Journal of Accounting Research, Organization and Economics

JAROE

Fraud Risk Management and Fraud Prevention Factors in the Local Government

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A R T I C L E I N F O

Received 16 April 2024;
Received in revised form 15 September 2025;
Accepted 1 October 2024
Available online 15 July 2025

JEL Classification:
M41, M42, M48

To cite this article:
Tarjo, T., Anggono, A., Yuliana, R., Said, J., & Sakti, E. (2025). Fraud risk management and fraud prevention factors in the local government. *Journal of Accounting Research, Organization and Economics*, 8(1), 12-23.

A B S T R A C T

Objective – This study aims to empirically examine the influence of religiosity, leadership ethics, and local wisdom on prevention of fraudulent financial statement by implementing Fraud Risk Management in local governments throughout Madura, Indonesia.
Design/Methodology – The research method used in this study is a quantitative survey method. The dependent variable of this research is fraudulent financial statement prevention. The independent variables of this research are religiosity, leadership ethics, and local wisdom. At the same time, the mediating variable in this research is Fraud Risk Management. The sample of this research is 252 respondents to test this study's hypothesis using Structural Equation Modeling-Partial Least Square (SEM-PLS).
Results – Religiosity, leadership ethics, and local knowledge also significantly positively affect the application of Fraud Risk Management and its impact on fraudulent financial statement prevention. This study's main finding is that religiosity, leadership ethics, and local wisdom indirectly influence fraudulent financial statement prevention through Fraud Risk Management.
Research limitations/implications – This research contributes to improve the prevention system in local government. Furthermore, applying Fraud Risk Management can mitigate fraudulent financial statements in the local government.
Novelty/Originality – This research presents the latest results from applying Fraud Risk Management to prevent fraud, which is rarely explored in the government sector. Apart from that, the research gap regarding weak ethical values in implementing Fraud Risk Management can be addressed by adding variables such as religiosity, leadership ethics, and local wisdom, which have direct and indirect impacts on fraud prevention. The addition of the mediating variable improves the level of originality of this research. The Fraud Risk Management, as the mediating variable, provides solutions and updates in implementation of Fraud Risk Management in the local government sector.

Keywords: Financial fraud prevention, fraud risk management, religiosity, ethical leadership, local wisdom

1. Introduction

The prevention of financial statement fraud is a system and procedure designed to minimize the potential for fraud and maximize the early detection system for the possibility of financial statement fraud (ACFE, 2020). Several ways to prevent financial statement fraud include proactive audits, anti-fraud training, looking at personal characteristics, imposing penalties, and employee rotation (ACFE, 2020). Apart from that, preventing financial report fraud can also be done by implementing internal audit (Petraşcu & Tieanu, 2014), internal control (Singal et al., 2019), Enterprise Risk Management (ERM) (Glowka et al., 2021), policy implementation fraud reporting, staff rotation, fraud hotlines, and forensic accounting (Othman et al., 2015). However, all the methods suggested by previous research are still less effective in preventing fraud.

Based on a survey by the Association of Certified Fraud Examiners (ACFE) in 2022, it was found that the number of fraud cases reached 2,110 cases, with total losses reaching \$3.6 billion (ACFE, 2022). On the other hand, fraud prevention in financial reports is increasing, with 81% of organizations starting to implement internal controls (ACFE, 2022). Meanwhile, implementing other prevention measures, such as management reviews, increased by 75%, and 64% of organizations have implemented proactive analytical data monitoring (ACFE, 2022). Meanwhile, in Indonesia, based on the Indonesian fraud survey, it was found that the number of cases in 2019 reached 239 cases, with a total loss of IDR 873,430,000,000 (ACFE, 2019). The most effective fraud prevention system is the complaint system, with a percentage of 22.6%, anti-fraud policy at 13.8%, and monitoring at 9.6% (ACFE, 2019). Thus, the policy for preventing financial reporting fraud in Indonesia has begun to improve compared to previous years. Even though the financial fraud prevention system implemented so far is good, the potential for fraud in Indonesia is still relatively high, especially in the local government (ICW, 2022). This data proves that implementing the fraud prevention system is still less effective in Indonesia.

Behavioral factors are the main factor causing the lack of effectiveness in preventing financial report fraud. Based on the global ACFE survey, 85% of fraudsters have problems with behavioral factors such as extravagant living, financial problems, divorce, family problems, and unstable behavior (ACFE, 2022). Meanwhile, in Indonesia, the cause of the ineffective implementation of preventing financial reporting fraud is the attitude of superiors who cannot be role models for their subordinates and the lack of anti-fraud training (ACFE, 2019). Based on the ACFE survey and the Indonesian fraud survey, it can be stated that behavioral problems are the main reason why fraud prevention is still unable to eradicate fraud while fraud is still growing altogether.

One way to prevent fraud in financial reports is to start by improving employee behavior in each component of an organization (Dion, 2008). One of the factors that influences the behavior of each organizational component is religiosity (Tuhin et al., 2020). Religiosity can also be important in mitigating fraud (Said, Alam, et al., 2018b, 2018a). Several studies agree that religiosity can prevent fraudulent financial reports (Hayati & Amalia, 2021; Purnamasari & Amaliah, 2015). Research confirms that Islamic religiosity can reduce fraud, such as corruption (Eslampanah et al., 2017; Suhendi et al., 2020).

Ethical factors can also influence the behavior of each organizational component (Dion, 2008). Ethics can also reduce the potential for fraud (Said, Omar, et al., 2018), reduce the occurrence of fraud caused by employees (Haron et al., 2011), and mitigate acts of fraud (Said et al., 2017). Several studies have also proven that ethics can improve fraud prevention performance (Abdullahi & Mansor, 2015) and prevent fraud (Maifizar et al., 2020).

The final factor, which is no less critical, is the cultural side (Said, Omar, et al., 2018). Cultural factors can also prevent fraud (Soehari et al., 2020). Culture is also influenced by sound local wisdom, which can positively influence fraud prevention (Setiawan, 2019). Thus, the presence of religiosity, leadership ethics, and local wisdom positively impacts the prevention of fraud in financial reports.

