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Audit Quality, Financial Distress, and Corporate Governance Factors on Financial Report Integrity in Banking

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ARTICLE INFO	ABSTRACT	
<p>History article; Submitted June 25, 2024 Article revision July 19, 2024 Accepted September 10, 2024</p> <hr/> <p>Corresponding author; Arif Nur </p> <hr/> <p>Keywords: Audit quality, financial distress, audit committee, independent commissioners, financial statement integrity</p>	<p>Objective: Seeing this, the purpose of this study is to know how the limit of audit quality, financial distress, audit committee, independent commissioner and institutional ownership affects the integrity of financial statements in banks listed on the Indonesia stock exchange (ISE).</p> <p>Methods: This study employs a quantitative research approach utilizing secondary data from bank company financial statements analyse through multiple regression and classical assumption tests.</p> <p>Results: The results also show a positive effect of audit quality on the integrity of financial statements and a negative effect of financial distress on the transparency of financial reporting. The audit committee, independent commissioners, and institutional ownership, are shown to affect the integrity of financial statements positively but statistically not significant. Our findings indicate that whilst audit-quality is essential in the delivery of reliable financial reports, the mechanisms of governance described should be further refined to ensure their efficacy in promoting the financial transparency of firms in developing economies.</p> <p>Novelty: This study offers insight into the determinants of financial statement integrity in the Indonesian banking sector thereby adding to transactions in this area. It sheds light on the significance of audit quality and the challenges that financial distress presents and provides new evidence regarding the limited effects of corporate governance, such as audit committees and independent commissioners.</p> <p>Research Implications: The report highlights the importance of rigorous audits and intervention to address financial distress, as banks can produce higher quality audited financial statements. An implication to policymakers and regulators is to take time to enhance the effectiveness of governance mechanisms, encourage and explore alternatives to reducing financial distress but with greater transparency on financial statements. Future work is needed to investigate the impact of effective governance structures on financial statement integrity across industries and regions.</p>	<p></p>
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1. Introduction

Integrity of financial statements has turned out to be the most important phenomenon for funding establishments everywhere. Financial reports are a vital component for decision-making, investment analysis, and transparency. In recent years, the integrity of financial reporting has come under scrutiny due to several high-profile cases of data manipulation and misleading disclosures. Rezaee (2004), Rezaee & Tuo (2017), explain that obstructed financial reporting can cause severe reputational damage, a loss of investor confidence, and regulatory scrutiny. These challenges particularly affect the banking sector as it supports the economy and relies on stakeholder trust (Au & Kauffman, 2008; S. Gupta et al., 2019; Shankar et al., 2002). In Indonesia, where banking regulations are still undergoing improvements, the need

for reliable financial reports is urgently required, because the financial industry in this region has grown rapidly (Kim & Wood, 2020; Wibowo & Wilhelm Alfen, 2014). It is, therefore, necessary to identify the determinants of the quality of banking financial reports for both practitioners and policymakers (Daske & Gebhardt, 2006; Enright & Newton, 2004; Ibrahim et al., 2022).

Although more attention has been drawn to this issue, it remains an unsolved problem what the factors influencing the integrity of the financial report are in the banking sector (Adams & Frost, 2008; Alalwan et al., 2017; Thompson & Cowton, 2004). In this context, previous research highlights several determinants that may impact the relationship between audit delay, including audit quality and financial distress, as well as corporate governance constructs like audit committees and independent commissioners (Carcello et al., 2011; Habib &



Muhammadi, 2018). But earlier studies have had mixed findings about their effectiveness. Aldamen et al. (2012), Habib & Jiang (2015), Jiang et al. (2018) have found both higher audit quality associated with better financial report integrity, while factors such as financial distress have proven to adversely affect reporting practices. which also shows that the presence of audit committees and independent commissioners does not guarantee consistency in the improvement of financial transparency (Han et al., 2022; Ogharanduku et al., 2021; Wynter & Oats, 2018). Corporate governance pales in comparison when firms are either distressed or undergoing significant instability, indicating its influence is limited in such cases (German et al., 2020; Ghaemi Asl & Ben Jabeur, 2024). Thus, significant scope exists to delve deeper into these matters to provide greater clarity for decision-making by the policymaking authorities and banking institutions (Dwivedi et al., 2024; Malekpour et al., 2020; Wang et al., 2018).

