

Development of the Theory of Fraud Towards the New Fraud Triangle

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ABSTRACT: *The phenomenon of fraud in the business world, especially fraud in financial statements is a very interesting phenomenon to be discussed. This is because the phenomenon of fraud is a phenomenon that can cause losses in business, ranging from the scale of small losses to bankruptcy. Therefore, various types of developments in the theory of fraud appear that discuss the causes of fraud. This article seeks to explore more deeply about the development of the theory to the latest model of fraud theory, namely The New Fraud Triangle. This article conducts a discussion based on some literature such as from books and journal articles as reference sources. The results of the discussion have shown that from the beginning until now there have been six types of fraud theory namely white collar crime theory, triangle fraud theory, fraud scale theory, diamond fraud and M.I.C.E models, the new fraud triangle model. The six models of fraud theory conduct discussions on fraud actions and complement each other between one theory and another. Thus, future research is expected to be able to carry out empirical testing related to fraud theories that have never been used as a theoretical basis in previous studies.*

KEY WORD: *Financial Statement Fraud, Fraud, The New Fraud Triangle Model*

Date of Submission: 29-03-2019

Date of acceptance: 09-04-2019

I. INTRODUCTION

Fraud is a form that violates the law. This is because fraud can cause harm to the party. Fraud means a business dictionary is interpreted as an act or fraud, negligence, or deviation of truth in order to get a profit. The term fraud emerged since 1940 when Sutherland sparked the white collar crime theory. The initial issue of fraud is only known as a crime which is included in the category of acts of crime or violence. Poverty in the white-collar crime is rarely the root cause of someone committing a crime [1]. Therefore, the theory of fraud has developed more widely.

Fraud and fraud theory began to become interesting topics and experienced rapid development since the discovery of fraud from a large company called Enron. The Enron case began to be revealed since 2001, where this case also dragged the well-known Public Accountant Office, Arthur Andersen. Enron and Arthur Andersen allegedly collaborated to manipulate financial statements. The impact of the case ultimately caused Enron to experience a financial decline marked by a decline in its share price. This is because the capital market players at that time had no trust in Enron. The Enron case finally began to make researchers interested in conducting research related to fraud and developing theories related to fraud.

The theory of fraud has been developed because of the desire to know the motives or reasons underlying fraud in the business world. The earliest developing fraud theory is the theory of triangle fraud. This fraud theory was discovered by Cressey (1950). The reason of fraud was caused by three things, namely pressure on financial problems (pressure), the opportunity to commit a violation of trust (opportunity), and rationalization by rationalization violators [2]. However, the theory of the fraud triangle in its development received a lot of criticism. Therefore, this article will conduct a theoretical study related to the development of the fraud theory.

This article conducts a theoretical review of the development of fraud theory aimed at providing reference sources related to the latest theory of fraud. Thus, the results of this article can be used as a basis for conducting empirical research related to fraud. This article will conduct a theoretical review related to the development of fraud theory by using several kinds of literature such as books and journal articles that have relevance to the theory of fraud.

II. THE UNDERSTANDING CONCEPT OF FRAUD

Fraud in terms can be interpreted as fraudulent or deceptive actions to obtain benefits both materially and non-materially. Fraud in the business world often occurs in financial statements. Fraud perpetrators often manipulate financial statements to cover intentional errors. Fraud is a permanent misstatement or negligence of

the amount or disclosure in order to deceive the user [3]. Therefore, fraud that occurs in financial statements always causes harm to other parties. In addition, the existence of fraud in financial statements will cause a decrease in the reputation and bankruptcy of the company[4].

Fraud or cheating can be divided into various types and types. There are several types of fraud, namely [5]:

- a. Misuse of Company Assets. This form of cheating uses or extracts assets such as money, supplies, official cars, or other personal interests.
- b. Fraud of Financial Statements. Forms of fraud that carry out actions to hide financial information, change financial statements, or the like in order to trick users of financial statements for personal or corporate interests.
- c. Corruption. Forms of fraud that perpetrate abuse of authority or position for personal purposes.
- d. Fraud based on frequency, namely cheating which is divided into non-repeated, repeated.
- e. Cheating based on conspiracy
- f. Cheating based on uniqueness, which includes special fraud and general fraud.

The fraud that occurs in the business world usually causes an indication that shows signs of fraud. The signs are indicated by the behavior of the perpetrators who committed fraud. There are some signs that can indicate the occurrence of fraud as follows [4]:

- a. Luxury lifestyle
- b. Easy emotional
- c. Many audit findings were not addressed

Fraud in the company is more common in several things that have high opportunities and profits. There are several fields that are often targeted by fraud, namely (1) purchasing and payroll, (2) sales and inventory, (3) cash and check, (4) physical security, (5) IPR (Intellectual Property Rights) and confidentiality information, (6) Information technology [6].

