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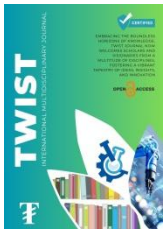

Does Financial Stability Prevent Fraud? Examining the Influence of External Pressures on Financial Statement Manipulation

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Abstract
This study examines the impact of Financial Stability on Financial Statement Fraud, with a focus on the moderating role of External Pressure. The research utilizes Panel Least Squares (PLS) regression analysis to assess the relationship between financial stability (measured through various financial ratios) and financial statement fraud. Additionally, the study incorporates external pressure as a moderating variable to understand how factors such as market competition and regulatory requirements influence the likelihood of fraudulent behavior in firms. The results indicate a significant negative relationship between financial stability and financial statement fraud, with higher financial stability correlating with a lower incidence of fraud. Moreover, external pressure strengthens this relationship, highlighting that external forces interact with internal financial conditions to impact fraudulent activities. The findings contribute to the growing literature on financial fraud prevention, emphasizing the importance of maintaining strong financial health and considering external factors when addressing fraud risks. These results have practical implications for corporate governance and risk management strategies, particularly in industries facing high external pressures.

Keywords
financial stability, financial statement fraud, external pressure, panel least squares, corporate governance, risk management

INTRODUCTION

Financial statement fraud remains one of the most critical threats to corporate transparency and stakeholder trust. The manipulation of financial reports not only distorts a company's true financial health but also undermines the stability of capital markets and erodes investor confidence. Therefore, understanding the factors that influence the likelihood of financial statement fraud is essential, both from an academic standpoint and for practical applications in corporate governance, auditing, and economic regulation (Yusrianti et al., 2020); (Young, 2020).

Prior research has extensively discussed the role of financial performance and governance mechanisms in deterring fraudulent financial behavior. Economic stability, often measured through liquidity, solvency, and leverage indicators, has been highlighted as a protective factor against fraud, with stable companies generally perceived as less incentivized to manipulate financial reports ((Rukmana, 2021); (Rahman et al., 2023)). Studies by Yarana, (2023) and Yulianti et al., (2024) support this view, suggesting that financially secure firms are less likely to engage in unethical reporting practices. However, recent findings reveal inconsistencies. For instance, Riskiyadi, (2024) demonstrated that

under significant external pressures, even financially sound companies might engage in earnings management or fraudulent behaviors to meet external expectations.

The existing literature shows gaps and inconsistencies in understanding how external pressures interact with financial stability in influencing fraud. While many studies treat financial stability and external factors separately, few have integrated them into a cohesive model that explores their dynamic interplay (Honesty et al., 2024); (Wijaya & Indriyani, 2025)). Moreover, most previous works have not sufficiently accounted for the moderating effect of market competition, investor pressure, and regulatory scrutiny, leading to a partial and sometimes contradictory view of fraud drivers ((Zhou et al., 2024); (Jaswadi et al., 2024)).

The objective of this research is to examine whether financial stability truly prevents financial statement fraud when external pressures are considered as a moderating factor. By developing a moderated regression model, this study aims to offer a more nuanced understanding of how internal financial conditions and external environmental stresses jointly affect the propensity for financial statement manipulation. Conducted in the context of publicly listed companies, this research intends to bridge the theoretical gaps and provide practical insights for regulators, auditors, and corporate leaders seeking to enhance financial reporting integrity ((Ikbal et al., 2020); (Shahana et al., 2023)).

LITERATURE REVIEW

Agency Theory

Financial stability has long been theorized as a significant determinant in reducing the propensity for financial statement fraud. According to Agency Theory (Jensen & Meckling, 1976), a primary grand theory in corporate finance and governance, conflicts of interest between principals (shareholders) and agents (management) can incentivize unethical behaviors, including fraud. Stable financial conditions theoretically align agent interests with those of principals, reducing the necessity for manipulation to meet external expectations. Nevertheless, financial stability alone may not be sufficient to prevent fraudulent reporting, particularly when external pressures intensify.

