Jurnal Riset Akuntansi dan Keuangan

Journal homepage: https://ejournal.upi.edu/index.php/JRAK/

Organizational Ethics Failures in the Financial Reporting of PT Indofarma Tbk.

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ABSTRACT

This study analyzes ethical failures behind financial reporting irregularities at PT Indofarma Tbk using Moral Disengagement, Ethical Infrastructure, and Tone at the Top perspectives. Employing a qualitative descriptive case study, it examines secondary data from the 2024 BPK RI investigative audit, national news, and 2021–2023 annual reports. Findings show that moral disengagement enabled individuals to justify improper revenue recognition, inflated inventories, and misappropriation of funds. Organizational weaknesses such as poor documentation, noncompliance with procurement procedures, ineffective internal controls, and delayed corrective actions created structural gaps that allowed repeated reporting deviations. Furthermore, a weak tone at the top contributed significantly, as leadership failed to enforce ethical standards, ensure governance discipline, and maintain transparency. The interaction of individual, structural, and leadership failures fostered sustained financial manipulation, leading to significant financial deterioration and capital deficiency. This study highlights importance of strengthening ethical governance in state-owned enterprises, especially in regulated sectors like pharmaceuticals.

INFO ARTIKEL

Article History:
Submitted/Received 25 February 2026
First Revised 03 March 2026
Accepted 07 March 2026
First Available online 16 April 2026
Publication Date 29 April 2026

Keyword:
ethical infrastructure; financial reporting; moral disengagement; state-owned enterprises; tone at the top.

1. INTRODUCTION

Financial reporting plays an important role in realizing the accountability and transparency of a company. Financial information must be accurate, reliable, and faithfully represent a company's economic condition so that it can serve as a sound basis for decision-making (Dechow et al., 2010) . From a business ethics perspective, financial reporting is not merely a technical process but also reflects ethical values such as honesty, integrity, and accountability (Treviño et al., 2006). According to Kiradoo (2020) the main purpose of accounting and auditing is to provide the accurate and fair financial status of a company to help stakeholders, and that ethical principles play an important role in maintaining the trust and reputation of an organization. However, ethical dilemmas often arise due to organizational, financial, or political pressures that encourage managers to pursue short-term results. Rossy (2011) notes that falsifying financial records constitutes a breach of fiduciary responsibility, and in such cases individuals may even be tempted to "cook the books" to benefit themselves.

The case of PT Indofarma Tbk reflects this type of ethical failure. The Indonesian Audit Board's Investigative Audit Report (2024) shows that there were instances of revenue recognition that did not match the substance of the transactions, inflated inventory values, and weak documentation of transactions with subsidiaries. The irregularities at PT Indofarma Tbk can be further understood through findings from the investigative audit conducted by the Audit Board of the Republic of Indonesia (BPK RI, 2024), which identified indications of fund misappropriation in subsidiary transactions, including significant amounts that were not properly transferred to the parent company. Such practices contributed to cash flow imbalances and reflected weaknesses in financial control and accountability. In addition, the audit revealed prolonged financial reporting manipulation, including improper revenue recognition and irregularities in procurement activities that potentially resulted in state losses. These findings are consistent with prior studies showing that financial misstatements are often associated with weak internal controls, ineffective monitoring, and opportunistic managerial behavior (Dechow et al., 2010; Agostini et al., 2022). Furthermore, research indicates that poor governance and lack of accountability mechanisms can lead to operational disruptions, including financial distress and failure to meet organizational obligations (Irawan et al., 2025).

The selection of PT Indofarma Tbk as the object of this research is based on the complexity, systemic nature, and academic as well as practical relevance of the case. The findings of BPK RI (2024) indicate that financial reporting irregularities at Indofarma are not merely technical issues but also involve interactions between individual behavior, weaknesses in internal controls, organizational culture, and leadership's inability to maintain reporting integrity. Furthermore, as a state-owned enterprise in the pharmaceutical sector, Indofarma operates under strict regulatory oversight and has a direct impact on public health and public trust. Therefore, ethical failures in such an organization reflect significant governance challenges and underline the importance of maintaining accountability and transparency in financial reporting.

Previous studies on Indonesian state-owned enterprises have largely focused on issues of fraudulent financial reporting and supervisory weaknesses (Achmad et al., 2022). However, research that examines organizational ethics, particularly within state-owned pharmaceutical companies, remains very limited. Furthermore, the integration of moral disengagement

DOI: https://doi.org/10.17509/jrak.v14i1.93441
p- ISSN 2338-1507 e- ISSN 2541-061X

mechanisms, the effectiveness of organizational ethical infrastructure, and tone at the top in analyzing financial reporting irregularities in SOEs, including the pharmaceutical sector, has not been widely explored. Therefore, Indofarma is a relevant and strategic research context for evaluating the relationship between individual behavior, organizational ethics, and leadership in financial reporting accountability failures.