III. FRAUD THEORY DEVELOPMENT

The theory of fraud that began from the beginning of the theory of fraud has now developed into six theories. The whole theory of fraud discusses the causes of fraud. The six theories are refinements of several previous theories. Here's a more detailed explanation of each of these theories:

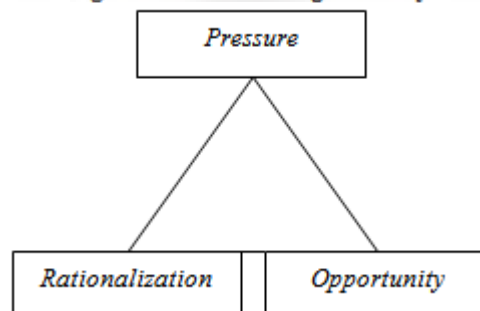
1. White-Collar Crime Theory

The term crime was originally attached to crimes that occurred on the streets, including crimes in the form of physical violence. However, fraud were other crimes, besides street crime which was also a crime [1]. The crime referred to by Sutherland, is a structured crime committed by a professional, where the victims are the general public, who are not aware that they are victims of this crime. This crime is related to economic and business activities, commonly known as white-collar crime. Sutherland stated that previously, theories about crime assumed that poverty was the root cause of a crime. But this does not apply in the white-collar crime. Still, according to Sutherland, there are three differences between white-collar criminals and street criminals and perpetrators of violence. First, white-collar criminals are generally professionals. Second, because the perpetrators are professionals, the law imposed on them is not too heavy. Third, identification of perpetrators and victims is more difficult because this crime is not easily seen by most people. This theory is the basis for the next theory of fraud.

2. Fraud Triangle Theory

The development of fraud theory after the theory of white-collar crime has developed into a theory of triangle fraud. Sutherland (1940) sparked the white-collar crime theory, then Cressey (1950) observed the theory. According to him, there are three factors that encourage fraud, namely: pressure (pressure), rationalization, and opportunity. These three factors are further known as the fraud triangle theory.

Figure 1. Fraud Triangle Theory



The pressure in an organization can be one of the triggers for fraud. The pressure referred to in the theory of fraud triangle refers more to financial pressures such as lifestyle, debt crunch, dependence on drugs, and others. The luxury lifestyle is believed to be able to make someone will always try to keep abreast of the latest trends, both fashion, culinary, automotive, and others. The nature of a luxurious lifestyle is not only owned by people who are in the economic category and above. Someone who is included in the middle economic and even economic category does not rule out the possibility of having a luxurious lifestyle. With the demand to keep abreast of the latest trends, without being followed by the development of income generated by someone, it can make someone try to do anything so that what he wants is fulfilled. Including committing fraud.

Furthermore, rationalization is an important element in fraud. Fraud perpetrators will always try to justify their actions. For example, in a tender, one of the tender participants promised to give several percents to the procurement committee, if it was won in the tender. Furthermore, the procurement committee will rationalize that it is not a fraud, but only a gift.

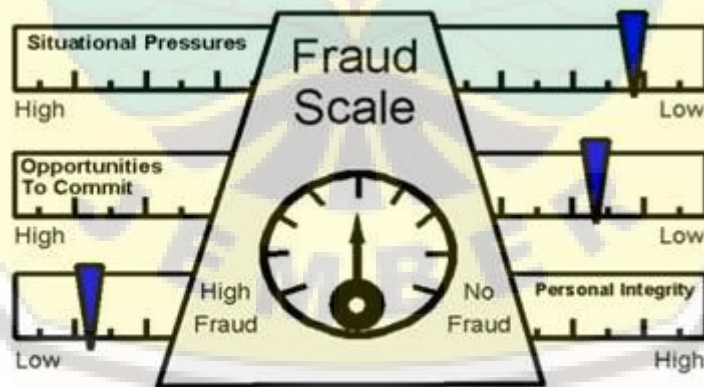
The third factor in the fraud triangle theory proposed is opportunity. Weak internal control in an organization, lack of supervision, and abuse of authority can trigger opportunities for someone to commit fraud. Among the three factors in the fraud triangle theory, opportunity factors are the most likely factor to be minimized, by strengthening internal control, and early detection of fraud attempts. Of the three factors above, it can be said that, when a financial pressure arises, followed by the opportunity that is felt that the action will not be detected, and the rationalization that the action does not violate, can make an individual professional conduct fraud. Furthermore, this theory is the basis for the development of future fraud theories.