On the other hand, some oppose the argument that religiosity, leadership ethics, and local wisdom positively impact measures to prevent fraud in financial statements. Kirana et al. (2015) found that the influence of religiosity did not have an impact on increasing the prevention of financial statement fraud but increased the potential for fraud. Meanwhile, Hayati and Amalia (2021) argue that leadership ethics are ineffective in preventing financial report fraud. Hendri et al. (2020) prove that local wisdom does not prevent financial report fraud. Some argue that if there is local wisdom fraud in an area, local wisdom factors will also encourage fraud, so local wisdom is not suitable for preventing fraud (Kirana et al., 2015). These findings prove that behavioral factors do not directly influence fraud prevention in financial statements.

Suppose you only focus on prevention from a behavioral perspective. In that case, it will still be less effective because other factors are no less critical, such as weak internal controls, that make preventing financial report fraud less effective (ACFE, 2019, 2022). To resolve internal control problems, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) recommends Fraud Risk Management (FRM) (COSO, 2016). FRM is considered the most suitable guide for improving financial fraud prevention performance and resolving internal control problems because FRM is specifically designed to eradicate fraud (COSO, 2016). In addition, FRM provides various strategies that can be used to prevent financial statement fraud (COSO, 2016). Several studies also found that FRM can prevent all types of fraud (Chepkoech & Rotich, 2017; Jackson, 2013; Yang & Lee, 2020).

FRM has five main components that can help local governments prevent fraud. First, Fraud Risk Governance plays a role in improving the integrity and ethics of local government employees (Tarjo, et al., 2021). Second, Fraud Risk Assessments aim to assess risks, including fraud risks in local governments (Tarjo et al., 2022). Third, Fraud Control Activities can improve fraud prevention and detection systems in local governments (KPMG, 2014). Fourth, fraud investigation and corrective action can be a mediator to communicate information about fraud and follow up on fraud (COSO, 2016). Fifth, Fraud Risk Management Monitoring Activities play a role in monitoring the previous four components to run according to organizational goals (Chen et al., 2015).

On the other hand, religiosity, leadership ethics, and local wisdom can also improve FRM performance (Kazemian et al., 2018; Nawawi et al., 2017; Sunarti et al., 2020). Religiosity plays an essential role in increasing the integrity of fraud risk governance, which is one of the components of FRM (Bouslama & Lahrichi, 2017). Leadership ethics also plays a role in improving the ethical side, which is an essential point in running FRM (Souvenir et al., 2024). Local wisdom affects a better control environment, thereby improving the performance of FRM (Aditya & Hapsari, 2020). The main reason why religiosity, leadership ethics, and local wisdom can improve FRM performance is that religiosity, leadership ethics, and local wisdom can complement the weaknesses of FRM on the fraud risk governance (Siregar & Tenoyo, 2015). FRM and behavioral factors (religiosity, leadership ethics, and local wisdom) have synergy and complement each other so that they can be combined. Thus, the issue developed in this research is whether integrating ethical factors (religiosity, leadership ethics, and local wisdom) and FRM can prevent fraud in local governments throughout Madura. The model developed in this research is expected to solve the problem of the effectiveness of fraud prevention caused by behavior and weak internal control. Based on the explanation of the theories and phenomena discussed above, this research aims to empirically test the influence of religiosity, leadership ethics, and local wisdom on preventing financial statement fraud and FRM as a mediating variable.

In terms of theory, the Theory of Planned Behavior (TPB) is the main foundation for improving fraud prevention (Azman & Vaicondam, 2020). Fraud occurs due to intention, so TPB is proper in explaining the intention to commit fraud (Ajzen, 1991). FRM itself is a guide to preventing fraud so that it can suppress the intention to commit fraud (COSO, 2016). The five components of FRM require behavioral roles so that all components run as they should (KPMG, 2014). However, Siregar & Tenoyo (2015) criticized the fraud risk governance component, which is rooted in ethics. Therefore, to support this deficiency, there need to be other factors that can improve it, such as eligibility, leadership ethics, and local wisdom, to ensure that the intention to commit fraud does not arise in local governments.

The novelty of this research lies in the addition of FRM elements as a mediator of the influence of religiosity, leadership ethics, and local wisdom. The addition of FRM as a mediator is because there is still a lot of debate about the influence of religiosity, leadership ethics, and local wisdom on preventing fraud in financial reports. Apart from that, the selection of FRM is also based on COSO suggestions because FRM is specifically designed to prevent all kinds of fraud and is different from internal control in general (COSO, 2016). The impact of adding FRM also aims to overcome the problem of weak internal control (COSO, 2016).

On the other hand, FRM performance can also be strengthened by religiosity, leadership ethics, and local wisdom (Kazemian et al., 2018; Nawawi et al., 2017; Sunarti et al., 2020). FRM itself has severe ethical problems (Siregar & Tenoyo, 2015). So, with a combination of religiosity, leadership ethics, local wisdom, and FRM, we can cover each component's weaknesses and can be mutually beneficial.

The next novelty lies in the local government of Madura. Local government is known to have a high potential for fraud. A global ACFE survey found that the percentage of fraud incidents in the local government sector reached 32% of all cases in the government sector, and the median loss reached $75,000. Apart from that, based on the Indonesia Corruption Watch (ICW), East Java province is the first province where fraud often occurs (ICW, 2022). Fraud cases also occurred in the local government in Madura, which is known as one of the islands with high religiosity (Sami an & Prakasa, 2021). Madura is also known for its people, who have a noble level of religiosity and local wisdom (Djasuli, 2017; Kutsiyah et al., 2020). Madura also often has regional leaders from the Kiai community, and the Madurese community greatly respects the Kiai (Pribadi, 2014). This obedience is a disadvantage because a kiai cannot necessarily be an excellent regional leader, so he can abuse his role when leading (Setiawan, 2019). Hidayaturrahman (2018) found a case where a regional leader from the Kiai community committed corruption. The high number of fraud cases committed by their leaders causes a high potential for Corruption, Collusion, and Nepotism (KKN) in its local government (Tarjo, Faizah, et al., 2021). Based on this case, Madura is worthy of being an object of research because the government system is rooted in the kingdom system and is usually led by a kiai, which makes Madura unique and suitable as an object of research for FRM research and fraud prevention. Of course, this is further strengthened by the solid Islamic culture that should be able to help open the eyes of fraud perpetrators in local government.

