

Financial Distress and Financial Statement Fraud: Systematic Literature Review

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ABSTRACT

This study seeks to examine the association between financial distress and financial statement fraud by employing a Systematic Literature Review (SLR) method. Financial statement fraud involves the deliberate misrepresentation of financial information intended to deceive stakeholders, whereas financial distress reflects a firm's declining financial performance that may lead to bankruptcy. The study adopts the PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) framework to systematically identify, assess, and synthesize relevant literature sourced from the Scopus database. The findings indicate that financial distress has a significant relationship with the increased risk of financial statement fraud. Financial pressure encourages management to engage in manipulative practices such as earnings management, tax avoidance, and misrepresentation of financial information to maintain corporate image and investor confidence. These findings are consistent with the Fraud Triangle Theory, which identifies pressure as one of the primary factors motivating individuals to engage in fraudulent behavior. Furthermore, good corporate governance, effective auditor supervision, ESG practices, and machine learning technology are found to help reduce fraud risk and improve early detection of financial distress and financial reporting irregularities.

INTRODUCTION

Financial statements function as a medium for communicating a company's financial information to stakeholders; therefore, the quality and credibility of financial statements are highly important in maintaining investor confidence and supporting capital market stability (Zahro, 2024). However, cases of financial statement fraud still frequently occur across various industrial sectors. Financial statement fraud is defined as the deliberate manipulation or misstatement of financial information intended to deceive users of financial reports (Andrew et al., 2022). This fraudulent practice often occurs when companies face financial or operational pressures. One condition that is frequently associated with financial statement fraud is financial distress.

Financial distress refers to a condition in which a company experiences a decline in financial performance prior to bankruptcy. Firms facing financial distress commonly encounter liquidity constraints, decreasing profitability, rising debt obligations, and weakening operational performance (Sari & Subardjo, 2022). Under such circumstances, management may be driven to manipulate financial statements to portray the company as financially sound. The connection between financial distress and financial statement fraud can be understood through the Fraud Triangle Theory introduced by Donald Cressey. This theory suggests that fraud arises from three key elements: pressure, opportunity, and rationalization. In this context, financial distress serves as a form of pressure that can motivate management to engage in fraudulent financial reporting.

The phenomenon of financial statement fraud has become increasingly widespread, occurring in both international and Indonesian companies. Internationally, the Enron scandal in 2001 became one of the largest business scandals in world history. The company manipulated its financial statements to conceal debts and company losses, thereby misleading investors and the public. In addition, the Toshiba case in 2015 demonstrated profit manipulation practices that had been carried out for years due to pressure to maintain company performance. A similar phenomenon occurred in the Luckin Coffee case in 2020, where the company was proven to have falsified sales transactions to improve its performance image in the eyes of investors. These cases indicate that financial pressure and demands to maintain corporate performance can become driving factors behind financial statement fraud.

In Indonesia, financial statement manipulation practices also remain a serious concern. One notable case involved PT Tiga Pilar Sejahtera Food Tbk, which was suspected of inflating funds and manipulating financial statements. Furthermore, the case of PT Garuda Indonesia (Persero) Tbk in 2019 revealed controversy regarding profit recognition that was considered not to reflect the company's actual financial condition. These phenomena demonstrate that financial statement manipulation can still occur in large companies facing pressure to maintain their performance image before investors and shareholders.

In the food and beverage subsector, financial pressure may arise due to increasing raw material prices, inflation, changes in consumer consumption patterns, and increasingly intense business competition. Post-pandemic

conditions have also caused many companies to experience declining sales and supply chain disruptions, which negatively affect corporate financial conditions. Such situations increase the risk of financial distress, which may ultimately trigger financial statement manipulation in order to maintain the confidence of investors and creditors.