To comprehensively analyze the root causes of these problems, an approach is needed that not only looks at the technical aspects of fraud but also examines moral justification mechanisms, the effectiveness of organizational ethics systems, and the influence of leadership on ethical behavior. Moral Disengagement Theory Theory (Bandura, 1999) explains how individuals can dis s their moral standards through mechanisms such as moral justification, displacement of responsibility, and minimization of consequences. At the organizational level, the Ethical Infrastructure Framework Kaptein (2008) provides a framework for evaluating how elements such as clarity of values, behavioral exemplarity, reporting mechanisms, and the application of sanctions influence the consistency of ethical behavior.

Previous studies have shown that financial reporting irregularities in companies, including state-owned enterprises, are often influenced by individual behavioral factors, weaknesses in organizational ethical infrastructure, and indecisive leadership. According to Achmad et al. (2022), pressure factors, especially external pressures and financial stability concerns play a significant role in driving fraudulent financial reporting within state-owned enterprises. Meanwhile, Sudrajat et al. (2023) report that the potential for fraudulent financial reporting in state-owned enterprises is strongly influenced by "pressure" arising from financial targets and by "ego" manifested through CEO duality, both of which create conditions that allow misrepresentation of financial information. Recent research by Irawan et al. (2025) indicates that stronger governance structures particularly those that enhance oversight functions and managerial accountability are associated with higher financial reporting quality. Patelli & Pedrini (2015) demonstrate that tone at the top plays a crucial role in shaping reporting behavior, as certain leadership-driven linguistic cues are linked to higher levels of financial reporting aggressiveness.

These findings indicate that previous studies have focused on structural and technical issues such as operational pressures, audit mechanisms, or weaknesses in internal controls without explicitly discussing how individual moral justification processes, the effectiveness of ethical infrastructure, and leadership role models interact in shaping reporting quality. In addition, state-owned enterprises in the pharmaceutical sector have different characteristics of control, regulation, and parent-subsidiary structures from those in the construction, energy, and transportation sectors, requiring an analytical approach that considers the dynamics of ethics and organizational behavior more comprehensively

Based on these gaps, this study analyzes financial reporting irregularities at PT Indofarma Tbk through the integration of three perspectives, namely *moral disengagement* mechanisms, the effectiveness of corporate ethical infrastructure, and the role *of tone at the top*. This study seeks to explain how individual behavior, organizational ethical systems, and leadership contribute to reporting accountability failures. The contribution of this study lies in the use of integrated ethical perspectives, namely Moral Disengagement Theory (Bandura, 1999), Ethical Infrastructure (Kaptein, 2008), and Tone at the Top (COSO, 2013) to provide a more comprehensive understanding of reporting irregularities in pharmaceutical SOEs. This approach offers a relevant perspective for examining the relationship between individual

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behavior, organizational ethical structure, and leadership in the context of PT Indofarma Tbk's financial reporting.

LITERATUR REVIEW

Teori *Moral Disengagement*

Moral Disengagement (MD) is an important concept that helps us understand why people who actually have ethical values can cheat or break the rules. According to Moore (2008), drawing from Bandura's Social Cognitive Theory, moral disengagement refers to cognitive mechanisms that allow individuals to disconnect their moral self-sanctions from their behavior, enabling them to act contrary to their moral standards without experiencing self-condemnation Essentially, MD is a form of "self-justification" in which individuals create cognitive reasons that allow them to act harmfully without feeling guilty or criticizing themselves. This separation is very effective because it helps a person maintain their image as a good person, even though they have just committed an ethical violation Structurally, MD consists of eight interrelated ways of thinking, which are grouped into four main focuses, such as how individuals reframe their behavior or how they view their victims (Newman et al., 2020).

The cognitive mechanisms in Moral Disengagement work by shifting the focus away from the moral core of an action, such as when someone justifies a small lie for a greater purpose (Moral Justification) or blames their boss for giving dishonest orders (Displacement of Responsibility). In an organizational context, Moral Disengagement has been shown to be a strong predictor of various negative behaviors, ranging from aggression to workplace deviance. Black et al. (2022) provide empirical evidence that moral disengagement precedes and shapes TPB variables, exerting significant effects on individuals' attitudes, subjective norms, and perceived behavioral control as modeled in ethical decision-making contexts. Therefore, reducing Moral Disengagement in employees or members of an organization is a crucial step in improving ethical intentions and behavior as a whole.

