IJ-ER
INDONESIAN JOURNAL
ECONOMIC REVIEW

Received: 15 Aug 2025 | Revised: 26 Aug 2025 | Accepted: 25 Sep 2025 | Published: 10 October 2025 E-ISSN: 2986-478X, P-ISSN: 2986-1535

DOI: 10.59431/ijer.v5i2.612

RESEARCH ARTICLE

# Analysis Of The Effect Of Financial Distress On Trust Financial Report

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**Abstract**
This paper investigates the impact of financial distress on financial statement trustworthiness. State-owned holding companies from Indonesia were selected for diagnostic analysis on the basis that Structural Equation Modeling (SEM) could be implemented by Partial Least Squares(PLS). The result shows that financial distress is worsba than the confidence in financial reports based on. Companies under financial stress have more broken and less timely financial statements, causing confidence in their Financial information to diminish likewise. The findings underscore the importance of keeping the economy stable to protect the integrity of financial information. Because there are distinct regulatory and financial characteristics for state-owned businesses this analysis highlights how financial distress can imperil information disclosure. Research can take a case-study, official interview and incorporate methods of more qualitative nature in order to further explore the links between financial distress and stakeholder trust. In its significance to policy makers, service providers and managers in state-owned enterprises these conclusions remind us that greater financial discipline and risk management are needed for such against a backdrop of stiffer financial examination.

**Keywords**
Trust in Financial Reports; Financial Distress; State-Owned Enterprises; Financial Credibility; Risk Management.

# 1 | INTRODUCTION

In recent 20 years, the business terrain of Indonesia has changed drastically and is now very competitive. The standard from all industries is higher everyday as everyone strives to accommodate consumers' constantly changing and unpredictable tastes. The goals, conflicts, thresholds described efficiently and measurably in this article are completely consistent with this type of management transfers procedure requirement for strategy that a company 's top management must be able to implement at any one time. Specifically, these strategies must cope with the ever-increasing challenges facing today's global market, such as calls for innovation, production efficiency; as well as heightened demands on corporate governance including more detailed and conscientious financial accounting practices.

According to the 2020 financial report of the Central Government, the provision of public goods and services by Indonesia's national firms (SOEs) has obviously decreased income.Revenue from SOEs under the Ministry of SOEs was recorded at 43.88 trillion rupiah in 2020,down from 49.77previous year 4)the SOEs revenue under the Ministry of Finance also decreased in 2020, dropping from 860.5 billion rupiah in 2019 to 710. 8 billion rwupiahMeanwhile, revenue from the surplus of Indonesian banking institutions amounted to 21.48 trillion rupiah in 2020, down from 30.09 trillion on previous year.The revenue from all Indonesian SOEs in 2020, including those under both the Ministry of SOEs and the Ministry of Coerce, as well as banks, was 66.08 trillion rupiah,a drop of 18.65% on 2019.The fact that it is such a large figure is a clear indicator of the profound impact that SOEs in recent years have had on their overall financial performance.Yet how to tell if they will continue to do well remains unclear.

To restore public trust in state-owned enterprises, close attention must be paid to the quality of financing reports published by them.Over the past year, the public has faced a number of problems concerning SOEs' contentious financial statements including Garuda Indonesia, Jiwasraya and Asabri.You need but contrast these corporate scandals with what has happened in financial statements and the audit trigger. The public has practically lost trust in accountants (Demetriades & Owusu-Agyei, 2021)' These two episodes illustrate real problems behind some state-owned enter prises' publication of financial statements, which undermines their transparency and makes them unaccountable.

Many countries, such as Indonesia, are now using accounting standards designed for global operations. However, we cannot deny the fact that since IFRS has been adopted by many countries in the world, there have been numerous accounting scandals leading to trust erosion in reported financial statements. For example, in Japan's Toshiba Corp. case of 2015 and the cases of Airbus Group in Austria and France 2016-there is also a list of scandals that one would never expect: Rolls Royce (UK), British Telecom (UK), Mexican Oil (Mexico), Caterpillar (USA) 2017. Indonesia has also experienced similar incidents. In Indonesia, such phenomena as PT. Indosat Tbk and PT. "Bank Bukopin" audits (audits by Purwanto, Sungkoro, and Surya Public Accounting Firm (Ernst & Young Indonesia) in 2017), as well as PT. Sun Primanusantara Payment (SNP) audits (audits by Satrio, Bing, Eny, and Rekan Public Accounting Firm (Deloitte Indonesia) in 2018), attracted public attention. In addition, PT. Garuda Indonesia Tbk is under investigation for a case in 2018 involving recognition of sales revenue despite the forbiddance published with its annual financial report, audited by Tanubrata Sutanto Fahmi Bambang & Rekan (BDO International) in 2019 (Sailendra, 2019).

