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FRAUD DIAMOND DETERMINANTS OF POTENTIAL FINANCIAL REPORTING FRAUD

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Abstract

Financial statement fraud is a highly risky practice in financial reporting. This research aims at investigating the effect of the fraud diamond (Pressure, Opportunity, Rationalization, and Capability) on the probability of financial statement fraud. The sample consisted of 132 cooperatives over three years (2022–2024). The data analysis technique used logistic regression. The findings showed that pressure was a significant factor driving fraud, arising from various financial obligations that had to be met. Opportunity also influenced the occurrence of financial statement fraud, as a weak internal control system created opportunities for manipulation. Rationalization played a role in enabling fraud, as individuals justified their actions through various rationalizations. Additionally, capability increased the potential for fraud, as individuals with specialized knowledge and skills were more likely to commit fraudulent activities. These findings emphasize the importance of strengthening internal controls and addressing financial pressures to mitigate the risk of financial statement fraud.

INTRODUCTION

In recent times, increasing attention has been given to the Sharia economy as Islamic financial institutions continue to expand. Among these entities is the Sharia Cooperative Parent (Inkopsyah), a microeconomic institution in Indonesia based on Sharia principles. Inkopsyah operates not only as a Sharia-compliant financial institution adhering to Islamic law but also emphasizes an ethical and transparent approach to financial reporting and management.

Inkopsyah has 354 members spread across 27 provinces in Indonesia, consisting of the Primary Sharia Cooperative and the Sharia Cooperative Center (Puskopsyah). All Sharia cooperatives affiliated with Inkopsyah serve Micro, Small, and Medium Enterprises (MSMEs) at the grassroots level, supporting their business development. With this strategic role, Inkopsyah plays a crucial part in strengthening the Sharia-based economy and empowering the MSME sector.

The structure, system, and activities of Inkopsyah, as a Sharia-compliant financial institution, extend beyond adherence to Islamic laws and practices. Its focus is also directed toward implementing ethical and transparent processes in financial information provision. However, like all financial institutions, Inkopsyah is exposed to the risk of financial reporting fraud, which could undermine public confidence and threaten the entire Sharia microfinance system. According to Rozali and Fitriani (2024), fraud prevention can be achieved through the implementation of a whistleblowing system.

Analyses of financial reporting fraud allegations in Indonesia and other countries highlight widespread concerns regarding the credibility of corporate financial statements. A well-known example is PT Indofarma Tbk (INAF), which showed indications of manipulation in 2024, as identified by a Public Accounting Firm (KAP). The losses from this manipulation amounted to IDR 371 billion, leading to the confirmation of fraud in the company's financial reports.

Another major financial fraud case involves the startup eFishery, which has gained international attention. Internal audit reports have revealed financial statement manipulations dating back to 2018. According to Patrick Walujo, one of the company's major investors, such practices have negatively impacted perceptions of Indonesia's startup ecosystem from its early stages. Allegedly, eFishery inflated its profits by as much as IDR 9.74 trillion during this period. Due to these financial irregularities, the company is now facing severe cash flow problems and has announced mass layoffs. In response, the eFishery workers' union has expressed its commitment to assisting affected employees. Meanwhile, the Corruption Eradication Commission (KPK) uncovered fraud in the healthcare sector, resulting in losses of approximately IDR 20 trillion—equivalent to about 10 percent of total public health expenditures. This situation underscores the urgent need for stricter oversight and greater transparency in managing healthcare funds to prevent substantial financial losses that ultimately affect the broader community. Another notable case occurred in 2018 when PT Garuda Indonesia reported a net income of USD 809,850 after recording a loss of USD 216.5 million in 2017. However, two commissioners refused to approve the financial statements due to irregularities in revenue recognition. The company had recorded USD 239 million in revenue from a partnership with PT Mahata Aero Teknologi, even though this amount had not yet been fully collected. This practice violated the Financial Accounting Standards (SAK).