Therefore, in this study, the most prominent theory used is the Agency Theory, which discusses the relationship between principal shareholders and agents company executives. Agency issues occurs due-to the conflict of interest between agents and principals (Jensen & Meckling, 2019; Mouselli & Hussainey, 2014). In such cases managers will have incentives to either to manipulate earnings or to withhold information in financial reporting in an attempt to prop up the fiction of the company (Armstrong et al., 2024; Hope & Wang, 2018; Preuss & Königgruber, 2021). Here, the quality of audit comes into play because auditors are seen to act as independent monitor of managerial behaviour. High quality audits mitigate information asymmetry and align the interests of managers and shareholders (Alhababsah, 2019; Alhababsah & Yekini, 2021). In addition, audit committees and independent commissioners are both examples of mechanisms that mitigate agency costs and monitor behaviours in order to mitigate costs that can distort financial reporting (Habib et al., 2019; Ustinova, 2023). Recent studies Alsmady (2022), Galletta et al. (2022), Sadaa et al. (2023) reinforce the need for solid corporate governance in increasing the reliability of financial statements within the banking industry as well.

This study is timely because global attention has focused increasingly on the integrity of financial reports, particularly in the banking industry. With the increasing interconnectedness of financial markets, systemic failure due to financial misreporting becomes a growing risk, highlighting the importance of transparency and reliable financial information. The recent studies examining the relationship among audit quality, financial distress and governance structures have been unethical. As an

example, studies conducted by Wang et al. (2022); Singh and Sharma (2020) have studied that audit quality benefits financial integrity and the studies from Lee et al. Kartal et al. (2018) conducted research in the banking demand firm and finding little effect of audit committees and independent commissioners on the accuracy of financial statements. On the other hand, financial distress worsens this problem, and the quality of financial reports decreases (Haryanto and Oktaviani, 2024). This study contributes to the literature by synthesizing these various findings and offering a unified picture of how these variables interact in the context of Indonesian banking companies. In doing so, this study contributes to the existing literature as regards the significance of corporate governance mechanisms and audit quality in safeguarding the quality of financial reports in the face of financial distress.

This study was conducted to prove the effect of audit quality, financial distress, audit committees, independent commissioners, and institutional ownership on financial report integrity in the banking sector. In particular, it investigates (a) the effect of audit quality on the accuracy and transparency of financial statements, (b) the impact of financial distress on integrity, and (c) how the structure of corporate governance affects the integrity of financial reporting. The research outcome is likely to give necessary recommendations to the banks and regulators in increasing financial report reliability, critical in ensuring stakeholders trust and economic stability.

2. Theoretical framework and development

2.1 *The impact of audit quality on financial statement integrity*

The importance of audit quality for the integrity of financial statements, must be emphasized, and is discussed in the literature, and plays a crucial role in assuring the reliability of reported financial statements. As per the literature, high-quality, independent, and professional audits are essential for transparency and trust in financial statements. Based on the work of DeAngelo (1981), the key to quality in an audit is said to be auditor independence and competence. They demonstrated that auditors who possess the necessary capabilities and are independent are more apt to identify financially significant discrepancies and misstatements in financial reports, rendering a more reliable financial feed back within the business performance.

In addition, work by Choi et al. Evidence is gathered from accounting literature (Basu et al. 2020; Hasan & Shamsuddin 2021) confirming the relationship between audit quality and financial statements quality. These

studies demonstrate that industries with complex transactions, like banking, require high-quality audits even more. Due to the sensitivity with which financial reporting in these industries can be manipulated either through expertise (error) or through malice (fraud), the ability and independence of the auditors of such companies are paramount in the financial statements relaying an accurate reflection of the company's financial standing. Auditors play a fundamental role in determining the trustworthiness of the financial reports by exercising professional skepticism and ensuring its objectivity, which allows if anything goes wrong, they can mitigate reduce the risk of financial misstatement.