In order to restore public trust in financial statements, especially for newly established firms that are large SOE holdings, there must be research into the elements that will influence trust in financial statements, taking account of matters such as financial distress. One of the major causes of loss of faith in the financial statements is financial distress, which often results from external pressures such as global financial crises, fluctuating exchange rates, declining profitability in the manufacturing sector and falling commodity prices for mining products leading directly to a reduction in a company's revenues and profits. Past studies have shown that financial distress significantly affects a company's capacity to prepare accurate and creditable financial statements. Financial distress can destroy the authenticity of published financial statements and diminish stakeholder confidence in the enterprises. Therefore, in order to regain public trust in financial statements of SOEs, especially those recently established holding enterprises, further research is needed to investigate the impact of financial distress on such financial statements. Accordingly, this research study will focus on the following question: How does financial distress influence trust in financial statements at SOE holding companies in Indonesia? It is hoped that this research will give rise to ideas for liberating financial reports from the bonds of bureaucratic obscurity and encourage genuine reform, in addition to fostering public attitudes toward the attending SOEs as well-run responsible enterprises.

# 2 | BACKGROUND THEORY

Financial statements are a structured presentation of the financial position and financial performance of an entity (Dzomira, 2017). The purpose of financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to most users of financial statements in making economic decisions (Wicaksana & Suryandari, 2019). Financial statements also show the results of management's accountability for the use

of resources entrusted to them. In order to achieve these objectives, financial statements present information about entities that includes: 1. Assets 2. Liabilities 3. Equity 4. Income and expenses, including profits and losses. 5. Contributions from and distributions to owners in their capacity as owners 6. Cash flows This information, along with other information contained in the notes to the financial statements, assists users of financial statements in predicting the entity's future cash flows and, in particular, the timing and certainty of obtaining cash and cash equivalents (IAI, 2016).

Meanwhile, according to the Oxford English Dictionary, trust is giving responsibility to do (something) or a strong belief in the reliability, truthfulness, or ability of someone or something. Meanwhile, according to Miriam Webster's Dictionary, trust is (the) firm belief in the character, ability, strength, or truthfulness of someone or something. From these definitions, the concept of trust is generally closely related to the concepts of assurance and reliability or reliance. To achieve this kind of reliability, various mechanisms or efforts can be implemented, one of which is through corporate governance and external audits of the financial information provided by the company. Good corporate governance and external audits of financial reports should lead to reasonable assurance about financial reports, as the final source used by stakeholders and shareholders outside the company (Saputra & Salim, 2020).

The concept of trust in the economic, accounting, and financial dimensions is in line with the qualitative framework for financial reporting presented by the IAI (2018) and IASB (2015). Furthermore, according to (IAI, 2018; IASB, 2015), the characteristics of financial reporting to make financial statement information useful and reliable (trust) consist of fundamental characteristics, namely relevance and proper representation. As well as enhancing characteristics consisting of comparability, verifiability, timeliness, and understandability. The concept of trust in the economic, accounting, and financial dimensions is closely related to the transparency, accountability, and integrity of data and information conveyed to the public in a democratic society (M. Pirson *et al*., 2019). The main idea is that society holds the true power for the sustainability of an institution or corporation. Therefore, public trust attached to companies, which is reflected in financial reports, is part of an institution that must be respected and protected (Pirson *et al*., 2017).

Financial distress is a condition in which a company is unable to meet its obligations (insolvency) (Vianez *et al*., 2020). Haq *et al*. (2017) in their research stated that financial distress occurs before bankruptcy actually occurs. There are two criteria for financial distress, namely stock-based insolvency and flow-based insolvency. Stock-based insolvency is a condition where a company's financial position report shows negative equity (negative net worth), while flow-based insolvency is a condition where operating cash flow cannot meet the company's current obligations. Sayari & Mugan (2017) define financial distress as a condition in which a company experiences negative net income for several years. Thus, it can be concluded that financial distress is a condition of financial decline reflected in the company's financial statements and operational activities that occurs before the company goes bankrupt. Gutiérrez *et al*. (2015) define financial distress as a condition in which a company's finances are unhealthy or in crisis. In other words, financial distress is a condition in which a company experiences financial difficulties in meeting its obligations. Meanwhile, financial difficulties are liquidity difficulties that prevent a company from running its operations properly (Darmansyah, 2016).