When viewed through the lens of Inkopsyah, the risks associated with financial reporting fraud became more complex due to its nature as an Islamic microfinance institution. On one hand, the Islamic principles on which Inkopsyah was founded such as the prohibitions against riba (usury), gharar (uncertainty), and maysir (gambling) were expected to serve as a strong ethical barrier against fraudulent practices. On the other hand, however, the intricate nature of Islamic financial products, the overlap with the microfinance sector, increasing demands from stakeholders, and competitive pressures created conditions that were conducive to financial reporting fraud.

Applying the Fraud Diamond theory developed by Wolfe and Hermanson (2004) on an ad hoc basis at Inkopsyah helped analyze the underlying causes of financial reporting fraud. This theory was a modification of Cressey's (1953) Fraud Triangle, with capability added as a fourth dimension alongside pressure, opportunity, and rationalization. The four elements of the Fraud Diamond pressure, opportunity, rationalization, and capability provided a more comprehensive framework for examining the causes of financial statement fraud.

The first element, pressure, in the context of Inkopsyah, originated from various sources. The economic necessity to achieve growth in either assets or profits, the need to maintain a certain image of performance among members and regulators, and interpersonal pressures exerted on key individuals within the organization were all considered risk factors for dishonest conduct. For instance, there might have been situations where performance metrics for Inkopsyah declined. In such cases, management might have attempted to manipulate financial records to prevent members from making mass withdrawals in search of better-paying deposits elsewhere.

The second element, opportunity, pertains to the internal control or supervision system within the organization that allows for the commission and concealment of fraud. In the context of Inkopsyah, certain Islamic financing instruments, such as mudharabah and musyarakah, could be easily exploited in profit-sharing due to inherent ambiguities in recording and remitting transactions. Furthermore, insufficient manpower and limited capabilities in financial monitoring, particularly in a rural setting like Inkopsyah, increases the organization's vulnerability to fraud.

Rationalization, the third element of the Fraud Diamond proposed by Wolfe and Hermanson (2004), referred to the mindset that allowed a fraudster to justify their actions without experiencing guilt. In the context of Inkopsyah, which was expected to operate based on Islamic principles, this rationalization became even more complex. Fraudsters might have convinced themselves that their actions were necessary for the institution or its members, believing that certain adjustments they made were permissible under Sharia law based on their interpretation (Albrecht et al., 2011).

The final component, capability, as proposed by Wolfe and Hermanson (2004), referred to an individual's ability to recognize and exploit opportunities for committing fraud. Within Inkopsyah's structure, this role could have been held by a financial manager or even a member of the Sharia supervisory board individuals who possessed the knowledge, access, and authority not only to detect fraudulent schemes and their perpetrators but also to execute and conceal them (Dorminey et al., 2012).

However, examining the determinants of the Fraud Diamond was particularly crucial in the context of Inkopsyah, given its strategic importance in Indonesia's Islamic microfinance landscape. Data from the Financial Services Authority (OJK) indicated that the asset base of Islamic cooperatives in Indonesia had been on a steady rise in recent years, reflecting growing public trust in this financial model (OJK, 2023). However, this growth needed to be accompanied by strengthened governance and improved financial reporting quality to ensure the sector's sustainability and credibility (Ministry of Cooperatives and SMEs, 2022). Furthermore, the relevance of the Fraud Diamond's determinants in assessing the potential for financial statement manipulation at Inkopsyah was closely tied to broader challenges in the development of Indonesia's Islamic financial sector. With the introduction of new regulations by OJK and governance measures for cooperatives and Islamic financial institutions by the Ministry of Cooperatives and SMEs, fraud risks were increasingly recognized as a serious threat. Consequently, proactive steps had been taken to mitigate these risks (OJK, 2023; Ministry of Cooperatives and SMEs, 2022). Nevertheless, it remained essential to evaluate the effectiveness of these regulations in preventing and detecting financial reporting fraud, particularly considering Inkopsyah's unique characteristics (Tuanakotta, 2020).