This research contributes to the empirical literature on religiosity, leadership ethics, local wisdom, FRM, and prevention of financial statement fraud. Research on FRM still needs to be carried out in Indonesia. Research on FRM still needs to be carried out in Indonesia. Therefore, this research will provide additional literature regarding the implementation of FRM in local government. Meanwhile, the local government contributes to improving the system for preventing fraud in financial reports and increasing religiosity, leadership ethics, and local wisdom possessed by each organization component. The existence of FRM can improve the system for preventing fraud in financial reports in local governments. Apart from that, the support from religiosity, leadership ethics, and local wisdom makes preventing fraud in financial reports better and more effective. The final contribution is creating a regional government system free from fraud, one of which is fraudulent financial reporting.

2. Literature Review, Theoretical Framework, and Hypotheses Development

2.1. Theoretical Framework

2.1.1. Theory of Planned Behavior (TPB)

Fraud cases in regional governments start from the intention to commit fraud (ACFE, 2020). A theory suitable for studying an intention to commit fraud is the Theory of Planned Behavior (TPB) (Ajzen, 1991). One example of the application of this theory concerns fraudulent behavior carried out by managers (Cohen et al., 2010). On the other hand, this theory is suitable for explaining intentions to prevent fraudulent financial statements (Wardah et al., 2022). Several studies also reveal that TPB is closely related to financial reporting fraud prevention strategies such as religiosity (Said, Alam, et al., 2018b, 2018a), leadership ethics (Dion, 2008), local wisdom (Said, Omar, et al., 2018; Soehari et al., 2020), and FRM (Dzomira, 2015).

Religiosity makes government employees' hearts closer to Allah SWT. Closeness to Allah SWT improves a person's behavior, and they have a lower intention to commit fraud (Said, Alam, et al., 2018b, 2018a). Hayati & Amalia (2021) explain TPB that religiosity can strengthen the excellent behavior of local government employees so that employees have a low intention to commit fraud. So, religiosity is in line with TPB, especially in reducing the intention to commit fraud.

Furthermore, leaders with good ethics can be role models for their subordinates (Dion, 2008; Nawawi et al., 2017). Subordinates' obedience to the leader means they will do the same, namely act according to ethics and behave well so that their intention to commit fraud will also decrease (Wicaksono & Urumsah, 2017). Having a leader with good ethics can impact the organization he leads, especially in preventing the intention to commit fraud (Wardah et al., 2022).

Meanwhile, local wisdom creates a positive culture within the organization (local government) (Aditya & Hapsari, 2020). Noble local wisdom creates a good environment and habits, and of course, will influence the emergence of good behavior so that employees do not have the opportunity to commit fraud (Said, Omar, et al., 2018; Soehari et al., 2020). In line with TPB, local wisdom also influences the intentions of government employees, especially in suppressing the intention to commit fraud (Tarjo et al., 2024).

Finally, FRM can be a guideline for local governments to prevent fraud (Sunarti et al., 2020). FRM provides a complete strategy to prevent, detect, and respond to potential fraud. Implementing FRM will reduce the intention of local government employees to commit fraud (Tarjo, Anggono, et al., 2021). Of course, FRM can have an essential role in preventing fraudulent intentions so that employees do not commit fraud (Tarjo et al., 2024). Thus, TPB is suitable for use in this research model.

2.1.2. Fraud Risk Management

COSO developed FRM guidelines that can be applied in various organizations (COSO, 2016). COSO's five FRM principles are Fraud Risk Governance, Fraud Risk Assessment, Fraud Control Activity, Fraud Investigation and Corrective Action, and Fraud Risk Management Monitoring Activities (COSO, 2016). Fraud Risk Governance regulates environmental control and a code of ethics. Fraud Risk Assessment functions to assess potential fraud while designing prevention, detection, and response systems. Fraud Control Activity regulates the organization's internal controls. Fraud Investigation and Corrective Action play a role in investigating and correcting every FRM decision and principle already in effect. Lastly, Fraud Risk Management monitors all Fraud Risk Governance activities, Fraud Risk Assessment, Fraud Control Activity, and Fraud Investigation and Corrective Action. Research by Tarjo et al. (2021a) shows that all FRM principles developed by COSO can be applied to prevent fraud in local governments.

The FRM framework prepared by COSO in 2016 is significantly different from several other frameworks, such as Enterprise Risk Management (COSO, 2017), internal control (COSO, 2013), and the risk management framework developed by ISO 31000 (ISO, 2018), It is also different from that developed by ACFE, namely the fraud risk management framework (ACFE, 2020). Therefore, the FRM framework from COSO is unique and suitable for preventing fraud.

Other COSO frameworks, such as Enterprise Risk Management and internal control, differ on the risk side. These three frameworks have five main components that are almost the same. Enterprise Risk Management and internal control have five similar components, namely the control environment, risk assessment, control activities, information and communication, and monitoring (COSO, 2013, 2017). In contrast to FRM, which adds elements of fraud to its five components, it becomes Fraud Risk Governance, Fraud Risk Assessment, Fraud Control Activity, Fraud Investigation and Corrective Action, and Fraud Risk Management Monitoring Activities (COSO, 2016). So, the COSO FRM framework emphasizes the risk elements that lead to fraud.

The difference is also seen in ISO 31000, which only focuses on the risk side but has not yet addressed fraud cases and their follow-up. The components of ISO 31000 consist of components, namely principles, frameworks, and processes. Principles are more directed at creating and protecting value. Frameworks help organizations integrate Risk Management into significant activities and functions. Finally, the process of systematic application of policies, procedures, and practices for communication and consultation activities, setting context, assessing, handling, monitoring, reviewing, documenting, and reporting risks. It can be seen that the components of ISO 31000 only focus on the risks faced by the organization but do not lead to fraud risks.

The FRM framework developed by ACFE is also different. ACFE developed FRM based on ISO 31000 and Enterprise Risk Management, which gave rise to three main components, namely prevention, detection, and investigation (ACFE, 2020) . Although overall, it is almost the same as the FRM framework from ACFE, the FRM from COSO is more complex and complete than that of ACFE.

