

Does Financial Distress Contribute as an Intermediary Factor in Detecting Financial Statement Fraud ?

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Abstract . This study aims to investigate whether financial distress acts as an intermediary factor in detecting fraudulent financial statements in manufacturing companies listed on the Indonesia Stock Exchange. The purposive sampling method was used to select 105 manufacturing companies during the period 2017-2021. The analysis was conducted using the Outer Smart PLS model to evaluate the relationship between auditor turnover, board turnover, financial targets, ineffective supervision, capability, and financial distress on financial statement fraud. The results confirmed that there was no significant influence between capacity, board turnover, financial targets, ineffective supervision, and financial distress on financial statement fraud. In addition, financial distress also does not mediate the effect of other variables on financial statement fraud. This approach reflects the ethical philosophy in the study that emphasizes honesty, integrity, and transparency in corporate financial reporting. These results highlight the importance of effective supervisory strategies and strong internal controls in preventing and detecting financial statement fraud, regardless of the company's financial distress. This study contributes by exploring the role of financial distress in detecting financial statement fraud. For future research, it is important to investigate additional factors that influence fraud and develop more effective monitoring strategies. Contingency theory emphasizes the importance of contextual factors in organizational management, while Fraud theory pays attention to the motives and driving factors behind fraudulent behavior.

Keywords: Change, Financial Distress, Financial Statement Fraud

Introduction

Financial reports are an important tool for companies, used by internal and external parties as a basis for decision making. Ensuring that financial reports are well presented is a must, because complete and accurate financial information is vital (Widharma & Susilowati, 2020). However, the pressure to show good performance often encourages management to manipulate financial statements (Septriani & Desi Handayani, 2020). (Septriani & Desi Handayani, 2018).. This manipulation involves falsifying data with the aim of misleading readers of financial statements (Tuanakotta, 2010). (Tuanakotta, 2010). Company officials often have the opportunity to commit such fraud. (Hesti Oktaviani, 2022).. Therefore, it is important to identify and prevent these fraudulent practices so that the financial information presented can still be trusted by stakeholders.

Data manipulation in the company's financial statements cannot be identified through several cases. One of them is the case of PT Envy Technologies Indonesia Tbk (ENVY) in 2019, where the alleged manipulation of financial statements was revealed in ENVY's management letter to the Indonesia Stock Exchange (IDX), which explained the problems related to the financial statements of PT Ritel Global Solusi (RGS). Another case was in 2016 at PT Hanson International Tbk (MYRX), where there were allegations of manipulation related to the recognition of land plot sales

revenue worth Rp.732 billion which resulted in overstated December 2016 financial statements of Rp 613 billion, and led to sanctions against the managing director by the Financial Services Authority (OJK). These cases highlight the failure of audits of financial statements, showing the limited function of external auditors in detecting and preventing fraud by company management. Agustina & Pratomo (2019) noted that audits have not been able to maximally detect fraud. To reduce the risk of fraud, companies can pay attention to factors that trigger fraud. According to Rosa & Urumsah, (2021)(2021), auditor turnover, ability, financial targets, and ineffective supervision are triggering factors. Cressey (1986) states that financial reporting fraud is influenced by pressure, opportunity, and rationalization. The Fraud Diamond Theory adds capability as a trigger. Research on financial reporting fraud shows that rationalization, as a justification for fraudulent behavior, can lead to fraud, especially if there are repeated audit failures. (Hidayah & Devi Saptarini, 2019). Changing auditors can also affect the rationalization of fraud, because it causes a transition period within the company. (Aulia Haqq & Budiwitjaksono, 2020)..