The understanding of the determinants of the Fraud Diamond in Inkopsyah has significant implications in several ways. First, it contributed theoretically by adding to the existing literature on the application of the Fraud Diamond theory among Islamic Microfinance Institutions, which has generally been less explored compared to research conducted on mainstream financial institutions or corporate entities. Additionally, the practical findings of this study could assist in formulating more efficient and tailored fraud detection and prevention measures for Inkopsyah, thereby enhancing its internal control mechanisms and governance.

Furthermore, such research could provide valuable insights to authorities seeking to enhance the regulatory and supervisory frameworks of Inkopsyah, particularly concerning the issuance of financial reports and Sharia audits. According to Khan et al. (2023), implementing stricter regulations and effective supervisory mechanisms could mitigate the risk of fraud in the financial reports of Islamic financial institutions. In this context, risk-based supervision was increasingly advocated, as highlighted by Wahab et al. (2007), who emphasized that a supervisory framework incorporating risk-based supervision enabled regulators to concentrate on high-risk areas, thereby improving the efficiency and stability of the Islamic financial sector.

In addition, transparency and honesty within the Islamic finance industry have been emphasized in several studies, including one conducted by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). According to AAOIFI (2021), stringent reporting and auditing policies were essential for ensuring that Islamic financial transactions complied with Islamic law and remained free from manipulations that could harm investors.

The Islamic finance industry has experienced significant growth on an international scale, and Indonesia, as part of the largest Islamic economic environment in the world, played a strategic role in ensuring the sustainability of this industry (Bank Indonesia, 2022). Therefore, studies related to fraud risk in financial reporting needed to be conducted to protect investors and maintain trust in the Islamic financial sector (Rosli et al., 2023). This program also aimed to support the global initiative to enhance the integrity and transparency of the Islamic finance sector, as envisioned by the Islamic Financial Services Board (IFSB).

Agency Theory was particularly relevant in this context. One of the most notable advancements in Agency Theory was made by Jensen and Meckling (1976), who highlighted the conflict of interest within organizations between the principal (owners or shareholders) and the agent (managers). Agency Theory assumed that agents tended to act in their self-interest, sometimes at the expense of the principal's benefit. The components of the Fraud Diamond (Pressure, Opportunity, Rationalization, and Capability) played a crucial role in financial fraud, as these factors often reinforced one another in meeting certain objectives. Cressey (1953) initially introduced the Fraud Triangle Theory, which served as the foundation for the Fraud Diamond. This framework explained how major factors influenced the opportunity for fraudulent activities within an organization. Building on this concept, Wolfe and Hermanson (2004) expanded the Fraud Triangle by introducing the element of Capability. This addition highlighted that individuals with the necessary skills, authority, and access to internal controls were more likely to exploit system loopholes and commit fraud. The integration of these elements provided a comprehensive understanding of how fraud could occur and persist within organizations.

Financial reporting fraud in financial institutions has been extensively researched. However, there remained a lack of studies specifically addressing Inkopsyah and the application of the Fraud Diamond theory to Islamic microfinance institutions. Previous research had yielded inconsistent findings regarding the determinants within the Fraud Diamond framework. This study aimed to investigate the influence of the Fraud Diamond components (Pressure, Opportunity, Rationalization, and Capability) on financial reporting fraud at Inkopsyah.

Several studies had demonstrated that pressure was a significant factor in financial reporting fraud. According to Nadia et al. (2023), pressure had a positive and significant effect on fraudulent activities. In contrast, Sugiarti (2024) differentiated between internal and external pressures, finding that only external pressure was significantly related to fraud. Nurbaiti and Arthami (2023) emphasized that pressure was significantly associated with fraud prevention, indicating that both organizational and environmental factors contributed to the significance of this variable. The opportunity factor presented mixed results. Noviyanti et al. (2024) and Sugiarti (2024) found that opportunity had a strong and positive effect on financial reporting fraud, whereas Aulia et al. (2024) reported a negative effect of opportunity on fraud, suggesting that effective internal controls or a robust organizational culture could mitigate the chances of committing fraud.