As for Indonesia's context, the relevance of audit quality needs to be ascertained in the banking industry. Haryanto and Oktaviani (2024) highlight that when it comes to the auditing environment, auditors are facing pressure to conduct thorough examinations of financial statements and as such, the number of financial misreporting cases decreases, especially in banking institutions. These findings suggest that high quality audits enhance financial statement credibility. Their role in providing an accurate and unbiased assessment is even more critical as auditors are being tasked with scrutinizing more complex transactions. Big Four auditors are known for having more rigorous auditing standards and the presence of such auditors results in financial statements of firms audited by Big Four being more trustworthy and this in turn brings some stability to the financial system.

Additionally, Nguyen et al. Big-Four auditors provide more integrity to financial statements, and this belief was strengthened further by (2022). Also, researchers found that those who were audited by larger, more established firms have been known to have more accurate financial statements than those companies who were audited by smaller firms. The reason being the better credibility and transparency when it comes to financial reporting through better auditing processes and standards by the big four audit firms. Such evidence is in accordance with Choi et al.'s findings (2020) and this also strengthens the argument that the constraint in high quality audit is an important factor in ensuring the credibility of the financial statements.

In addition, audit quality goes beyond the assurance of correct financial statements. It also plays its part in the general corporate governance of an organization. Krishnan (2003) shows that better audits improve corporate governance by ensuring ethical business practices and regulatory compliance by companies. Independent auditors play a critical role in protecting against fraud and holding companies responsible for their financial performance. This backward provides to greater

confidence of stakeholders like investors and regulators in financial tsunami statements which finally results in a more transparent and efficient financial market.

Several credible studies and evidence support that high quality audits lead to more accurate financial statements. More robust and independent audits lead to increased reliability of the financial statements. This link is particularly robust in complex industries, such as banking, where misreporting financial information could have tremendous ripple effects. DeAngelo (1981), Choi et al. (2023), Hasan & Shamsuddin (2024), Haryanto and Oktaviani (2020), and Nguyen et al. (2022) emphasize the significance of audit quality in preserving the integrity of financial statements. Hence it is obvious that audit quality had positive impact on financial statements integrity as shown in hypothesis (H1).

H1: Audit quality has a positive effect on financial statement integrity.

2.2 *The effect of financial distress on financial statement integrity*

The relationship between financial distress and financial reporting quality is a well-documented phenomenon in the accounting and finance literature. Financial distress a potentially lethal state for a company in which severe liquidity and solvency issues are present has been associated with reduced reporting quality and reliability. According to the Agency Theory proposed by Jensen and Meckling (1976), in times of financial distress, agency problems become more pronounced due to an effort through which managers will put their interest ahead of those who own the capital whether the shareholders or the stakeholders. Such misalignment can cause manipulation of financial statements or earning management, which aggravates the lack of transparency in financial reporting. Consequently, the financial statements may not be a true reflection of the firm's actual state of affairs. The study carried out by Chen et al. (2020) and Wang et al. (2022) confirms that financial distress is indeed detrimental to financial statement integrity. These publications emphasize that financially distressed firms are more likely to exhibit questionable accounting behavior, such as earnings management, in an effort to preserve the illusion of financial health or at least to maintain the confidence of investors. This type of maneuver, known as "window dressing", is employed to cover the company's financial problems making financial statements are less reliable distorting the true financial performance and position of the company.

