Beyond Expectations: Corporate Governance's Insufficiency in Fraud Prevention

Nuraini A*, Nita Erika Ariani, Maya Febrianty Lautania
Universitas Syiah Kuala, Indonesia
*Corresponding Author: nurainia@usk.ac.id

Abstract
Objective –The specific objectives to be achieved in this research are to (1) test the Beneish model (1999) as a predictor of reliable manipulation or indicator to reveal signals or symptoms of financial reporting fraud. (2) Test whether corporate governance effectiveness reduces financial statement fraud.

Design/Methodology –The research analyzed publicly listed non-financial firms listed in Indonesia's stock exchange (IDX) from 2017 to 2022. Simple random sampling was used to select 86 companies per year, resulting in 617 year-firm observations. Data analysis was carried out by logistic regression multiple with panel data. The test was carried out by adopting the Beneish benchmark index (Z-score) model which is effective for predicting indications of fraudulent financial statements.

Results –The test results show that there is 99.8% of incidents indicated financial statement fraud and the other 0.2% did not indicate financial statement fraud. Corporate governance mechanisms consisting of institutional ownership, audit committees, and audit quality does not mitigate fraud. It is anticipated that the research's contribution will serve as a practical guide and reference for the examination of indicators of fraud in corporate finances. The findings of this study are expected to provide valuable insights for policymakers and regulators seeking to improve corporate governance practices.

Research limitations/implications –This research does not incorporate the competency and capability specifications of governance structures such as the board of commissioners, audit committees, and external auditors. Future investigations are anticipated to delve more profoundly into the internal and external corporate governance capabilities and specifications.

Novelty/Originality –This study reveals that, on the whole, a significant proportion of companies are implicated in fraudulent activities, while corporate governance mechanisms are deemed inadequate in overseeing management activities conducive to fraud. The outcomes of this research challenge the prevailing paradigm of corporate governance as an effective deterrent against fraudulent behavior.

Keywords: Corporate Governance, Corporate Fraud

1. Introduction

Corporate governance has become a major focus in the public and private sectors in recent decades. Hong (2019); Kachouri & Jarboui (2017); Wondem & Singh Batra (2019) endeavors persist in scrutinizing corporate governance, revealing substantial evidence indicating inadequate implementation of corporate governance practices. Following significant corporate scandals such as Enron, WorldCom, Tyco, Parmalat, and numerous others, financial reports credibility and auditors and accountants' responsibilities became subjects of widespread questioning (bin Kiflee & bin Ali Khan, 2020). These issues emerged as focal points of concern within corporate governance for several years. In fact, corporate scandals unveil vulnerabilities in both internal and external controls within companies, underscoring the imperative for

effective governance practices to identify and address such shortcomings (Costa, 2017; Rezaee & Riley, 2012; Solomon, 2020).

Assessing the efficacy of corporate governance in thwarting fraud is a complex task. (Sadique et al., 2019) indicate that numerous characteristics associated with robust corporate governance do not possess the capability to identify instances of corporate fraud. Following instances of financial statement fraud, companies tend to enhance their corporate governance practices in response to the fraud occurrence (Nasir et al., 2019).

On the other hand, many research results claim that strengthening corporate governance serves as a deterrent against a range of egregious offenses including fraud, corruption, abuse of authority, and others, all of which have far-reaching negative repercussions across various facets of life (Kassem, 2022; Nasir et al., 2019; Rohmatin et al., 2021). Corporate governance stands as a vital mechanism in preventing and uncovering fraud and corruption through an effective framework of checks and balances, diligent oversight, and transparent practices (Arens et al., 2017; Hopwood et al., 2012; Rezaee & Riley, 2012). Effective corporate governance results in better supervision and control, thereby reducing the possibility of creative accounting and fraud (Costa, 2017; Sadique et al., 2019). However, in its development, corporate governance is seen as less capable of reducing various white-collar crimes.

The phenomenon of white-collar crime such as fraud constitutes an underlying peril that poses a global threat. According to research findings from the Association of Certified Fraud Examiners (ACFE) Global, on average, approximately 5% of an organization's revenue falls prey to fraudulent activities each year. The ACFE's research detailed in the Report to the Nations (RTTN) elucidates that in 2016, the collective losses incurred due to fraud amounted to USD 6.3 billion, with an average financial loss per case exceeding USD 2.7 million (Fadli & Junaidi, 2022). At the national level, many IDX listed firms are involved in corporate fraud cases (Sari & Preambul, 2019).

In light of the escalating instances of financial crimes like fraud, it becomes imperative for corporate governance evolution to align with distinct needs and environment of the company. This adaptation should extend beyond mere compliance with regulatory requirements (Sadique et al., 2019). The efficacy of corporate governance is contingent upon the legal, regulatory, environmental, and institutional frameworks. Meaningful alterations in governance mechanisms should be directed towards rectifying governance deficiencies, thereby instilling confidence among both shareholders and stakeholders (Costa, 2017).

In the literature, It is asserted that various methods or models exist for the detection of fraud, and one such model is the Beneish model (1999) which has been tested in several studies such as research by Seifzadeh, Rajaeei, & Allahbakhsh (2022) and Martins & Júnior (2020) proves that the Beneish ratio (1999) is predictor reliable manipulation or indicator to measure signals or symptom fraudulent financial reporting (Martins & Júnior, 2020; Ratmono & Cahyonowati, 2016; Seifzadeh et al., 2022).