3. Fraud Scale Theory

The theory of fraud triangle only discusses what reasons underlie fraud, but does not in detail look at the scale of the probability of fraud occurring from the existence of these three causes. Therefore, the theory of triangle fraud developed into the theory of fraud scale [7]. In this theory, there are three factors that cause fraud, namely situational pressure, the opportunity to commit fraud, and personal integrity. Albrecht replaced the rationalization factor in the triangle theory of fraud, with personal integrity, because personal integrity is easier to observe. According to Albrecht, the rationalization factor is more abstract to others. Unlike personal integrity, which is easier to trace from their past behavior.

The violations of ethics, honesty, and responsibility are the essence of the act of accounting fraud [8]. Ethical factors are caused by rationalization, and to a certain extent, the pressure factor associated with fraud can be traced by examining the condition of individuals who are perpetrators of fraud by considering whether their actions are right or wrong.

Figure 2. Fraud Scale Theory



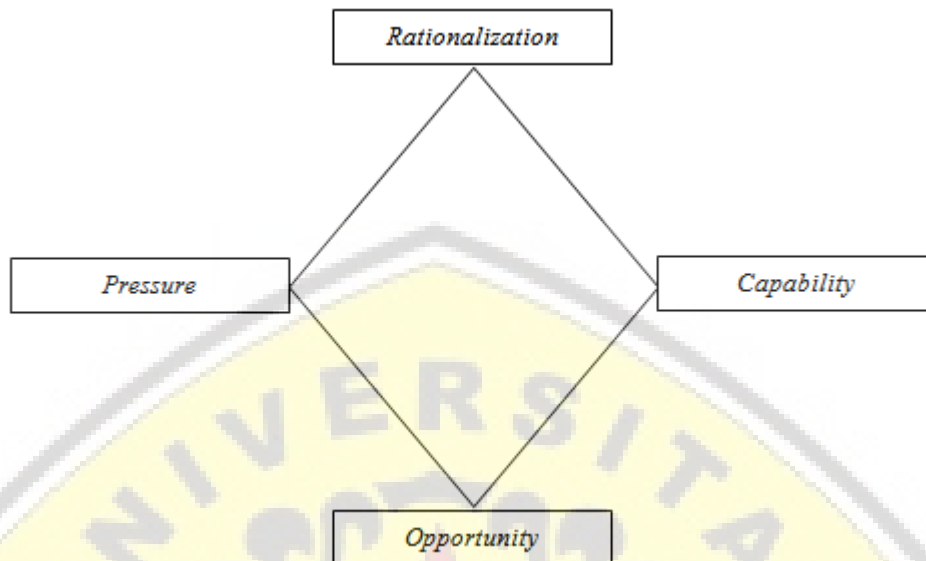
Based on the theory of fraud scale images, it can be seen that the three factors in this theory relate to one another. If situational pressure and the opportunity to commit fraud are high, but personal integrity is low, then the possibility of fraud will be high. Conversely, if situational pressure and opportunity are low, but personal integrity is high, then the possibility of fraud is low.

4. Modern Fraud Theories (A-B-C Analysis)

The theory of fraud triangles that have been previously considered incomplete explains the reasons for fraud. The triangle fraud can be extended by adding a fourth factor, namely capability [9]. The capability is attached to the position in the organization, as well as adequate knowledge. The opportunities to commit fraud,

pressure (pressure), and rationalization, make someone approach the road to fraud, but it requires capability (capability) to take advantage of opportunities to take action fraud [10].

Figure 3. Fraud Diamond



In addition to adding a capability factor, the diamond fraud theory also modifies the pressure factor. The pressure factor does not only refer to financial pressure [11]. For example, in a bribery case involving more than one party, there is a possibility that not all parties involved are motivated by financial needs. The executives who are rich and influential in society, are also involved in fraud [12]. This shows that financial factors are clearly not the main motive in fraud. Situational pressure that can motivate fraud can occur due to four factors better known as MICE models, namely: money (money), ideology, coercion (coercion) and entitlement (rights) [11]. Factor money (money) which refers to the financial pressure that makes someone commit fraud.

Financial pressure can be caused by urgent lifestyle, debt, or family needs, as expressed by the theory of triangle fraud. The ideology factor is the assumption of the perpetrator that his behavior in committing fraud is for the greater good. For example, the perpetrator considers that getting income illegally, will not be a problem, because then he will donate the money to people in need.