When it comes to the banking industry, the ramifications of financial distress on the integrity of financial statements is starkly apparent. Lee et al. (2023) states that during bad times, banks in developing nations,

like Indonesia, will put pressure on themselves to show fake or fake financial statements to get approval from investors or stakeholders. These institutions may often have the option of misrepresenting their current state of finances by overstating their assets or understating their liabilities, directly defeating the purpose of the financial reports themselves. This falsification on the part of the stakeholders hinders clear financial reporting and misrepresents the stakeholders' ability to evaluate the accurate performance of the company. Moreover, just as the world's banks were enjoined during the crisis to improve perceived connectedness and financial stability, so might any firm in stress experience upward pressure on its standardized corporate language. In such time, there is no administrator to check what the managers are doing, hence it will increase the agency cost and lead to more misrepresentation, managers may use the aggressive accounting policies to show the financial health of the firm or delay the recognition of losses, which is not correct financial condition of the firm. Thus, financial distress is a significant challenge which negatively impacts the accuracy, transparency and completeness of these financial statements.

Moreover, the inverse relationship between financial distress and the integrity of financial statements is supported by prior work. For example, Altman (1968), by constructing the Z-score model showed that financial distressed firms are more prone to falsify their financial statements to prevent bankruptcy or satisfy investors and creditors. Accordingly, this results in a diminishing of both the integrity and credibility of the financial statements, enhancing the significance of considering financial distress when assessing the quality of financial reporting. Overall, financial distress poses a serious concern in safeguarding against the veracity of financial statements. According to the Agency Theory, during periods of financial distress, managers may have different interests than stakeholders, leading them to take unethical actions such as manipulating or misreporting earnings. The findings of Chen et al. (2020), Wang et al. (2022), and Lee et al. (2023) show that the propensity to misstate the financial statements increases during financial distress, especially within industries such as banking that face significant motivation to avoid investor losses. Consequently, it is obvious from the hypothesis above (H2) that financial distress has an adverse effect on financial statement integrity.

H2: Financial distress has a negative effect on the integrity of financial statements in banking companies.

2.3 The influence of the audit committee on the integrity of financial statements

It is well established that the audit committee is essential to the integrity of financial statements and represents a key component of effective corporate governance. The Audit Committee is responsible for overseeing the financial reporting process, compliance with relevant legislation and the integrity of financial statements. In summary, an appropriate best practice regarding the prevention of financial misstatements is that a well-functioning independent audit committee can be a central building block on the path to high-quality financials.

Zoort et al. As noted by Zhou (2002), a well-functioning audit committee was found to have a higher chance of averting financial misstatements. The study finds that independent audit committee members with the requisite knowledge are better candidates to interpret financial reports, detect upcoming problems, and certify that financial statements are fairly stated without material misstatements. This means that there is another body overseeing what happens, making sure that there are no errors, fraud or manipulation in financial reporting. These functions have additional relevance in banking institutions, given the complexity and volume of transactions that take place and the serious impact that financial misstatement can have on stakeholders.

Yuliana (2022) and Nguyen & Tran (2023) also supported the positive influence of audit committees on financial statement reporting quality. The results of their analysis show that the quality of financial reporting is higher for those banking institutions that have active and well structured audit committees. And the credibility of the reports is improved by ensuring that financial statements are correct and compliant with regulatory standards. Using a range of different methods, the recent studies show how the independence and expertise of the audit committee can lead to better financial reporting quality. The ability of an audit committee to properly monitor and evaluate the financial reports is intimately tied to the independence of its members in relation to management as well as their knowledge of accounting and auditing practices.

In this regard, the effectiveness of an audit committee essentially depends on its structuring and composition along with the activity level at which the committee performs and meets. The audit committee's role in protecting the integrity of financial reporting can be done most effectively by accepting full engagement in the monitoring process, regular meetings, and continuous updating on new financial rules and sector criteria. Scant and ignorant audit committees will be less likely to detect financial misstatements, threatening the integrity of the financial statements. As a result, the success of the audit

committee in improving the quality of financial reporting depends on its involvement and the skills of its members.

Sari and Utami (2021) concluded that in the context of Indonesia, audit committees in banks are crucial in enhancing financial statement reliability. Their study showed that creative and effective audit committees in banks has played an export role to report the more truth and faithful financial statements than those banks that don't have active audit committees. These align with global studies, which undertake an integrated view of the role of audit committees in monitoring financial reporting practices, reducing the incidence of fraudulent reporting. The results further indicate that the state of regulation and corporate governance in Indonesia leads to the formation of sound audit committees that play a beneficial role in maintaining financial statement integrity.