Rationalization as a factor of influence yielded mixed results. Nadia et al. (2023) and Nurwahyuni (2024) concluded that it had a strong positive influence, while Prakoso and Setiyorini (2021) and Sugiarti (2024) found that the influence was not significant. This perspective might have been shaped by the psychological and cultural factors within an organization, which determined the extent to which rationalization for fraudulent behavior was accepted. Capability, one of the components of the Fraud Diamond, was also a contentious issue. Studies by Nurbaiti and Arthami (2023), Putra and Herawaty (2024), and Sugiarti (2024) argued that capability was not relevant to financial statement fraud. In contrast, Aulia et al. (2024) later assessed capability as a crucial factor, particularly in organizations with poor governance.

The gap in the research necessitates an introspection into the role of each constituent element of the Fraud Diamond across various organizational contexts, particularly within Islamic cooperatives, which have distinct mechanisms and governance values. This study contributes valuable insights by examining the application of the Fraud Diamond to the situation at Inkopsyah. It explores how these elements are interconnected within Islamic microfinance institutions and seeks to identify strategies for managing fraud in values-based frameworks such as Islamic cooperatives.

METHOD

Financial reporting fraud refers to an intentional act or negligence that results in materially inaccurate information in financial statements. This type of fraud was identified using a dummy variable, where a value of 1 indicated that a company had restated its financial statements, and a value of 0 indicated otherwise (Prakoso and Setiyorini, 2021). Pressure arose when management or employees felt compelled or incentivized to engage in dishonest behavior; this pressure was measured by Return on Assets (ROA) (Prakoso and Setiyorini, 2021). Opportunity refers to the existence of circumstances that enabled or facilitated fraudulent activities, allowing management or individuals to commit fraud. This opportunity is assessed through the measure of Ineffective Monitoring (IND), calculated using the formula:

Ineffective Monitoring (IND) was calculated as the number of independent audit committee members divided by the total number of audit committee members (Mardianto and Tiono, 2019). Rationalization refers to the cognitive process of providing justifications for fraudulent actions that have been committed or are planned to be executed. Regarding AUDCHANGE, this was measured using a dummy variable, where a value of 1 indicated a cooperative that changed auditors within two years of the audit period, while a value of 0 indicated a cooperative that did not make such changes (Bawekes et al., 2018). Capabilities encompass the ability of an individual committing fraud to undermine the internal controls of the cooperative, devise complex fraud strategies, and manipulate social situations to gain advantages by influencing others to collaborate with them. The ability or competence was represented by the Change of the Board of Directors (DIRCHANGE), which was also measured using a dummy variable: a value of 1 indicated a cooperative that changed its directors, while a value of 0 indicated a cooperative that did not change its directors (Faradiza, 2019).

The population in this study consisted of all cooperatives that were members of Inkopsyah, totaling 354 cooperatives. The study focused on these cooperatives because they possessed unique characteristics, such as principles of justice, transparency, and sustainability in their business processes, distinguishing them from other Sharia-based entities. Inkopsyah was the largest network of Sharia cooperatives in Indonesia and played a significant role in community-based economies; therefore, it provided a relevant context for exploring the potential for financial statement fraud. Furthermore, the Sharia cooperative sector frequently encountered challenges related to financial pressures, internal monitoring, and organizational culture, which aligned with the factors outlined in the Fraud Diamond. This made it an appropriate case for examining the primary causes of fraud. The study employed purposive sampling, selecting cooperatives that had consecutively reported their finances for three years, specifically from 2022 to 2024, and had complete data. Based on these criteria, a sample of 132 cooperatives was obtained. The data analysis techniques used in this study included descriptive analysis and logistic regression analysis.

RESULTS

Table 1 presents data on the minimum, maximum, and mean values of the variables associated with potential financial reporting fraud and the Fraud Diamond, which included pressure, opportunity, rationalization, and capability in Inkopsyah for the period from 2021 to 2023.

Table 1. Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Financial Reporting Fraud	396	0	1	0.18	0.387
Pressure	396	-17.47	17.40	0.49	0.122
Opportunity	396	0	33.33	2.78	1,247
Rationalization	396	0	1	0.11	0.309
Capabilities	396	0	1	0.17	0.381
Valid N (listwise)	396				

Source: Processed data, 2024.