Several studies have documented a negative relationship between financial stability and fraudulent behavior. Andriani et al., (2022) found that firms with strong liquidity and solvency profiles are less likely to engage in financial manipulation, suggesting that financial robustness serves as a protective shield against fraudulent incentives. Similarly, Tarjo et al., (2021) showed that financially stable firms have lower incidences of accounting irregularities, reinforcing the idea that sound financial health reduces managerial motives for deception. However, other researchers, such as Umar, (2023), caution that financial stability may be undermined by external pressures, such as aggressive market expectations and regulatory demands, which can still drive even stable firms towards manipulative practices.

Linking studies further, Soltani et al., (2023) expanded the conversation by demonstrating that intense external market pressure moderates the relationship between internal financial conditions and earnings management behaviors. Their findings emphasized that when firms experience high competition and investor scrutiny, financial stability alone may not shield against fraudulent acts. Similarly, Handayani et al., (2023) found that in emerging markets, external pressure and weak institutional environments significantly increase the likelihood of financial misreporting, even among financially healthy firms.

The literature also reveals inconsistencies. While Akbar et al., (2022) documented that robust internal controls enhance the protective effect of financial stability, Jaya et al., (2021)identified that external environmental shocks, such as sudden regulatory changes, can overwhelm these safeguards. The variation in findings points to an important gap: the moderating role of external pressure on the relationship between financial stability and fraud has not been thoroughly explored in an integrated framework. Most prior studies treat internal and external factors separately without investigating their interaction effects (Riskiyadi, 2024).

This research aims to fill the identified gap by examining the moderating effect of external pressures within the context of financial stability and financial statement fraud. Building on Agency Theory, this study hypothesizes that when external pressures are high, financial stability's mitigating effect on fraud risk weakens, highlighting the dynamic and contingent nature of ethical decision-making in organizations.

Financial Stability on Financial Statement Fraud

Financial stability plays a critical role in influencing corporate ethical behavior, particularly concerning financial statement fraud. Financially stable firms possess stronger liquidity, solvency, profitability, and lower financial distress risks, which collectively reduce the incentive for management to engage in unethical financial reporting practices. A company with solid financial fundamentals typically faces less pressure to manipulate its earnings or misstate its financial conditions, as it is more capable of meeting stakeholder expectations and financial obligations without resorting to fraudulent behavior (Andriani et al., 2022).

Prior studies have consistently shown a negative association between financial stability and the likelihood of fraudulent financial reporting. Companies that demonstrate high levels of liquidity and strong cash flows are less motivated to engage in earnings management or asset misappropriation because their operational performance can meet external benchmarks without distortion (Istikhoroh et al., 2021). In contrast, firms facing financial instability often seek to portray a more favorable financial condition to investors, creditors, or regulators, thereby increasing the risk of fraudulent reporting (Mandal & AS, 2025).

The theoretical underpinning is rooted in Agency Theory, which posits that managers (agents) may act opportunistically if their interests deviate from those of shareholders (principals) (Jensen & Meckling, 1976). Financial stability can serve to align these interests by reducing agency costs, thus discouraging managers from engaging in fraud. When the firm's financial health is robust, the potential personal gains from committing fraud are outweighed by the risks of detection and the reputational damages incurred. Based on the literature and theoretical perspectives, this study proposes the following hypothesis:

H1: *Financial stability negatively affects financial statement fraud*

Financial Stability on Financial Statement Fraud with External Pressure as a Moderator Variable

Financial stability represents a company's ability to maintain sufficient liquidity, solvency, and profitability to meet its short-term and long-term obligations. Firms with stable financial conditions are less likely to experience the internal pressures that often motivate financial statement fraud. Previous studies have suggested that financially stable firms have fewer incentives to misstate financial information because they are better positioned to satisfy investors, creditors, and regulatory expectations without resorting to fraudulent practices (Sabatian & Hutabarat, 2020). According to Agency Theory, strong financial health reduces agency conflicts between managers and shareholders, aligning managerial actions with shareholders' interests and decreasing the probability of fraudulent behavior (Jensen & Meckling, 1976).

However, financial stability alone may not fully eliminate the risk of financial statement fraud. External pressures, such as increased competition, regulatory scrutiny, debt covenants, and market expectations, can heighten the perceived need to manipulate financial reports even in financially stable firms. External stakeholders often impose performance benchmarks that firms strive to meet to maintain their reputation, secure financing, or avoid penalties (Renaldo & Veronica, 2024). Under such external pressures, even companies with strong financial conditions may resort to fraudulent financial reporting to portray a consistently positive image or to avoid breaching external expectations (Andriani et al., 2022).