While there has been a considerable amount of prior research on corporate governance, there remains a gap in understanding the effectiveness of corporate governance in preventing fraud. Some studies indicate a positive correlation between strong corporate governance mechanisms and reduced fraud (Halbouni et al., 2016; Sadique et al., 2019; Yang et al., 2017), while others also suggest that specific corporate governance characteristics may not effectively mitigate fraud (Christinawati & Setiyawati, 2022; Herawati, 2012). This gap necessitates further examination of the corporate governance characteristics contributing to fraud prevention and the conditions under which governance mechanisms may fail to detect fraudulent behavior.

In contrast to previous research mostly supporting the idea of corporate governance as an effective deterrent to fraudulent behavior, this study investigates whether corporate governance remains relevant as an effective mechanism for fraud

prevention, considering the prevalence of fraud cases in companies with effective corporate governance.

This research aims to provide a different perspective on the relationship between corporate governance and fraud mitigation, thereby contributing to the ongoing discourse on the effectiveness of governance. Furthermore, it endeavors to examine the function of corporate governance mechanisms in mitigating such indications and ascertain potential differences in corporate governance structures between entities implicated in fraudulent financial reporting and those devoid of such allegations.

The paper is structured into five sections. The second section conducts a comprehensive literature review, theoretical framework, and hypotheses development to assess prior research on corporate governance and constructs a conceptual foundation based on the literature reviewed. The third section outlines the research method, detailing data collection and analysis procedures. Subsequently, the fourth section, results and discussion presents the empirical findings, interpreting them in light of the hypotheses and theoretical framework. Finally, the last section concludes the findings, limitations, and suggestions for future research.

2. Literature Review, Theoretical Framework, and Hypotheses Development

2.1 Literature Review

The agency theory, as articulated by Jensen and Meckling (Jensen & Meckling, 1976), centers on the relationship between owners and agents within a company, emphasizing the divergence of interests between them. In this theory, the most common contractual relationship is between principals and agents. It has been widely applied across various fields, including accounting, management, and economics, and also provides insights into the appointment and performance of external auditors (Payne & Petrenko, 2019), and plays a crucial role in understanding conflicts of interest between managers and shareholders (Bendickson et al., 2016).

The relationship between agency theory and corporate fraud lies in the theory's emphasis on the principal-agent relationship and inherent conflicts of interest. Research has shown that agency theory associates uncertainty in performance outcomes with moral hazard and adverse selection (Su & Zhang, 2017). Moreover, its application in supply chain management has highlighted its relevance in addressing control issues and opportunistic behaviors (Köksal & Strähle, 2021). Furthermore, the literature has explored implications (Greenwood & Tao, 2021).

Moreover, behavioral agency theory, as discussed by Erlei & Schenk-Mathes (2017), offers a different understanding of how bounded rationality influences the principal-agent relationship, highlighting behavioral aspects that may contribute to fraudulent activities within organizations. This perspective aligns with a critical evaluation of agency theory, which seeks to uncover its limitations and address its criticisms (Rahman et al., 2019). The governance mechanisms also reduce conflicts of interest by providing oversight functions over management in the company (Handayani et al., 2023). Corporate governance plays a moderate role in preventing and detecting fraud; hence, senior management and the board of directors must better understand the importance of their oversight function. This understanding will enable senior management and the board of directors to fulfill their fiduciary duties and responsibilities to stakeholders (Halbouni et al., 2016).

2.2 Research Hypothesis

What drives companies to engage in corporate misconduct is a primary topic in corporate governance research (Wang et al., 2016). Corporate governance plays a moderate role in preventing and detecting fraud; hence, senior management and the board of directors must better understand the importance of their oversight function. This understanding will enable senior management and the board of directors to fulfill

their fiduciary duties and responsibilities to stakeholders (Halbouni et al., 2016). Many strong characteristics of corporate governance are unable to detect corporate fraud occurrences (Sadique et al., 2019).

Meanwhile, Kassem (2022) asserts that effective corporate governance can help reduce the risk of fraud, prevent it, and detect fraud, whether it involves financial statement fraud or asset misappropriation. Some companies utilize corporate governance mechanisms to enhance their reputation following fraud detection. Ineffective corporate governance increases the risk of fraud, provides opportunities for fraudulent activities, and reduces the likelihood of fraud detection.

The ultimate goal of corporate governance is to ensure that the company is well-run, achieves its objectives, and assures stakeholders that their trust is placed in the right hands (ICSA, 2020). However, ensuring stakeholder trust and the long-term success of an organization is not solely the responsibility of management and directors. Effective corporate governance also requires efforts and commitment from auditors, audit committees, and employees with honesty and competence, as well as effective legal frameworks and regulations. Effective corporate governance mechanisms in achieving their objectives consist of broad governance aspects, including board leadership and the role of ethics; board characteristics, composition, and structure; ownership structure; and accountability (Kassem, 2022).

