



## The influence of corporate governance and audit quality on financial reporting fraud (empirical study of manufacturing companies listed on the Indonesia Stock Exchange 2022-2024)

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### Abstract

This study aims to examine the effect of corporate governance and audit quality on financial statement fraud, proxied by the Beneish M-Score Model. The corporate governance variables include independent commissioners, the remuneration structure of the board of commissioners and directors, audit committee activity, and institutional ownership. Meanwhile, audit quality is measured by audit firm size, audit tenure, and audit fees.

The population of this study consists of manufacturing companies listed on the Indonesia Stock Exchange during the 2022-2024 period. A total of 158 companies were selected using purposive sampling. Hypothesis testing was conducted using logistic regression analysis with SPSS software.

The findings reveal that the remuneration of the board of commissioners and directors, as well as audit committee activity, are negatively associated with financial statement fraud. In contrast, institutional ownership is positively associated with financial statement fraud. Meanwhile, independent commissioners, audit firm size, audit tenure, and audit fees do not exhibit a statistically significant effect on financial statement fraud.

**Keywords:** Corporate governance, audit quality, financial statement fraud, beneish m-score, agency theory

### Introduction

Financial statement fraud is defined as the act of manipulating or omission of material information in financial statements that is deliberately carried out by the company's internal parties. The goal is to mislead perceptions and influence the decision-making process of financial report users (ACFE, 2024) <sup>[1]</sup>. Based on Occupational Fraud 2024: A Report to the Nations published by the Association of Certified Fraud Examiners (ACFE), 5% of the total fraud cases investigated were contributed by financial statement fraud with the highest financial loss reaching \$766,000 per case. From various accounting scandals given, such as the scandals of Enron, WorldCom, Satyam Computer Services, Waskita Karya, and Toshiba at the international level. The financial fraud scandal of PT Tiga Pilar Sejahtera Food Tbk, PT Kimia Farma Tbk, PT Asuransi Jiwasraya, PT Hanson International Tbk, and PT Garuda Indonesia Tbk at the national level shows that financial manipulation scandals are a phenomenon that cannot disappear on their own and always emerge with new schemes.

Various regulations have been tightened, such as the Sarbanes-Oxley Act (SOX) of 2002 which aims to strengthen corporate governance practices. This regulation requires increasing the independence of the board, strengthening the role of the audit committee, transparency of financial reporting, and tightening the independence of auditors through restrictions on non-audit services and audit partner rotation obligations to prevent the relationship between auditors and clients from becoming too close (Clark, 2011) <sup>[9]</sup>. In Indonesia, through the Otoritas Jasa Keuangan, ratified POJK No. 21/POJK.04/2015 concerning Guidelines for Public Company Governance (Otoritas Jasa Keuangan, 2015a) and POJK No. 55/POJK.04/2015 concerning the Establishment and Guidelines for the Implementation of the Audit Committee's Work (Otoritas Jasa Keuangan, 2015b) as clear evidence of the

government's efforts to strengthen the company's internal supervisory function. The regulation demands higher transparency and a more active oversight role from governance bodies to mitigate agency conflicts. External supervision is also emphasized through POJK No.9 of 2023 concerning the Use of Public Accountant Services and Public Accounting Firms to ensure the independence and objectivity of auditors (Otoritas Jasa Keuangan, 2023). This is reinforced by the implementation of Audit Standard 240 which requires auditors to maintain professional skepticism and carry out sharper fraud detection procedures (IAPI, 2021) <sup>[13]</sup>.

The results of the study show that there is a negative correlation between corporate governance and audit quality and financial statement fraud. Management's intention to manipulate reports can be reduced by strengthening the governance structure (Indiraswari *et al.*, 2025; Razali & Arshad, 2014; Rostami & Rezaei, 2022) <sup>[14, 28, 29]</sup>. Not only does it provide better supervision and control, but the effectiveness of corporate governance also directly reduces profit management practices and indirectly strengthens fraud prevention by improving management motivation and audit quality (MNIF & Tahri, 2025; Nguyen *et al.*, 2024) <sup>[18, 20]</sup>. Audit quality also plays a vital role, where the reputation of the audit firm, the competence of the auditor, the opinions issued, and the duration of engagement are significantly correlated with a decrease in the incidence of financial statement fraud (Chaari *et al.*, 2022; Yang, 2022; Nejad *et al.*, 2024) <sup>[8, 19]</sup>.