Several previous studies have investigated the influence of financial distress on financial statement fraud; however, the results remain inconclusive. Some studies indicate that financial distress has a positive effect on financial statement fraud, as financial pressure may encourage management to manipulate financial reports. In contrast, other studies argue that financial distress does not necessarily result in fraudulent financial reporting due to factors such as strong internal controls, effective corporate governance, and rigorous external auditing. Therefore, this study seeks to systematically review prior research concerning the effect of financial distress on financial statement fraud, with a particular focus on food and beverage subsector companies in Indonesia.

THEORETICAL REVIEW

Fraud Triangle Theory

The Fraud Triangle Theory, developed by Donald Cressey, explains that fraudulent behavior arises from the existence of three primary elements: pressure, opportunity, and rationalization. Pressure arises when individuals or companies experience financial or non-financial pressures. Opportunity occurs when internal control systems are weak, while rationalization refers to the justification made by perpetrators for committing fraudulent acts. In the context of financial statement fraud, financial distress can be viewed as a form of pressure faced by company management. Such pressure may encourage management to manipulate earnings, assets, or other financial information in order to make the company's condition appear better (Eirene & Diandra, 2026).

Financial Distress

Financial distress refers to a condition in which a company faces financial difficulties that may ultimately result in bankruptcy if not managed promptly (Nurrohman & Supriatna, 2026). Financial distress is generally characterized by declining profitability, negative cash flows, inability to meet obligations, and deteriorating company performance. Companies experiencing financial distress tend to have a greater likelihood of manipulating financial statements in order to conceal their actual financial condition. According to Edward I. Altman, financial distress can be predicted through financial ratio analysis that reflects a company's liquidity, solvency, profitability, and operational activities. One of the most commonly used methods for identifying financial distress is the Altman Z-Score model, which is utilized to assess a company's financial condition and its likelihood of bankruptcy.

Financial Statement Fraud

Financial statement fraud refers to the intentional presentation of financial statements that do not reflect the company's actual condition with the purpose of misleading users of financial statements. This practice is deliberately carried out by management to portray the company as being in a better condition than its real situation, thereby influencing the decisions of investors, creditors, auditors, and other stakeholders. Financial statement fraud can be conducted through various methods, such as fictitious revenue recognition, reduction or concealment of company liabilities, manipulation of expense records, fictitious transactions, and earnings management practices aimed at adjusting company profits to meet certain targets. Such manipulation is generally carried out when companies face financial pressure, operational pressure, or the desire to maintain a positive corporate performance image in the eyes of the public (Ho et al., 2026).

The practice of financial statement fraud can generate various negative impacts on both companies and stakeholders. For investors and creditors, manipulated financial statements may lead to errors in investment and lending decisions because the information used does not accurately reflect the company's actual financial condition. Furthermore, fraud practices can reduce trust in auditors and regulators who are responsible for maintaining transparency and accountability in corporate financial reporting. In the long term, financial statement fraud can damage a company's reputation, reduce market confidence, and disrupt capital market stability because the reliability of financial information becomes weakened (Zavitsanos et al., 2025).

Previous Research

Table 1. Previous Research

No	Title	Author and Year	Results
1	The Effect of Financial Distress on Financial Statement Fraud Moderated by Corporate Governance	(Mardiana, 2021)	The research findings reveal that financial distress has a positive and significant influence on financial statement fraud.
2	The Effect of Financial Distress, Political Connection, and Growth on Fraudulent Financial Statements	(Puspita & Budiwitjaksono, 2025)	These findings suggest that financial pressure may motivate management to manipulate financial statements, whereas stable company growth can minimize the likelihood of fraudulent activities
3	Analysis of the Effect of Financial Performance and Corporate Governance on the	(Ardhiansyah et al., 2019)	The results of this study demonstrate that financial distress, liquidity, leverage, and corporate

No	Title	Author and Year	Results
	Likelihood of Financial Statement Fraud		governance significantly influence financial statement fraud. Furthermore, profitability, liquidity, leverage, and corporate governance are also found to have significant effects on financial distress.

