that with the results of this research, shareholders, regulators and the government as well as investors will be able to gain an understanding of the fraud cases that have occurred recently. Theoretical suggestions are expected for further research to adapt the latest fraud theory because there are variables that are other causes of financial statement fraud and the broader research population.

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