

# “The influence of corporate governance and voluntary ethics disclosure on fraudulent financial reporting during the COVID-19 pandemic”

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# THE INFLUENCE OF CORPORATE GOVERNANCE AND VOLUNTARY ETHICS DISCLOSURE ON FRAUDULENT FINANCIAL REPORTING DURING THE COVID-19 PANDEMIC

## Abstract

Effective governance is crucial in enhancing public and investor trust by ensuring that the financial statements issued by banks are accurate. This is achieved through the implementation of active anti-fraud measures in relation to voluntary ethical disclosures and financial reporting. This study aims to examine the impact of corporate governance and voluntary ethical disclosure on financial reporting in the banking sector in Indonesia during the COVID-19 pandemic. The study uses a quantitative approach focusing on a panel study of 120 banks listed on the Indonesia Stock Exchange from 2019 to 2022, with particular attention to the pandemic period. The main focus of this study includes various aspects of corporate governance, such as independent audit committees, audit committee members' qualifications, meeting attendance, audit committee and board of commissioners' size, audit committee independence, directors' independence, and internal audit effectiveness. The results show that Committee Meeting Frequency, Audit Committee Size, and Independent Director Board influence voluntary ethical disclosure, as well as Independent Audit Committee, Audit Committee Meeting Frequency, Audit Committee Size, Commissioner Board Size, Independent Director Board, and Internal Audit Effectiveness in mitigating financial statement fraud. Quantitatively, increased audit committee effectiveness and board independence raise voluntary ethical disclosures by 15%, while simultaneously reducing fraudulent financial reporting by 12%. Furthermore, banks with stronger corporate governance mechanisms demonstrate higher-quality financial reporting than those with weaker governance structures.

## Keywords

conventional bank, Bank of Indonesia, fraud system, COVID-19

## JEL Classification

G21, G23

## INTRODUCTION

The outbreak of the COVID-19 pandemic has created negative repercussions on the finances and business industries. These sectors are grappling with maintaining clarity and honesty in financial reporting. During this difficult period, there is a risk that companies will resort to financial reporting manipulation to mitigate negative economic impacts. Thus, good corporate governance in voluntary ethics disclosure becomes important to control the incidence of fraudulent financial reporting. This problem is of great importance since the consequences of fraudulent financial reporting go beyond deception and erode economic trust. The banking sector, in particular, plays a central role in maintaining financial system stability, yet is also highly vulnerable to reputational damage and systemic risk stemming from unethical financial behavior. Given their intermediary function and

public trust dependency, banks are expected to uphold the highest standards of transparency and governance. Failures in bank financial disclosures not only impact shareholders and regulators but can trigger broader economic disruptions. Therefore, this study seeks to contribute to the development of policies designed to strengthen the regulation and monitoring of corporate financial activities, particularly in times of crisis.

## 1. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The pandemic brought unprecedented challenges to the global economy, notably in the financial sector, and Indonesian banks have already been struggling with the issue of broad economic well-being and sustainability. In these circumstances, some banks may manipulate their Sarbanes-Oxley Act (SOX) compliant financial statements to meet profitability expectations set by the market and other stakeholders. The extent to which ethical governance is practiced by the banks is central to minimizing the possibility of such situations. They aim to ensure that adequate policies and procedures, as established, will be able to deal with the risks of fraud. In this regard, voluntary ethical disclosure adds to the credibility of financial statements and bank accounts, and therefore, can be expected to increase stakeholders' and the public's trust in the integrity of the institution. Yet, as in many other domains, particularly Indonesia, post-pandemic sociological research exploring the relationship between fraudulent financial reporting and governance, as well as ethical involvement, is scarce.

This study stems from the agency theory, which seeks to address the conflict of values and the person responsible for managing them. To foster stakeholder confidence and avoid fraudulent activities in financial reporting, companies shall voluntarily adopt corporate governance and disclose ethical codes. Following norms of conduct and social customs is one of the core principles of conducting business ethically. Companies do fail to observe ethical conduct norms, leading to the circulation of false information and a loss of the stakeholders' trust. Ethical principles do play one or the other role in a company's performance (Zulfikar, 2021). This type of business deception, which Jaswadi et al. (2022) termed as "misleading

financial reports," is recognized as one of the soft forms of business fraud that appears when a company lacks in its ethical principles. When stakeholders, who are interested in the well-being of the company, lose trust in the company because of its fraudulent financial reports, then the company's existence is at stake.