Consequently, the study confirms the H3 which asserts that the audit committees positively affect financial statements integrity A strong, independent, and well-functioning audit committee can increase transparency and reliability of financial reporting by overseeing internal and external auditors, identifying potential errors and misstatements, and ensuring compliance with accounting standards. The function of audit committees has been played which provide reliability and trustworthiness of financial reporting, as one of the most significant elements of corporate governance, should not be easily overlooked, especially in industries that are highly oriented towards regulatory factors and financial transparency such as in the banks.

H3: Audit committee has a positive effect on financial statement integrity

2.4 The influence of independent commissioners on the integrity of financial statements

Supervising managers with an eye to protecting shareholders and other stakeholders is the key role of independent commissioners in corporate governance. Their central role is providing objective scrutiny of the company's activities, especially in areas that can raise conflicts of interest, like financial reporting. Independent commissioners perform this oversight, thus reducing agency conflicts — the divergence between the managers' personal goals and that of the shareholders or stakeholders. In doing so, they help provide the credibility and integrity of these financial statements, making sure that these reports represent the company's financial status well. According to Lin et al. (2019) independent commissioners aid in enhancing financial transparency through providing independent judgment and by monitoring management's financial decision. They are

expected to provide a level of reassurance against the risks of financial misstatement, fraud or earnings manipulation. Similarly, Choi et al. (2021) argue that independent commissioners are especially important in highly regulated industries like banking, where accurate financial reporting is necessary to the upkeep of public trust and investor confidence. This independent oversight helps to ensure that financial statements comply with regulatory requirements and provide a true and fair view of the company's financial health.

Particularly in banking institutions, the role of independent commissioners is very vital because this is a sector that is sensitive to the ethical principles of financial reporting. The results demonstrated by Hasan and Shamsuddin (2021) indicate that banks with greater independent commissioners are not likely to commit earnings manipulations or financial misstatements. Independent commissioners with their neutral oversight serve as a check on management's actions, which lowers the risk of financial twiddling that might deceive investors or regulators. This is in line with agency theory which suggests that independent directors can help solve conflicts arising between shareholders and management in order to make such financial reporting transparent and reliable. In Indonesia, Pratama et al. (2023) also drives home the need for independent commissioners to uphold high financial reporting standards. We find that independent commissioners play a key role in ensuring that banks respond to increasing regulatory scrutiny. Stricter rules regarding financial transparency and governance have increased the importance of independent commissioners in preserving the integrity of banks' financial reports in Indonesia. This is similar with global research that supports the independent commissioner in enhancing corporate governance including the quality of financial reporting and banking.

Although the share of such independent cost-reducing commissioners in enhancing the integrity of financial statements was undoubtedly relevant, the full one-quarter of the context in which they are involved, nonetheless. Independent commissioners also need adequate qualifications, experience, and resources to adequately oversee management's actions and ensure compliance with financial reporting standards. Moreover, by the general corporate governance context in which they are embedded, including the independence of the audit committee and the external audit quality. In conclusion, the literature provides support for hypothesis (H4), which states that independent commissioners positively influence the integrity of financial statements. Third, it also provides another layer of independent oversight that mitigates the potential for intimidation and reduces the

risk of financial misreporting, ensuring that financial statements properly reflect the company's financial position. This is especially important in heavily regulated industries such as banking, where transparency and compliance with financial regulations are vital. However, the question is now evolving, granting more emphasis on independent commissioners who play a key role in ensuring the integrity of financial statements in light of mounting regulatory pressures and shareholder expectations.

H4: Independent commissioners have a positive impact on the integrity of financial statements.