Ethical Infrastructure Framework

The concept of *the Ethical Infrastructure* Framework is a fundamental idea used to review how an organization consciously designs and manages all moral and ethical issues within it. Simply put, ethical infrastructure comprises the organizational elements both formal and informal that contribute to an organization's ethical effectiveness, including communication, surveillance, sanctioning systems, and the supporting ethical climate (Tenbrunsel et al., 2003). The formal elements that make up this framework include visible structures, such as a Code of Ethics, an internal monitoring system, and structured ethics training programs. According to Fernández et al. (2016), informal elements encompass conversations, stories, myths, own language, informal performance rules, and verbal and nonverbal behaviors that reflect the ethical climate and the underlying organizational culture. These two types of elements must work in a balanced and harmonious manner, like a solid foundation, to ensure the ethical effectiveness of the organization.

Tenbrunsel et al. (2003) explain that an ethical infrastructure is developed to enhance an organization's ethical effectiveness by integrating formal and informal systems including communication, surveillance, and sanctioning mechanisms along with organizational climates for ethics, respect, and justice that support ethical behavior. In other words, this infrastructure functions as a navigation system that guides, supports, and also sanctions the

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behavior of members, so that every action is in line with the values set by the company. A clear and effective infrastructure ensures that employees have concrete guidelines that greatly assist them in dealing with complex moral dilemmas in the workplace. A strong infrastructure has been proven to instill the ethical standards needed by organizations to achieve competitive advantage. Therefore, the *Ethical Infrastructure* Framework is a critical determinant in shaping an organizational climate that supports ethical behavior and prevents all forms of misconduct.

The Concept *of Tone at the Top*

In the realm of organizational ethics, moral direction often comes from the top leadership, a phenomenon summarized in the concept *of Tone at the Top*. This important term was first introduced by the Treadway Commission Report in 1987, which placed serious emphasis on the fundamental role of top executives in shaping the corporate ethical climate. *According to* Gunz & Thorne (2015)*,* Tone at the Top refers to the ethical atmosphere created in the workplace by organizational leadership, with the tone set by management exerting a trickle-down effect on employees. Schwartz et al. (2005) emphasize that directors hold overall responsibility for the ethics and compliance programs of the corporation, and the tone at the top that they set by example and action becomes central to the ethical environment of the firm, shaping how employees perceive and respond to ethical issues. Thus, the role of leadership becomes the main moral reference point for all members of the organization regarding the standards of behavior that are valued and permitted.

The managerial implications of Tone at the Top are substantial, as Gunz & Thorne (2015) highlight that the ethical atmosphere established by leadership plays a central role in preventing and detecting unethical conduct, consistent with the Treadway Commission’s findings. When leaders demonstrate high ethical consistency and communicate transparently, employees tend to internalize these practices, while strengthening their trust in the company's commitment to integrity. Conversely, when the tone at the top conveys *conflicting or inconsistent signals*, it can create ambiguity that weakens corporate rules and increases employees’ tendency to engage in noncompliant behavior (Ewelt-Knauer et al., 2022). Thus, *Tone at the Top* is an essential variable that determines the health of an organization's ethical culture, accountability, and overall integrity.

2. METHODOLOGY

The research method used in this study is a descriptive qualitative method with a case study design based on document analysis. This method was chosen because it allows researchers to explore the phenomenon of financial reporting irregularities at PT Indofarma Tbk in depth through credible textual data. (Lambert et al. (2012) state that descriptive qualitative is appropriate for describing phenomena as they are based on factual information in documents A case study approach was used to examine a single organization in depth and understand its internal dynamics, particularly through document-based evidence when direct observation is not feasible (Baxter & Jack, 2015).

The research utilizes secondary data derived from official and publicly available documents relevant to the financial reporting irregularities of PT Indofarma Tbk. The primary data sources include: (1) the 2024 investigative audit report issued by the Audit Board of the Republic of Indonesia (BPK RI), and (2) the company’s annual reports for the 2021–2023 period. This

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p- ISSN 2338-1507 e- ISSN 2541-061X

period was selected because the irregularities were indicated to have occurred during 2021–2022, continued to impact subsequent reporting periods, and were formally identified through the BPK RI investigative audit in 2024. All documents were selected based on their credibility, verifiability, and relevance to the research objectives.

