

Corporate Governance Effectiveness as a Deterrent to Financial Statement Fraud: Indonesian Evidence

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ABSTRACT

This study aimed to examine the effect of internal and external corporate governance effectiveness in deterring Financial Statement Fraud (FSF). Internal governance mechanism proxied by director competencies and the independent audit committee (INDAC), while the external governance mechanism is proxied by the change of external auditor (CHEXA). The final sample consisted of 187 companies in the year 2023 from the manufacturing companies listed in the IDX (Indonesia Stock Exchange). The financial statement fraud was determined using the Beneish M-Score. The independent variables are represented by director competencies (OSHIP, BIND, and CHDIR), INDAC, and CHEXA. All data was obtained from both Eikon Datastream and the IDX official website. This study finds that INDAC has a positive and significant relationship with FSF due to the opportunity of INDAC to reveal FSF (Fraud Diamond Theory). While other governance indicators show insignificant results on the FSF. This study adds to the growing literature on corporate governance in Indonesia, and it is fruitful for the regulator to revise the code (The Code of Good Corporate Governance Indonesia) to ensure its alignment with the recent market development and stakeholder needs. This study only focuses on the manufacturing industry and a one-year observation.

Keywords: Beneish M-Score, corporate governance mechanism, financial statement fraud, Fraud Diamond Theory

INTRODUCTION

Financial statement fraud is the intentional distortion of a company's financial statements, either by omission or exaggeration, to present a more favourable view of the company's financial position, performance, and cash flow (Netsuite, 2022). According to the Association of Certified Fraud Examiners (ACFE), financial statement fraud falls under the category of occupational fraud within its fraud classification framework. The ACFE (2020) describes it as an intentional misrepresentation carried out to mislead stakeholders through manipulated or inaccurate financial disclosures. Furthermore, FSF is widely acknowledged as a subset of corporate fraud. The Chartered Institute of Management Accountants (CIMA, 2009) describes corporate fraud as the deliberate distortion of financial information or business practices by management, employees, or external parties, with the purpose of deceiving stakeholders and securing unfair benefits over competitors.

Financial statement fraud (FSF), commonly referred to as fraudulent financial reporting, entails the deliberate manipulation of accounting information, including the overstatement of assets, revenues, or earnings and the understatement of liabilities, expenses, or losses. Such practices raise significant concerns for key stakeholders—investors, creditors, employees, and the broader public—due to their extensive economic and social implications. The outcomes may include workforce retrenchment, diminished investor returns, creditor losses, and declining trust in regulatory systems. Accordingly, organisations and financial professionals, including auditors and

accountants, are required to exercise heightened vigilance in detecting, preventing, and responding to fraudulent financial reporting.

The financial statement is a crucial output of a company's accounting function, serve as a critical source of decision-useful information. The fundamental objective of accounting is to record, measure, and communicate to relevant stakeholders the effects of economic events or transactions on a business (Ross, 2016). Once the information in the financial statements is misstated or fails to present objective and faithful representation of financial figures, the published statements do not serve their intended purpose. Such distortions create information asymmetries, which in turn exacerbates agency problems among users of financial statements.

The outbreak of COVID-19 at the end of 2019 intensified agency conflicts, as firms were required to reconcile survival-oriented strategies with increased accountability to stakeholders. Organisations faced the dual challenge of maintaining operational continuity while safeguarding employee welfare and contributing to broader societal stability, highlighting the critical role of robust corporate governance during periods of crisis. The pandemic has been projected to precipitate widespread bankruptcies across multiple industries as prolonged mobility restrictions and economic stagnation disrupt business operations (Forbes, 2020). Moreover, persistent uncertainty surrounding the pandemic's resolution raised significant concerns within the corporate sector regarding the potential adverse impact on financial statements for 2020 and subsequent fiscal periods.

The reliability of financial statements is substantially affected by declining corporate revenues, primarily driven by reduced consumer purchasing power and potential inflationary pressures (Universitas Padjadjaran, 2020). Companies that base their performance targets only on financial parameters are more likely to experience significant discrepancies in their performance results. In response, some companies may seek to preserve the appearance of financial stability by producing seemingly flawless financial reports (Marviana et al., 2021). This condition, in turn, heightens the risk of financial statement fraud, particularly during periods of economic distress such as the COVID-19 pandemic.

Although these issues have long been present, the demand for robust corporate governance has recently attracted heightened attention from the public, regulators, and scholars (Khoufi & Khoufi, 2018). The International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC, 2010) explicitly states in International Standard on Auditing (ISA) 240 that the primary responsibility for fraud prevention and detection rests with those charged with the governance and management of the entity. Accordingly, effective corporate governance plays a pivotal role in mitigating financial statement fraud, as the coexistence of pressure, opportunity, capability, and rationalisation creates conditions conducive to the manipulation of financial statements to achieve organisational objectives.