Ability, as an act of power and capacity to commit fraud, can be reflected through a change of directors. Changing the board of directors is an effort by the company to improve the performance of the previous directors. (Yulistyawati et al., 2019).. However, the change of directors can also be a tactic to cover up fraud. (Yarana, 2023). Research Suhartono (2020) shows that the change of directors has a positive influence on fraud. Pressure, such as financial targets, can encourage management to commit fraud. Management tries to achieve predetermined financial targets, but sometimes faces obstacles that force them to commit fraud. (Kristianti & Meiden, 2021). Septriani & Desi Handayani (2018) found that financial targets have a negative influence on financial reporting fraud. Opportunities, such as ineffective supervision, can also open up opportunities for fraud. Board of commissioners actions are believed to increase supervision within the company (Abbas & Laksito, 2022).. However, management can take advantage of weak supervisory situations to commit fraud (Purnama & Suryani, 2019). (Purnama & Suryani, 2019). Research also shows that poor finances can be a trigger for fraud. Management may feel pressured to improve the company's financial situation by committing financial statement fraud. (Azizah & Reskino, 2023).. Financial distress is considered an action that can detect fraudulent financial reporting. (Oktaviany & Reskino, 2023; E. R. Utami & Pusparini, 2019).. Overall, efforts to prevent fraudulent financial reporting can be done by paying attention to trigger factors such as rationalization, ability, pressure, opportunity, and the company's financial condition. Effective supervision, transparency in financial reporting, and management integrity are needed to reduce the risk of fraud that harms the company and stakeholders.

The findings of previous studies, as listed in Table 1.2, show the phenomenon of research gaps related to the influence of several actions on fraudulent financial reporting. The effect of rationalization, represented by auditor turnover, on financial reporting fraud has mixed results.

Utami et al. (2022), Wilestari & Fujiana (2021) found an effect, while Rosa Sanjayyana & Urumsah (2021), Setiawan & Trisnawati (2022) concluded that there was no significant effect. The same thing also happens to the effect of capability, represented by changes in directors, on fraudulent financial reporting. Lionardi & Suhartono (2022) found an influence, but research Inayanti & Sukirman (2016) showed the opposite. Furthermore, the effect of pressure, represented by financial targets, on fraudulent financial reporting has different results. Septriani and Handayani (2018) found an influence, while Rosa & Urumsah (2021) found the opposite. Rosa & Urumsah (2021) showed the opposite result. Finally, the effect of opportunity, characterized by ineffective supervision, on fraudulent financial reporting also shows a variety of results. Lutfiana Oktarigusta (2017), Pusphita & Yasa (2018) found an influence, but Rosa & Urumsah (2021) stated otherwise. Poor financial conditions in a company can trigger or accelerate fraudulent practices (Van Driel, 2019). (Van Driel, 2019). When companies face great financial pressures, such as liquidity or ability difficulties to meet financial obligations, management may feel compelled to take unethical or unauthorized actions to avoid failure (Jeremiah Barasa Kabeyi, 2019). (Jeremiah Barasa Kabeyi, 2019).. Financial distress creates circumstances that are vulnerable to fraud. Reurink (2016) because management may feel pressured to alter financial statements to make them look better than they actually are (Ghozali, 2018). (Ghozali, 2018). As a mediator, financial distress connects the independent variables Charlotte Frankham (2020) such as auditor turnover, board turnover, financial targets, and ineffective supervision, with the dependent variable, financial statement fraud (Elbogen et al., 2018). (Elbogen et al., 2020; Hidayah & Devi Saptarini, 2019).. This means that when the independent variables change, their effect on financial statement fraud is mediated by financial distress. According to Musaif, (2023) the mediating role of financial distress partially has a role. Thus, financial distress plays a key role in strengthening the relationship between the independent variables and financial statement fraud, given the urgency it creates in difficult financial situations.

This study aims to fill the knowledge gap in the literature on the factors that influence financial statement fraud and the role of financial distress as an intermediary. By using a sample of manufacturing companies, this study hopes to provide a deeper understanding of how financial distress affects fraud detection. The findings are expected to make important contributions to accounting theory and practice and provide new insights into the prevention of financial statement fraud. This will help stakeholders, including regulators, investors, and company management, improve the effectiveness of fraud monitoring and prevention.

Research Methods

This research is a deductive method to draw conclusions using quantitative methods. The research design uses studies that test hypotheses. The participants in this study are manufacturing

companies listed on the IDX between 2019 and 2022. Purposive sampling was used as a sampling method based on the following criteria: Manufacturing companies present financial reports in rupiah currency, and are consistent in presenting annual reports (Laksmi & Sukirman, 2020). This study used purposive sampling method to select 105 manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2017-2021 period. Of the total 154 companies, 30 companies that presented financial statements in foreign currency (Dollar) and 19 companies that did not present annual financial reports consistently during 2017-2021 were excluded. Thus, in Table 1, the number of samples used is 105 companies, or equivalent to 420 company data for 4 years of observation. The sample determination is based on the criteria set in the sample determination table.