Financial difficulties can be categorized as follows

1) Economic Failure, which means that the company's income cannot cover its own costs. This means that the profit margin is smaller than the cost of capital.
2) Business Failure, defined as a business that ceases operations, resulting in losses for creditors, and is then declared bankrupt even though it did not go through normal bankruptcy proceedings.
3) Technical insolvency, a company can be considered to be experiencing financial difficulties if it does not meet its maturing obligations. Technical insolvency indicates a temporary lack of liquidity, whereby at some point the company can raise money to meet its obligations and continue operating.
4) Insolvency in bankruptcy: a company can be said to be experiencing financial difficulties if the book value of its total liabilities exceeds the market value of its assets.
5) Legal bankruptcy: a company is said to be legally bankrupt unless a formal claim is filed under the law. Indications of financial distress can be identified from a company's financial performance.

Financial performance can be obtained from accounting information derived from financial statements. Financial statements are reports on the position, capabilities, and financial performance of a company, as well as other information required by users of accounting information. According to the IAI (2016), financial statements are part of the financial reporting process. Complete financial statements consist of a balance sheet, income statement, statement of changes in financial position, notes, and other reports related to these statements. Various parties can use financial statements as a basis for making decisions on investment and financing activities, both internal and external to the company. External parties to the company usually react to distress signals such as delays in delivery of goods, product quality issues, bank bills, and so on, which cause changes in operating costs so that the company is unable to meet its obligations. Early indications of financial distress in a company can be seen from the financial statements published by the company, especially the income statement, where the company experiences a net loss and a negative spread due to low borrowing costs compared to deposit interest rates. This study aims to analyze the effect of financial distress on trust in financial statements. According to Clench *et al*. (2021), trust in financial statements has declined since the global financial crisis. Furthermore, trust in financial statements is also directly or indirectly influenced by financial distress (Santosa *et al*.,

2020). Based on and referring to previous literature and research, it can be concluded that trust in financial statements is influenced by financial distress, which is information asymmetry from the perspective of the business-to-business investor relationship with the company.

Figure 1. Conceptual framework

The quality of financial statements greatly affects accountability. Good quality financial statements will promote dedication to accountability or responsibility for the financial statements produced, which will affect the credibility of the financial information presented (Alsmairat *et al*., 2019). The financial condition of companies experiencing financial distress causes them to receive negative audit opinions and lose the trust of their stakeholders. This opinion is also supported by Ardelean (2015); Berglund & Kang (2013); Dunstan (2017), who state that the better the company's financial condition, the less likely it is that there will be high confidence in the financial statements. The company's financial condition is a condition that can be measured quantitatively to describe the state of the company. The company's financial condition referred to is the financial condition that is generally described in the Financial Statements published by the company. Financial difficulties, often referred to as financial distress, are something that all companies try to avoid. Financial distress is defined as the financial condition of a company that experiences a cash shortage on the asset side and excessive debt on the liability side (Izquierdo *et al*., 2020). A shortage of cash inflows results in uncertainty in meeting the company's financial obligations. Financial distress is defined as a condition in which a company experiences difficulties in meeting its obligations, requiring the company to take corrective action. The financial condition of a company reflects its true health (Kurnia *et al*., 2019). If a company experiences liquidity problems, it is very likely that the company will begin to experience financial distress, and if this condition is not quickly resolved, it could result in bankruptcy (Platt & Platt, 2006). This indicates that there is a bad sign, namely that the higher the company's financial distress, the higher the risk of bankruptcy and inability to continue its business, thereby reducing confidence in the company. A company can be said to be experiencing financial distress when there is negative cash flow, a decline in equity prices, layoffs, elimination of dividend payments, technical defaults on debt, predictions of bankruptcy in the future, several years of negative operating income, cessation of operations, and plans for restructuring (Waqas & Md-Rus, 2018). Based on the above explanation, the research hypothesis proposed is that financial distress affects trust in financial statements.

