

Does Competence Deter Financial Statement Fraud? The Moderating Role of Morality and Audit Committee Governance

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Abstract

Financial statement fraud remains a serious threat because it causes large losses and is difficult to detect, especially in the pharmaceutical sub-sector, which has a history of financial reporting manipulation. This study aims to analyze the effect of competence on financial statement fraud and to examine whether morality and the audit committee moderate that relationship. This study uses a quantitative approach with secondary data from the financial statements and annual reports of pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) during 2020–2025, selected through purposive sampling, resulting in 66 firm-year observations. Competence is proxied by change in director, morality by the frequency of integrity-related words disclosed in the annual report, the audit committee by the number of committee members, and financial statement fraud by the Beneish M-Score. Data were analyzed using panel data regression and Moderated Regression Analysis (MRA) with EViews 12. The results show that competence has no significant effect on financial statement fraud, morality does not moderate the effect of competence on financial statement fraud, and the audit committee does not moderate the effect of competence on financial statement fraud. These findings indicate that a change in director reflects organizational regeneration rather than an indicator of fraud risk, and that the mere existence of moral disclosure and an audit committee does not guarantee effective control over fraudulent reporting.

Keywords: *audit committee, change in director, competence, financial statement fraud, morality*

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INTRODUCTION

Financial statements are documents prepared by a company over a certain period to present its financial condition, performance, and operating results. They serve as a means of communication between the company and external parties, such as investors and creditors, and are also used internally as a basis for managerial decision making (Kusumosari & Solikhah, 2021). Financial information is useful only when it is of good quality, that is, relevant, faithfully representative, comparable, verifiable, timely, and understandable. Low-quality information almost certainly leads stakeholders to poor business decisions because investment and credit decisions rely heavily on the reliability and relevance of the information presented (Mustapha & Suleiman, 2025).

The intentional presentation of financial information that does not reflect actual conditions for personal gain is referred to as fraud (Agustine & Susilowati, 2022). The Association of Certified Fraud Examiners (ACFE) classifies fraud into three main categories: asset misappropriation, corruption, and financial statement fraud. Based on the 2024 Indonesia Fraud Survey, corruption was the most common form of occupational fraud (47.6%), followed by asset misappropriation (40.2%), while financial statement fraud ranked lowest (12.2%). Although financial statement fraud occurs less frequently, its impact is comparable to corruption, with reported losses reaching between IDR 1 billion and IDR 50 billion (ACFE, 2025). Because it is difficult to detect and can mislead the decisions of financial statement users, financial statement fraud requires special attention.

Sectorally, the pharmaceutical sub-sector deserves particular attention because the need for medicines makes it defensive against crises and attractive to investors (Rasyad, 2022). At the same time, the sector has a track record of manipulation, as illustrated by PT Kimia Farma Tbk and, more recently, PT Indofarma Tbk, where an audit found indications of fraud that caused state losses of up to IDR 371.8 billion through inventory inflation and fictitious transactions (CNBC, 2024). These phenomena confirm the fundamental role of financial statement quality in economic decision making.

Various theories explain the drivers of financial statement fraud, beginning with the fraud triangle (Cressey, 1953) and developing into the fraud hexagon (Vousinas, 2019), which adds the element of collusion to pressure, opportunity, rationalization, capability, and arrogance. Among these elements, the competence is a key factor in designing financial statement fraud (Rahayu & Susilowati, 2025). Compared with arrogance and collusion, which are difficult to measure objectively, capability is more readily proxied through managerial competence, giving it clearer and more consistent empirical measurement in quantitative research (Hardirmaningrum & Rohman, 2023). In this study, competence is proxied by change in director. A change in director reflects the company's effort to obtain more competent leadership, but frequent changes may raise suspicion because newly appointed directors may lack sufficient knowledge of the company, potentially triggering fraud under pressure to meet shareholder expectations. Prior studies report mixed findings: several studies find that change in director does not affect financial statement fraud, whereas others find that it does.

This study relies on agency theory (Jensen & Meckling, 1976), which explains that the relationship between principals and agents creates conflicts of interest arising from information asymmetry. Management, as the agent, has full control over the preparation and reporting of financial information, while shareholders depend on those reports for investment decisions. This condition may encourage management to manipulate financial statements to increase reported profit, meet performance targets, or avoid the risk of bankruptcy.