Indonesia's corporate governance guidelines, most recently revised in 2014, are designed to enhance oversight and minimise the risk of financial misreporting. The economic pressures brought about by the COVID-19 pandemic—particularly reflected in elevated vacancy rates within the manufacturing sector (OECD, 2022)—have intensified managerial incentives to manipulate financial results. Consequently, the implementation of robust corporate governance mechanisms remains crucial for mitigating the risk of financial statement fraud.

LITERATURE REVIEW

Financial Statement Fraud

Fraud is generally defined as a deliberate act or negligent omission undertaken to mislead, resulting in losses to others while conferring undue benefits to the perpetrator. It is commonly classified into three major forms: financial report manipulation, misappropriation of assets, and unauthorised expenditure (The Institute of Internal Auditors, 2007). Financial statements, in turn, serve as a primary medium for communicating an organisation's financial condition and performance (Institut Akuntan Publik Indonesia, 2013). They fulfil the broader public interest by providing information on cash flows, financial results, and overall financial position, thereby enabling users to make informed economic decisions. These reports present comprehensive details regarding assets, liabilities, equity, income, expenses, changes in equity, and cash flows, accompanied by explanatory notes that assist stakeholders in evaluating future cash flow prospects.

Financial statement fraud (FSF) refers to the intentional misrepresentation of financial statements by management to deceive stakeholders, particularly investors and creditors, through the preparation and dissemination of materially misleading financial information (Rezaee & Riley, 2009; Pratiwi & Ghazali, 2022). FSF is often associated with weak corporate governance structures, substantial internal and external pressures, and deficiencies in internal control systems (Kucuk & Uzay, 2009). According to the American Institute of Certified Public Accountants (AICPA, 2002), fraudulent financial reporting can occur through: (1) destruction, alteration, or falsification of accounting records; (2) deliberate omission or misrepresentation of events or transactions in financial statements; and (3) intentional misapplication of accounting principles related to recognition, classification, presentation, or disclosure.

Corporate Governance Mechanism

Corporate governance encompasses the legal frameworks, policies, and practices that regulate relationships among shareholders, management, creditors, employees, government authorities, and other internal and external stakeholders (Forum for Corporate Governance in Indonesia, 2001). According to Martins and Júnior (2020), corporate governance functions as a mechanism to mitigate conflicts of interest between principals and agents through the disclosure of reliable financial information, with each governance structure playing a distinct role in preventing financial statement fraud, earnings manipulation, and potential corporate failure. Corporate governance mechanisms refer to the structures, processes, and practices adopted by organisations to ensure effective, transparent, and accountable governance. These mechanisms are generally categorised as internal and external (Gillan, 2006; Rezaee, 2007).

Corporate governance can be broadly divided into internal and external mechanisms, each serving as a safeguard against financial statement fraud. Internal mechanisms include the board of commissioners, managerial incentives, capital structure, corporate bylaws, and internal controls, whereas external mechanisms encompass laws and regulations, market discipline, financial analysts, and other forms of independent oversight (Gillan, 2006). In the present study, internal governance is operationalised through the board of directors, audit committees, and internal control systems, while external governance is represented by the function of independent auditors. Collectively, these mechanisms promote transparency, accountability, and corporate integrity by clearly delineating financial reporting responsibilities: management is responsible for preparing financial statements and maintaining effective internal controls, the audit committee monitors the reporting process and evaluates control adequacy, and external auditors provide an independent assessment of the fairness of the financial disclosures (Deloitte, 2018).

The board of directors acts on behalf of shareholders to oversee corporate operations and safeguard shareholder interests. Its primary responsibilities include addressing conflicts of interest between managers—who serve as agents responsible for day-to-day operations—and shareholders as principals (Kamarudin et al., 2014). Consistent with Fama and Jensen (1983), the board is tasked with monitoring managerial performance, enhancing shareholder value, and preventing actions that could adversely affect corporate performance. Prior research has examined various board characteristics—such as size, meeting frequency, tenure, independence, and members' international experience—as determinants of governance effectiveness.

The audit committee, a specialised subcommittee of the board of directors, is tasked with overseeing the financial reporting and disclosure processes of the organisation. To function effectively, audit committees must possess a comprehensive understanding of the organisation's internal control systems and reporting procedures (Corporate Finance Institute, 2023). Serving as an intermediary between the board of directors and both internal and external auditors, the audit committee plays a pivotal role in safeguarding the integrity of financial reporting. Its responsibilities include evaluating prospective external auditors, determining the scope of the audit, reviewing audit findings, assessing the adequacy of internal financial controls, and scrutinising financial information prior to publication (Sori & Kharbari, 2006). Furthermore, the committee bears a fiduciary duty to remain vigilant in mitigating managerial misconduct, including practices that may result in asset misappropriation or earnings manipulation (Kamarudin et al., 2014). From the perspective of shareholder protection, the audit committee is widely regarded as one of the most critical governance structures within a corporation (Indonesia Corporate Governance Manual, 2014).