However, the existing literature points to some inconsistencies. A number of studies suggest that certain corporate governance characteristics may not be effective in mitigating financial statement fraud (Nuraini A *et al.*, 2024; Shanikat & Aldabbas, 2025) <sup>[23, 32]</sup>. Similarly, some studies have found no significant correlation between audit quality and the prevention of financial statement fraud (Honesty *et al.*, 2024; Nuraini A *et al.*, 2024) <sup>[12, 23]</sup>. The inconsistency of

the findings of previous studies shows that the role of corporate governance and audit quality in preventing financial statement fraud is a complex issue and needs to be explored more deeply.

## Literature review

### Agency Theory

Based on Agency Theory, there is a contractual relationship between the principal and the agent. The basic assumption of the theory is that both the principal and the agent are rational individuals who are oriented towards personal interests, so it may give rise to a conflict of interest. In this theory, the principal gives the agent the authority to run the company's operations directly. The delegation of duties and authority gives rise to two conditions, namely: (1) the principal does not always have the same information as the agent, so it depends on the agent to achieve the goal, (2) the agent as the party who is given the power has more in-depth access to information about the state of the company than the principal. This situation creates asymmetric information that provides opportunities for management to act opportunistically, including manipulation of profits and financial statements to optimize personal profits (Jensen and Meckling, 1976).

Agency Theory identifies one way to prevent and reduce agent opportunistic behavior through the development of a governance framework that is able to monitor and evaluate the actual behavior of agents. Corporate governance includes all rules, procedures, and institutions on which a business entity is systematically operated, guided, and monitored. This system regulates the interaction between shareholders, directors, commissioners, and other interested parties, such as employees, creditors, customers, regulators, and the wider community (Khan, 2011) [16]. The main goal is to ensure effective supervision, transparency, and accountability in the company's decision-making.

Furthermore, to ensure the fairness of financial statements, an independent external audit is required. External auditors as a third party are responsible for providing reasonable guarantees regarding the presentation of financial statements that are completely free from material errors. Optimal audit quality plays an important role in increasing the credibility and transparency of accounting information, so that it is effective in reducing information asymmetry (Alsmady, 2022) [4]. Thus, corporate governance and external auditing are essential components in the framework of Agency Theory that function to maintain the integrity of financial information and protect the interests of principals.

### The Influence of the Board of Independent Commissioners on Financial Statement Fraud

In the framework of corporate governance, the existence of independent commissioners is one of the instruments to mitigate the risk of irregularities. Their position as independent parties allows them to be more objective and critical in evaluating policies, company strategies, and the fairness of financial statements, so as to reduce the chance of fraud and increase the possibility of detecting irregularities in financial statements. Research by Rostami & Rezaei (2022) [29] and Shanikat & Aldabbas (2025) [32] found that more effective and independent supervision successfully reduces the risk of financial statement fraud. This means that, under strict and independent supervision, management has little room to commit fraudulent acts.

**H1:** An independent board of commissioners has a negative and significant effect on financial statement fraud.

### The Effect of the Remuneration of the Board of Commissioners and the Board of Directors on Financial Statement Fraud

Competitive remuneration not only serves as a reward for professionalism, but also as a control tool to reduce management's intention to commit fraud. When directors receive commensurate remuneration, they are motivated to maintain transparency and quality of financial statements in order to maintain their economic position in the company (Alkebsee *et al.*, 2022) [3]. Similar to the remuneration of the board of commissioners, the amount of remuneration received can affect their motivation to carry out more intensive and critical supervisory functions on management behavior. Previous studies have found that proper remuneration is an effective strategy to reduce the risk of financial statement fraud, as adequate incentives can increase motivation to maintain integrity and transparency of reporting (Candra *et al.*, 2024) [7]. This is in line with the concept of cost-benefit, where the potential for loss of position and income in the future has a greater economic burden than the short-term incentives obtained from fraudulent acts (Girau, 2021) [1].