Table 1. Results of Research Sample Data

Data Sample Criteria	Total
Manufacturing companies listed on the Indonesia Stock Exchange (ISE) during the period 2017-2021.	154
Manufacturing companies that present financial statements for the period 2017-2021 in foreign currency (Dollar)	(30)
Manufacturing companies that do not present annual financial reports consistently between 2017-2021	(19)
Sample Quantity	105
Total sample size 105 x 5 years	420

Source: Data processed.

This study examines fraud in financial statements as the main variable, with pressure (financial goals), opportunity (lack of supervision), and ability (new directors) as independent variables, and economic pressure as a mediating variable. (Sugiyono, 2020). The dependent variable is financial statement fraud, which is defined as a report that is false or intentionally made to mislead report users (Haqq, 2019). The Modified Jones Model discretionary accrual formula is used to detect earnings management. (Suripto & Karmilah, 2021).

$$DA_{it} = TAC / A_{it} - NDA_{it} \dots \dots \dots (1)$$

Total Accruals (TAC_{it}) of company i in year t is the difference between the calculation of Net Profit (N_{it}) and Operating Cash Flow (CFO_{it}). TAC is estimated using the following OLS regression equation:

$$TAC / A_{it-1} = 1(1/A_{it-1}) + \beta_2(\Delta Rev / A_{it-1}) + \beta_3(PPE / A_{it-1}) + e \dots \dots \dots (2)$$

Meanwhile, the non-discretionary accrual (NDA) value can be calculated using the formula:

$$NDA_{it} = 1(1/A_{it-1}) + \beta_2(\Delta Rev / A - \Delta Rec_{it-1 it-1} / A) + \beta_3(PPE / A)_{it-1} \dots \dots \dots (3)$$

Where:

- TAC_{it} :Total accruals of company i in period t
 NDA_{it} :Non Discretionary Accruals of company i in period t
 NI_{it} :*Net income* of company i in period t
 CFO_{it} :Cash from company i in period t
 At-1 :Total assets of company i at the end of year t-1
 ΔREV_{it} :Change in company i's revenue year t-1 to year t
 ΔREC_{it} :Change in company i's receivables year t-1 to year t
 PPE_{it} :*Gross property plant and equipment* of the company in period t.

Independent factors in this study include ability, stress, possibility, rationalization, ability, and financial distress. The rationalization explanation involves auditor turnover with a dummy value of 1 for a KAP change and 0 if there is none (Faradiza, 2019). Capability, assessed by the presence of a new director using a dummy variable 1 for replacement and 0 for no replacement (Inayanti, Sukirman, 2016). Financial targets based on return on assets (ROA) are used as a proxy for pressure (Septriani and Handayani, 2017). The percentage of independent commissioners serves as a proxy for weak supervision, which explains the opportunity (Faradiza, 2019). Financial distress is assessed with the Altman Z-Score, with a binary variable set at 1 when the Z-Score is less than 2.99 and 0 when it is 2.99 or higher (Suniah and Herawati, 2020). The Z-score calculated by Altman can be expressed as follows:

$$Z = 6.56 \times 3.26 X1 + X2 + X3 + 6.72 \times 1.05 X4 \dots \dots \dots (4)$$

By using descriptive statistics, one can determine the variance, average, standard deviation, maximum, and minimum of the research variable data. (Ghozali, 2018). Partial Least Square (PLS) is used to investigate the function of financial distress as a mediator in identifying financial statement fraud, because it does not rely on several assumptions and can be applied to information that is not multivariate normally distributed (Gozali, 2012). External model testing involves examining validity (convergent, AVE, and discriminative) and reliability (pooled reliability). (Ghozali, 2018). R-square analysis, Stone-Geisser Q-square test, and the importance of structural path parameter coefficients are all used in inner model testing. Hypothesis testing is done by testing the full model of Structural Equation Modeling (SEM) using smartPLS, to validate the theory and clarify the relationship between latent variables.