2.2. Hypothesis Development

2.2.1. Religiosity and Fraud Risk Management

Religiosity is related to a person's belief in God. In Islam, the highest trust is in Allah SWT (Sham & Yusof, 2015). This belief underlies a person's behavior, whether good or bad. Singhapakdi et al. (2013) argue that belief in God can make a person's behavior wiser and more ethical. Religiosity can also increase the ethical component in FRM (Sabău, 2013). Sunarti et al. (2020) prove that implementing religiosity into FRM can increase strength.

Based on the TPB, religiosity can make FRM run well. Applying religiosity and FRM in local government has the same goal: preventing fraudulent intentions from appearing within the organization. The existence of religiosity can cover FRM's weaknesses, namely on the ethical side. Good religiosity will create good ethics as well. Thus, religiosity can be an additional factor that can be applied to FRM so that FRM performance increases. It can be concluded that religiosity will positively influence the implementation of FRM in local government. Therefore, the hypothesis developed is:

H1. Religiosity has a significant positive effect on FRM.

2.2.2. Leadership Ethics and Fraud Risk Management

Ethics has a close relationship with FRM (COSO, 2016). FRM provides various strategies to improve ethics, one of them being the improvement of the code of ethics (KPMG, 2014). However, the application of ethics in FRM can be said to be less effective (Siregar & Tenoyo, 2015). The reason why FRM still needs to be more effective is because it only focuses on employees. Good ethics must be applied by the leader (Dion, 2008). The good and bad of a leader's ethics will determine the effectiveness of implementing FRM. This argument is also supported by the Indonesian fraud survey, which found that the cause of poor fraud prevention is leaders who cannot be role models (ACFE, 2019). So, it is clear that leadership ethics will influence FRM performance.

Several studies argue that leadership ethics can improve FRM performance (Harahap et al., 2021; Mu & Carroll, 2016; Nawawi et al., 2017). Meanwhile, Sunarti et al. (2020) prove that a leader's good ethics can increase the effectiveness of FRM. From the TPB's point of view, a leader's ethics can influence the ethics of his subordinates and ultimately result in the intention to commit fraud. Leadership ethics play a crucial role in determining the effectiveness of FRM. Leadership ethics can also cover FRM's weaknesses in the ethics section because it only focuses on the code of ethics. Therefore, leadership ethics can have a positive impact on FRM. Therefore, the hypothesis developed is:

H2. Leadership ethics has a significant positive effect on FRM.

2.2.3. Local Wisdom and Fraud Risk Management

Local wisdom refers to the culture and behavior of individuals. It emerges from an early age and remains embedded into adulthood (Djasuli, 2017). Local wisdom influences a person's ethics (Kazemian et al., 2018). It can also improve FRM performance (Chowdhury & Shil, 2019; Dzomira, 2015; Harahap et al., 2021). Local wisdom has become ingrained since childhood and is subconsciously ingrained in the human mind. Noble and good local wisdom will cause individuals to act more wisely.

Based on the TPB, noble local wisdom will influence the intention to do something, one of which is not intending to commit fraud and tending to have the intention to do good. Habits from local wisdom make someone always try to have good ethics. The impact of local wisdom is that it can improve and strengthen FRM. Besides that, local wisdom has the same role as religiosity and leadership ethics, perfecting the FRM components and incredibly individual behavioral issues. So, local wisdom has a positive effect on FRM. Therefore, the hypothesis developed is:

H3. Local wisdom has a significant positive effect on FRM.

2.2.4. Fraud Risk Management and Financial Fraud Prevention

FRM is designed to improve the fraud prevention system (COSO, 2016). The fraud prevention section of FRM will focus on the proactive identification and assessment of fraud risks and appropriate steps to overcome these risks. Apart from that, fraud prevention is the first line of defense against fraud in an organization and generally includes policies, procedures, training, and communication (COSO, 2016). FRM can also be a solution to mitigate fraud in the government sector (Chepkoech & Rotich, 2017; Jackson, 2013; Yang & Lee, 2020). Several studies also argue that FRM has a positive impact on preventing financial statement fraud (Denziana, 2015; Petraşcu & Tieanu, 2014; Siahaan et al., 2019; Sow et al., 2018).

Based on the TPB, the existence of FRM can reduce the intention of local government employees to commit fraud, making it suitable for preventing fraudulent financial reports. Implementing FRM can increase the effectiveness of the fraud prevention system. The better the implementation of FRM, the better the prevention of fraud in local government. So, it can be concluded that FRM has a positive effect on preventing fraud in financial reports. Therefore, the hypothesis developed is:

H4. Fraud risk management has a significant positive effect on preventing fraud in financial reports.

2.2.5. Religiosity, Leadership Ethics, Local Wisdom, Fraud Risk Management, and Prevention of Financial Report Fraud

Behavior is the main problem that causes all strategies implemented to prevent fraud to be less effective (ACFE, 2019, 2022). Several ways that can be done to improve behavior are by increasing religiosity, leadership ethics, and local wisdom (Dion, 2008; Sunarti et al., 2020; Tuhin et al., 2020). These three components can also improve performance in preventing financial report fraud (Bakri et al., 2017; Said et al., 2017; Said, Alam, et al., 2018a; Said, Omar, et al., 2018). Thus, religiosity, leadership ethics, and local wisdom can help prevent fraud in financial reports.

On the other hand, behavior must be addressed because another problem that is no less important is weak internal control (ACFE, 2019, 2022). Internal control is also caused by the bad behavior of government employees and the inappropriate implementation of internal control. COSO recommends FRM as a replacement for the internal controls implemented because FRM is designed to mitigate all types of fraud (COSO, 2016). The results show that FRM is suitable for eradicating fraud and is a support system for preventing financial statement fraud (Chepkoech & Rotich, 2017; Jackson, 2013; Yang & Lee, 2020). FRM also has weaknesses in ethical behavior (Siregar & Tenoyo, 2015). However, this weakness can be covered by religiosity, leadership ethics, and local wisdom (Chowdhury & Shil, 2019; Mu & Carroll, 2016; Sabău, 2013). Several studies also found that religiosity, leadership ethics, and local wisdom can improve FRM performance and prevent financial report fraud (Kazemian et al., 2018; Nawawi et al., 2017; Sunarti et al., 2020).