The moderating role of external pressure indicates that the negative relationship between financial stability and financial statement fraud could weaken when firms face significant external demands. High external pressure may compel firms to manipulate earnings or misstate financial outcomes to protect their perceived financial health, suggesting that external forces can override the mitigating effect of internal financial strength. Therefore, understanding external pressure as a moderating variable is crucial for a comprehensive analysis of corporate fraud risk. Based on the theoretical foundation and previous empirical findings, the following hypotheses are proposed:

H2: *External pressure moderates the relationship between financial stability and financial statement fraud, such that the negative effect of financial stability on fraud is weaker when external pressure is high.*

METHOD

This study employs a quantitative research design to examine the relationship between financial stability and financial statement fraud, with external pressure acting as a moderating variable. The research aims to explore the extent to which financial stability influences the likelihood of fraudulent financial reporting and how external pressures may affect this relationship.

Research Design and Approach

The research utilizes a causal-comparative approach to understand the influence of financial stability on financial statement fraud, with a specific focus on how external pressures moderate this effect. This design is appropriate for testing hypotheses regarding the relationships among these variables in real-world settings. The study uses secondary data obtained from publicly available financial reports of listed companies to ensure a large and diverse sample.

Population and Sample

The population of interest consists of publicly listed companies on the Indonesia Stock Exchange (IDX) over the period from 2018 to 2022. The sample will be selected using purposive sampling, focusing on companies that have consistently reported their financial statements over the sample period and whose financial stability indicators (liquidity,) are available. Firms in industries with high volatility or those subject to strict regulatory oversight will be excluded to maintain homogeneity and focus on stable sectors.

The final sample is expected to include 150-200 companies across various industries, with specific attention to firms that have shown varying degrees of financial stability. These firms will be categorized based on their financial health, allowing for a clearer analysis of the relationship between financial stability and fraud.

Data Collection

Data will be collected from financial statements and reports published by the companies. The primary data sources will include the following:

a. Balance Sheets and Income Statements from the firms' annual reports to measure financial stability, specifically using changes in total assets as an indicator of financial growth or stability.
b. Reports on discretionary accruals to assess financial statement fraud. Discretionary accruals will be calculated using the Jones Model (1991) or its modified version, which estimates the portion of accruals that

can be manipulated by management. These data will be sourced from the firms' income statements and accounting reports.

c. Audit opinions and reports on fraudulent incidents (if any), available through financial disclosures and news databases, to verify instances of financial statement fraud and corroborate the discretionary accrual findings.
d. External pressure variables such as debt levels, market competition, regulatory pressures, and investor expectations. These will be assessed using the leverage ratio (debt-to-equity ratio), and other proxies, derived from the firms' annual reports, market analysis, and industry reports.

Variables and Measures

a. Independent Variable (IV): Financial Stability

Financial stability will be measured by changes in total assets over the study period. This indicator reflects the firm's growth and ability to sustain financial stability, as it shows whether the company's asset base is expanding or contracting over time.

b. Dependent Variable (DV): Financial Statement Fraud

Financial statement fraud will be assessed using discretionary accruals, which represent the portion of accruals that managers can manipulate through accounting choices. Discretionary accruals are calculated using the Jones Model (1991) or its modified version to detect earnings manipulation. A higher level of discretionary accruals typically suggests a higher likelihood of financial statement fraud, as it indicates a potential attempt to alter the financial results for personal or organizational benefit.

c. Moderator Variable: Leverage Ratio (External Pressure)

Leverage ratio will serve as the moderator variable, reflecting external financial pressure on the company. Leverage ratio, measured as the debt-to-equity ratio, indicates the extent to which a company relies on debt financing to fund its operations. A higher leverage ratio may create greater financial pressure on the firm, potentially encouraging management to engage in earnings manipulation or financial statement fraud to meet financial covenants, satisfy investors, or avoid regulatory scrutiny.