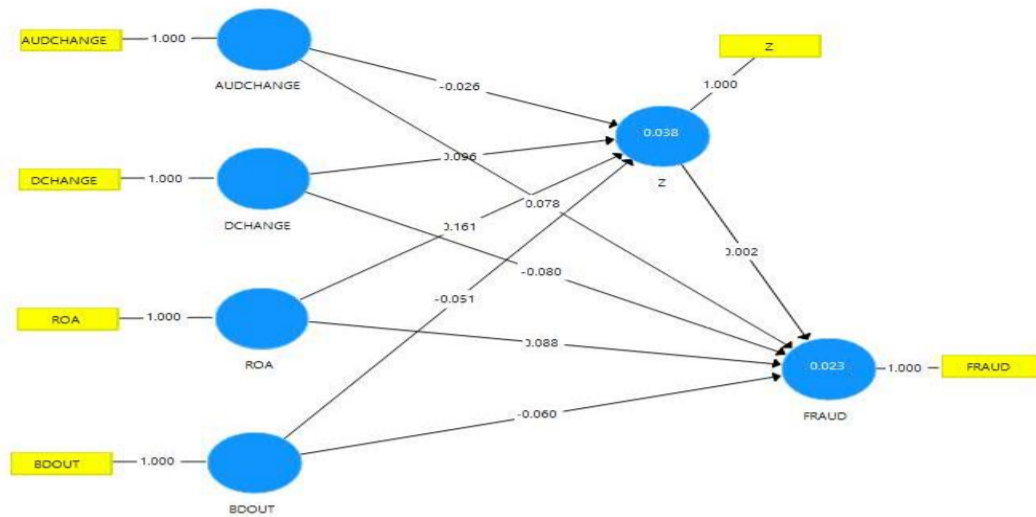


Figure 1. Measurement of Convergent Validity Value Using Outer Loading (Measurement Model) SmartPLS

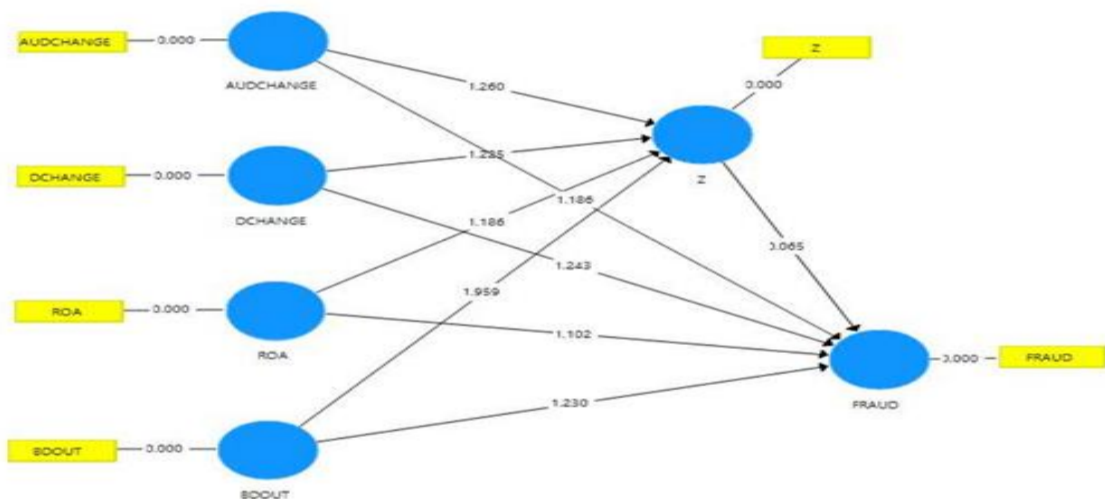


Figure 2. Measurement of Convergent Validity Value Using Outer Loading (SmartPLS Measurement Model)

Results and Discussion

Table 2 presents the results of descriptive statistical testing showing the minimum, maximum, mean, or standard deviation of the following variables: pressure (auditor turnover), opportunity (board turnover), insufficient leadership capacity, financial distress, and financial statement fraud. The table showing the results of the descriptive statistical analysis will outline the underlying features of the data used in this study.