## 3 | METHOD

This study analyzes the empirical phenomenon of trust in financial reports of state-owned enterprises that have become holding companies with a total of 67 companies. The target of this study is accountants who follow the financial developments of state-owned holding companies. The reason for using accountants as the target is because it is hoped that this study can provide a more objective opinion on the real situation regarding the company's financial condition. Furthermore, the researcher determined the criteria for accountants who were the targets of the study, namely.

1) Auditors who work as public accountants.
2) Minimum education of a bachelor's degree.
3) One year of work experience.
4) The target is not limited by the auditor's position at the public accounting firm (junior auditor, senior auditor, supervisor auditor, manager, partner). Thus, all auditors who work as public accountants can be included as respondents.

Table 1. Operationalization of Variables

| Variable | Dimension | Indicator |
|---|---|---|
| Trust Financial report | 1. Benevolence<br>2. Accountability<br>3. Credibility<br>4. Ability<br>5. Transparency<br>6. Integrity | 1. Benevolence<br>2. Accountability<br>3. Credibility<br>4. Restatement of financial reports<br>5. Ability<br>6. Transparency<br>7. Public financial reports<br>8. 8. Integrity |

| Variable | Dimension | Indicator |
|---|---|---|
| Financial distress | 1. Internal<br>2. External | 1. Decline in sales volume<br>2. Decline in the company's ability to generate profits.<br>3. Heavy dependence on debt.<br>4. Decline in dividends<br>5. Continuous decline in profits and the company suffers losses.<br>6. Closure or sale of one or more business units.<br>7. Large-scale layoffs.<br>8. Continuous decline in market prices. |

Source: Compiled by the researcher, 2025

# 4 | RESULTS AND DISCUSSION

### 4.1 Results

The financial statements used in this study were gathered, based on reliable sources, from state-owned enterprises (SOEs) in Indonesia for the years 2019 and 2020. The reports were nerves from both the Ministry of SOEs and the Ministry of Finance. The analysis was concentrated on the financial performance of these companies, with special reference to cases of distress. To get a better feeling for the challenges facing SOEs, the study incorporated data related to famous corporate scandals such as negative effects on public trust in ourreportage of 2017 GCorruption ofposts involving Garuda Indonesia, Jiwasraya and Asabri. Added information on macroeconomic factors was also collected: fluctuation in exchange rates and commodity price changes significantly affected the financial status of these firms.By combining financial and other elements of data, the research aimed to determine how financial distress affects trust in public company financial reporting.

Table 2. Path Coefficients (Mean, STDEV, t-Value)

| Hipotesis | Original Sample (O) | Sample Mean (M) | Standard Deviation (STDEV) | T Statistics (\|O/STDEV\|) | P Values |
|---|---|---|---|---|---|
| *financial distress* -> *trust financial report* | -0,764 | -0,651 | 0,067 | 11,355 | 0,008 |

Source: Output SmartPLS, 2025

Table 2 presents the path coefficients between financial distress and trust in financial reports. The original sample coefficient (O) is -0.764, indicating a negative relationship between financial distress and trust in financial reports. The sample mean (M) is -0.651, and the standard deviation (STDEV) is 0.067. The t-statistic, calculated as the absolute value of the original sample divided by the standard deviation, is 11.355, which is well above the threshold of 1.96, confirming statistical significance. The p-value of 0.008 further supports this, as it is less than the 0.05 significance level, indicating that financial distress significantly affects trust in financial reports.

Table 3. R Square

| Variable | R Square | R Square Adjusted |
|---|---|---|
| Financial distress | 0,980 | 0,979 |
| Trust Financial Report | 0,680 | 0,670 |

Source: Output SmartPLS, 2025

Table 3 shows the R Square and Adjusted R Square values for the variables in the model. For financial distress, the R Square value is 0.980, with an adjusted value of 0.979, suggesting that the model explains nearly 98% of the variation in financial distress. This indicates a very strong fit. For trust in financial reports, the R Square value is 0.680, and the adjusted value is 0.670. These values indicate a moderate level of explanatory power, meaning the model accounts for around 68% of the variation in trust in financial reports.

Table 4. Direct and Indirect Influences

| Hypothesis | Direct Effect | Indirect Effect |
|---|---|---|
| *financial distress* -> *trust financial report* | -0,764 | |

Source: Processed from smartPLS output (2025)

Table 4 presents the direct and indirect effects between financial distress and trust in financial reports. The direct effect of financial distress on trust in financial reports is -0.764, indicating a strong negative relationship. There is no indirect effect reported in this analysis. This suggests that financial distress directly impacts trust in financial reports without any significant mediation or indirect pathways identified in the model. The negative value further reinforces the notion that as financial distress increases, trust in the financial reports of the company declines.