3. Methods innovations

3.1 Research Design

This study aims to provide empirical evidence of the effect of audit quality and financial distress on the integrity of financial statements by (1) supporting the audit committee and (2) independent commissioners as moderating variables in banking companies listed on the Indonesia Stock Exchange (IDX) in the 2020-2024 period. Such research is mostly quantitative, investigating trends and changes over time by quarterly accounting records of selected businesses. This study captures the financial performance, governance factors effecting the quality of financial statements in banking industry as quarterly data has been use for the study from quarterly data is very much substantial and statistically significant.

Quarterly financial reports were chosen in line with Hair et al. Broader questions can be addressed with nest ED data, which has the potential to identify relevant variation in association that are rooted in relationship over time (Granger, 2020). This setup is especially appropriate for studies involving the banking industry, in which financial statements are mandated by regulatory authorities and affected by different economic factors that can change greatly in a short period of time. Through examining the interaction among the three factors during this period, the study would shed the light on the dynamic forces that underpin the financial reporting quality in the banking sector of Indonesia. It offers a solid empirical basis for understanding the impact of governance behaviors on the fidelity of financial statements, emphasizing the role that good internal controls and external audits must play in ensuring transparency of financial information.

3.2 Research Sample

The dataset of this study are banking companies listed on the Indonesia Stock Exchange (IDX) 2020-2024. In order to find the appropriate data for analysis, a purposive

sampling method was used to define the companies that met certain minimum characteristics and fit the analysis' right criteria. The companies selected needed to publish quarterly financial reports on a consistent basis during the time frame of this research, and follow corporate governance disclosure standards. Consequently, 136 observations (quarterly data) were collected from 34 eligible banking companies (with 50 listed on the IDX).

In research using qualitative research methods, purposive sampling is selected based on certain conditions of interest that meet certain criteria (Sekaran & Bougie, 2020). The reason for that is because this method of data collection aims to only use companies that have complete and reliable financial data and therefore ensures that the least biased results are generated which further enhances the validity and generalizability of the findings (Creswell, 2014). The study follows the recommendations from scholars like Gompers et al. the importance of governance in maintaining high standards for data reliability (G2020).

Moreover, quarterly data is more consistent with Hair et al.'s suggestion (2020), which enables researchers to examine the time-varying interactions among financial variables in multiple time windows. Quarterly data enables the tracking of trends over the years, besides providing a broader view of financial performance that is essential for a strictly regulated industry like banks (Berger, 2003) This account offers us an in-depth analysis of the effectiveness of corporate governance mechanisms instrumented for managerial oversight of financial statement integrity, especially relevant in the current fast-moving banking landscape in Indonesia. Using several quarters of financial data to derive insights on this relationship, this study provides an empirical groundwork for exploring governance practices and financial disclosure in one of the prominent emerging markets.

3.3 Instruments variable

All constructs: the All constructs here are widely used in the existing literature which is why the constructs used are operationalized and provided on the basis of the sources in the study. Using established indicators makes them reliable and comparable with previous studies. Table (2) provides a summary of how each variable is measured and supported in the literature.

Audit quality is a dummy variable equal to 1 if the firm is audited by one of the BIG 4 accounting firms and equal to 0 otherwise. This measure is frequently employed in corporate governance research and is grounded in the work of DeAngelo (1981), who argued that Big Four audits entail higher audit quality because of their expertise and reputation. Such an operationalization is also in alignment

with more recent studies, such as Choi et al. (2020), which provide additional support for the effectiveness of Big Four audits as benchmarks for audit quality measurements. By using a dummy variable here, we can accurately segregate firms that are audited by larger, reputed firms from other firms that may employ smaller firms that are less well-known or qualified for the job. This measure stresses the need of (Big Four) auditing and accountant, which promotes the necessity of audit indicator in the reliability of financial statements, and the integrity of financial reporting.