Data collection was carried out using the documentation method by searching, reading, and selecting official and public documents relevant to the PT Indofarma Tbk case. Data analysis was carried out using a combination of content analysis and deductive thematic analysis. Content analysis was used to systematically examine the messages, chronology, and main findings in the documents, as described Bowen (2009) that document analysis includes the process of reading, selecting relevant information, and critically interpreting the content. After that, thematic analysis was conducted deductively, where thematic categories were not constructed from a technical coding process, but were derived directly from three theoretical research frameworks, namely *Moral Disengagement* (Bandura, 1999) *Ethical -Infrastructure* (Kaptein, 2008), and *Tone at the Top* (Gunz & Thorne, 2015; Patelli & Pedrini, 2015). These three theories were used as an analytical framework to organize the document findings into three main themes, namely moral justification mechanisms, the strengths and weaknesses of organizational ethical systems, and leadership commitment to integrity. With this approach, the analysis process produced a thematic interpretation of how these three factors interacted and created conditions that enabled financial reporting irregularities at PT Indofarma Tbk. In interpreting the document findings, this study uses a framework that combines three main theoretical perspectives. Moral disengagement, as described by Bandura (1999), consists of cognitive mechanisms that allow individuals to disengage moral self-sanctions and reframe harmful or unethical conduct so that it appears acceptable or justified. *Ethical infrastructure* Kaptein (2008) explains how the strengths or weaknesses of values, rules, and oversight mechanisms shape organizational ethical behavior. Meanwhile, Tone at the Top reflects leadership commitment and exemplary behavior in maintaining integrity and influencing organizational conduct (Gunz & Thorne, 2015; Patelli & Pedrini, 2015). These three theories are analyzed simultaneously to explain the conditions that opened up opportunities for financial reporting irregularities at PT Indofarma Tbk.

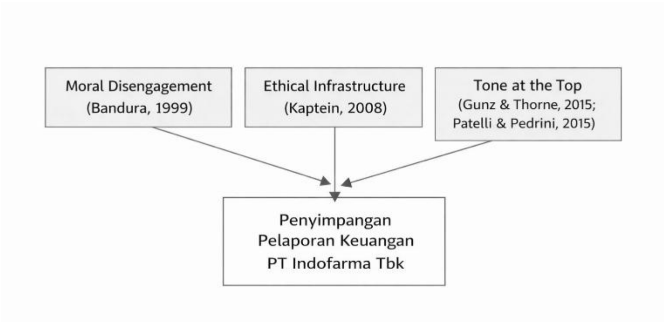

Figure 1. Conceptual Framework.

3. RESULT AND DISCUSSION

Financial Condition of PT Indofarma Tbk in 2021–2023

The consolidated financial performance of PT Indofarma Tbk from 2021 to 2023 shows a very significant and sustained decline. Based on the descriptive statistical analysis presented

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p- ISSN 2338-1507 e- ISSN 2541-061X

in Table 1, total assets decreased substantially from IDR 1.97 trillion in 2021 to IDR 759.83 billion in 2023, representing a decline of 61.6%, with an average value of IDR 1.41 trillion over the three-year period. In contrast, total liabilities slightly increased by 2.1%, indicating growing financial pressure and a more leveraged capital structure. This condition is further reflected in the company's equity, which shifted from a positive IDR 444.79 billion in 2021 to a capital deficiency of IDR 804.15 billion in 2023, with an average deficit of IDR 121.89 billion, indicating a deterioration of 280.8%.

A similar downward trend is observed in operational performance. Net sales declined sharply by 82.0%, from IDR 2.90 trillion in 2021 to IDR 523.60 billion in 2023, with an average of IDR 1.47 trillion. This decline was accompanied by a significant increase in operating losses, averaging IDR 297.59 billion, with a deterioration of 1,115.3% over the period. Furthermore, the company recorded continuous net losses for three consecutive years, with an average loss of IDR 392.89 billion, indicating persistent financial distress and serious operational inefficiencies.

The use of a three-year observation period (2021–2023) is considered representative in describing the company's financial condition, as the descriptive statistics consistently show a downward trend across all key financial indicators, rather than temporary fluctuations. Moreover, the data are derived from audited annual reports, ensuring reliability and validity. Therefore, the results provide a sufficient basis to capture the underlying financial condition of the company. Overall, these findings indicate that the company is experiencing severe financial pressure, which may also reflect broader organizational challenges, including weaknesses in risk management and financial reporting practices.

Table 1. Descriptive Statistical Analysis: Consolidated Financial Performance (2021–2023) *(In millions of IDR, except for Percentages)*

Description	2021	2022	2023	Mean (Average)	Growth/ Decline (%)
Total Assets	1,976,879	1,481,412	759,829	1,406,040	-61.6%
Total Liabilities	1,532,081	1,487,737	1,563,981	1,527,933	2.1%
Total Equity / (Deficiency)	444,798	- 6,325	- 804,152	- 121,893	-280.8%
Net Sales	2,901,987	980,371	523,599	1,468,652	-82.0%
Operating Profit (Loss)	59,434	- 348,750	- 603,461	- 297,592	-1115.3%
Profit (Loss) for the Year	-30.116	- 457,649	- 721,000	- 392,893	2393976.2%
					(loss)

Consolidation Financial Trends

To understand the dynamics of PT Indofarma Tbk's financial performance during the 2021–2023 period, a trend analysis was conducted on four key indicators: total assets, total liabilities, total equity/capital deficiency, and profit performance (net sales, operating profit/loss, and current year profit/loss). Separate graphs were used so that the patterns of change in each indicator could be observed more clearly, avoiding visual distortion due to differences in scale between variables. This analysis provides an overview of the company's financial condition, potential risks, and changes in capital structure over the last three years. The following is a description of financial trends based on each graph.

