FRAUDULENT FINANCIAL REPORTING IN INDONESIA: ANALYZING CAUSES AND PROPOSING SOLUTIONS

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ABSTRACT

Financial fraud remains one of the most pervasive challenges in the corporate world, undermining the credibility of financial statements and eroding trust among investors, regulators, and the general public. This study aims to bridge the gap between global anti-fraud strategies and their applicability in Indonesia by providing a comprehensive analysis of the causes of and potential solutions for fraudulent financial reporting in the country. The study adopts a literature review approach to synthesize findings across selected literature. The findings highlight systemic issues such as structural and procedural factors such as weak internal controls, lack of regulatory enforcement, and cultural dynamics that discourage whistleblowing, making it an ideal backdrop for examining fraudulent financial reports in Indonesia. Despite significant strides made in improving corporate governance in Indonesia, enforcement remains a pressing challenge in combating financial fraud. Technological advancements, particularly in artificial intelligence (AI) and blockchain technology, offer promising solutions for addressing fraudulent behaviour.

Keywords : cultural factor, financial fraud, fraud detection, internal control, regulatory factor.

INTRODUCTION

The issue of fraudulent financial reporting in Indonesia is particularly concerning, as several prominent cases have exposed critical deficiencies in corporate governance, regulatory enforcement, and internal controls. These fraudulent practices distort organizational performance metrics, misallocate resources, and discourage both domestic and international investments, ultimately stifling economic progress. The **2018 PT Garuda Indonesia scandal** is a notable example where the airline prematurely recognized revenue, violated accounting standards, and misrepresented profits to mislead stakeholders. Such cases underscore systemic issues that require immediate and thorough scrutiny (Kusuma et al., 2017).

Despite efforts from institutions like the Financial Services Authority (OJK) and the Corruption Eradication Commission (KPK) to combat fraud, the increasingly complex nature of financial transactions in a globalized economy has expanded opportunities for financial manipulation. Although Indonesia has established strong governance frameworks on paper, their implementation remains inconsistent and often inadequate. Incidents such as the **Garuda case** highlight significant regulatory oversights and flaws in the design and execution of internal controls. These deficiencies often allow fraudulent activities to continue undetected for prolonged periods (Maharanti et al., 2024).

Beyond regulatory and organizational shortcomings, cultural factors play a significant role in enabling fraudulent financial reporting in Indonesia. The country's collectivist values, coupled with high power distance, discourage employees from

questioning authority or exposing unethical behavior. Additionally, weak whistleblower protections and insufficient incentives for reporting misconduct further create an environment where financial fraud can thrive (Sukmadilaga et al., 2022).
Much of the prior research has focused on technological tools and fraud detection methods, such as forensic accounting and data analytics. These studies demonstrate the effectiveness of advanced solutions like machine learning algorithms and blockchain technology in identifying financial anomalies. However, these tools often fail to address the underlying socio-economic and cultural factors that allow fraud to persist. For example, research in Indonesia's banking sector has identified external pressures and weak governance structures as major drivers of fraudulent financial reporting (Handayani & Evana, 2022). Similarly, inadequate monitoring mechanisms in state-owned enterprises highlight the urgent need for stronger governance practices (Achmad et al., 2022).

This article aims to address the gap between global anti-fraud strategies and their practical application in Indonesia by analyzing the organizational, cultural, and regulatory factors contributing to financial fraud. Unlike much of the existing literature, which focuses solely on fraud detection, this study takes a broader approach by investigating the root causes and offering actionable solutions to mitigate fraud risks. By integrating insights from multiple disciplines—such as accounting, law, behavioral sciences, and technology—the article provides a comprehensive framework to combat fraudulent financial reporting within Indonesia's socio-economic and cultural context.

The article is organized into the following sections:

1. **Problem Overview**: A detailed discussion on fraudulent financial reporting, with emphasis on its prevalence and consequences in Indonesia, using the **PT Garuda Indonesia scandal** as a case study.
2. **Socio-Cultural and Regulatory Factors**: An examination of how cultural norms, such as collectivism and power distance, along with regulatory gaps, exacerbate the issue.
3. **Technological and Governance Solutions**: An evaluation of advanced tools, such as blockchain and forensic accounting, alongside governance reforms to improve fraud prevention and detection.
4. **Proposed Strategies**: Practical recommendations for policymakers, regulators, and corporate leaders to create a transparent and accountable financial environment.