2.2.1 Board of Directors and Fraud

Based on agency theory, managers have their interests, and independent directors are efficient monitoring tools to protect shareholders' interests, prevent managers from acting in their best interests, and reduce principal-agent conflicts. In line with this, boards with a higher number of independent directors are more capable of fulfilling monitoring functions and supporting business performance improvement (Jensen & Meckling, 1976). There is diverse evidence in empirical literature regarding whether independent boards can serve as efficient monitoring tools and reduce corporate fraud.

Biduri, Nur Fadhila, Rahma Dewi, & Maryanti (2023) identified that to control managerial actions was the presence of a larger board of independent commissioners compared to a board affiliated with internal company interests. A larger size of independent boards has resulted in better control over management. Independent commissioners, through their presence, bring stronger governance implementation. The significant size of independent boards can notably reduce fraudulent actions occurring within the company (Aldaoud, 2019). Companies engaged in fraud tend to have weak governance structures and lack strong controls over management activities. Kaituko, Githaiga, & Chelogoi (2023) found that the independence of commissioners and the frequency of board meetings significantly reduce the likelihood of financial statement fraud.

On the other hand, Yang et al. (2017) did not find that the percentage of independent commissioners plays a role in preventing financial fraud in China. Gulzar, Haque, & Khan (2020) found empirical evidence that the independence of the board does not impact the performance of textile companies listed in India. Companies engaged in fraud tend to have fewer independent commissioners both in number and percentage. The authors found that businesses lacking independent directors and with CEO duality are more likely to falsify their financial reports. Despite empirical discrepancies from previous research, the hypotheses proposed in this study refer to the concept of positivism. Therefore, the following hypotheses are suggested:

H1. The independent board of commissioners affect corporate fraud

2.2.2 Audit Committee and Fraud

Effective audit committees play a crucial role in preventing fraudulent activities, as evidenced by the findings of Halbouni et al. (2016). Mousavi, Zimon, Salehi, &

Stępnicka (2022), as well as Nasir et al. (2019), highlight the importance of having audit committees in addressing fraud and monitoring the financial management of companies. The size of the audit committee becomes a crucial determinant of the quality of earnings, showing a deep correlation with agency theory (Hamdan et al., 2017). Audit committees are linked to increasing the integrity of information presented in financial reports and shareholders' perceptions of the independence of the external auditors selected by the company. Quality audit committees contribute more significantly to mitigating threats to auditor independence in assessing the fairness of the company's financial reports (Halbouni et al., 2016; Hilton & Arkorful, 2021; Mousavi et al., 2022; Sadique et al., 2019). Conversely, Al-Rassas & Kamardin (2015) and Asikin, Zakiy, Zaenuri, & Fauziah (2022)did not find a significant relationship between the two in their research. Thus, the following hypotheses are proposed:

H2. The audit committee affect corporate fraud

2.2.3 External Audit Quality and Fraud

The fairness of a company's financial statements can be observed through the audit results. The quality of the audit is influenced by the competency of the resources possessed by auditors. Lee, Rhee, & Yoon (2018) argue that audit services play a role in addressing agency problems. The resources or competencies possessed by auditors strongly impact the audit reports generated. External auditors play a crucial role in providing accurate and reliable perspectives regarding the fairness of a company's financials (Apriliana & Agustina, 2017). Lee et al. (2018) identified the superior reliability of audit quality among Big 6 auditors compared to non-Big 6 auditors. Conversely, Apriliana & Agustina (2017) found that revenue management is less practiced in companies using Big 6 audit services. Hence, the following hypotheses are proposed:

H3. Audit quality affect corporate fraud

2.2.4 Institutional Ownership and Fraud

Institutional ownership structure refers to stock ownership by external institutional entities. Rakayana, Sudarma, & Rosidi (2021) and Agustina & Mappadang (2022)found that when the percentage of institutional shares is higher, the operation of company assets tends to be more effective. It can be interpreted as implying that the greater the institutional share ownership, the higher the level of management oversight. A. Girau, Bujang, Paulus Jidwin, & Said (2022) as well as Rizwan & Chughtai (2023), provide empirical evidence that institutional investors actively perform management monitoring functions and tend to indirectly pose threats regarding their stock divestment. In Malaysia, where the economy is actively regulated, expanding institutional ownership has been found to increase management oversight and efficiency in reducing fraudulent activities and other illegal actions (A. Girau et al., 2022). Hence, the following hypothesis is proposed:

H4. Institutional ownership affect corporate fraud

3. Research Method

The study's population comprised IDX non-financial listed firms from 2017 to 2022, encompassing a total of 618 companies. We used simple random as sampling method, with the Slovin formula approach, with an error margin of 10%, 86 companies were obtained per year. The total samples followed Slovin's formula is:

$$n = \frac{N}{1 + Ne^2}$$

$$n = \frac{618}{1 + 618(0.1)^2}$$

$$n = 86$$

The method used for research purposes is a quantitative method. Quantitative methods are used to predict the possibility of indications of fraud in financial reports in company financial reports and to test the effectiveness of corporate governance between companies that are indicated to have committed financial report fraud and those that have not committed financial report fraud. The corporate report fraud variable is measured utilizing the Beneish (1999) model to predict indications of corporate fraud, which has been widely adopted in numerous research due to its effectiveness in analyzing financial statement fraud (Martins & Júnior, 2020; Seifzadeh et al., 2022). Additionally, the Beneish model has been considered as a cost-effective and efficient method for identifying potentially fraudulent activities within companies.