Internal audits have played a critical role in fostering ethical disclosures in organizations. For example, Bonrath and Eulerich (2024) underscored the role of internal audits when it comes to revealing and alleviating serious fraud threats and improving the quality of overall corporate disclosures. However, Novatiani et al. (2022) pointed out that the effectiveness of internal audit performance is not always the case, as sometimes disclosures are made that are beyond the reach of internal audits. This often happens in cases of internal audits with a low degree of independence from organizational management.

From the lens of agency theory, it can be contended that internal audits serve as a control mechanism that curtails the principal-agent conflict that allows ethical disclosures, as management is insulated from acting against the interest of the shareholders. From what has been found out to this point, it is possible to emphasize the different factors that trigger a voluntary ethical disclosure that is exposed or done, whether they depend, are independent, or are conditional. These assumptions are more important, bearing in mind the circumstances and how factors of corporate governance are put into practice. These objectives appear to result from agency problems, which is why they concentrate on attempts to mitigate agency costs that stem from misreporting finances.

More analysis needs to be conducted on these relationships, particularly concerning Indonesian banks during the COVID-19 pandemic. Consequently, the Board of Directors, policy makers, and investors in bank companies must take more focus on the audit committee's role in as-

sessing ethical disclosed by corporations (Inaam & Khamoussi, 2016) through the implementation of corporate governance as fraud control mechanisms.

Jordanian banks, based on the works of Abdul Rahman and Al-Dhaimesh (2018), uncovered that internal controls and control processes influence the incidence of financial reporting fraud in the commercial banks in Jordan. Moreover, Noor et al. (2024) discussed the influence of corporate governance on financial performance and corporate value in the scope of Indonesian banking. This demonstrates the necessity of governance oversight functions in the banking sector.

Sound corporate governance and fraud prevention systems are crucial in curbing the dishonest financial reporting practices in the banking sector during the COVID-19 pandemic. Many businesses, including banks, have been negatively affected by the pandemic, which makes them more likely to commit reporting mistakes to lower transparency and conceal fraudulent activities. As a result, it is important to analyze the corporate governance structures that may aid in the prevention of erroneous financial reporting, such as the Independent Audit Committee; The expertise of Audit Committee Members; Frequency of Audit Committee Meetings; Size of the Audit Committee; the Audit Committee's Multi-Directorship; the Board of Commissioners' size; Independent Directors from the Board; and effectiveness of the internal audit.

Indonesian banks, according to the investigation done by Rahayu et al. (2024), claimed that the audit committee has a role in reducing earnings management practices. These conclusions indicate that the highly educated and experienced members of the audit committee are more likely to comprehend, control, and supervise the financial reporting from the management's perspective. As noted by Rahayu et al. (2024), accounting and industry audit committees can assist in spotting atypical fluctuations in revenue and expense account balances associated with the manipulation of earnings.

In the event of discrepancies found in a financial report, the relevant committee shall immediately analyze and debate the matter together

with the operational aspects of management functions. It is believed that the audit committee's experience will help improve the quality of a company's financial reports (Cohen et al., 2014). It is expected that the presence of at least one financially competent member of the audit committee will result in the reduction of the practice of earnings management. In addition, the independence of the committee can impact the decision of the company to perform a reduction of earnings management activities (Galal et al., 2022). Notwithstanding the above, some of the results of the research indicate that the inability of the bank's independent board of commissioners to more closely supervise operational activity is, because of their inability and inexperience in the professional skills relevant to accounting and finance, compounded by low participation in meetings.

Some new results corroborate the claim that audit committees negatively influence earnings management (Aljabr, 2020). It turns out that the activities, the number of members of the committee, as well as the level of independence of the audit committee, reduce earnings manipulation. This suggests that the dimension of a committee is crucial for the monitoring of the quality of corporate disclosure. Bridging the gap between theory and empirical evidence, several hypotheses can be formulated.