Based on the argument that religiosity, leadership ethics, and local wisdom require FRM to increase the effectiveness of financial fraud prevention, FRM needs the support of all three to cover its weaknesses. This argument is in line with research by Sunarti et al. (2020), which shows that FRM has a role in mediating the influence of religiosity, leadership ethics, and local wisdom on preventing financial report fraud. From the TPB point of view, religiosity, leadership ethics, local wisdom, and FRM aim to reduce and prevent employees from intending to commit fraud, such as fraudulent financial reports.

Thus, FRM can be a mediator of religiosity, leadership ethics, and local Wisdom to increase the prevention of financial report fraud. Religiosity, leadership ethics, and local Wisdom positively impact the implementation of FRM. On the other hand, implementing FRM makes the fraud prevention system for financial reports better and more effective. So, it can be concluded that religiosity, leadership ethics, and local Wisdom indirectly influence fraud prevention through FRM. Therefore, the hypothesis developed is:

H5a. Religiosity has an indirect influence on preventing financial statement fraud through FRM.
H5b. Leadership ethics has an indirect influence on preventing financial report fraud through FRM.
H5c. Local Wisdom has an indirect influence on preventing financial report fraud through FRM.

3. Introduction Research Method

3.1. Research Data

The research method used in this research is quantitative, with a questionnaire as research data. The questionnaire was distributed to local governments throughout Madura-Indonesia. The sampling technique used purposive sampling with categories such as (1) department heads of all local governments throughout Madura, (2) internal auditors of local governments throughout Madura, and (3) staff working in local governments throughout Madura.

This study distributes questionnaires directly to respondents and does not use online questionnaire distribution. This research refers to the research of Said, Alam, et al. (2018b) , which makes the entire number of questionnaires distributed as the research population. Furthermore, only respondents who complete the questionnaire will be the final data and research sample.

3.2. Data Analysis Techniques

The research uses Structural Equation Modeling-Partial Least Square (SME-PLS) to answer the hypothesis. The statistical tool used is WarpPLS 7.0. Two stages are used to test data and models: outer and inner (Kock, 2020).

The outer model is a stage that ensures that the data is valid and reliable. Outer consists of several tests, including convergent validity, discriminant validity, composite reliability, and Cronbach alpha (Kock, 2020). Convergent validity is obtained from the loading factor value and Average variance extracted (AVE). The alpha loading factor limit is 0.4 (Chin, 2010; Rasoolimanesh et al., 2015) and the AVE is 0.5 (Kock, 2020). Discriminant validity uses the square root value of AVE. The square root value of AVE must be greater than the value between variables for the data to be said to be valid in discriminant validity. Composite reliability and Cronbach alpha are reliability tests, and each has a value requirement of 0.7.

The inner model is the stage after the entire outer model has been qualified. The inner model consists of four tests, namely goodness of fit model, R-square, Q-square, and hypothesis testing (path coefficient) (Kock, 2020). The goodness of fit model has ten tests that serve to test how fit the research model is. R-square serves to see how much influence the independent variable has on the dependent. Q-square to test the accuracy of the research model. Finally, the path coefficient is used to test the research hypothesis. This research model is as follows:

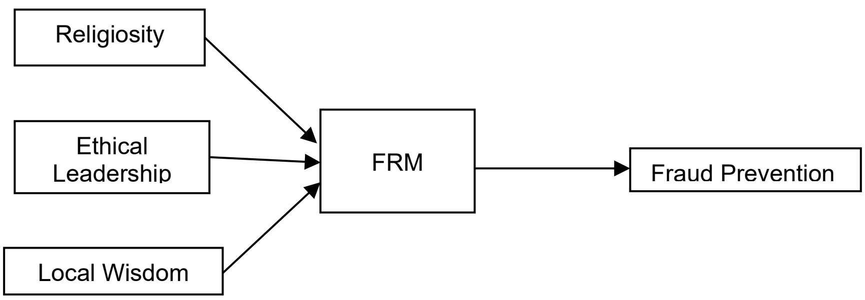

Figure 1: Conceptualization of hypotheses

3.3. Variable Measurement

The dependent variable in this research is financial fraud prevention. Fraud prevention is related to how local governments, such as codes of ethics, separation of duties, monitoring, and others (Singal et al., 2019). So, the number of questions used to measure fraud prevention is five questions.

There are three independent variables in the research, namely religiosity, leader ethics, and local wisdom. Religiosity refers to how employees carry out their worship, such as praying five times, reading the Koran, and carrying out the sunnah taught by the prophet (Said, Alam, et al., 2018b). So, religiosity with a total of 3 questions. Furthermore, leader ethics is a leader who always upholds ethical values and integrity and can be a role model for his subordinates (Said, Alam, et al., 2018b). Thus, there are three questions for leader ethics. Finally, local wisdom includes honest culture, democracy, integrating local wisdom into the organization (Upadhyay & Kumar, 2020). Therefore, local wisdom has four questions.

The mediating variable is FRM. FRM has five main components: Fraud Risk Governance, Fraud Risk Assessment, Fraud Control Activity, Fraud Investigation and Corrective Action, and Fraud Risk Management Monitoring Activities (COSO, 2016; Yang & Lee, 2020). Each of these five components has one question representing it, so the total number of questions for FRM is five. This study uses a Linkert scale from one (strongly disagree) to five (strongly agree).

4. Results and Discussion

4.1. Results

4.1.1. Research Sample

The objects of this research are all staff and heads of departments/Regional Apparatus Organizations (OPD) throughout Madura. Madura has four districts, namely Bangkalan, Sampang, Pamekasan and Sumenep. Based on the survey that was conducted, this research has succeeded in distributing 272 questionnaires. This population will be this study's population (Said, Alam, et al., 2018b, Omar, et al., 2018). However, 20 respondents still needed to complete the questions provided, so the sample for this study was 252 respondents. The sample of this research can be seen in Table 1 as follows:

Table 1: Selection of research samples

Description	Amount
Circulated questionnaires	272
Elimination	(20)
Total Sample	252
Sample distribution in districts:	
Bangkalan	72
Sampang	39
Pamekasan	42
Sumenep	99

4.1.2. Outer Model

The outer model test consists of two main tests: validity and reliability. The validity test consists of two testing stages: convergent validity and discriminant validity (Kock, 2020). Meanwhile, the reliability test uses composite reliability and Cronbach's alpha values (Kock, 2020).