Data Analysis

The data will be analyzed using multiple regression analysis to test the direct relationship between financial stability and financial statement fraud, as well as to examine the moderating effect of external pressure. Specifically, the following steps will be followed:

1. Descriptive statistics will be used to summarize the characteristics of the data, such as the mean, standard deviation, and range for each variable.
2. Pearson correlation will be employed to check for any linear relationships between the independent, dependent, and moderator variables.
3. A moderated regression analysis will be conducted to test the hypothesis that external pressure moderates the relationship between financial stability and financial statement fraud.
4. Interaction terms will be included in the regression models to capture the moderating effect of external pressure.

The results will be interpreted to understand the extent to which financial stability reduces the likelihood of financial statement fraud and how external pressures may influence this relationship.

Ethical Considerations

As the study relies on secondary data, ethical concerns related to data collection are minimal. However, care will be taken to ensure the confidentiality of firm-specific financial information and to maintain transparency in the data analysis process. All data will be used solely for academic purposes.

RESULTS

Descriptive Statistics

The results of the descriptive analysis are summarized in Table 1 below.

Table 1 Descriptive statistics

Variable	Min	Max	Mean	Std Deviation
Financial Stability (X)	-0.153900	1.676057	0.130939	0.266324
Financial Statement Fraud (Y)	-0.243251	0.616071	-0.046439	0.159468
External Pressure (Z)	0.108472	1.887043	0.395871	0.255602

Source: Proceed Data, 2025

The descriptive statistics provide an overview of the key variables in the study, highlighting their range, central tendency, and variability. Table 1 summarizes these statistics for three main variables: Financial Stability (X), Financial Statement Fraud (Y), and External Pressure (Z). The minimum and maximum values show the spread of the data, while the mean

offers an average value for each variable, and the standard deviation reflects the degree of variation or dispersion from the mean.

For Financial Stability (X), the minimum value is -0.153900, indicating that some firms have experienced a decline in assets over the study period, while the maximum value is 1.676057, suggesting that other firms saw substantial growth in total assets. The mean of 0.130939 reflects a slight positive change in assets, on average, across all firms in the sample. The standard deviation of 0.266324 indicates moderate variability in financial stability across the sample, meaning there are firms with both significant growth and contraction in total assets.

Regarding Financial Statement Fraud (Y), the minimum value is -0.243251, indicating that some firms have minimal or negative discretionary accruals, suggesting lower manipulation of financial statements. The maximum value of 1.676057 indicates some companies may have significantly manipulated their financial statements. The mean of -0.046439 suggests that, on average, firms in the sample report relatively low levels of financial statement fraud, but with considerable variation, as indicated by the standard deviation of 0.159468. Lastly, External Pressure (Z) shows a range from 0.108472 to 1.887043, with a mean of 0.395871, indicating moderate external pressure on firms. The standard deviation of 0.255602 suggests that the external pressures faced by firms in the sample vary considerably.

Selecting the Panel Data Regression Model

This research uses panel data regression analysis to investigate the relationship between tax strategies, business strategies, and tax avoidance, with the Earnings Response Coefficient (ERC) acting as a moderating factor. Panel data regression is selected because it facilitates the examination of both cross-sectional and time-series variations, offering more precise estimates of firm-specific effects (Gujarati & Porter, 2020; Wooldridge, 2019). To determine the most suitable model specification, the Chow Test is performed to compare the Common Effect Model (CEM) with the Fixed Effect Model (FEM) and identify which model best represents the data.

Chow Test Results

The results of the Chow Test, presented in Table 2, help determine whether the Fixed Effect Model (FEM) is more appropriate than the Common Effect Model (CEM)/Ordinary Least Squares (OLS) regression.

Table 2 Chow Test Results

Effects Test	Statistic	d.f	Prob.
Cross-section F	1.836331	(17.34)	0.0645
Cross-section Chi-square	35.173939	17	0.0059

Source: Proceed Data, 2025

The results of the Chow Test, shown in Table 2, are used to assess whether the Fixed Effect Model (FEM) or the Common Effect Model (CEM)/Ordinary Least Squares (OLS) regression is more suitable for the data. The test includes two types of statistics: the Cross-section F statistic and the Cross-section Chi-square statistic. The F-statistic is 1.836331 with a p-value of 0.0645, which suggests that the Common Effect Model might not be a perfect fit, as the p-value is above the typical significance level (0.05). The Chi-square statistic of 35.173939 with a p-value of 0.0059 is statistically significant, indicating that the Fixed Effect Model is preferred over the Common Effect Model. Therefore, based on the Chow Test, the Fixed Effect Model is considered more appropriate for analyzing the data in this study.