**H2:** The remuneration of the board of commissioners and directors has a negative and significant effect on financial statement fraud.

### The Influence of Audit Committee Activities on Financial Statement Fraud

The frequency of audit committee meetings improves governance in several ways. First, regular meetings allow for a more real-time exchange of information and evaluation of financial reporting processes, accounting policies, and internal and external audit findings. Second, this meeting increases accountability and interaction between management and the audit committee, where management must account for its decisions periodically. Third, the high frequency of meetings facilitates collective learning and increases the capacity of committee members in identifying red flags.

In line with opinion Nindito *et al.* (2025) [20, 21] Effective communication and collaboration in meetings allows members to express their views on financial reporting issues, thereby improving the ability to detect and address suspicious activity. Supported by the findings of Shanikat & Aldabbas (2025) [32] which also states that acts of financial statement fraud can be suppressed through more frequent committee meetings. This provides evidence that strict monitoring and intensive interaction create a more robust quality of control in maintaining the integrity of a company's financial information.

**H3:** The activities of the audit committee have a negative and significant effect on the fraud of financial statements.

### The Effect of Institutional Ownership on Financial Statement Fraud

Agency Theory identifies institutional ownership as an external governance instrument that serves to minimize potential agency problems in companies. Institutional investors who are generally supported by professional expertise, adequate resources, and economic interests serve to oversee management performance. In addition, because they are often long-term-oriented, institutional investors have an incentive to oversee management acting in the best interests of shareholders. Empirical evidence supports the supervisory role of institutional investors who find that a high proportion of institutional ownership is negatively

correlated with financial statement fraud (Nindito *et al.*, 2025 and Yanti *et al.*, 2024) [21].

**H4:** Institutional ownership has a negative and significant effect on financial statement fraud.

**The Effect of Public Accounting Firm Size on Financial Statement Fraud**

The appointment of an external auditor is a form of monitoring costs allocated by the company. The purpose is to verify and provide adequate confidence that the published financial statements have been prepared correctly. High-quality audits are a supervisory mechanism to strengthen corporate accountability and increase the credibility of financial statements presented to the public. Previous studies have also found that large KAP has a significant negative influence on financial statement fraud (Chaari *et al.*, 2022 and Nejad *et al.*, 2024) [8, 19]. Large KAP has superior resources, expertise, and quality control systems that make them able to increase the probability of detection and the preventive effect of financial statement fraud. In addition, large KAP is encouraged to produce higher audit quality to mitigate the risk of fraud in order to maintain trust, reputation, and strategic position in the market. (Nejad *et al.*, 2024) [19].

**H5:** The size of the KAP has a negative and significant effect on financial statement fraud.

**The Effect of Tenure Audits on Financial Statement Fraud**

Longer audit tenure periods allow auditors to develop a more comprehensive understanding of the client's business operations, accounting systems, and internal control environment. This understanding is able to reduce information asymmetry in the Agency Theory perspective and help auditors to detect all existing red flags. Research by Asadifar *et al.* (2024) [5], Khan *et al.* (2023) [17], and Nejad *et al.* (2024) [19] found that adequate tenure audits (neither too short nor too long) tend to be better able to identify the risk of material misrepresentation. Nejad *et al.* (2024) [19] revealed that a long engagement period is able to significantly lower the risk of fraud because the auditor's depth of understanding of the client's business will increase the effectiveness of substantive and analytical audit procedures. Better control of information by external

auditors through a continuous audit engagement period is useful for detecting and suppressing potential financial manipulation by management.