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p- ISSN 2338-1507 e- ISSN 2541-061X

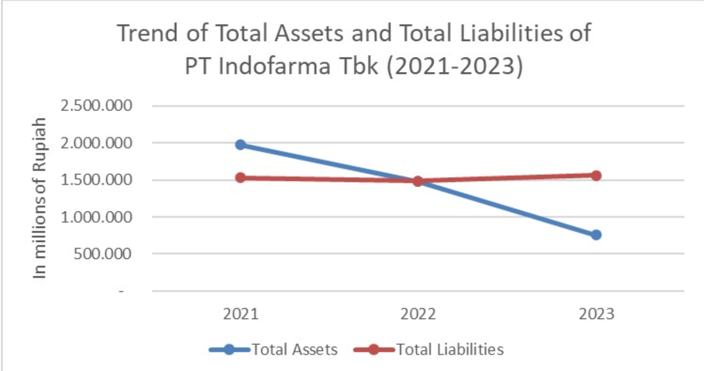

Figure 2. Trend of Total Assets and Total Liabilities

Indofarma's total assets declined sharply from IDR 1.98 trillion in 2021 to IDR 759 billion in 2023. Conversely, total liabilities remained relatively stable and increased again in 2023 to reach IDR 1.56 trillion. This pattern shows that the company's assets have shrunk significantly, while its debt-to-equity ratio remains high, widening the financial structure gap and increasing the risk of inability to meet long-term obligations.

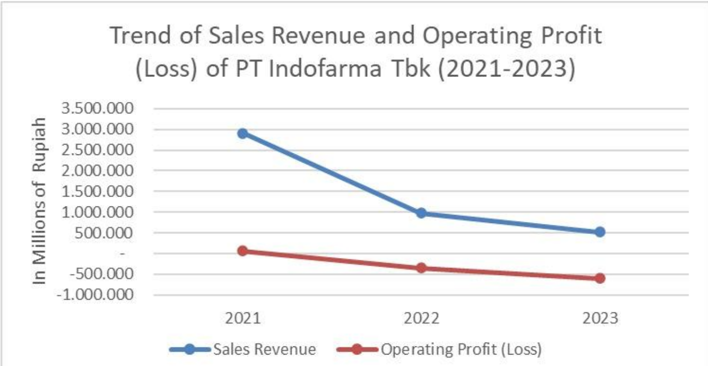

Figure 3. Trend of Sales Revenue and Operating Profit (Loss)

PT Indofarma Tbk's net sales showed a sharp decline from IDR 2.90 trillion in 2021 to IDR 1.00 trillion in 2022, and continued to decline to IDR 0.52 trillion in 2023. This decline in sales capacity was followed by a widening of operating losses, from a profit of IDR 59.4 billion in 2021 to a loss of IDR 348.7 billion in 2022, and worsening further to a loss of IDR 603.5 billion in 2023. This pattern shows that the company not only lost significant revenue, but also failed to contain escalating costs and operational inefficiencies during this period.

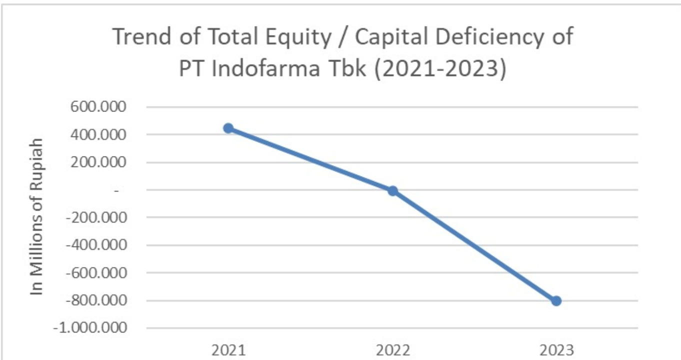

Figure 4. Trend of Total Equity

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PT Indofarma Tbk's total equity has declined dramatically in the last three years. In 2021, equity was still positive at around IDR 442 billion, but fell significantly to only IDR 41 billion in 2022. This condition worsened in 2023 when the company recorded a capital deficiency of IDR 809 billion. This pattern shows that the accumulation of continuous losses has eroded the company's equity to a negative position, reflecting an increasingly high solvency risk.

The Relationship Between Financial Trends and Findings from BPK Investigations

The decline in PT Indofarma Tbk's financial performance during the 2021–2023 period shows a strong relationship with the findings of the 2024 investigative audit conducted by the Audit Board of the Republic of Indonesia (BPK RI). The audit identified several significant irregularities in financial reporting and internal control processes, including revenue recognition that did not reflect the substance of transactions, overstatement of inventory balances, and procurement activities conducted without adequate feasibility studies.