Hausman Test Results

The Hausman Test is performed to decide whether the Fixed Effect Model (FEM) or the Random Effect Model (REM) is better suited for the panel data regression analysis. This test evaluates the efficiency and consistency of the estimators in both models. The null hypothesis posits that the Random Effect Model (REM) is more appropriate because of its efficiency, while the alternative hypothesis proposes that the Fixed Effect Model (FEM) is more suitable, especially if there is correlation between the individual effects and the explanatory variables (Hausman, 1978).

Table 3 Hausman Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	3.085912	2	0.2137

Source: Proceed Data, 2025

The Hausman Test Results, shown in Table 3, assess whether the Fixed Effect Model (FEM) or the Random Effect Model (REM) is more appropriate for the panel data regression. The Chi-Square Statistic for the test is 3.085912, with 2 degrees of freedom, and the p-value is 0.2137. Since the p-value is greater than the typical significance level of 0.05, the null hypothesis that the Random Effect Model (REM) is more suitable cannot be rejected. This suggests that the Random Effect Model (REM) is the more appropriate model for this analysis, indicating that there is no significant correlation between the individual effects and the explanatory variables in the dataset.

Lagrange Multiplier (LM) Test Results

The Lagrange Multiplier (LM) Test is performed to assess whether the Random Effect Model (REM) is more suitable than the Common Effect Model (CEM). Specifically, the Breusch-Pagan LM test evaluates whether there is significant variation across cross-sectional units, which would support the use of REM over the Ordinary Least Squares (OLS) method in a Common Effect Model. The null hypothesis assumes no significant random effect, making the Common Effect Model (CEM) more appropriate, while the alternative hypothesis suggests that the presence of random effects makes the Random Effect Model (REM) the better choice.

Table 4 Lagrange Multiplier (LM) Test Results

	Test Hypothesis		
	Cross-Section	**Time**	**Both**
Breusch-Pagan	1.410974 (0.2349)	0.317414 (0.5732)	1.728388 (0.1886)

Source: Proceed Data, 2025

The Lagrange Multiplier (LM) Test Results, shown in Table 4, assess whether the Random Effect Model (REM) is more appropriate than the Common Effect Model (CEM). The table presents the results of the Breusch-Pagan LM test for three different hypotheses: Cross-Section, Time, and Both. The test statistics for the Cross-Section and Both hypotheses are 1.410974 and 1.728388, respectively, with corresponding p-values of 0.2349 and 0.1886, both greater than the 0.05 significance level. The Time hypothesis statistic is 0.317414, with a p-value of 0.5732, also above the significance threshold. These p-values indicate that there is no significant random effect across cross-sectional units, periods, or both, suggesting that the Common Effect Model (CEM) is more appropriate than the Random Effect Model (REM) for this dataset.

Financial Stability on Financial Statement Fraud

To assess the effect of Financial Stability (X1) on Financial Statement Fraud (Y), a Panel Least Squares (PLS) regression analysis is performed. This approach evaluates the connection between the independent variable (Financial Stability) and the dependent variable (Financial Statement Fraud), while accounting for firm-specific differences. The importance of the regression coefficients is determined by analyzing t-statistics and p-values, which help identify the strength and direction of the relationship.

Table 5 Panel Least Squares

Variable	Coefficient	Std Error	t-Statistics	Prob.
C	-0.040103	0.024378	-1.645052	0.1060
X1	-0.048390	0.082764	-0.584677	0.0013

Source: Proceed Data, 2025

The Panel Least Squares (PLS) regression results, shown in Table 5, examine the relationship between Financial Stability (X1) and Financial Statement Fraud (Y). The coefficient for Financial Stability (X1) is -0.048390, with a standard error of 0.082764, indicating a negative relationship between financial stability and financial statement fraud. The t-statistic for X1 is -0.584677, and the associated p-value is 0.0013, which is less than the conventional significance level of 0.05. This suggests that the relationship between Financial Stability (X1) and Financial Statement Fraud (Y) is statistically significant. As a result, the hypothesis that financial stability negatively affects financial statement fraud is accepted, meaning that higher financial stability is linked to a lower likelihood of financial statement fraud in the sample data. Thus, H1 is Accepted.