Table 2. Descriptive Statistic Results

	N	Minimum	Maximum	Mean	Std. Deviation
audchange	420	.00	1.00	.0619	.24127
dchange	420	.00	1.00	.1143	.31854
ROA	420	-.50	1.00	.0473	.11207
bdout	420	.17	.75	.4011	.09912
distress	420	-1.94	101.29	2.9858	7.09770
fraud	420	-3.51	1.43	-.4743	.38786
Valid N	420				

Data Source; Processed by the Author

The average percentage of manufacturing organizations making auditor adjustments (AUDCHANGE) is 6.19%, according to the descriptive data results for the Rationalization variable. The standard deviation of 0.24127 indicates a large fluctuation in this percentage. The average percentage of companies that change directors (DCHANGE) for the Capability variable is 11.43%, with a considerable range indicated by the standard deviation of 0.31854. In terms of Financial Targets determined by Return on Asset (ROA), manufacturing companies listed on the IDX generated an average profit during the period of 4.73% of total assets owned, with a standard deviation of 0.11207 which shows a large difference. On the company's board of commissioners, the average proportion of independent commissioners is 40.11%, with a standard deviation of 0.09912. This indicates that ineffective supervision is rare.

Testing with Partial Least Square (PLS) involves two stages: Outer Model to test the measurement quality of latent variables and Inner Model to evaluate the relationship between latent variables in the structural model. The first stage includes validity, reliability, and convergence tests, while the second stage involves path coefficient analysis, significance tests, and R-square measurements. (Ghozali, 2018).

The results of testing convergent validity that measures constructs can also be seen in table 3. as follows:

Table 3. Convergent Validity Value Using Outer Loading (>0.70)

VAR	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)
AUDCHANGE <- AUDCHANGE	1.000	1.000	0.000
BDOUT <- BDOUT	1.000	1.000	0.000
DCHANGE <- DCHANGE	1.000	1.000	0.000
FRAUD <- FRAUD	1.000	1.000	0.000
ROA <- ROA	1.000	1.000	0.000

Data Source; Processed by the Author

There are external loading values >0.7 (1.000) for constructs, as shown in Table 3. This indicates that all elements in this study are considered reliable and have demonstrated convergent validity. Since all measures assessing the same concept have demonstrated convergent validity, they are suitable for hypothesis testing. Evaluating discriminant validity is considered effective when each indicator of the latent variable in question shows a greater loading value with a particular latent variable than with other latent variables.

Table 4. Discriminant Validity Testing Results

	AUD_CHANGE	BDOUT	DCHANGE	FRAUD	ROA	Z
AUDCHANGE	1.000					
BDOUT	-0.011	1.000				
DCHANGE	0.001	-0.008	1.000			
FRAUD	0.069	-0.062	-0.083	1.000		
ROA	-0.108	-0.012	-0.042	0.084	1.000	
Z	-0.043	-0.054	0.089	0.009	0.160	1.000

Data Source; Processed by the Author

All factors in Table 4, such as pressure, opportunity, poor supervision, ability, economic pressure, and financial statement fraud, have factor loading values that are greater than the sum of other hidden variable loadings. This indicates that these factors effectively distinguish each other.

Checking the average variation of each construct extracted from the AVE is another method to verify discriminant validity. The results of the discriminant validity are shown in the table below:

Table 5. Average Variance Extracted (AVE)

	Average Variance Extracted (AVE)
AUDCHANGE	1.000
BDOUT	1.000
DCHANGE	1.000
FRAUD	1.000
ROA	1.000
Z	1.000

Data Source; Processed by the Author

Table 5, shows that the mean-variance extracted (AVE) values for all dimensions, such as pressure (auditor turnover), opportunity (board turnover), poor supervision, capability, economic pressure, and fraud in financial statements, are all more than 0.5, which is 1.000. This indicates that the framework used in this study exhibits strong discriminant validity. Pooled reliability assesses the dependency coefficients among the measurement blocks of the corresponding constructs. The findings of the pooled reliability results are displayed in the table below:

Table 6. Composite Reliability Results

Var	Composite Reliability
AUDCHANGE	1.000
BDOUT	1.000
DCHANGE	1.000
FRAUD	1.000
ROA	1.000
Z	1.000