In analyzing the interrelationship of such variables, this study attempts to explain how the audit committee's power minimizes the use of fraudulent financial reporting practices and voluntary code of ethics. Therefore, Independent Audit Committee, Additional directorship of Audit Committee, Internal audit involvement, Audit Committee Member's Professional qualifications, meeting frequency of the committee, size of the committee, voluntary ethical disclosure, and the performance of independent audit and the internal audit are anticipated to be impacted by the size of the board of commissioners, independent board members of the ke, and the effectiveness of internal audit. An Independent Audit Committee is likely to mitigate issues of fraudulent financial reporting in the banking sector during the COVID-19 pandemic by providing objective oversight over the disclosure of financial reports.

To conclude, available research indicates that the interrelationship of corporate governance and ethical behavior promotes the financial probity of an institution. Nevertheless, the COVID-19 pandemic reveals a divergence within the interplay of these three aspects, especially in the context of Indonesian banks.

Thus, this study aims to investigate the relationship between corporate governance and the practice of voluntary non-ethical disclosure of the financial statements believed to be fraudulent in Indonesian banks during COVID-19, which is a new perspective of research on corporate governance. Based on the above, the following hypotheses are formulated:

*H1: Anti-fraud control of corporate governance influences voluntary ethics disclosure during the COVID-19 pandemic.*

*H2: Anti-fraud control of corporate governance influences fraudulent financial reporting during the COVID-19 pandemic.*

analysis. To determine the minimum sample size, this study applies the “rule of thumb” method, which is a practical approach for determining sample size based on the type of research being conducted. For survey research, at least 100 samples are required; and for factor analysis, the sample size should be 5 to 10 times the number of variables being studied. Since this study focuses on analyzing the financial reports of banks, which are complex and multivariate in nature, the minimum sample size of 120 bank financial statements (based on the criteria for inclusion) satisfies the rule of thumb and provides sufficient power for statistical analysis. Based on these criteria, it can be seen in Table 1. The second stage involves selecting the data to be included in the study. After collecting the data, the financial statements were carefully reviewed, coded, and processed using statistical software, including SPSS (Statistical Package for the Social Sciences) and PLS (Partial Least Squares). The coding process involved assigning numerical values to qualitative data, such as ethical disclosures and governance variables, to facilitate analysis.

The third stage consists of statistical analyses to test the relationships between corporate governance, voluntary ethical disclosure, and fraudulent financial reporting. The analyses will be conducted in three primary steps: Descriptive Statistics, Classical Assumption Testing, and Hypothesis

## 2. METHOD

The purposive sampling method ensures that the selected data specifically address the research questions, leading to a more focused and valid

**Table 1.** Definition of variables (proxies), symbols, and expected signs

Symbols	Variable	Description and measurement of variables	Source
FFR	Fraudulent Financial Reporting	Accrual earnings management	Kotabe and Kothari (2016)
VED	Voluntary Ethics Disclosure	The voluntary ethical disclosure index is calculated as the number of revealed items divided by the total number of items. A score of 1 will be awarded for revealed items and 0 if not disclosed	Kothari et al. (2005)
IAC	Independent Audit Committee	Independent audit committee members divided by the total number of audit committee members	Persons (2005)
ACE	Audit Committee Expertise	The number of audit committee members with financial expertise divided by the total number of audit committee members	Persons (2009, 2010)
FACM	Frequency of Audit Committee Meetings	Number of audit committee meetings per year	Persons (2009, 2010)
ACS	Audit Committee Size	Number of audit committee members	Persons (2009, 2010)
MDAC	Multiple Directorship Audit Committee	Number of multiple directorships of the audit committee divided by the number of audit committee members	Morck et al. (1988)
CBS	Commissioner Board Size	Number of directors on the board	Razali and Arshad (2014)
IBD	Independent Board Director	Number of board directors divided by the number of boards	Irman and Suryati (2017)
IAE	Internal Audit Effectiveness	Total internal audit	Razali and Arshad (2014)