**H6:** Tenure audits have a negative and significant effect on financial statement fraud.

**The Effect of Audit Costs on Financial Statement Fraud**

Audit fees reflect the amount of compensation paid to external auditors in line with the scope and depth of audit work performed. The higher the cost of the audit, the greater the effort, time, and professional resources allocated to test transactions, evaluate internal controls, and assess the risk of material misrepresentation. Higher audit costs often correlate with greater audit complexity and risk. Auditors tend to set higher costs when they identify the presence of a large inherent risk (Shehadeh *et al.* 2024) [33]. These costs are used to fund more extensive and in-depth audit procedures to address existing risks and increase the likelihood of detection. The audit costs will also be allocated to the use of superior resources and advanced audit technology, all of which will improve audit quality (Chaari *et al.*, 2022) [8].

**H7:** Audit costs have a negative and significant effect on financial statement fraud.

**Methods**

This research focuses its observation on manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2022-2024 period. In determining the analyzed sample, this study applies a purposive sampling technique to ensure that the research sample meets the criteria that have been set (Sekaran & Bougie, 2016) [31]. The parameters set in the sample selection process are as follows:

1. Companies that publish annual reports consecutively during the observation year.
2. Financial statements are presented using rupiah currency units.
3. The company presents complete data related to all the variables that are the focus of this research analysis.

The test in this study utilizes SPSS software to interpret the data accurately.

**Table 1:** Measurement of Variables

Variables		Measurements
Dependent Variable (Y)	Financial Statement Fraud (FSF_Y)	Beneish M-Score $M\text{-Score} = -4.84 + 0.920DSRI + 0.528GMI + 0.404AQI + 0.892SGI + 0.115DEPI - 0.172SGAI - 0.327LVGI + 4.679TATA$ 0 = Beneish M-Score < -2.22 indicates no indication of fraud. 1 = Beneish M-Score ≥ -2.22 indicates an indication of fraud.
	Independent Board of Commissioners (IND_X1)	The ratio of independent board of commissioners to the total number of board of commissioners
Independent Variables (X)	Remuneration of the Board of Commissioners and Directors (REM_X2)	The amount of remuneration received by the board of commissioners and directors in a year
	Audit Committee Activities (ACA_X3)	Number of audit committee meetings per year
	Institutional Ownership (INST_X4)	Total institutional shares
	Public Accounting Firm Size (SIZE_X5)	1 = Audited by the big four 0 = Audited by nonbig four
	Tenure Audit (TENURE_X6)	The number of audit engagements with the same public accounting firm consecutively during the observation year (2022-2024)
	Audit Fee (FEE_X7)	Financial statement audit fees

**Results**

**Table 2:** Descriptive Statistical Analysis

	N	Minimum	Maximum	Red	Std. Deviation
FSF Y	474	0	1	0,36	0,481
IND X1	474	0,25	0,833	0,415	0,099
REM X2	474	19,519	28,162	23,074	1,403
ACA X3	474	1	43	6,11	4,754
INST X4	474	0,0001	0,9996	0,75	0,253
SIZE X5	474	0	1	0,34	0,475
TENURE X6	474	1	3	1,81	0,804
FEE X7	474	17,959	25,591	20,236	1,405
Valid N (listwise)	474				

Source: SPSS output, 2026

**Table 3:** Goodness of Fit Test

Step	Chi-square	df	Sig.
1	3,303	8	0,914

Source: SPSS output, 2026

The test results in Table 3 obtained a chi-square value of 3.03 and a significance value of 0.914 > 0.05. This indicates that the research model has an adequate and feasible level of fit in subsequent hypothesis testing.

**Table 4:** Overall Model Fit Test

Block	- 2 Log Likelihood
Block 0: Beginning Block	619,854
Block Number 1: Method = Enter	573,193

Source: SPSS output, 2026

Table 4 compares the value of -2LL where there is a decrease in the value from 619.854 to 573.193, so that through the results of this test it can be seen that the

regression model after independent variables are entered is better. The conclusion is that the developed model is compatible with empirical data obtained from the field.