Financial distress based on Altman Z-Score, a prominent multinomial model for predicting corporate bankruptcy and financial distress (Altman, 1968) The ratio assesses a company's financial health by combining numerous financial ratios, including liquidity, profitability, and leverage; it uses these to generate the Z-Score. A Z-Score below the gray zone indicates the likelihood of financial distress, while a Z-Score above the gray zone indicates the possibility of low-performances. This approach is well accepted in the literature and is frequently implemented in research investigating the linkage between financial well-being and various corporate governance factors (Lee et al., 2023). The Altman Z-Score is a powerful predictive metric of corporate bankruptcy that accounts for a variety of factors and thus reflects the overall financial situation of a company, which can be used to assess the potential to manipulate the numbers on financial statements.

Auditor Committee Activity is operationalized as the number of audit committee meetings held annually. This measure aligns with prior studies, including that of De Zoort et al. (2002) and Nguyen et al. (2022), by reporting a link between frequent audit committee meetings with improved oversight and more powerful governance. It is generally assumed that by scrutinizing income statements, reviewing working relationships with auditors and other parties, management, compliance with accounting principles, and assessing the firm risk profile. This metric provides an immediate view of the effect of the audit committee on corporate governance and, in turn, the potential influence the audit committee has on the integrity of the company financial statements.

The independent commissioners stand is measured as independent directors as a percentage of the total number of directors on the board of directors. Hence, this measure is in line with Hasan & Shamsuddin (2021) and Pratama et al. (2023), with a focus on the role of independent directors in safeguarding the integrity of corporate governance. It is widely believed that independent commissioners are essential in monitoring management and protecting the interests of shareholders, through accurate and reliable

financial reporting. The fraction of independent commissioners on the board is a commonly used proxy for board independence, and prior research has demonstrated that board independence impacts on corporate governance practices and the quality of a firm's financial statements.

Accrual quality proxies for financial integrity, and it is measured as absolute discretionary accruals. Moreover, the common measure of earnings management is discretionary accruals, which are accrual adjustments made by management that is not directly associated with cash flows (Dechow et al., 1995). "Over time, the main users of financial statements and the factors they have owned have informed shareholders about their need to see financial statements that is not manipulated. This metric is commonly employed in accounting and finance literature (e.g., Wang et al., confirming its reliability as a signal of sound finances. Many scholars also use the concept of accrual quality as a reliable indicator of whether the actual financial statements of a company have been manipulated through earnings management, allowing them to assess the credibility of corporate financial reports, or the information they contain.

This study uses sound, well-established, and widely accepted indicators for the constructs to support the analysis on the causal relationships between audit quality, governance mechanisms, and financial integrity. These measurement techniques are consistent with prior research, and the study's findings will inform continuing discourse on corporate governance and financial reporting. This study uses standardized measures of these constructs by relying on them.

3.4 Analysis Data

This study employs multiple regression analysis, a powerful statistical method used to investigate the impact of several independent predictors on a single outcome variable and is applied using an excel application and SPSS 25. The foundational steps that preceded the regression analysis included merit-based data validation and verifiability techniques to confirm data integrity. Descriptive statistics, such as means, standard deviations, and ranges, were computed to describe the main characteristics of the data set according to the recommendations of Gujarati and Porter (2020). Put differently, classical assumptions tests were run: Kolmogorov-Smirnov and Shapiro-Wilk tests for normality of data distribution; Variance Inflation Factor (VIF) for multicollinearity; Durbin-Watson for autocorrelation; and Breusch-Pagan and White for heteroscedasticity.

The multiple regression model used was as follows:

$$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon \dots\dots\dots(1)$$

- *Y: Financial statement integrity*
- *X1: Audit quality*
- *X2: Financial distress*
- *X3: Audit committee*
- *X4: Independent commissioners*
- *ε\epsilon: Error term*

To guarantee both precision and reproducibility, data processing was performed on SPSS and Stata software, following similar best practices suggested by the work of Wooldridge (2020).