External auditors, as independent public accountants, are engaged to conduct audits, reviews, and assurance services with the objective of providing an impartial assessment of a company's financial statements and internal control systems (AccountingTools, 2024). Independence is a fundamental requirement, as it underpins the credibility and objectivity of the audit process. External audits are primarily responsible for attesting to the quality and reliability of disclosed financial information. Empirical evidence supports the notion that external auditing functions as a key governance mechanism that enhances the credibility of financial reporting (Amina, 2021).

Underpinning Theories

Agency theory, as articulated by Jensen and Meckling (1976), conceptualises the relationship between shareholders (principals) and managers (agents), wherein managers are entrusted with the responsibility of operating the firm on behalf of its owners. Given their direct involvement in daily operations, managers typically possess superior knowledge relative to shareholders, resulting in information asymmetry. This imbalance may incentivise self-serving behaviours, such as earnings manipulation or financial statement distortion, aimed at securing personal benefits, achieving performance targets, or preserving reputation.

The fraud diamond theory (Wolfe & Hermanson, 2004) complements this perspective by positing that fraud occurs when four conditions—pressure, opportunity, rationalisation, and capability—converge. Financial strain can exert pressure on managers to present favourable outcomes, while weak internal controls create opportunities for manipulation. Rationalisation provides a psychological justification for unethical conduct, and capability reflects the agent's knowledge, expertise, and authority to perpetrate the fraud. Collectively, these theories demonstrate how conflicts of interest and structural vulnerabilities within firms can elevate the risk of financial statement fraud, thereby highlighting the critical role of robust corporate governance mechanisms in mitigating such risks.

Hypotheses Development

Director Competency and Financial Statement Fraud

The board of directors constitutes a core internal governance mechanism that mitigates financial statement fraud (FSF) by addressing agency conflicts among managers, shareholders, and other stakeholders. From the perspective of agency theory, effective governance enhances accountability, transparency, and fairness, thereby aligning managerial actions with shareholder interests. Concurrently, the fraud diamond framework underscores that competent boards, in conjunction with external oversight, can reduce pressures, constrain opportunities, challenge rationalisations, and limit managerial capability to perpetrate fraud. In the present study, board competency is operationalised through insider ownership (OSHIP), board independence, and director turnover, while changes in external directors serve as an external governance mechanism to strengthen monitoring.

Insider Ownership and Financial Statement Fraud

Insider ownership (OSHIP) is classified as a pressure element, consistent with Skousen et al. (2008). Originally conceptualised as personal financial need, OSHIP is redefined in this study to enhance clarity, measured as the cumulative proportion of firm ownership held by insiders. Previous research by Skousen et al. (2008) suggested that an increase in OSHIP is associated with a lower likelihood of fraud, indicating a negative relationship between insider ownership and FSF.

However, empirical evidence on OSHIP is varied. Rukmana (2018) reported a positive association, whereby higher OSHIP corresponds with increased FSF. Recent studies by Wahyuningrum (2020), Herbenita et al. (2022), Khamainy and Setiawan (2022), and Gultom and Amin (2023) similarly found that OSHIP exerts a positive and significant effect on FSF, suggesting that greater insider shareholding may exacerbate fraudulent financial reporting. In contrast, Prasmaulida (2016) and Diansari (2019) observed no significant effect of OSHIP on FSF.

Based on the theoretical framework and prior empirical findings, this study proposes the following hypothesis::

H1a: Insider ownership positively affects financial statement fraud.

Board Independence and Financial Statement Fraud

The second element of fraud, according to the fraud diamond framework, is opportunity. In this study, opportunity is operationalised through two proxies, one of which is board independence (BIND). Fama and Jensen (1983) asserted that the presence of independent directors enhances the robustness of internal control mechanisms, while Ruankaew (2016) emphasised that opportunity is inherently linked to the strength of internal controls. By overseeing internal control systems, independent directors can effectively regulate the opportunity component that may facilitate fraudulent activities. Additionally, independent directors function as an internal governance mechanism aimed at mitigating conflicts of interest between principals and agents (Subair et al., 2020).

Empirical evidence regarding the relationship between BIND and FSF remains varied. Eneh (2018), Khoufi and Khoufi (2018), and Anichebe et al. (2019) reported a positive association, indicating that a higher proportion of independent (non-executive) directors correlates with an increased likelihood of FSF. In contrast, Uzun et al. (2005) demonstrated a negative association, suggesting that firms without fraud typically maintain a greater proportion of independent directors. Similarly, Kapoor and Goel (2019) found that BIND strengthens monitoring of corporate governance compliance and enhances the reliability of financial reporting. Subsequent studies by Subair et al. (2020), Budiantoro et al. (2022), and Haron et al. (2021) also observed a negative relationship between BIND and FSF, indicating that higher board independence can contribute to a reduction in fraudulent reporting. Nevertheless, Pramana et al. (2019) and Girau et al. (2022) reported no significant relationship between BIND and FSF, highlighting the inconsistency of empirical findings in this context.