These findings provide a clear explanation for the company's financial trends, such as high accounts receivable, slow inventory turnover, and declining revenue over time. Furthermore, the identified practices indicate that financial statements prior to 2023 did not fully reflect the company's actual financial condition due to reporting distortions. In other words, the financial anomalies observed over the three-year period were the result of accounting practices that deviated from established standards, combined with ineffective internal control systems that failed to detect irregularities at an early stage.

Overall, the BPK RI findings suggest that the financial difficulties experienced by PT Indofarma Tbk were not solely driven by external or operational factors, but were closely associated with persistent reporting irregularities, weaknesses in governance, and ineffective internal control mechanisms.

Organizational Ethics Analysis

Ethical analysis provides an understanding of why reporting irregularities can occur repeatedly. Financial data and investigative findings show that the problem is not only technical in nature but also involves moral justification mechanisms, weaknesses in ethical structures, and ineffective leadership in building a culture of integrity

A. Teori *Moral Disengagement*

Moral Disengagement Theory explains that a person can detach themselves from the moral standards they believe in when committing unethical acts through various cognitive processes, such as providing moral justification, using refined language, shifting responsibility, or downplaying the impact of their actions. Bandura (1999) states that through these mechanisms, internal moral control becomes dulled, allowing perpetrators to commit violations without feeling guilty. In an organizational context, *moral disengagement* is one reason why corruption or report manipulation can occur repeatedly and systematically. According to Moore (2008), moral disengagement allows individuals to *reinterpret unethical conduct as serving legitimate purposes*, which weakens moral constraints and increases the likelihood that such behavior becomes repeated and reinforced in social contexts. According to Ogunfowora et al. (2021) team moral disengagement composition defined as the aggregate mean level of members' propensities to morally disengage leads to *reduced team cooperation*

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and *greater team interpersonal deviance*, both of which undermine team effectiveness. These collective patterns illustrate how morally disengaging tendencies within teams can normalize harmful behaviors, offering insight into how misconduct such as financial reporting manipulation may endure in organizations like PT Indofarma Tbk.

In the case of financial reporting irregularities at PT Indofarma Tbk, the concept of moral disengagement helps explain how internal parties could feel it was "normal" to engage in actions such as recognizing unsubstantiated revenue, inflating inventory, or allowing inappropriate intercompany transactions. Moral justification mechanisms arise, for example, when manipulation is considered an effort to "save the company," while responsibility diffusion mechanisms are seen when employees assume that such actions are merely following orders from superiors or simply carrying out common practices. Newman et al. (2020) show that moral disengagement facilitates unethical or harmful behavior in organizational settings, and its activation is more likely in environments marked by weak or inconsistent ethical norms. Consistent with our findings, Robertson et al. (2021) emphasize that integrity breaches are more likely when organizations are “not equipped to manage integrity issues effectively,” allowing moral disengagement mechanisms to be activated and used to justify harmful conduct. Thus, moral disengagement illustrates that Indofarma's misconduct is not merely a procedural error, but a moral failure exacerbated by dysfunctional leadership and ethical infrastructure.

Empirical evidence also shows that moral disengagement mechanisms play a role in facilitating irregularities at PT Indofarma Tbk. Findings from the Indonesian Audit Board (BPK RI, 2024) indicate that revenue was recorded without a valid transaction basis or without actual delivery of goods, reflecting a form of moral justification in which manipulation is perceived as necessary to improve company performance. In addition, inventory values were overstated beyond actual conditions, indicating a distortion of consequences where the negative impact on financial statements was minimized or ignored.

The audit also revealed irregularities in subsidiary transactions, including significant funds that were not properly transferred, which may reflect a displacement of responsibility through unclear accountability among involved parties. Furthermore, the persistence of such irregularities over multiple periods suggests the normalization of unethical practices, a common characteristic of moral disengagement in organizational settings where unethical behavior becomes embedded in routine operations.

B. *Ethical InfrastructureFramwork*

The *Ethical Infrastructure* Framework explains that ethical behavior in organizations is formed from a combination of formal systems, informal mechanisms, work culture, and leadership roles. Kaptein (2008) explains that an organization’s ethical behavior is shaped by both its *ethics program* which includes formal elements such as rules, codes of conduct, reporting mechanisms, monitoring, and sanctions and its *ethical culture*, which is reflected in leadership role modeling and the norms that guide employees’ everyday conduct. In the context of the public sector, research Demir et al. (2023) shows that ethical infrastructure rests on four main components: awareness and knowledge**,** enforcement of rules**,** incentives, and policy support**.** All four are necessary to ensure that ethical behavior can be sustained consistently.