**Table 5:** Classification Matrix

Observed			Predicted		Percentage Correct
			Financial Statement Fraud		
Step 1	Financial Statement Fraud	Non-Fraud	Fraud		
		Non-Fraud	Fraud		
		269	34	88,8	
		119	52	30,4	
	Overall Percentage			67,7	

Source: SPSS output, 2026

According to the results of the classification matrix test in Table 5, the model was able to accurately identify 52 samples or 30.4% of the total 171 samples that committed fraud. The model has a higher level of accuracy in predicting companies that do not commit fraud, which is 88.8% or as many as 269 samples out of a total of 303

samples that do not carry out fraudulent practices of financial statements. Therefore, 67.7% of regression models have correctly predicted the probability of dependent variables, which shows that the model is quite *reliable* in projecting dependent variables based on available research data.

**Table 6:** Nagelkerke R Square

Step	Nagelkerke R Square
1	0,129

Source: SPSS output, 2026

The value of Nagelkerke R Square in Table 6 is 0.129, meaning that the independent variables tested in this study contribute 12.9% to the change in dependent variables. In

contrast, 87.1% of the variation in dependent variables was explained by factors other than this study model.

**Table 7:** Omnibus Test

Omnibus Tests of Model Coefficients				
		Chi-square	df	Sig.
Step 1	Step	46,660	7	0,000
	Block	46,660	7	0,000
	Models	46,660	7	0,000

Source: SPSS output, 2026

The results of the Omnibus Test showed a chi-square value of 46.660, a degree of freedom of 7 and a significance value of 0.000 < 0.05. In conclusion, the proposed regression model is statistically feasible and adequate to predict the

observed phenomenon (H0 is rejected). Simultaneously, the set of independent variables studied was shown to have a significant contribution in explaining the variation of dependent variables.

**Table 8:** Hypothesis Test

	<b>B</b>	<b>S.E.</b>	<b>Wald</b>	<b>df</b>	<b>Sig.</b>	<b>Exp B</b>
IND X1	0,098	1,061	0,008	1	0,927	1,103
REM X2	-0,440	0,113	15,183	1	0,000	0,644
ACA X3	-0,077	0,031	6,153	1	0,013	0,925
INST X4	0,945	0,449	4,439	1	0,035	2,573
SIZE X5	0,547	0,313	3,050	1	0,081	1,727
TENURE X6	-0,010	0,126	0,007	1	0,935	0,990
FEE X7	0,129	0,140	0,850	1	0,357	1,138
Constant	6,276	2,616	5,757	1	0,016	531,611

Source: SPSS output, 2026

Based on the results of the hypothesis test in table 8, it shows that the level of significance of the independent board of commissioners variables is  $0.927 > 0.05$  (H1 is rejected). These findings indicate that internal supervision through the existence of an independent board of commissioners has not been able to optimally reduce the number of financial statement fraud. This can be because the existence of independent commissioners in some companies tends to be a formality in order to comply with the provisions of OJK regulations which require a minimum proportion of 30% independent commissioners (Yuvn & Sormin, 2022). The insignificance of this relationship is also suspected because it does not include control variables, such as company size in this study. Without controlling the size of the company, the influence of the governance mechanism becomes distorted. Large companies tend to have more complicated fraud loopholes at the operational level as well as different market pressures than small companies.

Table 8 shows the significance level of the remuneration variable of  $0.000 < 0.05$  with a negative coefficient direction of  $-0.440$  (H2 accepted). These findings prove that the amount of remuneration allocated to the board of commissioners and directors is empirically able to mitigate the risk of financial statement fraud. Therefore, to align the interests of management with shareholders, an appropriate and performance-based compensation scheme is needed. This mechanism is one of the effective supervisory options that can reduce the urge to manipulate financial data.