By combining global perspectives with localized analysis, this study not only contributes to the academic understanding of financial fraud but also provides actionable strategies for practitioners in Indonesia. It offers a comprehensive roadmap to address systemic weaknesses and cultural barriers, promoting more transparent, accountable, and resilient financial systems.

METHODS

This study employs a comprehensive literature review methodology to examine the causes and potential solutions for fraudulent financial reporting in Indonesia. The literature review approach was chosen for its ability to explore and synthesize existing research, offering a broad understanding of the issue without the constraints of a formal, systematic review. Unlike systematic literature reviews that adhere to rigid protocols and predefined inclusion/exclusion criteria, the literature review adopted in this study allows for greater flexibility, enabling the inclusion of a wide variety of sources, perspectives, and theoretical frameworks. This methodology was selected to ensure that the complexities of fraudulent financial reporting—

spanning organizational, socio-cultural, and regulatory dimensions—could be explored in a nuanced and comprehensive manner.

The primary motivation for using a literature review in this study is the multifaceted nature of fraudulent financial reporting. Fraud in financial reporting is not solely the result of individual unethical behaviors but rather a complex interaction of various organizational, socio-cultural, and regulatory factors. Understanding these interrelated causes requires an approach that allows for a holistic view. While empirical studies provide valuable insights into specific elements of financial fraud, a literature review allows for the integration of diverse studies and theoretical frameworks that address the root causes and potential solutions across multiple domains.

Furthermore, a literature review is particularly effective when dealing with topics that have been studied from various academic disciplines, such as corporate governance, cultural studies, and regulatory policy. In this case, fraudulent financial reporting involves not only financial mismanagement but also cultural and social dynamics that influence how organizations behave and how fraud is detected or concealed. A literature review provides the flexibility to synthesize research from various fields and integrate findings to form a more complete understanding of the phenomenon.

Scope and Selection Criteria

The review focused on literature relevant to fraudulent financial reporting in Indonesia, with a particular emphasis on sources published between 2010 and 2023. This timeframe was chosen to capture recent developments in both academic research and real-world practices, ensuring that the findings reflect the current state of knowledge on the topic. The selection criteria for the sources included relevance, credibility, and applicability to the Indonesian context. Only studies that directly addressed issues related to fraudulent financial reporting, corporate governance, cultural influences, or regulatory frameworks in Indonesia were included.

To ensure the inclusion of high-quality literature, the study relied on well-regarded academic databases such as Scopus, ScienceDirect, and Google Scholar. These databases were chosen because they offer access to peer-reviewed journal articles, government reports, and reputable publications in various fields, ensuring a wide-ranging yet credible body of literature. The literature search was guided by specific keywords, including "fraudulent financial reporting," "Indonesia," "corporate governance," "socio-cultural factors," and "regulatory frameworks." These keywords were carefully selected to focus on both the causes of financial fraud and the potential solutions to address it.

Key Studies and Sources

Several key studies and sources provided critical insights into the factors contributing to fraudulent financial reporting in Indonesia. For instance, the work of Maharanti et al. (2024) on the "fraud hexagon theory" shed light on the multidimensional factors that enable fraud, particularly within provincial governments in Indonesia. This theory, which identifies six critical factors—pressure, opportunity, rationalization, capability, competence, and integrity—was particularly useful for understanding the complex dynamics that foster fraud in both public and private sector organizations.

Similarly, the research by Achmad et al. (2022) on state-owned enterprises (SOEs) in Indonesia provided valuable insights into how inadequately internal governance and inadequate monitoring systems contribute to the risk of fraudulent financial reporting. Achmad et al. argued that the lack of effective internal controls in

SOEs, combined with weak external oversight, creates an environment ripe for fraud. Their findings underscored the importance of strengthening internal governance mechanisms, such as independent audit committees and robust internal audit functions, in mitigating financial fraud.