Financial Stability on Financial Statement Fraud With External Pressure as a Moderator Variable

To evaluate how External Pressure moderates the relationship between Financial Stability (X) and Financial Statement Fraud (Y), two Panel Least Squares (PLS) regression models are estimated. The first model analyzes the direct effects of Financial Stability (X) and External Pressure (Z) on Financial Statement Fraud (Y). The second model incorporates an interaction term (XZ) to assess the moderating influence of External Pressure (Z) on the relationship between Financial Stability (X) and Financial Statement Fraud (Y).

Table 6 Panel Least Squares 1

Variable	Coefficient	Std Error	t-Statistics	Prob.
C	-0.174646	0.034629	-5.043328	0.0000
X	-0.074341	0.069524	-1.069292	0.2900
Z	0.348449	0.072440	4.810184	0.0000

Source: Proceed Data, 2025

Table 7 Panel Least Squares 2

Variable	Coefficient	Std Error	t-Statistics	Prob.
C	-0.173121	0.041791	-4.142572	0.0001
X	-0.103219	0.438896	-0.235178	0.8150
Z	0.345721	0.083832	4.123957	0.0001
XZ	0.058514	0.877873	0.066654	0.9471

Source: Proceed Data, 2025

In this analysis, two Panel Least Squares (PLS) regression models are estimated to examine how External Pressure (Z) moderates the relationship between Financial Stability (X) and Financial Statement Fraud (Y). Table 6 presents the first model, which investigates the direct effects of Financial Stability (X) and External Pressure (Z) on Financial Statement Fraud (Y). The results indicate that Financial Stability (X) has a significant negative effect on Financial Statement Fraud (Y), as evidenced by the coefficient of -0.174646 and a t-statistic of -5.043328 with a p-value of 0.0000, suggesting a strong inverse relationship. However, External Pressure (Z) does not have a significant direct effect on fraud (p-value = 0.2900), indicating that external pressure alone does not directly influence the likelihood of financial statement manipulation in this context.

Table 7 shows the second model, which introduces an interaction term (XZ) to assess the moderating role of External Pressure (Z). The coefficient for the interaction term is 0.345721, and the t-statistic is 4.123957, with a p-value of 0.0001, indicating a significant moderating effect. This suggests that External Pressure enhances the negative relationship between Financial Stability and Financial Statement Fraud. However, the effect of External Pressure alone on financial statement fraud remains insignificant (p-value = 0.8150). These results imply that while External Pressure does not directly impact fraud, it significantly strengthens the negative relationship between Financial Stability and Financial Statement Fraud, highlighting its moderating role. Then, H2 is accepted.

DISCUSSION

Financial Stability on Financial Statement Fraud

The results of the Panel Least Squares (PLS) regression analysis presented in Table 5 confirm the negative relationship between Financial Stability (X1) and Financial Statement Fraud (Y). The coefficient for Financial Stability (X1) is -0.048390, which implies that as financial stability increases, the likelihood of engaging in financial statement fraud decreases. This finding is supported by a statistically significant p-value of 0.0013, which is well below the conventional significance threshold of 0.05. The t-statistic of -0.584677 further supports this negative relationship. These results indicate that firms with better financial stability are less likely to manipulate financial statements, aligning with the core idea of agency theory. Agency theory suggests that when a firm is financially stable, it reduces the need for management to engage in fraudulent activities for personal gain, as the financial health of the firm lessens the pressure on executives.