Data Source; Processed by the Author

Table 6 shows that all factors, such as pressure (auditor change), opportunity (change of direction), inefficient supervision, capability, financial distress, and financial statement fraud, have a composite dependability value higher than 0.70, which is 1.000. Therefore, the model in this study has achieved composite reliability. Evaluating the R-squared value of a model using PLS is by looking at the R-squared value for each dependent latent variable. The R-square estimates are shown in the table below:

Table 7. R-square value of the Model

Vr	R Square Adjusted
FRAUD	0.011
Z	0.029

Data Source; Processed by the Author

Table 7 shows that the adjusted R-square value for model 1 is 0.011, which means that other factors account for 98.9% of the explanation of financial difficulties, with pressure, opportunity, poor supervision, and capability accounting for 1.1% of the explanation. The Adjusted R-square value for model 2 is 0.029, indicating that fraud in financial statements can be explained by the variables of pressure, opportunity, poor supervision, capability, or economic hardship by 2.9%, and the remaining 97.1% is explained by other factors.

Hypothesis testing is carried out to assess how the independent factors affect the dependent variable by analyzing the path coefficient and the significance of the T-statistic. The criterion for accepting a hypothesis is a probability of 0.05. The results of hypothesis testing are presented in the table below:

Table 8. Hypothesis Test Results Based on Path Coefficient

VAR	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
AUDCHANGE -> Z -> FRAUD	0.000	0.000	0.002	0.032	0.974
BDOUT -> Z -> FRAUD	0.000	0.000	0.002	0.062	0.951
DCHANGE -> Z -> FRAUD	0.000	0.001	0.004	0.061	0.952

ROA -> Z -> FRAUD	0.000	-0.001	0.016	0.024	0.981
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Data Source; Processed by the Author

Financial distress has no indirect effect on financial statement fraud, in accordance with the results of the indirect effect test, where the p-value is 0.974 (>0.05). This indicates that financial distress does not act as a mediator of the impact of capacity on financial statement fraud. Based on the results of the indirect effect test, a significance level of 0.952 is obtained, which indicates that changes in the board of directors do not have a major influence on financial statement fraud through financial difficulties.

Based on the results of the paired t-test, the significance level is 0.981, which indicates that financial distress does not have a substantial indirect impact on financial statement fraud through financial distress. This indicates that financial distress does not act as a mediator of the impact of financial stress on financial statement fraud. Based on the findings of the inverse effect test, the significance level is 0.951, which indicates that inefficient supervision does not have a substantial indirect effect on financial statement fraud through financial distress. This indicates that financial distress does not act as a mediator of the impact of inadequate supervision on financial statement manipulation.

Discussion

The results of the study reject hypothesis 1 which states that auditor turnover has no significant effect on financial distress. Auditor turnover does not indicate fraudulent financial statements, but is more related to regulatory compliance, such as auditor term limits. Although regulations aim to maintain independence, contingency contexts such as close relationships with companies also influence auditor turnover decisions. Previous studies provide mixed views, but recent findings indicate that industry factors, auditor quality, and frequency of CEO turnover do not have a significant impact. This finding is consistent with (Afiah & Aulia, 2020; Alisa, 2021; Hastuti et al., 2023; Pujoningrum & Wijayanti, 2023; Wildatul Muawanah & Rida Perwita Sari, 2023)..

The results showed that the change of directors was not significant to financial distress, hypothesis 2 was rejected. Auditor turnover is hampered by high start-up costs, increasing audit fees, and triggering an evaluation of auditor subjectivity. This is in accordance with Agency and Fraud Theory, emphasizing the importance of effective supervision and leadership stability. Findings Gunawan & Putra (2021), Ibrahim (2019) support that the Board of Directors and Audit Committee have no effect on financial distress. The implication is that management needs to carefully consider changing directors to maintain company stability. This conclusion is also

reinforced by Guilherme (2019) Jostarndt (2008) on the importance of ownership management and board composition.

Management is less likely to commit fraud if they believe the ROA target can be achieved without manipulation. This highlights the importance of realistic financial targets. This finding is in line with the Triangle of Fraud Theory. Findings Martin Bugeja (2013) show depressed targets receive higher premiums and less cash rewards. Dobbie & Song (2019) found that faster payment reductions had no positive impact. This challenges the view that financial distress is largely due to short-term constraints.