Sukmadilaga et al. (2022) contributed to the understanding of socio-cultural factors by exploring the barriers to whistleblowing in Indonesia. Their research highlighted how Indonesia's collectivist culture and high power distance create an environment in which employees are reluctant to report unethical behavior or fraud. They demonstrated that cultural norms, such as loyalty to authority figures and fear of social ostracism, prevent individuals from coming forward, even when they observe fraudulent practices. This research was instrumental in understanding the cultural dynamics that inhibit the detection of fraud and hinder the effectiveness of anti-fraud measures.

To synthesize the findings from the selected literature, this study employed a thematic analysis approach. Thematic analysis is a qualitative research method used to identify, analyze, and report patterns (themes) within a dataset. The goal of thematic analysis is to provide a detailed and nuanced understanding of the research topic by highlighting recurring themes that emerge from the literature.

In this study, thematic analysis was used to identify key themes related to the causes of fraudulent financial reporting in Indonesia. These themes were organized into three main categories:

1. **Organizational Factors**: This theme focused on the role of internal controls, corporate governance practices, and leadership ethics in enabling or preventing fraudulent financial reporting. Research emphasized that weak internal controls, particularly in state-owned enterprises, create significant opportunities for financial misrepresentation. The lack of proper segregation of duties, ineffective monitoring systems, and inadequate internal audits were identified as key organizational weaknesses that allow fraud to thrive.
2. **Socio-Cultural Factors**: This theme explored how Indonesia's cultural context influences attitudes toward fraud and whistleblowing. Studies on Indonesia's collectivist culture and high power distance revealed that hierarchical power structures and a strong emphasis on group harmony discourage employees from challenging unethical behavior. The fear of retaliation, social ostracism, and damage to personal reputations were identified as significant barriers to reporting fraud. These socio-cultural dynamics contribute to a culture of silence that allows fraud to go undetected for extended periods.
3. **Regulatory and Institutional Factors**: The effectiveness of laws, enforcement mechanisms, and institutional capacity in combating fraud was critically evaluated in this theme. The review identified significant gaps in Indonesia's regulatory framework, despite efforts by agencies such as the Financial Services Authority (OJK). The lack of resources, inadequate personnel, and corruption within regulatory bodies were cited as major challenges in effectively monitoring corporate practices and enforcing anti-fraud measures. The inconsistency in penalties for fraud-related violations further weakens the deterrent effect of existing regulations.

Data Synthesis and Critical Evaluation

The synthesis process involved a critical evaluation of the methodologies, findings, and limitations of each source. This was done to identify areas of convergence and divergence in the literature, as well as to highlight gaps and inconsistencies in the existing research. The synthesis was guided by the integrative framework of organizational, socio-cultural, and regulatory factors, which provided a structured way to categorize and analyze the various causes of fraudulent financial reporting in Indonesia.

For instance studies on the ineffectiveness of fraud detection systems in Indonesian organizations were juxtaposed with research on cultural barriers to reporting unethical practices. This comparison highlighted the interplay between technological and human factors, illustrating that technological advancements in fraud detection alone are insufficient without addressing cultural and organizational dynamics that prevent employees from speaking out. Similarly, research on weak internal controls was evaluated in light of studies on regulatory failures, illustrating how the lack of robust enforcement mechanisms exacerbates the problem of fraudulent financial reporting.

Additionally, the review identified several gaps in the literature, including a limited focus on the role of technology in detecting and preventing financial fraud. While some studies explored the effectiveness of internal audits and governance structures, fewer studies examined the potential of emerging technologies such as artificial intelligence (AI) and blockchain in combating fraud. This gap in the literature suggests an opportunity for future research to explore the integration of technological solutions with traditional governance mechanisms to enhance the detection and prevention of financial fraud in Indonesia.