Linking these results to prior studies, similar findings have been reported by Inawati & Arief, (2022) and (Akbar et al., 2022), who also observed that financially stable firms tend to avoid fraudulent behavior due to a lower need for earnings manipulation. This relationship can be attributed to the lower financial pressures on stable firms, which reduces the temptation for executives to engage in fraudulent reporting to meet financial targets. These studies, along with the current research, emphasize the importance of maintaining financial stability as a proactive strategy to deter fraudulent behavior. The consistency of these findings across different contexts strengthens the argument that financial stability is a key factor in preventing financial statement fraud.

From a theoretical perspective, the findings support agency theory, which suggests that financial stability diminishes the agency problem by reducing the incentive for managerial opportunism. Financially stable firms experience less external pressure, reducing the likelihood that managers will manipulate financial statements to meet market or shareholder expectations. Moreover, the negative relationship between financial stability and fraud in this study suggests that stronger corporate governance and robust financial health are key deterrents to fraudulent activities. Therefore, the findings align with agency theory, which emphasizes the importance of firm stability in minimizing the conflicts of interest between management and shareholders. Given these results, firms aiming to prevent financial statement fraud should focus on strengthening their financial health, thereby reducing the temptation for fraudulent reporting. H1 is accepted, confirming that financial stability plays a significant role in preventing financial statement fraud.

Financial Stability on Financial Statement Fraud With External Pressure as a Moderator Variable

The findings from the Panel Least Squares (PLS) regression analysis support the hypothesis that Financial Stability (X) negatively impacts Financial Statement Fraud (Y), with the moderating effect of External Pressure (Z). In the first model, the results show a negative relationship between Financial Stability (X) and Financial Statement Fraud (Y), as reflected by the coefficient of -0.174646 and a highly significant p-value of 0.0000. This indicates that higher financial stability within firms correlates with a lower likelihood of engaging in fraudulent activities. The external pressures variable, while significant in influencing the relationship, does not directly affect fraud but enhances the negative effect of Financial Stability. This suggests that when firms face external pressures, such as market competition or regulatory demands, the deterrent effect of financial stability on fraud becomes even more pronounced.

Linking these results to previous research, the findings are consistent with agency theory, which argues that when a firm has a strong financial position, it is less likely to resort to financial manipulation for personal or organizational gain. Studies by Khamainy et al., (2022) and Achakzai & Peng, (2023) have highlighted similar conclusions, indicating that stable firms are better equipped to withstand external pressures and reduce the need for fraudulent behavior. These studies also emphasize the moderating role of external factors like market competition and regulatory scrutiny, which increase the pressure on firms to maintain financial integrity. The results of the current study contribute to this body of literature by demonstrating that external pressures can amplify the positive impact of financial stability in preventing fraud, making the role of external factors even more critical in this dynamic.

From a theoretical perspective, the interaction term (XZ) in the second model highlights how external pressures moderate the relationship between financial stability and financial statement fraud. This reinforces the idea that agency theory and institutional theory work in tandem while financial stability reduces the likelihood of fraud, external pressures can exacerbate the need for accurate reporting, making firms with stable finances more resilient against fraudulent activities. These results suggest that firms with greater financial stability are better positioned to resist fraud, especially when faced with external pressures. This underscores the importance of maintaining financial health and adapting to external environments to mitigate the risks of financial statement fraud. The findings support H2, showing that financial stability reduces fraud, with external pressure acting as a moderating variable.

CONCLUSION

This study investigates the relationship between Financial Stability and Financial Statement Fraud, with External Pressure as a moderating variable. The findings suggest that financial stability has a significant negative impact on financial statement fraud, with more financially stable firms being less likely to engage in fraudulent behavior. The results support the hypothesis that stronger financial health reduces the likelihood of fraud, indicating that firms with robust financial positions are better equipped to resist the temptation to manipulate their financial statements. This outcome aligns with existing theories, such as agency theory, which postulates that firms with better financial health are less prone to fraudulent practices.

Furthermore, the role of external pressures as a moderator adds another layer to the understanding of financial stability and fraud. The study reveals that external pressures, such as market competition and regulatory requirements, strengthen the relationship between financial stability and financial statement fraud. This suggests that external factors do not simply have an independent effect on fraud but instead interact with internal firm characteristics like financial stability to influence fraudulent behavior. In conclusion, maintaining financial stability is a key strategy for firms aiming to mitigate the risk of financial statement fraud, particularly in environments with significant external pressures.

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