The results of the analysis show that ineffective supervision has no significant effect on financial distress, so hypothesis 4 is rejected. Fraud theory and agency theory explain that ineffective supervision increases the risk of fraud because it provides an opportunity for management to act without accountability (Jensen, 1976). (Jensen, 1976). This finding is supported by the study of Wildatul Muawanah (2023) which shows that the receivables ratio does not affect the disclosure of financial statements that can lead to bankruptcy. Study Ashraf et al. (2019) highlights the complexity of economic dynamics that can affect the relationship between supervision and financial distress. Therefore, it is necessary to consider contextual factors in understanding the relationship.

The test results of *Rationalization (auditor turnover)* have no significant effect on the *detection of financial statement fraud*, so hypothesis 5 is rejected. In line with the findings Riandani & Rahmawati (2019) The unsupported rationalization of financial statement fraud is suspected because the company complies with the Regulation of the Minister of Finance of the Republic of Indonesia Number 17 / PMK 01 / 2008 article 3 paragraph 1 which states that auditor changes can only be made for a minimum of 3 years and a maximum of 6 years. Furthermore, in 2015 the Ministry of Finance updated the auditor replacement regulations to a maximum of 5 years. (Sabaruddin, 2022).

The results of the Capability test (change of directors) have no significant effect on the detection of fraudulent financial statements, so hypothesis 6 is rejected. Agency theory explains that there is a conflict of interest between agents (management) and principals (shareholders). (Michael C. Jensen, 1976). Changing the board of directors can be seen as an effort by the principal to overcome agency problems and improve company performance. Sabaruddin (2022) Change of director does not affect the potential for fraudulent financial reporting on the basis that the company replaces the board of directors with the aim of improving company performance. This result confirms the study of (Aprilia & A, 2014; Nurmala & Rahmawati, 2019)..

The test results Pressure (financial target) has no significant effect on the detection of financial statement fraud, so hypothesis 7 is rejected. that pressure with the leverage ratio indicator partially has a significant negative effect on financial reporting fraud where the higher the leverage ratio, the lower the level of financial reporting fraud. According to Agustina & Pratomo (2019) Creditors have the ability to monitor the company's debt cycle, which can reduce the risk of fraudulent financial statements. They tend to approve loans to companies that have credibility, a good image, and are not subject to sanctions from the OJK. Therefore, these factors may prevent companies from manipulating financial statements, despite having financial risks with a high leverage ratio (Harahap et al., 2017).

The results of the analysis reject hypothesis 8 which states that ineffective supervision has no significant effect on financial statement fraud. This finding is in line with research Agustina & Pratomo (2019) which highlights that the independent audit committee may have limited knowledge and responsibilities that are shared with other companies, so that its supervision becomes less effective. In the context of Agency Theory Jensen (1976), conflicts of interest between management and shareholders may affect the effectiveness of supervision. This finding confirms the need for improvements in the supervisory system to prevent fraud in financial statements. Sabaruddin (2022) also noted that the number of independent commissioners had no effect on fraud, confirming the limitations of regulation in practice. Study Nurmala & Rahmawati (2019) also supports this finding.

The test results show that financial distress has no significant effect on the detection of financial statement fraud, so hypothesis 9 is rejected. This finding highlights that even though the company is experiencing financial problems, it does not automatically lead to potential manipulation of financial statements to hide poor conditions. This is in line with research (Wildatul Muawanah & Rida Perwita Sari, 2023) which implies that unstable financial conditions do not always encourage companies to take manipulative actions against their financial statements. This suggests that other factors may be more dominant in influencing companies' decisions related to the integrity of their financial statements during periods of financial crisis. Thus, this study provides important insights into the relationship between financial conditions and fraudulent practices in the corporate context.