Based on the theoretical framework and prior empirical findings, this study proposes the following hypothesis:

H1b: Board independence has a negative effect on financial statement fraud.

Change of Director and Financial Statement Fraud

According to the fraud diamond framework proposed by Wolfe and Hermanson (2004), capability refers to an individual's role or function within an organisation that may enable them to create or exploit fraudulent opportunities unavailable to others. As individuals repeatedly execute their organisational roles, their potential to perpetrate fraud may increase due to enhanced familiarity with processes and internal controls over time. In this study, the capability element is operationalised through changes in directorship (CHDIR). Director changes often involve strategic or political considerations, reflecting the interests of specific stakeholders and potentially giving rise to conflicts of interest.

A change in directors may indicate an effort by the company to improve board performance by appointing directors deemed more capable than their predecessors. Conversely, it may reflect an attempt to remove directors who are aware of prior fraudulent activities, with the transition period potentially causing initial performance challenges (Sihombing & Rahardjo, 2014). Hence, directors may either mitigate the risk of financial statement fraud (FSF) or inadvertently facilitate its occurrence, making CHDIR an appropriate proxy for capability.

Empirical findings regarding CHDIR and FSF are mixed. Manurung and Hardika (2015) and Utami and Pusparini (2019) observed a positive association, suggesting that the transition period for newly appointed directors may induce stress and adaptation challenges, temporarily affecting performance. In contrast, Ayuningtyas et al. (2021) and Budiantoro et al. (2022) reported a negative association, indicating that appointing more competent directors enhances oversight and reduces fraud risk. Nevertheless, a substantial body of research—including studies by Bawekes et al. (2018), Noble (2019), Putra (2019), Yendrawati et al. (2019), Harman and Bernawati (2020), Rahayu and Riana (2020), Haqq and Budiwitjaksono (2020), Mintara and Hapsari (2021), Handoko and Tandean (2021), Suripto and Karmilah (2021), Widnyawati and Widyawati

(2022), and Calista and Nugroho (2022)—found no significant relationship between CHDIR and FSF.

Based on the theoretical framework and prior empirical findings, this study proposes the following hypothesis:

H1c: Change of director has a positive effect on financial statement fraud.

Independent Audit Committee and Financial Statement Fraud

The audit committee is established by the board of commissioners to assist in fulfilling its supervisory responsibilities (Murtanto & Sandra, 2019). It functions as an intermediary among the board of directors, external auditors, internal auditors, and independent members, overseeing audit processes and ensuring that management implements corrective measures in compliance with applicable laws and regulations (Putra, 2019). In Indonesian publicly listed companies, the audit committee is chaired by an independent commissioner and may include other commissioners and/or external professionals, with at least one member possessing expertise in accounting or finance (The Indonesia Corporate Governance Manual, 2014).

In this study, the independent audit committee (INDAC) is classified under the opportunity element of the fraud diamond framework, reflecting its role in monitoring internal controls and mitigating conditions that may facilitate fraudulent activities (Albrecht, 2019; Indonesia's Code of Good Corporate Governance, 2006). Prior research has similarly positioned INDAC within the opportunity construct, including studies by Skousen et al. (2008), Tiffani and Marfuah (2015), Pramana et al. (2019), Suripto and Karmilah (2021), and Widnyawati and Widyawati (2022). The INDAC variable is operationalised as the number of independent audit committee members, rather than the total number of audit committees, consistent with Skousen (2019).

Empirical findings regarding INDAC and financial statement fraud (FSF) are varied. Abdullah et al. (2010) and Kamarudin et al. (2014) reported a positive association, suggesting that a higher number of independent directors on the audit committee corresponds with increased FSF. Conversely, Beasley (2000), Skousen et al. (2008), Tiffani and Marfuah (2015), and Pramana et al. (2019) observed a negative relationship, indicating that larger INDAC presence reduces the likelihood of FSF. Other studies, including Suripto and Karmilah (2021) and Widnyawati and Widyawati (2021), found no significant relationship between INDAC and FSF, highlighting the inconclusive nature of prior empirical evidence.

Based on the theoretical framework and prior empirical findings, this study proposes the following hypothesis:

H2: An Independent audit committee has a negative effect on financial statement fraud.

Change of External Auditor and Financial Statement Fraud

The independent auditor plays a critical role in evaluating the reasonableness of financial statements, which may generate tension between management and auditors. In some cases, management may opt to replace the independent auditor to reduce the likelihood of fraud detection (Pramana et al., 2019). Accordingly, this study classifies the change of external auditor (CHEXA) within the rationalisation element of the fraud diamond framework.