Table 8 shows that the significance of the audit committee activity variable is  $0.013 < 0.05$  with a negative regression coefficient of  $-0.077$  (H3 accepted). These findings prove that the meetings held by the audit committee actually help reduce financial statement fraud. The high frequency of meetings provides room for the audit committee to evaluate every piece of information contained in the financial statements and detect red flags early, so that preventive measures can be taken before fraudulent practices develop further. Thus, strengthening supervision through regular meetings is one of the effective preventive instruments to reduce the number of fraudulent practices in financial statements.

Table 8 shows that the institutional ownership variable has a significance value of  $0.035$  with a positive regression coefficient of  $0.945$  (H4 is rejected). These results show a significant positive correlation between institutional ownership and financial statement fraud. The condition can be because institutional investors tend to have a short-term orientation that focuses on obtaining dividends and quick capital gains, thus putting too high performance pressure on management. When a company's performance declines, management is pressured to manipulate financial statements in order to maintain investor confidence (Garel *et al.*, 2019) [10].

Table 8 shows the significance of the variable significance of the size of public accounting firms is  $0.081 > 0.05$  (H5 is rejected). Empirically, this study shows that the reputation of the Big Four KAP does not automatically guarantee a low probability of fraudulent financial statement practices. These findings are in line with the studies of Nindito *et al.* (2025) [21] and Raza *et al.* (2023) [27] which stated that the size of the KAP did not show a significant difference in mitigating financial statement fraud practices. One of the possible causes is the existence of professional standards and codes of ethics that apply to all auditors in Indonesia, so that the quality of audits is relatively uniform, both large and small.

Table 8 shows that the audit tenure variable obtained a significance value of  $0.935$ , which is above the threshold of  $0.05$  (H6 is rejected). The indication is that the duration of the audit engagement does not have a significant influence on detecting fraudulent practices in financial statements. Akuoko-Sarpong *et al.* (2024) [2] and Nuhu *et al.* (2024) [22] argue that an excessively long audit engagement period allows auditors to delve deeper into the client's business characteristics, but on the other hand has the potential to reduce auditors' independence and skepticism due to emotional and economic attachment to clients. This duality of effect suggests that the influence of tenure audits is very likely to neutralize each other in a linear regression model. Thus, tenure audits cannot be assumed only through a simple linear relationship with financial statement fraud, but rather tend to be non-linear or conditional.

Table 8 shows that the significance of the audit cost variable is  $0.357$ , which is above the threshold of  $0.05$  (H7 rejected). Empirically, this study proves that audit costs do not guarantee the quality of detection of financial statement fraud. These findings support the research of Nuhu *et al.* (2024) [22], Shanikat & Aldabbas (2025) [32] and Tantri & Chariri (2023), in which the effectiveness of auditors in detecting fraud cannot be determined solely by the amount of compensation received, but rather by the level of independence, integrity, and professionalism of the auditors. In addition, high audit costs at large accounting firms are often a compensation for the reputation and complexity of a client's business, not just as an effort to tighten fraud detection (Sealy & Simon, 2025) [30].

## Conclusion

Based on a series of tests that have been carried out, the research leads to the conclusion: The remuneration of the board of commissioners and directors as well as the activities of the audit committee are significantly able to play a role as an internal supervision mechanism to reduce financial statement fraud. Institutional ownership, on the other hand, has a positive effect which means that the

increase in institutional shareholding will put more pressure on management to manipulate its financial statements. Meanwhile, the independent board of commissioners, the size of the public accounting firm, tenure audits, and audit fees did not have a significant effect on financial statement fraud.

This study has not examined the existence of mediating variables or mediators that may be able to explain the relationship between variables more comprehensively. In addition, it does not include control variables, such as company size, debt, or profitability in the analysis model. This results in the research model being unable to isolate the purely influence of corporate governance mechanisms and audit quality on financial statement fraud.

Therefore, future research can integrate variables or indicators that have not been covered in this research model, such as individual integrity or organizational culture, leadership style, and whistleblower mechanisms to expand the scope of analysis, so that the mapping of significant factors in mitigating and detecting fraud risks becomes more in-depth and accurate. Adding control variables and mediator variables can also be done to explain the relationship between variables more comprehensively.

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