Variable	Measurement	Criteria
Financial Statement Fraud	1. *Days' Sales In Receivables Index* $\frac{(Account\ Receivable\ /\ Sales)\ t}{(Account\ Receivable\ /\ Sales)\ t_{-1}}$	When the ratio *DSRI* ≥ 1.465 indicated Fraud ≤1.031 not indicated
	2. *Gross Margin Index* $\frac{((Sales\ t_{-1} - Hpp\ t_{-1})\ /\ Sales\ t_{-1}))}{((Sales\ t - Hpp\ t)\ /\ sales\ t))}$	When the ratio *GMI* ≥ 1.193 indicated Fraud ≤ 1.014 is not indicated
	3. *Asset Quality Index* $\frac{(1 - ((Current\ Assets + net\ fixed\ asset)\ /\ Total\ Assets))\ t}{(1 - ((Current\ Assets + net\ fixed\ asset)\ /\ Total\ Assets))\ t_{-1}}$	When the ratio *AQI* ≥ 1.254 indicated Fraud ≤ 1.039 not indicated
	4. *Sales Growth Index* $\frac{(Sales)\ t}{(Sales)\ t_{-1}}$	When the ratio *SGI* ≥ 1.607 indicated Fraud ≤1.134 is not indicated
	5. *Total Accruals o Total Assets Index* $\frac{[\{\Delta CA_t - \Delta Cash_t\} - (\Delta CL_t - \Delta CLD_t - \Delta ITPt) - D\ and\ A_t]}{Total\ Asset}$	≥ 0.031 indicated Fraud ≤ 0.018 is not an indication of fraud

Table 1. Variable Measurements

To assess whether a company can be categorized as being suspected of committing fraudulent financial reporting, Beneish calculates the average benchmark index of the five ratios as follows:

$$Z = -4.840 + 0.920\ DIRI + 0.528\ GMI + 0.404\ AQI + 0.892\ IGI + 4.679\ ACC$$

If the z score value is > -1.99 then it is categorized as a company committing fraudulent financial reporting, while a z score value < -1.99 is categorized as a company not committing fraudulent financial reporting (Seifzadeh et al., 2022). Corporate governance is classified into several mechanisms, namely: 1) Board independence, gauged by the proportion of independent commissioners, 2) Audit committees, assessed by the composition audit committee member, 3) External audit quality, determined by Big and non-Big 4 KAPs, 4) Institutional ownership monitoring, assessed by ownership shares portion held by institutional investors.

To evaluate the corporate governance efficacy in mitigating corporate fraud, we employ logit regression with the subsequent formula:

$$\log\left(\frac{p}{1-p}\right) = b0 + b1\ X1 + b2X2 + b3X3 + b4X4$$

Where:

$\log\left(\frac{p}{1-p}\right)$ = Financial statement fraud

b0 = Constant
b1 = Regression Coefficient
X1 = Board of commissioners
X2 = Audit Committee
X3 = Audit Quality
X4 = Institutional ownership

Hypothesis:
H1. The independent board of commissioners affect corporate fraud
H2. The audit committee affect corporate fraud
H3. Audit quality affect corporate fraud
H4. Institutional ownership affects corporate fraud

4. Results

4.1 Statistic descriptive

Table 2 shows that 99.8% of IDX listed firms are indicated to have committed fraud. In this research corporate fraud is estimated using the model Beneish benchmark index (Z score) Z = -4.840 + 0.920 DIRI + 0.528 GMI + 0.404 AQI + 0.892 IGI + 4.679 ACC. If the z score value is > -1.99 (categorized as a company that commits corporate fraud), while the z score value < -1.99 (categorized as a company that does not commit corporate fraud). Conversely, the oversight of corporate governance mechanisms proves ineffective, as evidenced by the descriptive statistical values of audit quality and institutional ownership.

The results of descriptive statistics show that most companies are owned by institutional ownership with share ownership above 20%. This result should indicate a presence of supervision and control from strong institutional ownership in reducing practices of error, fraud, and irregularities within companies. However, the descriptive statistics results also reveal a high indication of fraud, which is 99.8%. It suggests that the supervisory role of institutional ownership may not be optimal in mitigating fraud risks. Similarly, the quality of audits conducted by Big-4 accounting firms, known for their excellent human resources, cutting-edge technology, and adequate facilities, does not guarantee the successful detection of fraud, errors, or irregularities.

		Frequency	**Percent**	**Valid Percent**	**Cumulative Percent**
Valid	Non-Fraud	1	.2	.2	.2
	Fraud	515	99.8	99.8	100.0
	Total	516	100.0	100.0	
Valid	Institutional Ownership <20%	5	1.0	1.0	1.0
	Institutional Ownership >20%	511	99.0	99.0	100.0
	Total	516	100.0	100.0	
Valid	Non-Big 4	197	38.2	38.2	38.2
	Big 4	319	61.8	61.8	100.0
	Total	516	100.0	100.0	

Table 2. Statistic Descriptive

4.2 Hypothesis Testing

To assess the impact of the Board of Commissioners, Audit Committee, Audit Quality, and Institutional Ownership on Financial Report Fraud, multiple logistic regression analysis was conducted, yielding the following results:

Table 3.
Hypothesis
Testing Results

Variables in the Equation							
		B	S.E.	Forest	df	Sig.	Exp(B)
Step 1[a]	Board Independent	-11.328	17.536	.417	1	.518	.000
	Audit Committee	-4.242	2.377	3.183	1	.074	.014
	External Audit Quality	20.274	1451. 268	.000	1	.989	638096370.4
	Institutional Share Ownership	7.702	5.481	1.975	1	.160	2213.488
	Constant	18.899	13.315	2.015	1	.156	161409800.1

Table 4.
Overall Model Fit
Testing results

Hosmer-Lemeshow Test			
Step	Chi-square	df	Say.
1	.029	8	1.000
Nagelkerke's R Square Test			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	6.610[a]	.015	.547

Classification Table				
		Predicted		
		Fraud		**Percentage Correct**
Observed		**Non-Fraud**	**Fraud**	
Fraud	Non-Fraud	0	1	.0
	Fraud	0	513	100.0
Overall Percentage				99.8

To test the suitability of the logit model, the Hosmer-Lemeshow test was used. Statistical value Chi-Square obtained is 0.029 with p (sig) = 1.000. Because the Chi-square count (0.029) is smaller Chi-square table (15.507) or with a significance of 1.000 > 0.05 shows that the logistic regression model can be used to predict financial statement fraud. Overall, the accuracy of the model classification in predicting financial statement fraud is 99.8%. The results of the logit model calculation show Nagelkerke R Square amounting to 0.547, which means that the Board of Commissioners, Audit Committee, Audit Quality, and Institutional Ownership have an influence of 54.7% on financial statement fraud, while the overall test results use test statistics Chi-Square, Omnibus Tests as follows.

Table 5.
All Test

Omnibus Tests of Model Coefficients				
		Chi-square	**df**	**Say.**
Step 1	Step	7.872	4	.096
	Block	7.872	4	.096
	Model	7.872	4	.096

Test statistical value Chi-Square and The Omnibus Tests obtained were 7.872 with a significance value of 0.096. From the Chi-square table for an error rate of 5% and degrees of freedom = 4, it is obtained (0.05;4) = 9.488. Because Chi-square count (7.872) <Chi-square table (9.488) with a significance of 0.096 (> 0.05), meaning the test is not significant. The test results can be concluded that the Board of

Commissioners, Audit Committee, Audit Quality, and Institutional Ownership do not affect financial statement fraud.

5. Discussion

Hypothesis testing is carried out using the Wald test to see the influence of the board of commissioners, Audit Committee, Audit Quality, and institutional ownership on financial statement fraud. Testing is carried out by looking at the Wald test value, namely comparing the values Chi-square table obtained from the table Chi-square for 0.05 and degree of freedom 1 is 3.841.

Based on table 3, shows that the Board of Commissioners has statistical values amounting to 0.417 with a significance level of 0.520. The statistical value-forest for the variable Board of Commissioners is smaller than the value Chi-square table (0.417 < 3.841) then H0 is received and Ha is rejected. The test significance value (p) for the Board of Commissioners variable is greater than the real level of 0.05 (0.518 > 0.05), which means the test is not significant. Therefore, board of commissioners does not have a significant effect on financial statement fraud. The results of this study are in accordance with Nawawi & Salin (2018), that the board of commissioners does not reduce financial statement fraud. The supervisory function of the board of commissioners through strategic policies does not reduce misstatements in financial reports. Nawawi & Salin (2018) state that in developing countries such as Malaysia, many boards of commissioner positions have a negative effect on the board's monitoring function, due to potential conflicts of interest and lower commitment from the board of commissioners, this is also in line with the results of this research.

The Audit Committee has a statistical value amounting to 3.183 with a significance level of 0.074. The statistical value-forest for the Audit Committee variable is smaller than the value Chi-square table (3.183 < 3.841) then H0 is received and Ha is rejected. The test significance value (p) for the Audit Committee variable is greater than the real level of 0.05 (0.074 > 0.05), which means the test is not significant. So, the Audit Committee does not have a significant effect on financial statement fraud.

The research results are in line with the research conducted by Asikin et al. (2022), and Al-Rassas & Kamardin (2015) The number of audit committees does not significantly influence financial statement fraud. The existence of an audit committee does not have a significant impact on audit quality and also identifies no significant impact on financial statement fraud. This result is also supported by research by Apriliana & Agustina (2017) where the appointment of committee members was due to compliance with relevant laws so that they were considered not yet convincing in terms of their ability to carry out their duties effectively because committee members still received benefits from the company.

Audit quality has a statistical value of 0.000, the significant level is 0.989. The statistical value-forest for the Audit Quality variable is smaller than the value of Chi-square table (0.000 < 3.841) then H0 is received and Ha is rejected. The test significance value (p) for the Audit Quality variable is greater than the real level of 0.05 (0.989 < 0.05), which means the test is not significant. So, audit quality does not have a significant effect on financial statement fraud. The results of this research are in line with previous research (Abdelmalek, 2020). The research results identified no significant differences in audit quality produced by both Big4 auditors and non-Big4 auditors. so that no significant influence of audit quality was found on the disclosure of fraud in financial statements.