Table 1 showed that financial statement fraud had an average value of 0.18 with a standard deviation of 0.387. The fraud variable ranged from 0 to 1, indicating that only a small portion of the sample was involved in financial statement fraud. The relatively low mean suggested that the majority of the sample did not engage in fraudulent practices. However, the standard deviation indicated some variation in the data, meaning that while fraud cases existed, they were not uniformly distributed across the sample.

Furthermore, the average value for the pressure variable was 0.49, with a standard deviation of 0.122. The wide range of pressure values, spanning from -17.47 to 17.40, highlighted a significant disparity in the levels of pressure experienced by respondents. The average value, which was close to zero, suggested that most respondents experienced low or balanced pressure. However, the presence of respondents with extreme pressure values indicated that a small number of individuals experienced either very high or very low pressure.

In the opportunity variable, the average value was 2.78, with a standard deviation of 1.247 and a range of values from 0 to 33.33. This indicated that there was a considerable opportunity for some respondents to commit fraud, with significant variations among individuals. The relatively low average, combined with a substantial standard deviation, suggested that while the overall opportunity for fraud was generally low, there were notable exceptions.

Rationalization had an average score of 0.11 with a standard deviation of 0.309. This suggested that only a small proportion of respondents provided justifications for committing fraud. The range of values from 0 to 1 indicated that, while rationalizations for fraud existed, their prevalence was low among the respondents. The relatively low standard deviation further suggested that the variation in rationalizations was quite limited.

The capability variable had an average of 0.17, with a standard deviation of 0.381 and a range from 0 to 1. This suggested that only a small proportion of respondents possessed the ability or opportunity to commit fraud, with minimal variation among the samples. The low average value indicated that, overall, the capacity to commit fraud was not widespread among respondents, although some individuals did have this capability.

The results of the logistic regression analysis are presented in the table below:

Table 2. Logistic Regression Test Results

		B	SE	Wald	df	Sig.	Exp(B)
Step 1(a)	X1	0.078	0.035	5,100	1	0.024	0.925
	X2	0.095	0.025	14,131	1	0,000	1,099
	X3	1,462	0.724	4,075	1	0.044	4,317
	X4	1,637	0.629	6,766	1	0.009	5,139
	Constant	-2,607	0.396	43,406	1	0,000	0.074

a Variable(s) entered on step 1: X1, X2, X3, X4.

The logistic regression test results, as shown in the table above, produce the following regression equation: $Y = -2.607 + 0.078X_1 + 0.095X_2 + 1.4621X_3 + 1.637X_4$

Based on Table 2, the test results are as follows:

The Wald statistic for the pressure variable was 5.100 ($p = 0.024$). The significance value of 0.024 was less than the significance level of 0.05 (5%), indicating that the regression coefficient of 0.078 demonstrated a positive effect of pressure on the potential for financial statement fraud. Therefore, the first hypothesis was statistically supported.

The Wald value of the opportunity variable was 14.131 ($p < 0.001$). The significance value of 0.000 was less than the significance level of 0.05 (5%), with a regression coefficient of 0.095. Therefore, the opportunity variable had a significant positive effect on the potential for financial statement fraud, confirming that the second hypothesis was statistically supported.

The Wald rationalization value was 4.075 ($p = 0.044$). The significance value of 0.044 was less than the significance level of 0.05 (5%), with a regression coefficient of 1.462. Therefore, rationalization had a positive effect on the potential for financial statement fraud, confirming that the third hypothesis was statistically supported.

The Wald value of the capability variable was 6.766 ($p = 0.009$). The significance value of 0.009 was less than the significance level of 0.05 (5%), with a regression coefficient of 1.637. Therefore, capability had a positive effect on the potential for financial statement fraud, confirming that the fourth hypothesis was statistically supported.