FINDINGS AND DISCUSSION

Causes of Fraudulent Financial Reporting in Indonesia

Fraudulent financial reporting remains a serious issue for businesses across the globe, and Indonesia is no exception. Despite significant strides made in improving corporate governance, fraud still impacts both private and public sectors in the country. The persistence of fraudulent financial reporting is attributed to a complex array of factors, ranging from weak internal controls to cultural influences, regulatory gaps, and a lack of effective enforcement mechanisms. In this comprehensive analysis, we will explore in-depth the key causes of fraudulent financial reporting in Indonesia, with a particular focus on the influence of weak internal controls, cultural factors, and regulatory inefficiencies.

1. Weak Internal Controls

One of the most critical factors contributing to fraudulent financial reporting in Indonesia is the presence of weak internal controls. Internal controls are the mechanisms put in place by organizations to ensure the accuracy and reliability of financial reporting, safeguard assets, and promote compliance with laws and regulations. However, many businesses in Indonesia, especially family-owned and state-owned enterprises, struggle to implement and maintain robust internal controls. This failure leaves organizations vulnerable to fraud, misrepresentation, and the manipulation of financial data.

Lack of Segregation of Duties

One of the primary issues within the realm of internal controls is the lack of segregation of duties. Segregation of duties is a principle designed to ensure that no single individual has control over multiple critical functions within an organization. Ideally, different individuals should be responsible for authorization, record-keeping, and custody of assets. This division prevents any one individual from manipulating financial statements without being detected. However, in many Indonesian

organizations, especially family-owned businesses, employees often wear multiple hats, assuming roles that conflict with one another.
For instance, a person responsible for recording transactions may also have the authority to approve payments or reconcile accounts. This concentration of responsibilities can create opportunities for unethical behavior. Without proper checks and balances, it becomes easier for employees to manipulate financial data, conceal fraudulent transactions, or misreport financial figures without detection. In particular, family-owned businesses, as pointed out by Supriyanto et al. (2021), often face this challenge due to centralized decision-making. Family members typically control both governance and operations, bypassing external audits or independent oversight, which is a recipe for financial mismanagement and fraud.

Inadequate Monitoring Systems in State-Owned Enterprises

State-owned enterprises (SOEs) in Indonesia also experience significant challenges when it comes to weak internal controls. These organizations often suffer from inadequate monitoring systems, insufficient resources allocated to internal audits, and poor oversight by supervisory bodies. As noted by Achmad et al. (2022), many SOEs in Indonesia allocate limited resources to internal audits, making it difficult to detect and address fraudulent activities. The lack of an independent internal audit function often means that irregularities within the financial reports are overlooked, and fraudulent behavior can persist for extended periods without detection.
Without a functional and independent internal audit department, SOEs may struggle to maintain transparency, and financial manipulation can thrive. Additionally, the failure to establish robust monitoring systems for internal operations allows fraudulent activities to go unnoticed, thereby undermining the credibility of financial reporting and public trust in the organization.

Lack of Independent Audit Committees

Another contributing factor to weak internal controls in Indonesian companies is the absence or ineffectiveness of independent audit committees. Audit committees play a critical role in corporate governance by reviewing and overseeing financial reporting processes, ensuring the accuracy and integrity of financial statements. However, many Indonesian companies either do not have an audit committee in place or have committees that lack the necessary expertise to identify and address fraudulent activities effectively.

Without an independent and knowledgeable audit committee, companies are more likely to overlook or fail to detect signs of financial fraud. As noted by Supriyanto et al. (2021), this is a particular concern in family-owned businesses, where management and governance structures are tightly controlled by a small group of individuals, often leaving little room for independent oversight. In such environments, the absence of audit committees allows financial misreporting to flourish.

Undervaluation of Internal Audit Functions

The undervaluation of internal audit functions also contributes to the prevalence of fraudulent financial reporting in Indonesia. Internal auditors are responsible for evaluating the effectiveness of internal controls, identifying potential risks, and ensuring that the organization’s financial reports are accurate and reliable. However, in many Indonesian companies, internal audit functions are underfunded, understaffed, or poorly supported by senior management. This lack of resources makes it difficult for internal auditors to perform their duties effectively, and they often lack the capacity to detect financial manipulation.