Empirical findings regarding the effect of CHEXA on financial statement fraud (FSF) are mixed and inconclusive. Noble (2019), Utami and Pusparini (2019), Pramana et al. (2019), Utomo et al. (2019), and Mintara and Hapsari (2021) reported a positive association, suggesting that auditor changes may facilitate concealment of fraud previously detectable by the outgoing auditor. In contrast, Bawekes et al. (2018), Amalia et al. (2020), Handoko and Tandean (2021), and Nuristya and Ratmono (2022) found no significant relationship between CHEXA and FSF. The findings of this study support the latter view, indicating that changes in external auditors are primarily motivated by dissatisfaction with prior auditor performance rather than by a deliberate attempt to obscure prior audit trails.

Based on the theoretical framework and prior empirical findings, this study proposes the following hypothesis:

H3: Change of external auditor positively affects financial statement fraud.

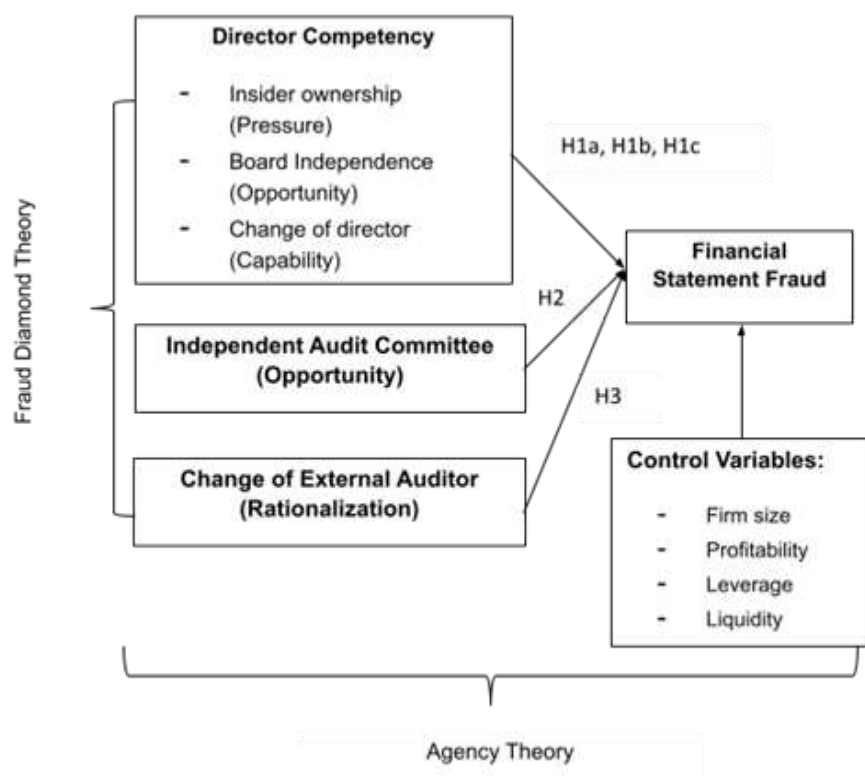


Figure 2.1 Conceptual Framework

RESEARCH METHODOLOGY

This study examines the effect of corporate governance mechanisms proxied by insider ownership, independent audit committee, board independence, change of external auditor, and change of director. This study controls for financial effects such as firm size, profitability, leverage, and liquidity on the likelihood of financial statement fraud in publicly listed companies in Indonesia.

The population of this study comprises the manufacturing industry, which is suspected to exhibit a high level of vulnerability to fraud. According to ACFE (2022), the manufacturing sector reports the highest incidence of fraud, with 194 cases and a median loss of \$177,000. Wholesale trade ranked second in median loss, amounting to \$400,000 across 28 cases. The study focuses on the manufacturing industry, which is divided into consumer non-cyclicals and consumer cyclicals. This time frame covers the listed companies in 2023 after considering the effect of COVID-19

The sample for this study was obtained using the purposive sampling technique. This research gathered financial and corporate governance data for the year 2023 using EIKON DataStream and the official website of the Indonesia Stock Exchange. The study sample was obtained by excluding the following criteria:

Table 1 Data Collection Procedures

No	Category	Sector	Industry	Population
1	Consumer Non-Cyclicals	D	D11-D42	87
2	Consumer Cyclicals	E	E11-E74	124
	Insufficient Data			(18)

Outlier			(6)
Final Sample Size			187

Source: EIKON DataStream and Indonesia Stock Exchange (2024)