4.1.2.1. Convergent Validity

The convergent validity test uses factor loading values and Average Variance Extracted (AVE) (Kock, 2020). Based on the tests in Table 2, the religiosity variable has a loading factor value of 0. 851, 0.815, 0.827, and an AVE of 0.691. Leader ethics with a loading factor of 0.860, 0.778, 0.781, and an AVE of 0.651. Local wisdom has a loading factor of 0.754, 0.803, 0.851, 0.707, and an AVE of 0.609. Turning to the mediating variable, namely FRM has a loading factor of 0.768, 0.809, 0.810, 0.673, 0.608, and an AVE value of 0.545. Finally, the dependent variable of this study, namely fraud prevention, has a loading factor of 0.753, 0.838, 0.818, 0.718, 0.729, and an AVE value of 0.597. This comprehensive research ensures that all loading factor tests are greater than 0.4 and AVE> 0.5, instilling confidence in the validity of our results. These results prove that the convergent validity test is a fit.

Table 2: Convergent Validity Test, Composite Reliability, and Cronbach's Alpha

Variable	Question	Factor Loading	AVE	Composite Reliability	Cronbach's Alpha
Religiosity	R1	0.851			
	R2	0.815	0.691	0.870	0.776
	R3	0.827			
Leadership ethics	EL1	0.860			
	EL2	0.778	0.651	0.848	0.731
	EL3	0.781			
Local Wisdom	LW1	0.754			
	LW2	0.803	0.609	0.861	0.784
	LW3	0.851			
	LW4	0.707			
FRM	FRM1	0.768			
	FRM2	0.809	0.545	0.855	0.787
	FRM3	0.810			

	FRM4	0.673			
	FRM5	0.608			
Fraud Prevention	Prev1	0.753			
	Prev2	0.838			
	Prev3	0.818	0.597	0.881	0.830
	Prev4	0.718			
	Prev5	0.729			

4.1.2.2. Discriminant Validity

The discriminant validity test compares the square root value of AVE with the correlation value between constructs (Kock, 2020). The condition for accepting discriminant validity is when the square value of AVE is greater than the correlation value between constructs (Kock, 2020). Based on the results in Table 3, religiosity has an AVE square root of 0.831, which is greater than 0.466, 0.205, 0.420, and 0.484. Leader ethics has an AVE square root value of 0.807, which is greater than 0.466, 0.465, 0.248, and 0.236. Local wisdom has an AVE square root of 0.781, which is greater than 0.205, 0.465, 0.154, and 0.162. FRM has an AVE square root of 0.738, which is greater than 0.420, 0.248, 0.154, and 0.046. Fraud prevention, as the last variable, has an AVE square root of 0.773, which is more significant than 0.484, 0.236, 0.162, and 0.046. Based on the test results, the square root value of AVE> the correlation value between constructs.

Table 3: Discriminant Validity Test

	Religiosity	**Leadership Ethics**	**Local Wisdom**	**FRM**	**Fraud Prevention**
Religiosity	(0.831)	0.466	0.205	0.420	0.484
Leadership ethics	0.466	(0.807)	0.465	0.248	0.236
Local Wisdom	0.205	0.465	(0.781)	0.154	0.162
FRM	0.420	0.248	0.154	(0.738)	0.046
Fraud Prevention	0.484	0.236	0.162	0.046	(0.773)

4.1.2.3. Reliability Test

The reliability test uses composite reliability and Cronbach's alpha (Kock, 2020). Based on the test results in Table 2, the composite reliability value for religiosity is 0.870, leader ethics is 0.848, local wisdom is 0.861, FRM is 0.855, and fraud prevention is 0.881. On the other hand, the Cronbach alpha value for religiosity is 0.776, leader ethics is 0.731, local wisdom is 0.784, FRM is 0.787, and fraud prevention is 0.830. So, all variables have met the requirements of composite reliability and Cronbach alpha of 0.7.

4.1.3. Inner Model

The inner model test consists of four main tests: goodness fit model, r-square, q-square, and path coefficient. Following are the results of each inner model test:

4.1.3.1. Goodness Fit Model

The goodness-of-fit model consists of ten tests and aims to test whether the model used is proper or fit. Based on the goodness of fit test results in Table 4, APC has a p-value of 0.001 < 0.05, ARS with a p-value of 0.001 < 0.05, AARS with a p-value of 0.001 < 0.05, AVIF has a value of 1. 121 <= 3.3, AFVIF has a value of 1.478 <= 3.3, GoF has a value of 0.414 >= 0.36, SPR, RSCR, SSR have a value of 1 >= 0.7, and NLBCDR has a value of 0.875 >= 0.7. Thus, the ten tests met the requirements of the goodness of fit model, so the model is said to be fit.

Table 4. Goodness Fit Model Test

Testing	**Index**	**Value**	**Description**
Average path coefficient (APC)	P<0.05	0.328. P<0.001	Fit
Average R-squared (ARS)	P<0.05	0.276. P<0.001	Fit
Average adjusted R-squared (AARS)	P<0.05	0.268. P<0.001	Fit
Average block VIF (AVIF)	Accepted if <= 5. ideal <= 3.3	1.121	Ideal
Average full collinearity VIF (AFVIF)	Accepted if <= 5. ideal <= 3.3	1.478	Ideal
Tenenhaus GoF (GoF)	Small >= 0.1. Medium >= 0.25. Large >= 0.36	0.414	Large
Sympson's paradox ratio (SPR)	Accepted if >= 0.7. ideal = 1	1	Ideal
R-squared contribution ratio (RSCR)	Accepted if >= 0.9. ideal = 1	1	Ideal
Statistical suppression ratio (SSR)	Diterima jika >= 0.7	1	Accepted
Nonlinear bivariate causality direction ratio (NLBCDR)	Accepted if >= 0.7	0.875	Accepted

4.1.3.2. R-square

The R-square test aims to determine how much influence between variables. The classification of R-square is 0.02 (low), 0.15 (medium), and 0.35 (large). Based on Table 5, the R-square value of religiosity, leader ethics, and local wisdom on FRM is 0.462 with an adj. R-square of 0.451. Meanwhile, the effect of FRM on preventing financial statement fraud is 0.091 with an adj. R-square of 0.085. Thus, religiosity, leader ethics, and local wisdom have a significant influence on FRM and vice versa; the influence of FRM on preventing fraudulent financial statements tends to be small.