One factor that may influence the intention to commit fraud is morality, that is, the attitude, behavior, or action a person takes based on experience, conscience, and advice (Ferdyanti & Priono, 2022). In Kohlberg's (1971) theory of moral development, individuals at higher moral stages avoid actions that harm themselves and others. In the organizational context, morality is reflected in a commitment to integrity, transparency, and accountability. Liu and Liang (2024) show that low

managerial integrity encourages moral masking behavior, indicating that organizational morality functions as a fraud-prevention mechanism. Accordingly, higher morality is expected to weaken the tendency of highly competent individuals to commit fraud.

Good corporate governance is another mechanism used to minimize conflicts of interest and improve oversight. Within governance structures, the audit committee plays an important role in supporting accountability, transparency, and independence. Under Financial Services Authority Regulation No. 55/POJK.04/2015, the audit committee assists the board of commissioners in overseeing the financial reporting process, the effectiveness of internal control, the conduct of audits, and regulatory compliance. Consistent with agency theory, the audit committee is part of the system designed by the principal to minimize agency costs (Anggraini & Suryani, 2021). Prior research indicates that audit committee characteristics can weaken the effect of fraud hexagon factors on financial statement fraud (Hartono & Mukhibad, 2024; Putra, 2023), although the evidence remains inconsistent.

Based on the gaps in prior findings, this study analyzes the effect of competence on financial statement fraud. Its distinction lies in positioning morality and the audit committee as moderating variables simultaneously with competence as the independent variable within a single study, a combination that has not been examined before. Accordingly, three hypotheses are proposed: (H1) competence has a positive effect on financial statement fraud; (H2) morality moderates the positive effect of competence on financial statement fraud; and (H3) the audit committee moderates the positive effect of competence on financial statement fraud. The research framework is presented in Figure 1.

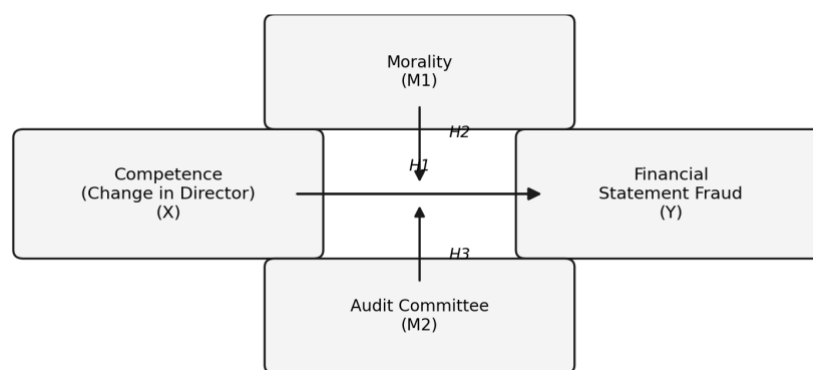


Figure 1. Research Framework
Source: Processed by the author (2026)

METHODS

This study uses a quantitative approach with secondary data obtained from the Indonesia Stock Exchange (IDX) website (<https://www.idx.co.id>) and the official websites of the sample companies. The object of this study is pharmaceutical companies listed on the IDX during the 2020–2025 period. The population comprises 14 pharmaceutical companies, and the sample was selected using purposive sampling with the criterion that companies published audited annual reports and financial statements throughout the observation period. Based on these criteria, 11

companies met the requirements, and after data tabulation the analysis used 66 firm-year observations.

The dependent variable, financial statement fraud (Y), is measured using the Beneish M-Score model, which is superior in detecting earnings manipulation and is expressed on a ratio scale (Luhri et al., 2021; Tarjo & Herawati, 2021). The model is:

$$M = -4.84 + 0.920 \text{ DSRI} + 0.528 \text{ GMI} + 0.404 \text{ AQI} + 0.892 \text{ SGI} + 0.115 \text{ DEPI} - 0.172 \text{ SGAI} + 4.679 \text{ TATA} - 0.327 \text{ LVGI}$$

Where the index components represent days sales in receivables, gross margin, asset quality, sales growth, depreciation, selling and administrative expenses, total accruals to total assets, and leverage.

The independent variable, competence (X), is proxied by change in director (DCHANGE), measured as a dummy variable on a nominal scale: a value of 1 is assigned if the company changed its board of directors during 2020–2025 and 0 if there was no change (Luhri et al., 2021).