Table 2 Summary Of Variable Measurement

Variable	Measurement	Operationalization	References
Financial Statement Fraud	M-Score	8 indices of M-Score	M.D Beneish (1999)
Insider Ownership	OSHIP	Cumulative percentage of ownership by insiders	Skousen et al (2008)
Board Independence	BIND	The number of independent directors divided by board size	Fama and Jensen (1983), Khoufi and Khoufi (2018), Subair et al (2020), Pramana et al (2019) and Girau et al (2022)
Change of Director	CHDIR	A dummy variable where 1 if there is change of director and 0 otherwise	Utami and Pusparini (2019), Haqq and Budiwitjaksono (2020), Handoko and Tandean (2021), Budiantoro et al (2022)
Independent Audit Committee	INDAC	The number of independent audit committees divided by the audit committee size	Skousen et al (2008)
Change of External Auditor	CHEXA	A dummy variable where 1 if there is a change of director and 0 otherwise	Pramana et al (2019), Mintara and Hapsari (2021), Handoko and Tandean (2021), Nuristya and Ratmono (2022)
Firm Size	SIZE	Log 10 of total assets	Persons (1995), Oktaviani et al (2023)
Profitability	PROFIT	Profit after tax divided by total assets	Persons (1995), Arifin and Prasetyo (2018), Oktaviani (2023)
Leverage	LEV	Total liabilities divided by total assets	Persons (1995), Arifin and Prasetyo (2018)
Liquidity	LIQUID	Total current assets divided by total current liabilities	Arifin and Prasetyo (2018)

Source: M.D Beneish (1999), Skousen et al (2008), Fama and Jensen (1983), Khoufi and Khoufi (2018), Subair et al (2020), Pramana et al (2019) and Girau et al (2022), Utami and Pusparini (2019), Haqq and Budiwitjaksono (2020), Handoko and Tandean (2021), Budiantoro et al (2022), Mintara and Hapsari (2021), Nuristya and Ratmono (2022), Persons (1995), Oktaviani et al (2023), Arifin and Prasetyo (2018).

DISCUSSION AND FINDINGS

Descriptive Analysis

Table 3 Descriptive Analysis Result

Continuous Variables	Obs	min	max	Mean	skewness	kurtosis
MSCORE	187	-12.466	17.183	-1.892	3.673	30.124

OSHIP	187	0.083	0.999	.733	-0.884	3.506
INDAC (%)	187	0	100	.35	1.635	12.185
BIND (%)	187	0	100	.052	2.923	12.427
SIZE (log)	187	6.962	11.256	9.311	-0.124	3.097
PROFIT	187	-0.891	0.292	.002	-3.504	20.551
LEV	187	0.002	5.141	.593	5.035	33.474
LIQUID	187	0.010	27.372	2.793	3.960	20.555

Based on Table 3, the minimum M-Score is -12.466, indicating an absence of potential financial statement fraud. The highest score is 17.183, indicating a potential risk of financial statement fraud. The mean M-Score of the collected data is -1.892, indicating an average absence of likelihood for financial statement fraud.

The independent variable of OSHIP shows a range of 0.83% to 99%, with the average of 73.3%. INDAC shows a range score of 0 to 100, with an average of 35% of the total committee size, signifying that the typical composition of the independent audit committee is 35%. The BIND ranges from a minimum of 0 to a maximum of 100, indicating that few publicly listed companies in Indonesia lack independent directors on their boards, while some have the most independent directors. The presence of independent directors is essential as their autonomy can mitigate agency problems associated with financial statement fraud.

The control variable of SIZE shows a range of 6.962 to 11.256, with an average of 9.311. PROFIT ranges from -0.891 to 0.292. While LEV shows a range from 0.002 to 5.141, with an average of 59.3%. The LIQUID ranges from 0.010 to 27.372.

Multiple Regression Analysis

Table 4 Multiple Regression

FSF	Coefficient	T-value
Constant	-1.619	-0.58
OSHIP	.183	0.19
INDAC	2.618	1.89**
BIND	-.955	-0.69
CHEXA	-.33	-0.57
CHDIR	-.377	-0.42
SIZE	-.117	-0.43
PROFIT	3.581	2.32**
LEV	-.347	-1.60*
LIQUID	.019	0.46
Observation	187	
Adj. R ²	5.16	
F - statistics	2.075**	

Notes: ***, **, and * present statistical significance at 1, 5, and 10 per cent, respectively.

The analysis presented in Table 4 indicates that INDAC exhibits a positive and statistically significant association with financial statement fraud (FSF), suggesting that independent audit committees may be correlated with higher incidences of fraudulent activity. This finding contradicts Hypothesis H2 and implies that firms implicated in FSF may strategically expand their audit committees by appointing additional independent commissioners, consistent with prior studies by Abdullah (2010) and Kamarudin and Ismail (2014). A plausible explanation is that the presence of independent audit committees facilitates the detection and disclosure of misleading financial statements, rather than directly preventing their occurrence.

According to Financial Services Authority (OJK) Regulation No. 55/POJK.04/2015, audit committees must comprise a minimum of three members, drawn from independent commissioners and external parties of the issuer or public company. Within Indonesia's two-tier corporate governance system, as defined by Law No. 40 of 2007 on Limited Liability Companies, the board of commissioners functions as a supervisory body, whereas the board of directors is responsible for management operations. This framework provides a robust institutional basis for independent audit committees to fulfil their oversight role, mitigate agency conflicts, and enhance corporate transparency.