4.1.3.3. Q-square

The q-square test aims to see the accuracy of predicting the validity of latent variables. For categories, the q-square value is the same as the category in the R-square test. Based on Table 5, the Q-square value of religiosity, leader ethics, and local wisdom on FRM is 0.467. Meanwhile, the q-square value of FRM to prevent financial statement fraud is 0,091. Thus, the predictive value of religiosity, leader ethics, and local wisdom on FRM is significant. In contrast, the predictive value of FRM in preventing financial statement fraud is negligible.

Table 5. R-square and Q-square Tests

Description	FRM	Fraud Prevention
R-square	0.462	0.091
Adj. r-square	0.451	0.085
Q-square	0.467	0.091

4.1.3.4. Path Coefficient

The path coefficient determines the direct and indirect influence of the developed model. The results of the path coefficient test will be used to answer the hypothesis. Based on Table 6, the direct influence of religiosity, leader ethics, and local wisdom on FRM is <0.001 with positive efficiency. These results indicate that religiosity, leader ethics, and local wisdom significantly affect FRM. Thus, hypotheses 1, 2, and 3 are successfully accepted.

Next, the test results show the effect of FRM on preventing financial statement fraud. Based on Table 6, the significance of FRM in preventing financial report fraud is <0,001 with a positive coefficient value, namely 0.302. Thus, the 4th hypothesis is accepted.

Finally, the results of the mediation test between religiosity, leader ethics, and local wisdom and the prevention of financial report fraud. Based on the results in Table 6, the value of indirect religiosity in preventing financial report fraud is 0.043, meaning that FRM can be a mediator. Furthermore, the indirect value of leader ethics in preventing financial report fraud is 0.046, meaning that FRM is suitable as a mediator. Finally, the value of indirect local wisdom in preventing financial statement fraud is 0.026, meaning there is mediation. So, this research succeeded in answering the 5th hypothesis.

Table 6. Path Coefficient Test

Description	Coefficient	P-value	Decision
R → FRM	0.325	<0.001	Accepted
EL → FRM	0.319	<0.001	Accepted
LW → FRM	0.367	<0.001	Accepted
FRM → Prev	0.302	<0.001	Accepted
R → FRM → Prev	0.098	0.043	Accepted
EL → FRM → Prev	0.096	0.046	Accepted
LW → FRM → Prev	0.111	0.026	Accepted

4.2. Discussion

4.2.1. Religiosity, Leader Ethics, Local Wisdom, and FRM

We found that religiosity, leader ethics, and local wisdom can also increase the implementation of FRM. These results can be seen in Table 6, where religiosity, leader ethics, and local wisdom have small significance values (below alpha) with a positive t count. Other evidence can be seen from the results of respondents who tend to answer "strongly agree: for the four variables so that all four have a positive relationship. Thus, this study accepted hypotheses 1, 2, and 3.

The results of this research align with research that argues that religiosity can improve the components of FRM, especially in the ethics section (Sabău, 2013). Similar results also occur with leader ethics, where leader ethics have a positive effect on FRM (Denziana, 2015; Petraşcu & Tieanu, 2014; Sow et al., 2018). Finally, the findings regarding local wisdom also align with previous research, which states that local wisdom positively affects FRM (Sunarti et al., 2020).

Based on TPB, these results prove that religiosity, leader ethics, and local wisdom can help FRM reduce employee intentions to commit fraud. These three components can help employees improve the organization's behavior and ethics to cover FRM's weaknesses. Thus, applying religiosity, leader ethics, and local wisdom makes stewardship theory work well to increase FRM's application in regional government.

The findings prove that religiosity, leader ethics, and local wisdom are essential in improving FRM. Previously, FRM had a fatal weakness, namely in the Fraud Risk Governance section, especially ethics and integrity issues. This problem must be fixed by improving employee ethics. Some ways that can be done are increasing religiosity, leader ethics, and local wisdom, which are the main foundations for employees to do something. Especially in the case of Madurese people who uphold high religious values, the existence of religiosity, leader ethics, and local wisdom can improve the ethical side and behavior of Madurese people. Therefore, an increase in religiosity, leader ethics, and local wisdom can have a positive impact on the application of FRM in local government, especially in Madura.

4.2.2. FRM and Fraud Prevention

We also found other empirical results, namely that the implementation of FRM had a significant positive effect on fraud prevention. These results are based on Table 6, which shows that the significance value of FRM in preventing fraud is below 5%. Other evidence can also be seen from survey results, which show that the average respondent has a uniform opinion, namely that FRM has been implemented in their organization. Thus, we accepted the fourth hypothesis.

The results of this research align with research that argues that FRM can be a solution to the shortcomings of financial fraud prevention systems (Chepkoech & Rotich, 2017; Jackson, 2013; Yang & Lee, 2020). Several studies also found that implementing FRM can improve financial fraud prevention (Denziana, 2015; Petraşcu & Tieanu, 2014; Sow et al., 2018).

Based on the TPB, implementing FRM can reduce employees' intentions to commit financial report fraud. FRM has five principles specifically designed to prevent fraud, one of which is financial statement fraud. Thus, implementing FRM in local government can improve the system for preventing financial report fraud.

Fraud prevention in Indonesia is a cause for concern (ACFE, 2019). However, Tarjo, Anggono, et al. (2021) show that FRM can be applied in local government. However, the form still does not exist because it is mixed with other programs, so its effectiveness is weak (Ariyanto & Bone, 2020). Therefore, improving FRM is needed to support fraud prevention. With these findings, local governments must immediately implement FRM correctly so that fraud prevention can increase. The reason FRM can increase fraud prevention is that FRM is specifically designed to take action to prevent, detect, and investigate fraud so that fraud can be suppressed. Therefore, FRM is very important for local governments in Madura and even local governments in Indonesia.

4.2.3. Religiosity, Leader Ethics, Local Wisdom, FRM, and Fraud Prevention

Finally, we will describe the main findings of this study. We have three main findings. The first main finding is that implementing FRM can mediate religiosity's influence on fraud prevention. Table 6 shows that the indirect value of religiosity in preventing financial report fraud is below the alpha value (0,05). Increasing religiosity can improve FRM performance. These results also align with research that argues that religiosity can complement the ethical component of FRM (Sabău, 2013). Furthermore, we also found that increasing religiosity based on Islamic values positively impacted fraud prevention. This argument is also supported by previous research such as (Said, Alam, et al., 2018b, 2018a; Said, Omar, et al., 2018). Finally, we found the influence of indirect FRM on religiosity and fraud prevention. The main findings that we managed to obtain are also in line with research that conceptualizes that increasing religiosity can improve FRM performance so that FRM can improve fraud prevention (Sunarti et al., 2020). Thus, hypothesis 5a is accepted.