The first moderating variable, morality (M1), is proxied by management's integrity commitment, measured on a ratio scale as the frequency of the words integrity, honesty, sincerity, trust, and fairness in the Management Discussion and Analysis section of the annual report, plus one (Liu & Liang, 2024). The second moderating variable, the audit committee (M2), is measured on a ratio scale as the number of audit committee members (Mohammadi & Saeidi, 2022).

Data were analyzed using panel data regression and Moderated Regression Analysis (MRA) with EViews 12. The regression equations are:

$$\text{Equation I, Fraud} = a + \beta_1 \text{ DCHANGE} + e$$

$$\text{Equation II, Fraud} = a + \beta_1 \text{ DCHANGE} + \beta_2 \text{ Morality} + \beta_3 (\text{DCHANGE} \times \text{Morality}) + e$$

$$\text{Equation III, Fraud} = a + \beta_1 \text{ DCHANGE} + \beta_2 \text{ AuCOMM} + \beta_3 (\text{DCHANGE} \times \text{AuCOMM}) + e$$

The estimation model was selected through the Chow test, the Hausman test, and the Lagrange Multiplier test, followed by a classical assumption test (multicollinearity), the coefficient of determination, the F-test, and hypothesis testing.

RESULTS AND DISCUSSION

Descriptive Statistics

Descriptive statistics provide an overview of the characteristics of the research data, including the minimum, maximum, mean, median, and standard deviation. The results are presented in Table 1.

Table 1. Descriptive Statistics

Variable	Obs.	Mean	Median	Minimum	Maximum	Std. Dev.
Fraud	66	-2.354848	-2.429500	-5.116000	2.144000	1.020147
DCHANGE	66	0.575758	1.000000	0.000000	1.000000	0.498015
Morality	66	41.666667	35.500000	3.000000	133.000000	25.770190
AuCOMM	66	3.848485	3.000000	2.000000	16.000000	2.920708

Source: Processed with EViews 12 (2026)

Table 1 shows that 66 observations were used. Financial statement fraud (Fraud), proxied by the Beneish M-Score, has a mean of -2.354848 and a median of -2.429500, with values ranging from -5.116000 to 2.144000, indicating variation in fraud risk across sample firms. Competence (DCHANGE) has a mean of 0.575758,

meaning that about 57.58% of the observations experienced a change in director during the observation period. Morality has a mean of 41.666667 with a relatively wide spread (standard deviation 25.770190), reflecting differences in the level of ethical disclosure across firms. The audit committee (AuCOMM) has a mean of 3.848485 members, ranging from 2 to 16 members.

Panel Data Model Selection

The Chow test results show that the probabilities of the Cross-section F and Cross-section Chi-square for all three equations are below 0.05, so the Fixed Effect Model (FEM) is preferred over the Common Effect Model (CEM). The Hausman test then yields probabilities of 0.8532, 0.9770, and 0.4319 for Equations I, II, and III, all greater than 0.05, indicating that the Random Effect Model (REM) is more appropriate than the FEM. The Lagrange Multiplier test supports the REM for Equations I and III (probabilities of 0.0299 and 0.0586), while Equation II yields 0.0171, which is very close to the significance threshold. To maintain estimation consistency across all equations, the Random Effect Model (REM) was adopted as the final model.

Because the selected model is the REM, and following Gujarati, normality, heteroscedasticity, and autocorrelation tests are not primary requirements under the Generalized Least Squares estimation used in the REM. Therefore, the classical assumption test focused on multicollinearity. Using the Variance Inflation Factor (VIF), DCHANGE (5.030842), Morality (4.086490), and the interaction DCHANGE × Morality (8.554265) all have Centered VIF values below 10, so the model is free from multicollinearity.

Panel Data Regression Results

Table 2. Panel Data Regression Results (Random Effect Model)

Variable	Equation I	Equation II	Equation III
C	-2.161533	-2.196617	1.533518
DCHANGE	-0.335758	0.018213	-3.856356
AUCOMM	–	–	-1.243091
DCHANGE × AUCOMM	–	–	1.202657
Morality	–	0.001561	–
DCHANGE × Morality	–	-0.008877	–
Adjusted R ²	0.011980	0.000018	0.012107
F-statistic	1.788149	1.000392	1.265530
Prob(F-statistic)	0.185885	0.398743	0.294018

Source: Processed with EViews 12 (2026)

The Effect of Competence on Financial Statement Fraud

Equation I tests the effect of competence (DCHANGE) on financial statement fraud, producing:

$$\text{Fraud} = -2.161533 - 0.335758 (\text{DCHANGE})$$

The coefficient of DCHANGE is -0.335758 with a probability of 0.1892, which is greater than 0.05, so the effect is not significant. The Prob(F-statistic) of 0.185885 indicates that the model is not significant overall, and the Adjusted R² of 0.011980

shows that competence explains only 1.20% of the variation in financial statement fraud. Therefore, Hypothesis 1 (H1) is rejected.