The observed effectiveness of INDAC highlights its capacity to address agency conflicts, particularly the opportunity element within the fraud diamond framework. Acting as intermediaries between principals and agents, independent audit committees in the sampled firms appear to reduce agency problems and limit the dissemination of misleading financial information, thereby contributing to improved financial reporting quality.

Among the control variables, PROFIT exhibits a positive and statistically significant association with financial statement fraud (FSF), suggesting that higher profitability creates pressure for managers to manipulate financial reports in order to sustain or exaggerate performance. This finding aligns with the pressure component of the fraud diamond framework and is consistent with Oktaviani et al. (2023), who reported that both large and small profit targets can incentivise fraudulent practices. Conversely, LEV demonstrates a negative and significant relationship with FSF, indicating that firms with lower leverage are more prone to engage in fraudulent reporting to portray a stronger financial position. Higher levels of debt are typically associated with more stringent oversight by creditors regarding the firm's creditworthiness (Subiyanto et al., 2022). Moreover, if a highly leveraged firm attempts to conceal the true extent of its liabilities through fraudulent activities, this could exacerbate financial distress and potentially lead to bankruptcy (Agusputri & Sofie, 2019). Collectively, the results for PROFIT and LEV reinforce the pressure element within the fraud diamond framework, supporting Hypothesis H1a.

OSHIP exhibits a positive but statistically insignificant association with financial statement fraud (FSF), leading to the rejection of Hypothesis H1a, which is consistent with the findings of Prasmaulidia (2016) and Diansari and Wijaya (2019). Personal financial need is defined as a condition in which a company's financial decisions are influenced by the personal financial circumstances of its executives (Skousen et al., 2009). In this context, insider stock ownership (OSHIP) confers rights to claim a share of the company's income and assets, representing a potential source of pressure as conceptualised in the fraud diamond framework.

Despite the positive association observed, the effect of OSHIP on FSF is not statistically significant, suggesting that the personal financial needs of executives do not exert a measurable influence on fraudulent financial reporting. Consequently, this finding does not support agency theory, indicating that OSHIP is insufficient to mitigate agency problems related to FSF. From a regulatory perspective, Indonesia does not impose specific limits on insider ownership; however, the Indonesia Stock Exchange (IDX) mandates a minimum free float of 7.5% of shares offered to the public, effectively limiting OSHIP to a maximum of 92.5%. This regulation is established under IDX Rule I-A, as specified in the Decree of the Board of Directors of the Indonesia Stock Exchange Number KEP-00101/BEI/12-2021 and supplemented by Circular Letter Number SE-00010/BEI/07-2023. The maximum OSHIP value reported in Table 3 reflects the full implementation of this rule, which is scheduled to take effect in 2025.

BIND exhibits a negative but statistically insignificant association with financial statement fraud (FSF), leading to the rejection of Hypothesis H1b. This finding provides limited support for both agency theory and the fraud diamond framework. The result aligns with prior studies by Pramana et al. (2019) and Girau et al. (2022),

suggesting that the presence of independent directors may not effectively reduce the occurrence of FSF within Indonesian companies. The negligible impact of independent directors may reflect a tendency by firms to appoint them primarily to comply with Indonesia Stock Exchange (IDX) listing requirements and corporate governance recommendations. In line with this observation, the IDX subsequently withdrew the mandate for independent directors in publicly listed companies, as specified in Indonesia Stock Exchange Regulation Number KEP-00183/BEI/12-2018.

Similarly, CHDIR shows a negative but statistically insignificant association with financial statement fraud (FSF), resulting in the rejection of Hypothesis H1c. This finding contradicts the theoretical underpinnings of both the fraud diamond framework and agency theory, which posit that enhanced board oversight should mitigate fraudulent financial reporting. The result suggests that replacing underperforming directors may be an essential step in strengthening board effectiveness and fraud prevention; however, the insignificant impact of CHDIR on FSF may reflect a strategic response by firms seeking to conceal prior fraudulent acts committed under previous directors, thus appointing more competent successors primarily to restore credibility rather than to deter fraud. These findings further imply that CHDIR alone is insufficient to resolve agency conflicts related to FSF. This conclusion is consistent with prior research by Bawekes et al. (2018), Noble (2019), Putra (2019), Yendrawati et al. (2019), Harman and Bernawati (2020), Rahayu and Riana (2020), Haqq and Budiwitjaksono (2020), Mintara and Hapsari (2021), Handoko and Tandean (2021), Suripto and Karmilah (2021), Widnyawati and Widyawati (2022), and Calista and Nugroho (2022), who similarly found no significant effect of director change on FSF.