The results of data analysis indicate that there is a significant effect of the financial distress variable on the financial report trust variable. The t-statistic value of 11.355 is greater than the t-table value of 1.962. The original sample value of financial distress is negative, indicating that the financial distress variable has a negative effect on financial report trust. The magnitude of the effect of the financial distress variable on financial report trust is -76.4%. A review of previous studies reveals that the effect of financial distress on trust in financial reports is a subject of considerable interest in the fields of accounting and finance. A number of studies have been conducted to identify the relationship between financial distress and the level of trust in company financial reports. One relevant study conducted by Muñoz-Izquierdo *et al*. (2020) shows that companies experiencing financial distress tend to face significant financial pressure, which in turn can affect the integrity and quality of the financial reports they present. Companies in financial distress have an incentive to engage in aggressive or non-conservative accounting practices in an attempt to improve their financial image or meet desired financial targets. This can reduce stakeholder confidence in the company's financial statements. Another study conducted by Francis *et al*. (2005) also revealed a relationship between financial distress and trust in financial reports. Their findings show that companies experiencing financial distress tend to have lower disclosure levels and lower overall financial report quality. This is due to the financial pressure faced by companies experiencing financial distress, which causes the company's main priority to shift from the quality of financial reporting to the company's survival. As a result, the level of trust in the company's financial reports may decline.

Based on the results of previous studies, it can be concluded that financial distress has a negative impact on trust in financial reports. When companies experience significant financial pressure, especially when facing financial distress, the integrity, quality, and reliability of their financial reports can be affected. This can reduce stakeholders' trust in the company's financial reports. Therefore, it is important for companies facing financial distress to improve the transparency, integrity, and quality of financial reporting in an effort to restore stakeholder confidence. In addition, several studies also highlight the factors that influence the effect of financial distress on trust in financial reports. The results of this study reinforce previous research findings that financial distress can have a negative effect on trust in financial reports. When a company experiences significant financial pressure, the integrity, quality, and reliability of its financial reports may be affected. Therefore, companies need to make efforts to ensure high-quality financial reporting and adequate transparency of information, especially when facing financial distress, in order to maintain or restore stakeholder trust.

### 4.2 Discussion

The relationship between financial distress and trust in financial reports is a significant topic in corporate governance and accounting. When companies face financial difficulties, they may resort to aggressive accounting practices to enhance their perceived financial health, which can undermine the reliability and credibility of their financial reports. This issue has been explored in several studies, with evidence suggesting that financial distress negatively impacts trust in the financial reporting of firms, particularly in state-owned enterprises (SOEs) in Indonesia. Financial distress occurs when a company struggles to meet its financial obligations, often due to a combination of low profitability, high leverage, poor liquidity, and declining revenue. Several studies, including those by Dirman (2020) and Habib *et al*. (2020), have discussed various factors contributing to financial distress and its impact on firm operations. For instance, Dirman (2020) examined how profitability, liquidity, leverage, firm size, and free cash flow affect a company's ability to manage financial distress. These factors play a critical role in the company's decision-making process, especially when determining how much transparency and integrity can be maintained in financial reports.

One of the key findings from this research is the role of corporate governance in mitigating the effects of financial distress. As noted by Abbas *et al*. (2021), the presence of independent commissioners and a strong audit committee can help ensure the integrity of financial statements, even during times of financial pressure. These governance mechanisms are especially important in SOEs, where the need for transparency and accountability is higher due to public ownership and regulatory oversight. Similarly, Chen *et al*. (2020) emphasized that strong corporate governance can act as a buffer against the negative effects of financial distress, ensuring proper monitoring and reducing the likelihood of financial manipulation. However, when companies are under financial stress, their primary focus often shifts from maintaining high-quality financial reporting to addressing immediate survival concerns. As shown by Du and Lai (2018), distressed companies may engage in practices like poor audit quality, which can worsen the issue by reducing the reliability of financial information. This leads to a situation where stakeholders, including investors, creditors, and regulators, lose trust in the financial reports, further exacerbating the company's financial difficulties.