DISCUSSION

Pressure could lead individuals or teams to falsify or manipulate financial reports to achieve specific goals or conceal underperformance. In this context, Jensen and Meckling (1976) suggested that risks such as fraud could arise from the inherent relationships in everyday business, as executives (agents) and shareholders (principals) often had conflicting interests. This created tension for management to meet the demands of owners or investors, particularly when those demands involved unrealistic financial performance expectations, which might have resulted in fraudulent financial reporting. Research conducted by Nadia et al. (2023), Prakoso and Setiyorini (2021), Aulia et al. (2024), Sugiarti (2024), Syafira and Cahyaningsih (2022), and Nurwahyuni (2024) indicated that the degree of financial pressure was positively correlated with the propensity to commit financial reporting fraud. This finding aligned with Zaki's (2017) research, which reported that the most prevalent type of fraud in Islamic banks in Indonesia was accounting fraud. However, these findings contradicted the views of Yusof (2016) and Abdullahi and Mansor (2015), who argued that pressure ranked low or did not predict the likelihood of financial statement fraud. Therefore, Inkopsyah should have implemented internal controls, enhanced supervision, and promoted ethical practices to mitigate the risks of financial pressure-related fraud. This study did not confirm the findings of Lou and Wang (2009), who analyzed the relationship between pressure and financial reporting fraud. They concluded that pressure was not a cause of such fraud and asserted that firms with good governance and a strong work ethic could manage pressure without resorting to fraudulent activities.

Opportunity has a positive and significant effect on financial reporting fraud. The likelihood of committing fraud increases when the internal control system is inadequate, monitoring is insufficient, or procedural loopholes could be exploited. This perspective contrasts with Cressey (1953), who argued that opportunity was merely one component of the fraud triangle, leading individuals or groups to commit fraud under the belief that there was a minimal chance of detection. Such opportunities typically arose when internal controls were weak, supervision was lacking, or there was unrestricted access to the company's resources. Marks (2012) explained that, despite the existence of opportunities, the likelihood of fraud increased when individuals or groups exhibited a high level of arrogance, believing they could manipulate the system without facing consequences. This perspective broadened the understanding of fraud by not only identifying opportunities but also examining the psychological factors that drove individuals to commit fraudulent acts.

Research conducted by Agustin et al. (2022) demonstrated that the availability of opportunities significantly increased the likelihood of fraud in financial reporting within financial institutions. This finding was supported by the research of Manurung and Hardika (2015), Prakoso and Setiyorini (2021), Putra and Herawaty (2024), Noviyanti et al. (2024), Sugiarti (2024), Nurwahyuni (2024), and Nurbaiti and Arthami (2023), all of which established that opportunity had a significant positive effect on occupational fraud in public companies in Indonesia, particularly in the financial services sector. Although there were some discrepancies in the findings, most researchers agreed on the strong impact of opportunity on the risks associated with financial statement fraud. Therefore, Inkopsyah needed to prioritize enhancing its internal control systems, increasing monitoring efforts, and implementing strict measures to mitigate the risk of fraud. Strategies to minimize the occurrence of financial statement fraud included the appropriate division of labor, employee rotation, regular audits, and the integration of technology for anomaly detection. The findings of this study did not support the conclusions of Larum et al. (2021), Dewi and Luthan (2023), and Nadia et al. (2023), which argued that opportunity was not a determinant of financial reporting fraud.

Rationalization has a positive and significant effect on financial reporting fraud. It is the third element in the fraud triangle, playing a crucial role in the occurrence of financial reporting fraud, including in Islamic financial institutions such as Inkopsyah. Rationalization refers to the internal justification process carried out by fraudsters to defend their actions. In the context of financial reporting fraud, rationalization is a psychological factor that enables individuals or groups to engage in unethical actions while maintaining their self-image as honest individuals. Research conducted by Cressey (1953), which became the basis for the fraud triangle theory, emphasized that rationalization was an important component that allowed someone to commit fraud. In his study, Cressey found that fraudsters often rationalized their actions as something acceptable or justified. This finding was highly relevant in the context of Inkopsyah, where Islamic Sharia values and business ethics should have been the foundation of operations. Nevertheless, structural changes in beliefs, as well as excessive liberalism in the interpretation of Sharia tenets, could pave the way for committing fraud under the pretence of justification. A study by Kassem and Higson (2012) proved the angle of rationalizing dishonest practices in the form of fraud on financial statements. The authors associated this phenomenon with organizational culture and the company's values, further reinforcing the argument that rationalization played a key role in facilitating financial reporting fraud.