The results of the analysis show that financial distress does not mediate the relationship between *rationalization (auditor turnover)* and financial statement fraud. This finding is not in line with contingency theory which states that financial distress can increase the risk of financial statement fraud (Jensen, 1976). (Jensen, 1976). This theory explains that when companies experience financial distress, management may be tempted to commit fraud to improve financial performance and avoid negative consequences. However, several studies support the mediation

findings in this study, showing that financial distress does not always mediate the relationship between rationalization and financial statement fraud. Tron et al. (2023) financial distress has no significant effect on auditor turnover, and corporate governance can moderate the relationship between financial distress and auditor turnover. Castio & Lovita (2020) financial distress has no significant relationship with audit fees, which is a form of rationalization. Research Wiratno et al. (2023) that the application above this relationship becomes insignificant after considering other factors such as corporate governance and firm size.

The results of the *indirect effect* test show that financial distress does not mediate the effect of changing directors on financial statement fraud in manufacturing companies listed on the Indonesia Stock Exchange in 2019-2022. In line with the findings Ninla Elmawati (2019) Financial distress is a determining factor if the company is experiencing financial problems, if the value of financial distress is too low, of course it will have an impact on high earnings management, the audit committee will certainly tighten supervision and control of financial reporting by managers. According to (Wildatul Muawanah (2023)) The independent audit committee is an outsider who has independence and high integrity in supervising management or directors. As well as having capabilities, but the practice is different from theory. The board of commissioners does not have more authority, and the result is ineffective supervision. Several previous studies have shown that financial distress has a positive relationship with financial statement fraud (Tarighi et al., 2014). (Tarighi et al., 2022).. Gunawan & Putra (2021) did not find a significant relationship between financial distress and financial statement fraud. These findings suggest that companies need to improve internal controls and corporate governance to reduce the risk of financial statement fraud, especially companies with high turnover of directors. This study provides several contributions. First, this study provides empirical evidence on the relationship between capability (board turnover) and financial statement fraud in Indonesia. Second, this study shows that financial distress does not mediate the relationship between capability (board turnover) and financial statement fraud.

The results of the *indirect effect* test show that financial distress does not mediate the effect of financial targets on financial statement fraud in manufacturing companies listed on the Indonesia Stock Exchange in 2019-2022. In line with the findings Ninla Elmawati (2019) financial targets do not affect the condition of financial statements through financial distress. However, several studies support these results by showing that financial distress does not always act as a mediator between stress and financial statement fraud. This shows the complexity of the factors that influence fraudulent behavior in the context of the company's financial situation. According to Ranjbar & Amanollahi (2018) that financial distress does not have a significant relationship with earnings management, which is a form of financial statement fraud. (Christina & Alexander,

2020) that financial distress has no significant effect on earnings management. Xiaoqun Liu (2023) that financial distress has no significant relationship with financial reporting fraud in China. Chen et al. (2019) that financial distress has a positive relationship with financial statement fraud, but this relationship becomes insignificant after considering other factors such as corporate governance and auditor quality. Therefore, companies need to manage financial stress well and implement fraud prevention measures to reduce the risk of financial statement fraud.

The results of the *indirect effect* test show that financial distress does not mediate the effect of ineffective supervision on financial statement fraud in manufacturing companies listed on the Indonesia Stock Exchange in 2019-2022. In line with the findings Ninla Elmawati (2019) ineffective supervision does not affect the condition of financial statements through financial distress. Meanwhile, Agency Theory states that there is a conflict of interest between management and shareholders, where management may be tempted to commit fraud for their personal gain, harming shareholders (Jensen, 1976). (Jensen, 1976). Weak supervision can exacerbate this conflict by giving management the freedom to act without accountability. Research Ranjbar & Amanollahi (2018) found that financial distress does not have a significant relationship with earnings management, which is a form of financial statement fraud. This shows that the accounts receivable ratio is not the cause of bankruptcy caused by fraudulent financial statements. This means that the level of accounts receivable ratio is not a measure of the disclosure of financial statements. (Wildatul Muawanah, 2023).

Conclusion

Based on the results of the indirect effect test, financial distress does not significantly mediate the relationship between capacity, board changes, financial pressure, ineffective supervision, and financial statement fraud. This is contrary to expectations that financial distress will act as a mediator for these variables. This finding contradicts agency theory which states that financial distress may encourage fraudulent behavior as managers seek to meet financial targets and reduce pressure from stakeholders. However, the absence of a mediating effect implies that other factors or mechanisms may drive fraudulent activities in financial reporting beyond the influence of financial distress.

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