The findings of this study support the hypothesis that financial distress negatively impacts trust in financial reports. The analysis of the path coefficients in Table 2 revealed a strong negative relationship between financial distress and trust in financial reports, with a path coefficient of -0.764. This indicates that as financial distress increases, the level of trust in

the company's financial reports decreases. The t-statistic of 11.355 and the p-value of 0.008 further confirm the statistical significance of this relationship. This result aligns with the findings of Muñoz-Izquierdo *et al*. (2020) and Francis *et al*. (2005), who demonstrated that financial distress often leads to lower disclosure levels and poorer overall financial report quality. Additionally, the R-square values in Table 3 suggest that financial distress accounts for a significant portion of the variation in trust in financial reports. The R-square value of 0.980 for financial distress indicates that the model explains nearly 98% of the variation in this variable, showing very strong explanatory power. For trust in financial reports, the R-square value of 0.680 indicates moderate explanatory power, with the model accounting for 68% of the variation in this variable. These findings suggest that while financial distress is a major factor influencing trust in financial reports, other factors such as corporate governance, audit quality, and market conditions also play a role.

This study highlights the direct impact of financial distress on trust in financial reports. As shown in Table 4, the direct effect of financial distress on trust is -0.764, reinforcing the idea that financial distress directly reduces the level of trust in a company's financial reports. No significant indirect effects were identified in this analysis, suggesting that the relationship between financial distress and trust is not mediated by other factors, such as audit quality or corporate governance mechanisms. Several studies, including Demetriades and Owusu-Agyei (2022) and Sayari and Mugan (2017), have explored the implications of financial distress for financial reporting and the credibility of financial information. Their findings indicate that when companies face financial pressure, they are more likely to engage in earnings management, which can lead to fraudulent financial reporting. The use of aggressive accounting techniques, such as manipulating revenue recognition or delaying expense recognition, can distort the true financial health of a company and erode stakeholder trust.

In the case of SOEs in Indonesia, as discussed by Erwin Pemana *et al*. (2019) and Sayidah and Assagaf (2020), the stakes are even higher. These companies are subject to public scrutiny and regulatory oversight, and any decline in the quality of their financial reports can have significant implications for their credibility and public image. The results of this study emphasize the importance of maintaining transparency and integrity in financial reporting, particularly during times of financial distress. Companies facing financial difficulties must prioritize accurate financial disclosure and avoid the temptation to manipulate financial statements to present a more favorable view of their financial health.

The findings of this research reinforce the growing body of evidence that financial distress negatively affects trust in financial reports. The relationship between financial distress and the quality of financial reporting is complex and multifaceted, influenced by factors such as corporate governance, audit quality, and the broader economic environment. To mitigate the impact of financial distress on trust in financial reports, companies, especially SOEs, must ensure strong governance mechanisms, maintain high audit quality, and prioritize transparency in financial disclosures. This is crucial not only for restoring stakeholder confidence but also for ensuring the long-term financial stability and credibility of the company.

## 5 | CONCLUSIONS AND FUTURE WORK

Financial distress negatively affects trust in financial reports. When a company experiences financial difficulties, it faces immense pressure to improve its financial position, which can compromise the integrity and quality of its financial statements. Companies in financial distress often resort to aggressive or non-conservative accounting methods to present a more favorable financial picture or to meet specific financial targets. These practices, such as inflating revenues or hiding liabilities, can distort the true financial health of the company and undermine the reliability of the financial reports. As financial distress intensifies, the company's primary concern shifts from providing accurate financial reporting to ensuring its survival. This shift reduces the emphasis on producing reliable financial statements, leading to potential manipulation of data. Stakeholders, including investors, creditors, and regulators, may begin to question the authenticity of the financial reports if they suspect that management is prioritizing appearance over accuracy. When management is tempted to use improper accounting practices to create a more positive financial outlook, trust in the company's financial statements erodes even further. This loss of confidence can have long-lasting effects, making it harder for the company to secure funding, damage its reputation, and result in legal consequences. Financial distress, therefore, not only affects the company's short-term financial health but also harms its credibility in the eyes of stakeholders. Once trust in financial reports is lost, recovery becomes much more difficult.

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How to cite this article: Setiawan, I., & Dharma, D. A. (2025). Analysis Of The Effect Of Financial Distress On Trust Financial Report. Indonesian Journal Economic Review (IJER), 5(2), 266-273. https://doi.org/10.59431/ijer.v5i2.612