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Other studies emphasize the importance of aligning formal elements of an ethics program such as codes of conduct, training, and reporting mechanisms with informal elements such as organizational culture, everyday interactions, and leadership example. Fernández et al. (2016) note that these informal cultural elements often exert substantial influence on how ethical norms are interpreted and enacted by employees in practice. White et al. (2000) add that ethical failures usually occur when organizations fail to provide three things simultaneously, namely means (clear rules and procedures), motivation (values and incentives that encourage ethical behavior), and opportunity (minimal structural loopholes that can be exploited for unethical behavior).

The case of PT Indofarma Tbk shows that financial reporting irregularities are not only caused by individual actions but also reflect systemic failures in the organization's ethical infrastructure. The BPK's findings regarding revenue manipulation, weak documentation, and ineffective supervision illustrate the weakness of enforcement and internal controls that should prevent violations. This situation is exacerbated by a weak ethical culture, such as a lack of open communication, minimal leadership role modeling, and non-transparent evaluation processes, so that formal rules are not translated into actual behavior. When viewed through the "*means motivation opportunity*" model, procedural loopholes, pressure to achieve targets, and weak supervision provide room for manipulation practices to become habitual. Thus, the ethical failures at Indofarma can be understood as a weakness in the overall ethical infrastructure that should be the foundation of financial reporting integrity.

The BPK's findings show that the ethical infrastructure at PT Indofarma Tbk is not functioning as it should. The BPK noted that many transactions were not accompanied by adequate supporting documentation, indicating the absence of formal controls, which are a core element of *ethical infrastructure*. The procurement process for medical equipment, which did not go through a feasibility study, also shows that the policies and procedures that should govern organizational behavior are not being implemented consistently. In addition, the internal control system proved incapable of detecting significant irregularities, as various anomalies were only revealed after the BPK conducted an investigative audit, indicating that the internal audit, reporting, and sanction enforcement mechanisms were not functioning effectively. Losses that were not reasonably reflected in the period prior to 2023 further demonstrate the failure of the internal reporting system to provide accurate and reliable information. These conditions are consistent with Kaptein's concept that when the mechanisms of values, reporting, and sanctions within an organization are not functioning or are not being adhered to, the risk of ethical deviations increases significantly.

C. *The Tone at the Top Concept*

The concept of *tone at the top* refers to the moral values, integrity, and ethical standards established and exemplified by top leadership. The literature confirms that the quality of internal control and financial reporting is largely determined by how leaders demonstrate their ethical commitment. Lail et al. (2015) state that *tone at the top* creates an ethical atmosphere and culture that influences all levels of the organization and plays a major role in determining the level of transparency in financial reporting. Furthermore, leadership integrity has been shown to be a critical determinant of effective governance and control systems (Gunz & Thorne, 2015). Research Patelli et al. (2015) even found that the CEO's communication style, which reflects his or her leadership character, is directly related to reporting aggressiveness; complex, rigid, or closed language tends to be associated with riskier reporting practices. Overall, these studies show that the attitudes, behaviors, and

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moral messages of leaders are not merely symbolic, but are real factors that can encourage or deter accounting fraud.

In the case of financial reporting irregularities at PT Indofarma Tbk, the concept *of tone at the top* helps explain that weak ethical commitment from leaders opens the door to income manipulation, inventory inflation, and poor transaction documentation. Pickerd et al. (2014) show that *tone at the top* will not be effective if it is not consistently carried through to lower levels of management. When senior leaders demonstrate weak ethical standards, staff tend not to see the issue as a moral one and are more likely to deviate from reporting standards. This situation was evident at Indofarma, where the irregularities that occurred were not only technical problems but also reflected the fragile ethical commitment of top management and the failure of ethical role modeling throughout the organization. When leaders do not uphold the value of integrity, internal control systems, even if formally in place, are unable to prevent manipulation. Therefore, *tone at the top* is a key element in understanding why irregularities at Indofarma can continue to recur and develop into systemic problems.

Findings related to leadership roles also reveal weak *tone at the top* at PT Indofarma Tbk. Corrective actions were only taken after the BPK findings, not on internal initiative, indicating that leaders were not proactive in maintaining integrity and governance. Long-standing irregularities without intervention mean that ethical standards were not consistently enforced by top management. The inability to control subsidiaries, including the failure to deposit Rp470 billion by IGM without immediate action, further indicates weak ethical leadership, resulting in ineffective control at lower levels. The drastic deterioration in financial trends from positive equity of Rp444 billio)

n in 2021 to negative Rp804 billion in 2023 also shows that leadership has failed to ensure oversight, transparency, and accountability. Overall, this situation is in line with the concept *of tone at the top*, which emphasizes that the quality of internal controls and ethical behavior within an organization is largely determined by the commitment, leadership, and actions of top management.