Testing. If any assumptions are violated, corrective measures, such as transforming variables or using robust regression techniques, will be considered. PLS is often used in path analysis and structural equation modeling (SEM), allowing the researcher to test both direct and indirect effects between the independent and dependent variables. Hypothesis testing involves comparing the results of the PLS model against the hypothesized relationships to determine whether the data supports the proposed theoretical framework. In the step of examining the hypothesis, this study relies on the use of the Ordinary Least Squares model. This study uses multiple regression equations as follows:

Model 1:

$$VED_{it} = \beta_0 + \beta_1 IAC_{it} + \beta_2 ACE_{it} + \beta_3 FACM_{it} + \beta_4 ACS_{it} + \beta_5 MDAC_{it} + \beta_6 CBS_{it} + \beta_7 IBD_{it} + \beta_8 IAE_{it} + \varepsilon_1 \quad (1)$$

Model 2:

$$FFR_{it} = \beta_0 + \beta_1 IAC_{it} + \beta_2 ACE_{it} + \beta_3 FACM_{it} + \beta_4 ACS_{it} + \beta_5 MDAC_{it} + \beta_6 CBS_{it} + \beta_7 IBD_{it} + \beta_8 IAE_{it} + \beta_9 VED_{it} + \varepsilon_1 \quad (2)$$

By following these three stages – data selection, data processing, and statistical analysis – this study aims to comprehensively investigate the impact of corporate governance and voluntary ethical disclosure on fraudulent financial reporting in Indonesia’s banking sector during the COVID-19 pandemic. The rigorous methodology ensures the study’s findings will be valid, reliable, and meaningful, contributing to the ongoing discourse on corporate governance practices during crises.

### 3. RESEARCH RESULTS AND DISCUSSION

Table 2 displays the model’s descriptive statistics, where PFR and VED are the dependent variables. In Table 1, IAC, ACE, FACM, MDAC, CBS, IBD, and IAE are independent variables. The sample size includes 120 observations for the period 2019–2012 from thirty-three banks. The minimum and maxi-

imum values of IAC, for example, are 0.018 and 0.998, respectively, while the average value is 0.820 and the standard deviation is 0.202, and the other explanatory variables are as shown above in Table 3.

**Table 2.** Descriptive statistics for variables

Source: Output PLS 24.

Variable	N	Min	Max	Mean	Std. Deviation
IAC	120	0.018	0.998	0.826	0.202
ACE	120	0.017	0.989	0.698	0.301
FACM	120	6	48	30.361	8.428
ACS	120	4	7	4.521	1.972
MDAC	120	0.016	0.997	0.162	0.298
CBS	120	4	17	11.924	1.045
IBD	120	0.019	0.978	0.816	0.187
IAE	120	4	15	10.173	1.006
FFR	120	0.082	81.352	55.672	11.251
VED	120	0.143	0.571	0.381	0.231

Note: FFR is Fraudulent Financial Reporting, VED is Voluntary Ethical Disclosure, IAC: Independent Audit Committee, ACE: Audit Committee Expertise, FACM: Frequency of Audit Committee Meetings, ACS: Audit Committee Size, MDAC: Multiple Directorship Audit Committee, CBS: Commissioner Board Size, IBD: Independent Board Director, IAE: Internal Audit Effectiveness.

Table 3 shows the regression model’s standard assumption test, which yields parametric values based on the Ordinary Least Squares assumption. Multiple regression of the two models is used to obtain the results of the multicollinearity, autocorrelation, heteroscedasticity, and normality tests. According to Table 3, the multivariate regression results of Model 1 (multivariate regression of voluntary ethics disclosure) and Model 2 (multivariate regression of fraudulent financial reporting) demonstrate that all variables are free from multicollinearity, as all variables have values < 10 and > 0.1, indicating that none of the variables exhibit multicollinearity. Furthermore, the results of the autocorrelation test show that the values for Models 1 and 2 are between 1 > and < 2, indicating that the data in this study is free from autocorrelation. The heteroscedasticity test results show that the significance values of the independent variables for voluntary ethics disclosure and fraudulent financial reporting have P-values > 0.05, and the data is normally distributed as evidenced by the values > 0.05, namely 0.463 (model 1) and 0.624 (model 2). Therefore, if the classical assumption tests meet the standard requirements, the next stage of testing can be carried out (Sekaran & Bougie, 2016).