METHODOLOGY

This study adopts a Systematic Literature Review (SLR) approach to identify, assess, and synthesize previous studies related to financial distress and financial statement fraud. The review process is conducted in accordance with the PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) guidelines (Oduro, 2024). PRISMA provides a clear and structured approach for identifying, selecting, assessing, and reviewing relevant research articles. The steps of this method are described in detail in Figure 1.

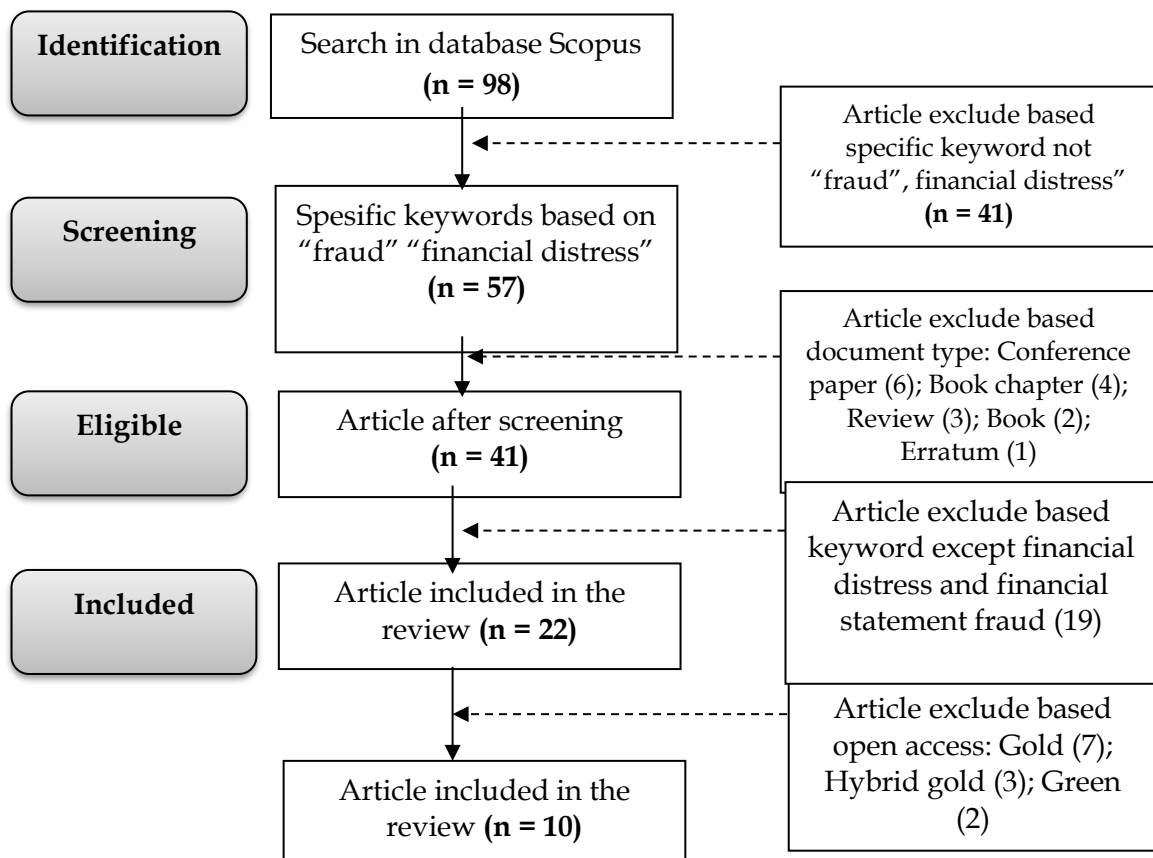


Figure 1. PRISMA Diagram

RESULTS

Based on the literature review conducted in the Scopus database using the PRISMA method, 10 relevant journals were identified regarding the relationship between financial distress and financial statement fraud.