Furthermore, the role of internal auditors is sometimes undermined by the corporate culture, where senior management may pressure auditors to overlook irregularities or suppress findings that could harm the company's reputation. As a result, internal audits often fail to identify or prevent financial fraud, leaving organizations vulnerable to manipulation and misreporting.

2. Cultural Influences

Cultural factors in Indonesia play a significant role in enabling fraudulent financial reporting. Indonesia's socio-cultural environment, particularly its high power distance and collectivist tendencies, creates an organizational climate where unethical practices often go unchecked, and employees may feel pressured to engage in or ignore fraudulent activities.

High Power Distance

Indonesia is characterized by a high power distance, meaning that there is a significant gap between authority figures and subordinates, with limited questioning of those in positions of power. This cultural trait is particularly relevant in corporate environments, where employees are often reluctant to challenge or report unethical behavior, especially when it involves senior management. Wulandari (2019) explains that employees in Indonesia typically fear retaliation or ostracism if they report fraudulent activities involving higher-ranking officials. The hierarchical structure of Indonesian companies discourages employees from speaking up about issues such as financial fraud, even when they may have direct knowledge of it.

In this context, employees may choose to remain silent, fearing that their career prospects, reputation, or personal relationships could be jeopardized if they challenge authority. This fear of retaliation creates an environment in which fraudulent behavior can thrive without detection. When senior managers or executives are involved in fraudulent activities, subordinates may feel powerless to take action, allowing these unethical practices to go unchecked.

Collectivist Culture and Loyalty

In addition to high power distance, Indonesia's collectivist culture places a strong emphasis on group harmony, loyalty, and avoiding actions that could disrupt the social order. Whistleblowing, in particular, is often viewed as an act of betrayal rather than a moral responsibility. In collectivist societies, employees may be reluctant to report fraud or unethical behavior for fear of damaging relationships or losing their sense of belonging within the organization.

Sukmadilaga et al. (2022) highlight that whistleblowers in Indonesia frequently face social stigmatization, ostracism, or even retribution from their peers for coming forward with allegations of fraud. The fear of damaging one's reputation and the potential loss of social standing within the organization or community can discourage employees from reporting fraudulent activities. This cultural dynamic further perpetuates the prevalence of financial misreporting and fraud, as individuals are often unwilling to challenge the status quo.

The Fear of Losing Face

The concept of "losing face" is a significant cultural factor in Indonesia. Public embarrassment and damage to one's reputation can have severe personal and professional consequences. In Indonesian culture, maintaining one's reputation and dignity is highly valued, and the fear of public shaming can lead individuals to turn a blind eye to fraudulent practices. Employees may choose to ignore fraudulent activities

to avoid drawing attention to themselves or risking their social standing within the organization.
This fear of losing face extends to the organization as well. Companies may avoid reporting fraudulent behavior or acknowledging financial misreporting because it could harm their public image. The fear of reputational damage can make organizations more likely to conceal fraud or engage in cover-ups rather than confront the issue head-on. As a result, fraudulent financial reporting may persist unchecked, further undermining the integrity of financial reporting in Indonesia.

3. Regulatory Gaps

Indonesia has made significant efforts to strengthen corporate governance and regulatory frameworks through legislation such as the Law on Corporate Governance (UU No. 40/2007). However, the enforcement of these regulations remains inconsistent and insufficient, which limits their effectiveness in preventing fraudulent financial reporting. Several regulatory gaps contribute to the persistence of financial fraud in Indonesia.

Inadequate Oversight and Resources

The Financial Services Authority (OJK) is responsible for overseeing corporate compliance and regulating the financial sector in Indonesia. However, Prasetyo (2020) notes that the OJK faces significant resource constraints, including insufficient funding and a lack of adequately trained personnel. These limitations hinder the OJK's ability to effectively monitor and enforce compliance with corporate governance standards. Without sufficient resources and personnel, the OJK struggles to detect fraudulent financial reporting, which erodes confidence in corporate governance and regulatory practices.