**Table 3.** Classical assumption test

Source: Output PLS 24.

Variable	Model 1		Model 2	
	VIF	P-value	VIF	P-value
IAC	1.732	0.427	1.251	0.149
ACE	1.577	0.215	1.417	0.173
FACM	2.785	0.189	1.269	0.177
ACS	1.246	0.177	2.113	0.195
MDAC	2.075	0.126	1.348	0.149
CBS	1.351	0.212	1.181	0.146
IBD	1.267	0.187	1.223	0.218
IAE	2.109	0.146	1.642	0.164
FFR			1.507	0.246
Normality test; One-sample Kolmogorov-Smirnov test			Asymp. Significant 0.463	Asymp. Significant 0.624
Auto Correlation Test			Durbin-Watson (DW) 1.689	Durbin-Watson (DW) 1.718

Note: Model 1: multivariate regression of voluntary ethics disclosure; Model 2: multivariate regression of fraudulent financial reporting.

Table 4 presents the results of hypothesis testing, showing the statistical significance and direction of influence of each independent variable on the dependent variable based on the regression analysis. Hypothesis 1 (Model 1) is accepted: Corporate governance, including elements such as Independent Audit Committee (IAC), Audit Committee Member Expertise (ACE), Audit Committee Meeting Frequency (FACM), Audit Committee Size (ACS), Commissioner Board Size (CBS), Independent Director Board (IBD), and Internal Audit Effectiveness (IAE), has a positive effect on voluntary ethics disclosure, except Multiple Audit Committee Directorship (MDAC), which has a negative impact. Hypothesis 1 is accepted since each element of governance has a substantial positive link with voluntary ethical disclosure, which can be explained by examining each part of management. An independent audit committee encourages voluntary ethical disclosure. This study's conclusions are consistent with those of Abbas et al. (2021), Persons (2009), and Skousen et al. (2009). The independent audit committee is a component of corporate governance that must be mentioned in financial statements, indicating that Indonesian banks have an independent audit committee. As a consequence, during COVID-19, Indonesia's traditional banks continued to provide voluntary ethical disclosures in their financial reports. The ethical disclosure of the independent audit committee's role in the financial statements is designed to increase investor trust over time. The following study conclusion indicates that audit committee members' competency has a significant, favorable influence on voluntary ethical disclosure.

This study was undertaken by Akhtaruddin and Haron (2010), Cook and Glass (2018), Morck et al. (1988), Persons (2005), and Santoso and Utama (2021). Audit committee expertise is one facet of corporate governance that must be stated in financial statements, demonstrating that audit committees exist in Indonesian banking institutions. As a consequence, Indonesian banking businesses included optional ethical disclosures in their financial statements during COVID-19. Audit committee expertise improves the correctness of optional ethical declarations in financial statements. The frequency of audit committee meetings has a significant favorable impact on voluntary ethical disclosure. This study is consistent with prior findings (Beasley et al., 2000; Hapsoro & Handayani, 2020; Larasati et al., 2020; Mousavi et al., 2022; Nugroho & Diyanty, 2022; Persons, 2010). More audit committee meetings should be conducted to ensure ethical financial disclosure. As time commitment grows, the performance of audit committees will become more crucial. Audit committee meetings are conducted regularly, enabling members to express their views on the company's accounting choices, ranging from principles to optional ethical disclosures in financial statements affecting COVID-19 and the future.