Institutional ownership has a statistical value amounting to 1.975 with a significance level of 0.160. Statistical value for the institutional ownership variable is smaller than the value of Chi-square table (1.975 < 3.841) then H0 is received and Ha is rejected. The test significance value (p) for the institutional ownership variable is greater than the real level of 0.05 (0.160 > 0.05), which means the test is not significant. So Institutional ownership does affect corporate fraud. In the institutional ownership setting in Indonesia, institutional ownership does not play an important role in

monitoring indications of fraudulent financial statements. These results suggest that institutional ownership in Indonesia is short-term oriented so that it does not provide supervision over company activities and misstatements in financial reports, Goodwin, Atilgan, Simsir, & Ahmed (2017) that correlation between myopic corporate decision-making and institutional ownership might be associated with the nature of institutional oversight.

The results of this study indicate that corporate governance does not influence preventing the likelihood of fraud. This finding contrasts with previous research on corporate governance mechanisms, such as Biduri et al. (2023), Aldaoud (2019), and Kaituko et al. (2023), which suggested that controlling deviant managerial actions could be achieved through the oversight of independent commissioners. The weakness of independent commissioner control provides a loophole for managerial involvement in errors or fraud.

Quality audit committees contribute more significantly to mitigating threats to auditor independence in assessing the fairness of a company's financial statements, including fraud (Halbouni et al., 2016; Hilton & Arkorful, 2021; Mousavi et al., 2022; Sadique et al., 2019). Actively supervising institutional ownership reduces fraudulent activities and other illegal actions (A. Girau et al., 2022; Rizwan & Chughtai, 2023).

The effectiveness of corporate governance in preventing fraud is quite complex and not easily measurable (Sadique et al., 2019). Effective corporate governance will result in better monitoring and control (if not) of management activities and corporate reporting. The findings indicate that many strong corporate governance characteristics failed to detect corporate fraud. It suggests that the development of corporate governance should be tailored to the unique needs and environment of the company within the Indonesian Stock Exchange settings, and not just focus on regulatory compliance. Specifically, board members and audit committees should be more effective in assessing and evaluating financial reports. This study also suggests that other corporate governance characteristics should be investigated to determine their relationship with the likelihood of corporate fraud.

6. Conclusion and Limitation

Governance has become one of the important indicators that a company must have in maintaining the effectiveness of company management by management, especially in preventing acts of fraud committed internally by the company. Fraud can occur when existing supervision is too weak. There is too much evidence that shows the implementation of governance is still low and inadequate in carrying out its functions. The indicators of governance in this research, including the independent board of commissioners, audit committee, external audit quality, and institutional ownership, demonstrate that they do not contribute to preventing fraud in the business environment. As a developing country, Indonesia is still one of the countries with low governance implementation. Certain internal positions, such as the board of commissioners, continue to exhibit a detrimental impact on the execution of their functions. Audit committee efficacy is perceived to be less pronounced. This is related to the size of the board as a form of compliance with regulatory provisions without considering the ability to fulfill its monitoring duties. The use of external auditor services also does not show a significant difference to audit quality, as well as the enforcement of institutional ownership monitoring functions which tend to be temporarily oriented.

In terms of recommendations for future research, it is encouraged that alternative indicators be explored to gauge the efficacy of corporate governance in averting fraud. Subsequent studies could delve further into governance implementation, specifically focusing on the capabilities and competencies of the governance structure. This may encompass the specialization of capabilities within the

audit committee and commissioner board, along with an examination of the resource competencies of the internal auditor.

References

A. Girau, E., Bujang, I., Paulus Jidwin, A., & Said, J. (2022). Corporate governance challenges and opportunities in mitigating corporate fraud in Malaysia. Journal of Financial Crime, 29(2), 620–638. https://doi.org/10.1108/JFC-02-2021-0045

Abdelmalek, M. (2020). Difference in audit quality between Big 4 and Non-Big 4: Evidence from accelerated and non-accelerated filers. Erasmus Universiteit Rotterdam.

Agustina, C., & Mappadang, A. (2022). The Effect Of Good Corporate Governance Implementation On Tax Avoidance Behavior. Widyakala: Journal of Pembangunan Jaya University, 9(1), 36. https://doi.org/10.36262/widyakala.v9i1.505

Al-Rassas, A. H., & Kamardin, H. (2015). Directors' independence, internal audit function, ownership concentration and earnings quality in Malaysia. Asian Social Science, 11(15), 244–256. https://doi.org/10.5539/ass.v11n15p244

Aldaoud, K. (2019). the Impact of Board Independence, Women on Board and Auditor Independence on the Fraud: Evidence From Jordanian Firms. September, 1–10. https://doi.org/10.20472/iac.2019.051.001

Apriliana, S., & Agustina, L. (2017). The Analysis of Fraudulent Financial Reporting Determinant through Fraud Pentagon Approach. Jurnal Dinamika Akuntansi, 9(2), 154–165. https://doi.org/10.15294/jda.v7i1.4036

Arens, A. A., Beasley, M. S., Elder, R. J., & Hogan, C. E. (2017). Auditing and Assurance Services An Integrated Approach (16th ed.). Pearson Education Limited.