This finding indicates that a change in director does not explain the occurrence of financial statement fraud in pharmaceutical companies. A change in director more likely reflects organizational regeneration, performance evaluation, or company policy than an indicator of increased fraud risk. This result is consistent with Sihombing and Panggulu (2022), Alfarago and Maburur (2022), and Rahayu and Susilowati (2025), who report that change in director does not affect financial statement fraud.

Morality Moderating the Effect of Competence on Financial Statement Fraud

Equation III tests the role of morality in moderating the effect of competence on financial statement fraud, producing:

$$\text{Fraud} = -2.196617 + 0.018213 (\text{DCHANGE}) + 0.001561 (\text{Morality}) - 0.008877 (\text{DCHANGE} \times \text{Morality})$$

The interaction term $\text{DCHANGE} \times \text{Morality}$ has a coefficient of -0.008877 with a probability of 0.5169, which is greater than 0.05. The Prob(F-statistic) of 0.398743 shows that the model is not significant overall, and the Adjusted R^2 of 0.000018 indicates that the model explains almost none of the variation in fraud. Therefore, Hypothesis 2 (H2) is rejected.

This finding indicates that morality, measured through the level of ethical-commitment disclosure in the annual report, has not been able to strengthen or weaken the relationship between competence and financial statement fraud. The disclosure of moral values in annual reports does not necessarily reflect the actual implementation of morality in management's decision-making process, so it has not become a factor that influences the relationship.

The Audit Committee Moderating the Effect of Competence on Financial Statement Fraud

Equation II tests the role of the audit committee in moderating the effect of competence on financial statement fraud, producing:

$$\text{Fraud} = 1.533518 - 3.856356 (\text{DCHANGE}) - 1.243091 (\text{AUCOMM}) + 1.202657 (\text{DCHANGE} \times \text{AUCOMM})$$

The interaction term $\text{DCHANGE} \times \text{AUCOMM}$ has a coefficient of 1.202657 with a probability of 0.2255, which is greater than 0.05. The Prob(F-statistic) of 0.294018 confirms that the model is not significant overall, and the Adjusted R^2 of 0.012107 shows that the variables jointly explain only 1.21% of the variation in fraud. Therefore, Hypothesis 3 (H3) is rejected.

This finding indicates that the audit committee is unable to weaken or strengthen the effect of competence on financial statement fraud. It suggests that the mere existence of an audit committee as a governance mechanism is not necessarily accompanied by effective oversight, so it has not been able to limit the potential misuse of competence in financial reporting. This result aligns with Luhri et al. (2021), who find that the audit committee does not moderate the relationship between competence and financial statement fraud.

CONCLUSION

Based on the analysis of the effect of competence on financial statement fraud with morality and the audit committee as moderating variables in pharmaceutical sub-sector companies listed on the Indonesia Stock Exchange during 2020–2025, this study concludes that competence, proxied by change in director, has no effect on financial statement fraud, so a change in director more likely reflects organizational regeneration than an indicator of fraud risk; morality is unable to moderate the effect of competence on financial statement fraud because ethical disclosure in annual reports does not necessarily reflect the actual implementation of morality in management decisions; and the audit committee is unable to moderate the effect of competence on financial statement fraud because the existence of an audit committee is not necessarily accompanied by effective oversight. This study is limited to the pharmaceutical sub-sector over a five-year period, uses a change-in-director proxy that does not fully capture managerial competence, relies on disclosure-based morality, and yields low coefficients of determination, indicating that other factors outside the model influence financial statement fraud. Future research is therefore encouraged to broaden the objects of study, use competence proxies that more directly capture directors' abilities, and add other variables such as internal control effectiveness, audit quality, institutional ownership, and financial pressure so that the model's explanatory power can be improved.

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