Synthesis and Implications of Finding

PT Indofarma Tbk's financial performance throughout 2021–2023 shows a significant decline in almost all key indicators. This condition not only illustrates operational challenges but also hints at long standing governance and ethical issues. The company's assets shrank sharply from IDR 1.97 trillion in 2021 to IDR 759.83 billion in 2023, while liabilities remained high, resulting in a huge capital deficiency of IDR -804.15 billion. The drastic decline in revenue and increasing operating losses show that the company has lost its ability to generate strong cash flow and manage risk. This consistent downward trend confirms that Indofarma's problems cannot be explained solely by operational or market factors, but are more related to fundamental failures in *governance*, reporting integrity, and internal control effectiveness.

Viewed through the lens of *Moral Disengagement Theory*, increasingly depressed financial conditions create an environment that allows management to use various mechanisms of moral justification. When the company lost equity in 2022 and faced a massive capital deficiency in 2023, some individuals within the organization began to believe that the irregularities were committed in order to "save the company," carry out orders from superiors, or simply make minor adjustments. Moore (2008) shows that moral disengagement works by restructuring detrimental conduct, minimizing responsibility, and distorting

DOI: https://doi.org/10.17509/jrak.v14i1.93441
p- ISSN 2338-1507 e- ISSN 2541-061X

consequences, thereby allowing unethical or manipulative behavior to appear acceptable. Such mechanisms help explain how long-term practices like inflated inventory values or unsupported revenue entries can persist within organizations.

From an *Ethical Infrastructure* perspective, Indofarma's financial decline reflects that the company's formal and informal ethical systems are not functioning as they should. Ideally, ethical infrastructure includes rules, reporting mechanisms, sanction systems, training, a culture of discussion, and leadership role models. However, the BPK's findings regarding weak documentation, the absence of procurement reviews, and invalid revenue recording indicate that these components are not functioning effectively. When rules are not enforced and oversight is weak, organizations enter a state that Kaptein (2009) refers to as *ethical vulnerability*, which is a high level of susceptibility to moral misconduct. This situation is consistent with the trend of declining assets and increasing losses, which shows that the ethical structure and internal controls have failed to prevent dysfunctional behavior.

Tone at the Top also provides an important explanation regarding the link between Indofarma's financial condition and ethical failures. Declining performance and significant capital deficiencies reflect the weak ethical commitment of top leadership in maintaining reporting integrity and ensuring effective internal controls. Prior studies emphasize that the effectiveness of internal control systems is closely linked to leadership integrity and ethical conduct, where weak ethical signals from top management increase the risk of manipulation and control failure (Ewelt-Knauer et al., 2022; Gunz & Thorne, 2015). Research by Patelli et al. (2015) found that the CEO's communication style influences reporting aggressiveness, and Pickerd et al. (2014) emphasizes that tone at the top must be consistent down to the managerial level. At Indofarma, the financial condition and cases of misconduct indicate that ethical messages do not flow well throughout the organization, so misconduct is considered normal or part of daily practice.

Overall, the combination of financial analysis and ethical theory reveals that Indofarma's financial pressures are interrelated with organizational ethical failures. Financial pressures encourage moral disengagement, a dysfunctional ethical infrastructure fails to stop deviations, and a weak tone at the *top* creates space for manipulative practices. These three factors form a negative cycle that is reflected in recurring losses, asset depreciation, and significant capital deficiencies. Thus, Indofarma's financial condition reflects fundamental organizational ethical and *governance* failures, rather than merely the impact of market dynamics or operational challenges.

4. CONCLUSSION

The financial reporting irregularities at PT Indofarma Tbk were proven to be the result of interactions between individual factors, organizational system weaknesses, and leadership roles. At the individual level, *moral disengagement* mechanisms made perpetrators feel it was acceptable to engage in manipulation, such as recording revenue that did not reflect the substance of transactions and inflating inventory. Various forms of moral justification, shifting of responsibility, and reduction of risk perception made such unethical behavior acceptable and ultimately ingrained in the company's activities.

At the organizational level, Indofarma's ethical infrastructure is ineffective. Weak internal reporting mechanisms, a lack of ethical role models, inconsistent sanctions, and weak documentation create an environment that is prone to irregularities. The findings of the

Indonesian Audit Board (BPK RI) and media reports reinforce this condition through evidence of procurement without review, improper revenue recording, and unsubmitted subsidiary funds. These weaknesses indicate that the internal control structure is unable to function as an early warning system or prevent manipulative practices.

On the leadership side, the weak tone at the top has contributed significantly to the continuation of irregularities over the years. Management's indecisiveness in maintaining integrity, inconsistent corrective actions, and a weak ethical culture have rendered the internal control system ineffective. The impact is reflected in Indofarma's decline in assets, capital deficiency, and operational losses in the 2021–2023 period. Overall, this situation shows that the failure of integrated ethics and governance at the individual, organizational, and leadership levels has had a direct impact on the collapse of the company's financial performance.

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