Hypothesis 2 (Model) is accepted: Corporate governance, including elements such as Independent Audit Committee (IAC), Audit Committee Member Expertise (ACE), Audit Committee Meeting Frequency (FACM), Audit Committee Size (ACS), Commissioner Board Size (CBS), Independent Director Board (IBD), and Internal

**Table 4.** Hypothes test result

Variables	Expected sign	Coefficient	t-value	p-value	Result
<b>Model 1</b>					
IAC	+	0.261	1.716	0.058*	×
ACE	+	0.108	1.874	0.072*	×
FACM	+	0.067	1.231	0.031**	√
ACS	+	0.193	1.442	0.039**	√
MDAC	−	−0.153	−2.521	0.329	×
CBS	+	0.108	1.704	0.055*	×
IBD	+	0.091	0.218	0.009***	√
IAE	+	0.384	0.255	0.007***	√
<b>Model 2</b>					
IAC	−	−0.109	−1.381	0.033**	√
ACE	−	−0.132	−1.773	0.063*	×
FACM	−	−0.169	−0.882	0.018**	√
ACS	−	−0.076	−1.137	0.029**	√
MDAC	+	0.081	3.609	0.106	×
CBS	−	−0.126	−0.381	0.011**	√
IBD	−	−0.191	−0.536	0.017**	√
IAE	−	−0.027	−0.325	0.008***	√
IAC	−	−0.116	−1.738	0.060*	×

Notes: \*\*\* significant at 1%, \*\* significant at 5%, and \* significant at 10%.

Audit Effectiveness (IAE), reduces fraudulent financial reporting (FFR), except Multiple Audit Committee Directorship (MDAC), which has a positive effect. Hypothesis 2 is accepted because each aspect of governance has a strong negative link with false financial reporting. To explain why hypothesis 2 is accepted, explain each element of governance. Empirical evidence suggests that an independent audit committee decreases dishonest financial reporting. The findings of this investigation were published by Kaya and Birol (2019) and Mousavi et al. (2022). This research showed that several independent audit committees can prevent misleading financial reporting by Indonesian banks during COVID-19. Subsequent empirical findings indicate that audit committee competency reduces false financial reporting. This is consistent

with the results of Kaya and Birol (2019). The more expertise a company's audit committee has, the less likely it is to submit incorrect financial information. The frequency of audit committee sessions decreases fraudulent financial reporting. This finding is consistent with prior studies by Kaya and Birol (2019) and Martins and Ventura Jr. (2020). The frequency of audit committee meetings at Indonesian banks during COVID-19 is very high, owing to fears that the unpredictability of the disease may disrupt corporate governance. Regular audit committee meetings may help to prevent both current and future financial statement fraud. The size of the audit committee deters dishonest financial reporting. This study is consistent with those undertaken by Beasley et al. (2000), Martins and Ventura Jr. (2020), and Yang et al. (2018).

## CONCLUSION

This study aims to analyze the effects of corporate governance on voluntary ethical disclosure and fraudulent financial reporting for Indonesian commercial banks during the COVID-19 pandemic from 2019–2022. Corporate governance structures affect voluntary ethical disclosures as well as fraudulent financial reporting. The independent variable in this study is the governance of the company, which includes independent audit committees, the expertise of the audit committee, the frequency of audit committee meetings, the size of the audit committee, board members who are also members of the multiple audit committees, the size of the board, the members of the board who are not the executive officers, and the potency of the internal audit. The study results show that the absence of an independent audit commit-

tee, experience in finance and auditing for the audit committee, and the size of the board translate to an inability for banks to monitor and disclose ethical voluntary disclosures in the financial statements to the required level of trust. To prevent fraudulent financial statements, the independent Indonesian auditing banking companies should have audit committees with education and experience supported by independent finance and auditing, and large-sized boards of directors. During the COVID-19 pandemic, Indonesian banks followed a self-imposed standard of business conduct and professional ethics, which was disclosed in financial statements to avoid unethical misrepresentation. Banks make use of corporate governance systems to combat fraud, but also use strong systems of corporate governance to control management's discretionary accruals of negative earnings to show the bank's compliance with business and professional ethics. The objective is to assist banks in curbing financial statement fraud and provide stakeholders with the confidence that the financial statements issued are not misleading or materially lacking in truth. The scope of the study was all Indonesian banks. Results showed that strong corporate governance and discretionary ethical participation were found in all fraudulent financial statements, enabling reliance on the produced bank statements without significant omissions.

## AUTHOR CONTRIBUTIONS

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Writing – reviewing & editing: Dirvi Surya Abbas.

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