Table 2. Literature Review Findings

No	Title	Author and Year	Results
1	Bankruptcy duration and resolution in healthcare: Evidence from chapter 11 filings	(Leach & Newsom, 2026)	Companies experiencing deteriorating financial conditions, complex capital structures, and prolonged bankruptcy processes tend to face high pressure from creditors, investors, and regulators. This pressure may encourage management to engage in manipulative actions in order to maintain the company's image and retain the trust of stakeholders
2	Fraud triangle factors and financial statement fraud: The moderating role of earnings management in an emerging market	(Ho et al., 2026)	The research findings indicate that financial distress increases the risk of financial statement fraud because financial pressure encourages management to manipulate financial reports. In addition, earnings management strengthens this relationship, meaning that companies experiencing financial difficulties tend to use earnings management to conceal their actual financial condition
3	Guardians or Bystanders? Auditors' Role in Curbing Earnings Management During Financial Distress in Indonesia	(Artiningsih et al., 2026)	Financial distress is positively related to earnings management, which is in line with prospect theory
4	Gender-diverse boards, liquidity, and financial	(Arifin & Koerniawan, 2025)	The research findings indicate that gender diversity in the board of directors and

No	Title	Author and Year	Results
	distress: Pathways to fraud deterrence in auditor judgments		liquidity affect going concern audit opinions. In addition, liquidity also influences financial distress, which acts as a mediating variable in this relationship. These findings highlight the importance of corporate governance and financial conditions in the audit assessment process.
5	Predicting financial distress in TSX-listed firms using machine learning algorithms	(Lokanan & Ramzan, 2024)	These findings underline the major predictors of financial distress, including revenue growth, dividend growth, cash-to-current-liabilities ratio, and gross profit margin.
6	Do Shariah-compliant Companies Engage Lesser Earnings Management Behaviour?	(Sabrun et al., 2018)	The findings of this study suggest that corporate reputation, financial distress, and financial performance are factors that influence earnings management behavior, while Sharia values are found to be ineffective in preventing management from engaging in earnings management practices.
7	The Mediation Effects of Financial Distress on the Relationship between Capital Intensity and Return on Assets towards Corporate Tax Avoidance	(Muhmad et al., 2024)	Statistical results confirm a significant relationship between capital intensity, return on assets (ROA), and the level of corporate tax avoidance.
8	ESG and Financial Distress: The Role of Bribery, Corruption, and Fraud in FTSE All-Share Companies	(Sastroredjo & Suganda, 2025)	The research findings reveal an interesting trend: ESG activities show a negative correlation with financial distress, suggesting that companies actively engaged in ESG practices are less likely

No	Title	Author and Year	Results
			to face default risk, even after robustness and endogeneity tests are considered. Furthermore, when analyzing the moderating role of bribery, corruption, and fraud issues, the findings show that lower levels of negative issues strengthen the negative relationship between ESG (governance pillar) and financial distress.
9	Machine Learning for Identifying Risk in Financial Statements: A Survey	(Zavitsanos et al., 2025)	Two important use cases are identified as fundamental risk factors for a company, namely the detection of financial misstatements and the prediction of financial distress.
10	A Machine Learning Approach to Audit Modification Risk Prediction in Financial Reporting: Methods, Data, and Human - Centered Challenges	(Silahtaroglu et al., 2026)	These findings indicate that an interpretable and risk-oriented machine learning framework can contribute to more transparent and actionable systems for monitoring financial reporting risks.

Source: Literature Review

DISCUSSION

Based on the results of the literature review, it can be explained that financial distress is an important factor contributing to the increasing risk of financial statement fraud. Financial distress creates pressure on management to maintain the company's image, preserve investor confidence, and meet obligations to creditors. This pressure encourages companies to engage in various manipulative actions, such as earnings management, tax avoidance, and the presentation of financial statements that do not reflect the actual financial condition. These findings are consistent with the Fraud Triangle Theory, which states that pressure is a key factor driving fraud.