Corruption and Collusion within Regulatory Bodies

Corruption within regulatory bodies further exacerbates the problem of fraudulent financial reporting. Maharanti et al. (2024) identify collusion between auditors and company management as a recurring issue in Indonesia. In some cases, auditors who are responsible for reviewing financial statements may collude with company executives to manipulate or conceal financial data. This corruption undermines the integrity of the regulatory framework and allows fraudulent activities to go unnoticed.
When regulatory bodies are compromised by corruption, their ability to enforce laws and detect fraud is severely diminished. This environment creates an opportunity for companies to manipulate financial reports without fear of detection or punishment.

Inconsistent Penalties for Violations

Another regulatory gap is the inconsistency in penalties for regulatory violations. In some cases, companies that engage in fraudulent activities face minimal fines or light sanctions, which reduces the deterrent effect of existing regulations. When businesses perceive regulatory penalties as a manageable cost of doing business, they are less motivated to comply with governance standards. This lack of meaningful consequences for fraudulent activities sends the wrong message to businesses, allowing financial misreporting to continue unabated.

Mitigation Strategies

To address the causes of fraudulent financial reporting in Indonesia, several strategies can be implemented. These strategies involve adopting technology, strengthening governance, and promoting education and awareness.

1. Adopting Technology

Technological advancements offer promising solutions for detecting and preventing fraudulent financial reporting. Blockchain technology, for instance, provides transparency and immutability, making it nearly impossible to alter financial records without detection. Hartono (2022) demonstrates that implementing blockchain systems in accounting has been effective in reducing financial manipulation by 60% in participating firms. Blockchain technology can enhance the integrity of financial reporting, making it easier to track transactions and detect fraudulent activities in real-time.

Similarly, artificial intelligence (AI) can be used to analyze vast datasets, identify irregularities, and flag suspicious transactions. AI systems can be programmed to detect patterns of financial fraud and alert organizations to potential risks, reducing the likelihood of financial misrepresentation.

2. Strengthening Governance

Enhancing corporate governance structures is crucial for reducing fraudulent financial reporting. One of the most important steps is to establish independent audit committees that are empowered with the authority and expertise to oversee financial reporting processes. These committees can ensure that financial statements are accurate, transparent, and free from manipulation. Supriyanto et al. (2021) recommend the establishment of independent audit committees in family-owned and state-owned enterprises to mitigate risks associated with weak internal controls.

Another critical aspect of improving governance is the establishment of whistleblower protection programs. These programs should provide employees with secure channels to report unethical behavior and ensure confidentiality. By offering tangible incentives and protecting whistleblowers from retaliation, organizations can encourage employees to come forward and report fraudulent activities.

3. Education and Awareness

Building a culture of ethical awareness is essential for addressing financial fraud in the long term. Educational initiatives can help employees understand the importance of accountability and transparency, fostering an environment in which fraudulent activities are less likely to occur. Wulandari (2019) highlights the need to address cultural stigmas associated with whistleblowing through training programs and public awareness campaigns. By challenging the stigma surrounding whistleblowing, organizations can create a culture where employees feel comfortable reporting fraud without fear of retaliation.

Furthermore, incorporating ethics and corporate governance into university curricula can help prepare future professionals to uphold high standards in their careers. By instilling ethical values early on, Indonesia can build a generation of professionals who are committed to upholding integrity in business practices.

Conclusion

Fraudulent financial reporting continues to pose a critical threat to Indonesia's economic stability, fueled by weak internal controls, cultural dynamics, and gaps in regulatory enforcement. To effectively combat this challenge, organizations must prioritize strengthening internal governance frameworks, adopting advanced technologies such as blockchain and data analytics, and fostering a culture of transparency and accountability. Policymakers and regulators should focus on enhancing whistleblower protection programs, ensuring consistent enforcement of existing regulations, and providing incentives for ethical business practices. Business leaders must take a proactive role in implementing robust internal controls and promoting ethical leadership to set the tone for accountability. By aligning these actionable strategies with targeted implementation plans, Indonesia can mitigate the root causes of financial fraud, restore investor confidence, and build a resilient, transparent business environment. A coordinated effort from policymakers, regulators, and corporate leaders is essential to drive meaningful change and secure sustainable economic growth.

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