The Inkopsyah situation implies that the absence of congruence between the Sharia principles embraced and practised in daily business operations would pose a risk of providing room for fraudulent genius. Such patterns of reasoning are evident within many scenarios. For instance, one may be a financial manager who considers it operationally acceptable to tamper with the organizational financial statements so that they do not offend investor expectations or monetary milestones that are increasingly being driven by senior management. The research conducted by Abdullahi and Mansor (2015) in the banking sector asserted that rationalization significantly influenced the occurrence of fraud in financial reporting. The reason for this was that once individuals were able to rationalize their behavior, Thrasher's barrier to committing fraud became low. This was highly relevant in the context of Inkopsyah, as the institution operated within the Islamic financial landscape, where principles and high moral standards were expected to be upheld at all times. The findings of this study aligned with the research of Nadia et al. (2023), Putra and Herawaty (2024), Aulia et al. (2024), Nurwahyuni (2024), and Nurbaiti and Arthami (2023), all of whom found that rationalization had a positive and significant effect on financial statement fraud. However, the results did not support the findings of Yusof (2016), who argued that in Islamic banks in Malaysia, rationalization did not significantly impact the occurrence of financial reporting fraud. Similarly, the study contradicted the findings of Prakoso and Setiyorini (2021), Noviyanti et al. (2024), and Sugiarti (2024), which concluded that rationalization did not affect financial statement fraud. The researcher contended that this discrepancy was due to the strong ethical and religious values embedded in Islamic banking in Malaysia. This finding suggested that a strong emphasis on ethical and sharia values could minimize the effect of rationalization on fraud. Although rationalization was an internal factor that was difficult to control directly, Inkopsyah could significantly shape the environment in which rationalization occurred. By fostering a strong cultural orientation based on honesty, transparency, and adherence to Sharia principles, Inkopsyah could reduce the motivation to engage in fraudulent behavior. Additionally, Inkopsyah needed to consider external factors that might trigger rationalization, such as industry trends, market conditions, and economic challenges. By taking these factors into account, Inkopsyah would be better equipped to develop a strategic approach to addressing the issue of financial statement misrepresentation.

Capabilities influence the likelihood of engaging in fraudulent financial reporting at Inkopsyah. The concept of capability, or ability, was the fourth element introduced by Wolfe and Hermanson (2004) in the fraud diamond model, which expanded upon the traditional fraud triangle. This element pertained to an individual's technical competencies, which facilitated both the identification and exploitation of fraud opportunities while effectively concealing illicit actions. In this context, individuals with a deep understanding of Islamic finance, financial reporting mechanisms, and weaknesses in internal control systems are better positioned to manipulate financial statements for fraudulent purposes. Kassem and Higson (2012) identified several capability-related factors that contributed to financial reporting fraud. These included an individual's job title or role, the ability to recognize and exploit systemic weaknesses, an inflated sense of self-confidence, and the capacity to manage stress effectively. Moreover, Kassem and Higson (2012) asserted that an individual's workplace environment could create conditions conducive to fraudulent activities. For instance, high-ranking personnel in finance or accounting possessed both the authority and the means to manipulate financial records. Their deep understanding of the Islamic financial system and the regulatory framework governing its operations further enabled them to conceal fraudulent actions with greater precision. Additionally, the capabilities of individuals in key positions played a critical role in the occurrence of fraud, as they had extensive access to and control over financial data (Kranacher and Riley, 2019).

Research conducted by Abdullahi and Mansor (2015) on financial institutions demonstrated that capability significantly influenced the occurrence of financial statement fraud. Their findings indicated that individuals with advanced technical skills and a deep understanding of internal control systems were more likely to engage in complex fraud schemes that were difficult to detect. This insight was particularly relevant to Inkopsyah, given the intricate nature of Islamic financial operations and the specialized expertise required to manage them effectively.