Our second main finding is that implementing FRM can mediate the influence of leader ethics on fraud prevention. In Table 6, the indirect value meets the requirements. Namely, the p-value is lower than 0.05. Based on our data, the average respondent believes they already have leaders who have good ethics. This argument is in line with previous research, which also agrees that leaders who have good ethics can increase the implementation of FRM while also covering the main weaknesses in implementing FRM (Harahap et al., 2021; Mu & Carroll, 2016; Nawawi et al., 2017).

Furthermore, we also found the positive impact that leader ethics has on the financial reporting fraud prevention system. This finding also aligns with previous research (Maifizar et al., 2020; Soehari et al., 2020). Finally, we find evidence that leader ethics can increase FRM so that FRM can positively prevent financial statement fraud (Table 6). Our main findings are also in line with previous research conducted by Nawawi et al. (2017). Thus, hypothesis 5a is accepted.

Our third and final main finding is that implementing FRM can mediate local wisdom's influence on fraud prevention. In Table 6, it can be seen that the resulting indirect value is lower than 5%. This result is also proven by the average respondent agreeing with the local wisdom questions we asked. This argument aligns with research that argues that organizational and local wisdom can increase fraud prevention (Said, Omar, et al., 2018). Apart from that, a comfortable work environment can also increase the effectiveness of implementing FRM. This argument also aligns with previous research (Chowdhury & Shil, 2019; Dzomira, 2015; Hess & Cottrell, 2016; Sabău, 2013). Finally, we succeeded in answering all the hypotheses developed in the research.

Based on the previous relationship, each variable we tested had a close relationship. Finally, the hypothesis we developed can be answered by these final findings. We found that FRM was successful as a mediator, so we succeeded in finding that local wisdom can increase FRM, and the impact of increasing FRM caused by local wisdom also has a positive effect on fraud prevention. Our final findings align with previous research (Sunarti et al., 2020). These results prove that TPB is essential in supporting the models and theories used in this research. The combination of religiosity, leadership ethics, and local wisdom with FRM makes local government employees not intend to do it. The low intention to commit fraud (fraudulent financial reports) has improved the effectiveness of the financial fraud prevention system in dealing with fraud.

Based on the above arguments, the implementation of FRM in local governments requires a significant contribution from religiosity, leader ethics, and local wisdom. The three play an essential role in patching up the shortcomings of FRM in terms of ethics. Therefore, religiosity, leader ethics, and local wisdom have a direct effect on increasing FRM. The increase in these five components of FRM after the inclusion of ethical elements causes FRM to be more effective and has a positive impact on the fraud prevention system. So, religiosity, leader ethics, and local wisdom have an indirect effect on prevention through FRM.

5. Conclusions and Recommendations

5.1. Conclusion

Based on the research results and discussions that have been carried out, all data can support all hypotheses developed. The first finding of this research is that religiosity, leader ethics, and local wisdom positively affect FRM. Religiousness plays a role in improving employee good behavior. Leader ethics plays a role in providing examples of good ethics. Local wisdom creates habits of good ethics. These three components complement each other and effectively improve the ethics of local government employees. Increasing the ethics of regional employees can cover the weaknesses of FRM in terms of ethics (code of ethics) so that the implementation of FRM is more effective.

The second finding of this research is that FRM has a positive effect on preventing financial report fraud. FRM itself has five main principles. The five principles regulate organizational environmental control, fraud risk assessment, internal control, investigation, response, corrective action, and monitoring. These functions aim to prevent fraud, such as fraudulent financial statements. This research proves that implementing FRM in regional government is good enough to increase financial fraud prevention.

Finally, the third or main finding of the research is that religiosity, leader ethics, and local wisdom indirectly influence fraud prevention through FRM. The results prove that religiosity, leader ethics, and local wisdom positively impact FRM while implementing FRM improves the fraud prevention system for financial reports. Thus, religiosity, leadership ethics, and local wisdom indirectly prevent fraud in financial reports through FRM. So, increasing ethical factors (religiosity, leader ethics, and local wisdom) can improve FRM so that the implementation of FRM can improve the fraud prevention system in local governance throughout Madura.

5.2. Implications

The resulting theoretical implications are in the form of additional literature regarding the application of FRM and fraud prevention in local government. More specifically, the results of this study provide empirical evidence that can be used to answer research gaps originating from previous research. These results also provide information to local governments in the form of the actual situation of FRM implementation. Finally, this research also provides research opportunities to be developed further in the future.

The resulting practical implication is the increased application of FRM in local governments. The results of this study can serve as guidelines for local governments to build an ideal FRM so as to increase its effectiveness. In addition, the behavioral side will also increase while implementing religiosity, leader ethics, and sound local wisdom. By utilizing religiosity, ethics, and sound local wisdom, local governments can increase the role of FRM while increasing fraud prevention. The last implication is the decline in fraud cases in local governments because local governments have implemented FRM, which integrates aspects of religiosity, leader ethics, and local wisdom.

5.3. Limitations and Recommendations

The main limitation of this study is that researchers cannot control the potential bias resulting from the survey method. Researchers only visited each agency once in Madura, so potential bias could not be avoided. Of course, this also affected the number of respondents who were not optimal because when researchers visited, several agencies conducted training, so there was some data that researchers did not get. In addition, this study did not include other variables that might affect respondents' answers, such as knowledge, economic conditions, pressure, and other things felt by respondents.

A suggestion for future research is to use mixed methods so that potential bias can be reduced. Mix methods offer a combination of quantitative and qualitative research so that when conducting surveys, researchers can also conduct interviews that are used to prove the results of the questionnaire. Future research can conduct multiple visits so that potential bias and lack of respondents can be resolved. Finally, other variables related to behavior or ethics, such as education, economic circumstances, pressures faced, etc., should be added to increase the accuracy of the research results.

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