Furthermore, coercive factors indicate that there are third parties who provide examples, intimidate and threaten to commit fraud. While entitlement refers to the individual ego who feels that, if he does fraud, it will not be detected. In addition, the ego is also driven by the desire to maintain or obtain a certain lifestyle.

5. Fraud Diamond and M.I.C.E. Model

This fifth fraud theory is a theory of fraud that seeks to clarify the theory of fraud triangle in terms of the scope of fraud perpetrators. The behavior is the root cause of fraud. He observed fraud through a sociological and psychological approach [12]. A year later, ABC model for analyzing and categorizing fraud, namely: a bad apple, a bad bushel and a bad crop.

A bad apple refers to fraud done individually. Furthermore, a bad bushel is interpreted as fraud carried out together. A bad crop refers to fraud carried out together with social and cultural mechanisms that influence fraud.

The most dangerous fraud category is the category of a bad crop. A bad crop category is characterized by moral deficiencies of organizational leaders, and moral deficiencies will quickly spread to their subordinates. Because it spread to almost all lines of the organization, fraud eventually became a culture, which was carried out from the lowest level to the top management level.

6. New Fraud Triangle Model

The last theory of fraud is the theory of the new fraud triangle model. This theory includes aspects of financial and non-financial reasons. Kassem and Higson (2012) classify the factors that cause fraud, which is different from the theory of fraud triangles triggered by Cressey. By reviewing some of the previous literature, about the theory of fraud, Kassem and Higson concluded that some researchers classify the causes of fraud because of personal, occupational, or external pressure. While other studies classify the factors that cause fraud

are financial and non-financial factors. However, the two classifications are actually interrelated. For example, personal pressure can occur due to financial or non-financial pressures.

In the same way, work pressure can also occur due to financial and non-financial factors. Thus, Kassem and Higson reminded external auditors that the pressure or motive for committing fraud could be personal pressure, work, or external pressure, and each type of pressure can also occur due to financial and non-financial factors.

Kassem and Higson also argue that all previous fraud theories are an extension of the fraud triangle theory, and must be integrated with one model which is further known as the new fraud triangle model, which includes motivation, opportunity, integrity, and ability.

The sixth theory of fraud above explains that at the beginning of the development of the theory of fraud began with the theory of white-collar crime. The theory of white-collar crime basically only includes fraud as a category of crimes committed by elite parties (white collared). Thus, the white collar crime theory is basically less specific to discuss fraud acts because they are still too general. Therefore, the theory of the fraud triangle appears to refocus the discussion on fraud actions.

The theory of the fraud triangle is a theory that is more focused on fraud compared to the white collar crime theory. This is because the theory of the fraud triangle is a theory that explains the causes of fraud. The theory of the fraud triangle provides three factors that encourage fraud, namely pressure (pressure), rationalization, and opportunity [2]. Therefore, this theory is called the fraud triangle because there are three factors that explain the occurrence of fraud. This theory is a theory known to many people who research related fraud.

The theory of fraud triangle along with the development of time began to be deemed less suitable and found some deficiencies. The shortcomings in the fraud triangle theory are (1) not calculating the scale of the probability of fraud from three factors, (2) forgetting the capability in fraud factor, (3) not dividing the fraud perpetrators, and (4) do not divide the pressure factor into financial and non-financial. Therefore, the next four development triangle fraud theories try to explain the shortcomings of the triangle fraud theory. The development of the theory of fraud that exists today can then be described in the form of a pyramid as follows:

Figure 4. The Pyramid of Fraud Theory



IV. CONCLUSIONS AND RECOMMENDATIONS

The results of the discussions that have been conducted in this article indicate that the existing theory of fraud has evolved into several phases of theory. Fraud theory explains overall that fraud is included in one type of crime committed by professionals (white collar crime). The theory of fraud also explains that fraud committed by professionals is caused by four factors, namely pressure, opportunity, rationalization, and capability. These four factors can be driven by financial and non-financial reasons. The theory of fraud also shows that there is a form of ABC (a bad apple, a bad bushel and a bad crop) at the fraud perpetrator level.

The results of this discussion, in general, have briefly explained the development of fraud theory that exists today. However, the explanation in this article still cannot prove empirically about the application of existing fraud theories. This is especially true of the theory of fraud that has just been developed at this time.

Therefore, future research is expected to be able to carry out empirical testing. The empirical testing conducted will later be able to further strengthen the validity of the theory in explaining fraud.

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Riza Dewi Al Ardi" Development of the Theory of Fraud Towards the New Fraud Triangle" International Journal of Business and Management Invention (IJBMI), vol. 08, no. 03, 2019, pp 56-61