Similarly, a study by Siddiq et al. (2017) on the Indonesian banking system established a positive correlation between capability and the propensity to commit financial statement fraud. Their research highlighted that the ability to exploit weaknesses in internal control systems and an in-depth understanding of applicable accounting frameworks were key factors enabling fraudulent activities. These findings aligned with those of Nurwahyuni (2024), who also asserted that capability played a crucial role in fraud occurrence. However, the present study did not confirm earlier findings by Yusof (2016), who reported an absence of financial reporting fraud among Sharia banks in Malaysia due to employees' lack of capability. Furthermore, the results contradicted studies by Nadia et al. (2023), Prakoso and Setiyorini (2021), Putra and Herawaty (2024), Noviyanti et al. (2024), Sugiarti (2024), and Nurbaiti and Arthami (2023), which found that capability did not influence financial reporting fraud. One possible explanation for this discrepancy was the presence of strong Shariah regulations and rigorous monitoring mechanisms within these financial institutions. Capability extended beyond technical proficiency; it also encompassed a comprehensive understanding of Shariah principles and the ability to navigate the complexities of Islamic financial law. Therefore, addressing capability-related risks requires a comprehensive and integrated approach. To strengthen fraud prevention, Inkopsyah could implement several strategies, including strict segregation of duties, systematic job rotation, enhancements to internal control systems, the adoption of advanced technology, rigorous Shariah oversight, regular fraud risk assessments, and increased transparency. Highly capable individuals with expertise in the Shariah financial system could serve as the first line of defense against fraud. However, Inkopsyah also needed to take proactive steps to mitigate capability-related threats while leveraging the skills of its workforce for positive organizational growth. Additionally, recognizing the interconnection between capability and other aspects of fraud would enable Inkopsyah to address financial statement fraud holistically. By considering the complexities of Shariah financial activities, Inkopsyah could effectively minimize fraud risks without hindering innovation and sustainable growth within the institution.

CONCLUSION

Pressure has a positive and significant effect on financial reporting fraud, indicating that as the level of pressure increases, so does the likelihood of fraudulent financial reporting. Pressure or stress is a primary factor that triggers financial reporting fraud, even in financial institutions such as Inkopsyah. This phenomenon applies to financial institutions both within and outside the organization. Financial stress can compel teams or individuals to falsify or manipulate financial reports to achieve specific objectives or conceal underperformance.

Opportunity also has a positive and significant effect on financial reporting fraud. The likelihood of fraud increases when internal controls are inadequate, monitoring is insufficient, or procedural loopholes can be exploited. Moreover, fraud is more likely to occur when individuals exhibit arrogance and believe they can manipulate the system without being detected.

Rationalization also has a positive and significant effect on financial reporting fraud. As the third element of the fraud triangle, it plays a crucial role in enabling fraudulent financial reporting, including within Islamic financial institutions such as Inkopsyah. Rationalization refers to the psychological process by which fraudsters justify their actions. In the context of financial reporting fraud, it serves as a cognitive mechanism that allows individuals or groups to engage in unethical behavior while maintaining their self-perception as honest individuals.

Capabilities also contribute to the likelihood of fraudulent financial reporting within Inkopsyah. This factor is particularly important in understanding financial statement fraud in Islamic financial institutions. The ability to exploit weaknesses in internal control systems, coupled with a deep understanding of relevant accounting principles, serves as a key enabler of fraudulent activities.

This study has several limitations, including the use of dummy variables, which may contribute to multicollinearity, and the assumption that predictor values remained static, potentially reducing the representativeness of the analysis. Additionally, the study focused solely on Inkopsyah member cooperatives, limiting the generalizability of the findings to other sectors. The observation period (2022–2024) is relatively short, making it difficult to capture long-term trends. Future research should consider incorporating a wider range of variable measures, expanding the sample to include other sectors, and extending the observation period to provide a more comprehensive understanding of fraud dynamics. Adopting mixed-method approaches could also offer deeper and more holistic insights.

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