Asikin, Z. I., Zakiy, F. S., Zaenuri, W., & Fauziah, N. N. (2022). Does audit quality, managerial reports, audit committee affect financial report quality? Case of companies listed on Jakarta Islamic Index (JII) 2018-2020. Asian Management and Business Review, 2(2), 207–219. https://doi.org/10.20885/ambr.vol2.iss2.art8

Bendickson, J., Muldoon, J., Liguori, E., & Davis, P. E. (2016). Agency theory: the times, they are a-changin'. Management Decision, 54(1), 174–193.

Beneish, M. D. (1999). The Detection of Earnings Manipulation. Financial Analysts Journal, 55(5), 24–36. https://doi.org/10.2469/faj.v55.n5.2296

Biduri, S., Nur Fadhila, S., Rahma Dewi, S., & Maryanti, E. (2023). Can Company Size Moderate Good Corporate Governance on Disclosure of Sustainability Reports? Journal of Accounting Science, 7(1), 60–70. https://doi.org/10.21070/jas.v7i1.1698

bin Kiflee, A. K. R., & bin Ali Khan, M. N. A. (2020). Risk Disclosure And Corporate Governance Characteristics. Progressing Beyond and Better: Leading Businesses for a Sustainable Future Proceedings of the 13th Asian Academy of Management International Conference 2019 (AAMC 2019), 08-10 October, 2019, The Wembley, Pulau Pinang, Malaysia, 88, 1–15. https://doi.org/10.15405/epsbs.2020.10.1

Christinawati, M., & Setiyawati, H. (2022). Factors Affecting Banking Fraud Prevention and Their Impact On The Quality of Financial Statements. International Journal of Social Science and Business, 6(2), 215–224. https://doi.org/10.23887/ijssb.v6i2.46538

Costa, A. P. P. (2017). Corporate Governance and Fraud: Evolution and Considerations. Corporate Governance and Strategic Decision Making. https://doi.org/10.5772/intechopen.68489

Erlei, M., & Schenk-Mathes, H. (2017). Bounded Rationality in Principal-Agent Relationships. German Economic Review, 18(4), 411–443. https://doi.org/10.1111/geer.12111

Fadli, N. Y., & Junaidi, J. (2022). Potential Fraud Detection Analysis of Finansial Statements: Diamond Fraud Approach. Telaah Bisnis, 23(1), 72. https://doi.org/10.35917/tb.v23i1.274

Goodwin, J., Atilgan, Y., Simsir, S. A., & Ahmed, K. (2017). Investor reaction to accounting misstatements under IFRS: Australian evidence. SSRN Electronic Journal, 1–33. https://doi.org/10.2139/ssrn.2844799

Greenwood, M. J., & Tao, L. (2021). Regulatory monitoring and university financial reporting quality: Agency and resource dependency perspectives. Financial Accountability and Management, 37(2), 163–183. https://doi.org/10.1111/faam.12244

Gulzar, I., Haque, S. M. I., & Khan, T. (2020). Corporate Governance and Firm Performance in Indian Textile Companies: Evidence from NSE 500. Indian Journal of Corporate Governance, 13(2), 210–226. https://doi.org/10.1177/0974686220966809

Halbouni, S. S., Obeid, N., & Garbou, A. (2016). Corporate governance and information technology in fraud prevention and detection: Evidence from the UAE. Managerial Auditing Journal, 31(6–7), 589–628. https://doi.org/10.1108/MAJ-02-2015-1163

Hamdan, A. M., Mushtaha, S. M. S., & Musleh Al-Sartawi, A. M. . (2017). The Audit Committee Characteristics and Earnings Quality: Evidence from Jordan. SSRN Electronic Journal. https://doi.org/10.2139/ssrn.2839158

Handayani, T., Widianti, H., Sulistyawati, D. R., & Andini, R. (2023). Proceedings of the Tegal International Conference on Applied Social Science & Humanities (TICASSH 2022). In Proceedings of the Tegal International Conference on Applied Social Science & Humanities (TICASSH 2022) (Vol. 2). Atlantis Press SARL. https://doi.org/10.2991/978-2-494069-09-1

Herawati, N. I. (2012). Pendidikan Pertama pada Anak. Jurnal Pendidikan Dasar Kampus Cibiru, 3(1).

Hilton, S. K., & Arkorful, H. (2021). Remediation of the challenges of reporting corporate scandals in governance. International Journal of Ethics and Systems, 37(3), 356–369. https://doi.org/0.1108/IJOES-03-2020-0031

Hong, S. (2019). Corporate governance and agency problems. International Journal of Economics and Business Research, 17(1), 70–86. https://doi.org/10.1504/IJEBR.2019.096586

Hopwood, W., Young, G., & Leiner, J. (2012). Forensic Accounting and Fraud Examination (2nd ed.). McGraw Hill.

ICSA. (2020). What is corporate governance?