In the Indonesian context, the tenure of directors is regulated by Law No. 40 of 2007 on Limited Liability Companies, which stipulates that directors are appointed for a fixed term and may be reappointed, but not indefinitely. Article 105(1) grants the General Meeting of Shareholders (GMS) the authority to dismiss directors at any time for justifiable reasons, regardless of the term specified in the company's articles of association. Additionally, Financial Services Authority (OJK) Regulation No. 33/POJK.04/2014 limits a director's term to a maximum of five years or until the conclusion of the next annual GMS, after which reappointment requires shareholder approval. Consequently, directors may serve multiple consecutive terms subject to re-election. Unlike some jurisdictions, Indonesian public companies do not adopt a "retire by rotation" mechanism for director tenure.

CHEXA demonstrates a negative but statistically insignificant association with financial statement fraud (FSF), resulting in the rejection of Hypothesis H3. The findings suggest that changes in external auditors are predominantly driven by corporate dissatisfaction with auditor performance, rather than by attempts to conceal prior audit evidence. Nonetheless, the lack of statistical significance implies a divergence from the theoretical expectations of both the fraud diamond framework and agency theory. Consequently, CHEXA, as a rationalisation construct, appears insufficient in deterring FSF and ineffective in alleviating the agency conflicts that contribute to fraudulent financial reporting.

CONCLUSION AND RECOMMENDATIONS

The primary findings of this study indicate that an INDAC positively and significantly effects FSF. This research suggests that INDAC effective as an opportunity element to reveal FSF. The presence of INDAC in publicly listed companies in Indonesia has fulfilled its role in mitigating agency problems and enhancing transparency within the company. Consistent with the findings of Abdullah et al. (2010) and Kamarudin and Ismail (2014), a greater number of INDAC members corresponds with a greater likelihood of FSF. In other words, firms implicated in FSF are more inclined to appoint additional independent commissioner to their audit committees.

The results indicate that LIQUID positively and significantly effects FSF. It suggests that elevated LIQUID will further enhance FSF. Another control variable in this study, PROFIT, demonstrates a positive and significant effect on FSF. Consequently, a greater PROFIT enhances FSF. On the other hand, LEV exhibits a negative and significant effect on FSF. This suggests that increased LEV diminishes FSF. The control variable LEV suggests that increased leverage does not compel the corporation to alter its financial figures. This discovery offers an alternative perspective on the components of the fraud diamond theory.

This study highlights key factors of financial statement fraud and suggests directions for improvement. Future research could benefit from adopting a longitudinal design to investigate how temporal variations in corporate governance structures influence the likelihood of financial statement fraud (FSF). Furthermore, broadening the empirical scope to encompass multiple sectors would enable a more comprehensive assessment of whether the observed relationships—particularly those pertaining to independent audit committee (INDAC) characteristics—remain consistent across diverse industry contexts. In addition, employing alternative proxies for FSF, such as data derived from regulatory enforcement actions, may facilitate methodological triangulation and mitigate potential biases arising from reliance on a single measurement model. Finally, the integration of qualitative approaches, including in-depth interviews with audit committee members and senior executives, could provide richer explanatory insights into the underlying mechanisms driving the quantitative results, particularly with regard to the seemingly paradoxical influence of INDAC on FSF.

Although the existing OJK and IDX provisions are generally aligned with international best practices regarding the composition and involvement of independent commissioners in audit committees, additional regulatory improvements are required to enhance oversight efficacy. The proposed reforms should encompass: (i) establishing term limits for audit committee members accompanied by a cooling-off period before reappointment to safeguard independence; (ii) clarifying the definition of independence to include previous business relationships, affiliations with controlling shareholders, and restrictions on former employees, consultants, or auditors within a specified period; (iii) reinforcing competency standards through mandatory professional certifications, relevant experience, and continuous training; (iv) mandating annual independent evaluations of audit committee performance, with results disclosed in the annual report; and (v) strengthening transparency regarding members' profiles, professional experience, independence status, and tenure. Adopting these recommendations would better align Indonesia's regulatory framework with the OECD Principles of Corporate Governance and enhance the audit committee's capacity to prevent and detect financial statement fraud.

Furthermore, the existing regulatory framework governing sanctions for public companies—principally articulated in OJK Regulation No. 21/POJK.04/2015 and its reference to Law No. 8 of 1995 on Capital Markets—provides only a general foundation for the imposition of penalties and does not specifically delineate sanctions for listing violations, particularly those related to good corporate governance (GCG). The absence of explicit and measurable criteria for determining such violations introduces interpretive ambiguities that may undermine regulatory enforcement, potentially creating loopholes in the implementation of GCG guidelines and the fulfilment of listing obligations for public companies in Indonesia. This regulatory gap underscores the need for more precise, operationally defined enforcement mechanisms to ensure consistency, transparency, and legal certainty in the application of sanctions.

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