The study by Leach & Newsom (2026) shows that companies with deteriorating financial conditions and complex capital structures face high pressure from creditors and regulators, thereby increasing the likelihood of financial statement manipulation. This pressure becomes even greater when companies are undergoing prolonged bankruptcy processes. Furthermore, Ho et

al. (2026) found that financial distress directly increases the risk of financial statement fraud, while earnings management strengthens this relationship. This means that companies experiencing financial difficulties tend to use earnings management as a means to conceal their actual financial condition.

Similar findings are also reported by Artiningsih et al. (2026), who found that financial distress is positively associated with earnings management. This suggests that when companies experience financial pressure, management is more likely to engage in opportunistic actions to preserve the company's perceived performance in the eyes of investors. Sabrun et al. (2018) also support this finding by stating that financial distress is one of the factors influencing corporate earnings management behavior. Even Sharia principles applied within companies have not been fully effective in preventing earnings manipulation practices.

In addition to financial pressure factors, several studies indicate that corporate governance and liquidity conditions play an important role in reducing fraud risk. Arifin & Koerniawan (2025) found that gender diversity on the board of directors and liquidity influence going-concern audit opinions, while financial distress serves as a mediating variable in the relationship. These findings suggest that good corporate governance can function as a control mechanism in reducing the risk of financial statement manipulation driven by financial pressure. Sastroredjo & Suganda (2025) likewise demonstrate an inverse association between ESG practices and financial distress, implying that firms characterized by robust governance structures and diminished exposure to fraudulent conduct are less susceptible to financial instability.

On the other hand, advances in technology and the implementation of machine learning have increasingly been utilized to identify the risks of financial distress and financial statement fraud. Lokanan and Ramzan (2024) highlight several major indicators of financial distress, including revenue growth, dividend growth, cash-to-current-liabilities ratio, and gross profit margin. Zavitsanos et al. (2025) explain that predicting financial distress and detecting financial misstatements are important components in identifying corporate fraud risk. This is supported by Silahtaroğlu et al. (2026), who show that machine learning approaches can enhance financial reporting risk monitoring systems in a more transparent and effective way.

Overall, the findings from various studies indicate that financial distress is closely related to financial statement fraud. The higher the level of financial pressure experienced by a company, the greater the likelihood that management will manipulate financial statements to maintain business continuity and stakeholder confidence. However, the presence of strong corporate governance, auditor oversight, ESG practices, and fraud detection technologies can help minimize the risk of financial statement fraud in financially distressed companies.

CONCLUSIONS AND RECOMMENDATIONS

Based on the results of the literature review, it can be concluded that financial distress is closely related to financial statement fraud. Financial distress represents a form of pressure that encourages management to manipulate financial statements in order to maintain the company's image, preserve investor

confidence, and meet obligations to creditors. The higher the level of financial pressure experienced by a company, the greater the likelihood of manipulative practices such as earnings management, tax avoidance, and the presentation of financial statements that do not reflect the actual financial condition.

FURTHER STUDY

This study has several limitations that should be taken into consideration. First, the research relies solely on the Systematic Literature Review (SLR) approach, meaning that the findings are dependent upon the quality and availability of the articles selected as literature sources. Second, the data sources are limited to the Scopus database, meaning that relevant studies from other databases may not have been included. Third, this study primarily concentrates on the relationship between financial distress and financial statement fraud without empirically examining the effects of other variables, such as corporate governance, audit quality, leverage, and additional non-financial factors. In addition, most of the studies reviewed are concentrated in certain industry sectors, so the findings may not be fully generalizable across all industries.

Future studies are expected to adopt empirical approaches utilizing both primary and secondary company data in order to directly examine the influence of financial distress on financial statement fraud. In addition, subsequent researchers are encouraged to broaden the scope of literature sources by incorporating other international databases, such as Web of Science, ScienceDirect, and Google Scholar, to generate more comprehensive findings. Furthermore, future research may consider integrating moderating or mediating variables, including corporate governance, audit quality, earnings management, ESG, and machine learning-based fraud detection technologies, to provide deeper insights into the determinants of financial statement fraud. Comparative studies across various industry sectors or different countries may also be undertaken to enhance the generalizability of the research findings.

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