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, Agency Costs and Ownership Structure. Journal of Financial Economics, 3(4), 305–360. https://doi.org/10.1016/0304-405X(76)90026-X

Kachouri, M., & Jarboui, A. (2017). Exploring the relation between corporate reporting and corporate governance effectiveness. Journal of Financial Reporting and Accounting, 15(3), 347–366. https://doi.org/10.1108/jfra-06-2016-0053

Kaituko, L. E., Githaiga, P. N., & Chelogoi, S. K. (2023). Board structure and the likelihood of financial statement fraud. Does audit fee matter? Evidence from manufacturing firms in the East Africa community. Cogent Business and Management, 10(2). https://doi.org/10.1080/23311975.2023.2218175

Kassem, R. (2022). Elucidating corporate governance's impact and role in countering fraud. Corporate Governance. The International Journal of Business in Society, 22(7). https://doi.org/https://doi.org/10.1108/cg-08-2021-0279

Köksal, D., & Strähle, J. (2021). Social sustainability in fashion supply chains—understanding social standard implementation failures in vietnam and indonesia using agency theory. Sustainability (Switzerland), 13(4), 1–35. https://doi.org/10.3390/su13042159

Lee, S. C., Rhee, M., & Yoon, J. (2018). Foreign monitoring and audit quality: Evidence from Korea. Sustainability (Switzerland), 10(9), 1–22. https://doi.org/10.3390/su10093151

Martins, O. S., & Júnior, R. V. (2020). The influence of corporate governance on the mitigation of fraudulent financial reporting. Revista Brasileira de Gestao de Negocios, 22(1), 65–84. https://doi.org/10.7819/rbgn.v22i1.4039

Mousavi, M., Zimon, G., Salehi, M., & Stępnicka, N. (2022). The Effect of Corporate Governance Structure on Fraud and Money Laundering. Risks, 10(9), 1–25. https://doi.org/10.3390/risks10090176

Nasir, N. A. B. M., Ali, M. J., & Ahmed, K. (2019). Corporate governance, board ethnicity and financial statement fraud: evidence from Malaysia. Accounting Research Journal, 32(3), 514–531. https://doi.org/10.1108/ARJ-02-2018-0024

Payne, G. T., & Petrenko, O. V. (2019). Agency theory in business and management research. Oxford Research Encyclopedia of Business and Management.

Rahman, I. K. A., Hussain, M. D., & Hossin, M. S. (2019). Microfinance governance: A multi-theoretical approach for ascertaining the wider stakeholder influencing forces. Asian Academy of Management Journal, 24, 203–216. https://doi.org/10.21315/AAMJ2019.24.S1.14

Rakayana, W., Sudarma, M., & Rosidi, R. (2021). structure of company ownership and tax avoidance in Indonesia. International Research Journal of Management, IT and Social Sciences, 8(3), 296–305. https://doi.org/10.21744/irjmis.v8n3.1696

Ratmono, D., & Cahyonowati, N. (2016). Kepercayaan Terhadap Otoritas Pajak Sebagai Pemoderasi Pengaruh Deterrence Factors Terhadap Kepatuhan Wajib Pajak Pribadi. Jurnal Akuntansi Indonesia, 2(1), 1. https://doi.org/10.30659/jai.2.1.1-15

Rezaee, Z., & Riley, R. (2012). Financial Statement Fraud. John Wiley & Sons, Inc.

Rizwan, S., & Chughtai, S. (2023). Reestablishing the legitimacy after fraud: does corporate governance structure matter? South Asian Journal of Business Studies, 12(4). https://doi.org/10.1108/SAJBS-08-2020-0286

Rohmatin, B. L., Apriyanto, G., & Zuhroh, D. (2021). The Role of Good Corporate Governance to Fraud Prevention: An analysis based on the Fraud Pentagon. Jurnal Keuangan Dan Perbankan, 25(2), 280–294. https://doi.org/10.26905/jkdp.v25i2.5554

Sadique, R. B. M., Ismail, A. M., Roudaki, J., Alias, N., & Clark, M. B. (2019). Corporate governance attributes in fraud detterence. International Journal of Financial Research, 10(3), 51–62. https://doi.org/10.5430/ijfr.v10n3p51

Sari, W., & Preambul, H. (2019). Ini Putusan Kasus Laporan Keuangan Tahunan PT Garuda Indonesia 2018.

Seifzadeh, M., Rajaeei, R., & Allahbakhsh, A. (2022). The relationship between management entrenchment and financial statement fraud. Journal of Facilities Management, 20(1), 102–119. https://doi.org/10.1108/JFM-02-2021-0026

Solomon, J. (2020). Corporate Governance and Accountability. John Wiley & Sons.

Su, X., & Zhang, L. (2017). A Reexamination of Credit Rationing in the Stiglitz and Weiss Model. Journal of Money, Credit and Banking, 49(5), 1059–1072. https://doi.org/10.1111/jmcb.12406

Wang, T., Cai, H., Sasazuki, S., Tsugane, S., Zheng, W., Cho, E. R., Jee, S. H., Michel, A., Pawlita, M., Xiang, Y.-B., Gao, Y.-T., Shu, X.-O., You, W.-C., & Epplein, M. (2016). Managerial Response to Constitutional Constraints on Shareholder Power. The Laryngoscope, 44(0), 2–31.

Wondem, B. A., & Singh Batra, G. (2019). The Impact of Corporate Governance Practices on Corporate Financial Performance in Ethiopia. International

Journal of Accounting Research, 07(01), 1–10. https://doi.org/10.35248/2472-114x.19.7.196

Yang, D., Jiao, H., & Buckland, R. (2017). The determinants of financial fraud in Chinese firms: Does corporate governance as an institutional innovation matter? Technological Forecasting and Social Change, 125(August 2015), 309–320. https://doi.org/10.1016/j.techfore.2017.06.035