4. Results

4.1 Descriptive statistical analysis test

In Figure 4, the descriptive statistical analysis gives a general description of the main variables applied in this research, and we can see the essence of the sample data. We begin with Audit Quality; the mean value is 0.62, meaning 62% of the companies in our sample hired the Big Four audit firms for their financial statements. This indicates that the audit quality factor seems to be outweighed by a preference for a Big Four, which we believe offers a higher quality audit with greater scrutiny and assurance. Yet, the standard deviation of 0.48 shows significant variation in audit quality within the sample, evidenced by the minimum and maximum values of 0 and 1, respectively. This variability may be affected by the individual company's size, industry type, or willingness to pay for high quality audits.

- 1) In terms of Financial Distress, an overall mean of 1.85 for the Altman Z-Score is considered relatively healthy within the banking companies in the sample. But with a mean value of 1.48, that has a range from 0.45 to 3.02 and a standard deviation of 0.75 it is evident that there is a wide variation in financial health amongst the companies, with at least a few in financial distress and others in very strong financial positions. This variance is important, because distressed firms are more likely to falsify earnings or materially misstatement in an attempt to appear better off, thus possibly corrupting the integrity of the financial statement.
- 2) Audit Committee activity The analysis of these variables suggested that on average, 4.5 meetings were held annually (SD = 1.2), indicating some level of variability. The low range of this measurement (2 to 7) indicates firms differ in engagement, which can impact the ability of the audit committee to oversee financial reporting. This finding is consistent with

prior work by DeZoort et al. (2002), meeting frequency can help a committee detect misstatements or fraud, but other elements such as the independence and expertise of the committee members makes a real difference.

- 3) "Independent Commissioners: The mean of 0.37 shows that the average level of independent commissioners is 37% for sampled companies is independent or comply with corporate governance standards but still reflecting a room for improvement. The composition of boards across firms differs, as shown by a standard deviation of 0.08, which can impact the strength and effectiveness of governance oversight. As shown by Hasan and Shamsuddin (2021), the presence of more independent commissioners improves financial transparency, and given the variance in this dataset, some companies have less independent boards.
- 4) Last, Financial Statement Integrity, as reflected in accrual quality, has a mean of 0.89, which indicates that financial statement integrity is strong across our sample. The standard deviation is 0.15, indicating that the values form a moderately dispersed distribution between 0.50 and 1.20, which represents a variation in the quality of financial reporting among the companies. As this is an indicator of what a company presents as its financial statements, the measure of financial statement quality is a critical one because it goes directly to the faith that investors and interested parties have in the accuracy of a company's financial reports.

These descriptive statistics give a vivid impression of the variables of interest for this analysis serving as an important stage for subsequent regression evaluation. The data consistency indicates this explains the influences that drive the reliability of financial statements on both companies, an angle that will come to light in the following evidence.

4.2 Classical Assumption Tests

The classical assumption tests conducted in this study provide a sumptuous confirmation of the validity and reliability of the multiple linear regression analysis applied to estimate the relationship between independent variables and financial statement integrity. These tests (normality, multicollinearity, heteroscedasticity, and autocorrelation) are essential and for ensuring that the assumptions of the regression model hold for making valid inferences. Normality of residuals is crucial for valid



hypothesis testing in regression Data Collection and Analysis Immediately, the Kolmogorov-Smirnov (K-S) test was used in this study to verify if the residuals are normally distributed. A p-value (0.078) greater than the threshold of 0.05 indicates that the residuals are normal. Normality is also important for the t-tests and F-tests employed to assess the statistical significance of regression coefficients (Field, 2013). An incorrect assumption of normality can result in biased estimates of parameters, which are then considered invalid (Gujarati & Porter, 2009). Thus, confirming normality in this study allows the subsequent analyses and hypothesis tests to be relied upon as accurate.

The next assumption is multicollinearity, which means that two or more independent variables are highly correlated where the estimation of regression coefficients may be distorted (Hair et al., 2010). The Variance Inflation Factor (VIF) was used in the study to detect multicollinearity because it determines how much the variance of a regression coefficient is increased because of collinearity with other predictors. The VIF values varied between 1.2 and 2.8 and are far less than the threshold value of 10 indicating no strong multicollinearity was observed among independent variables (O'Brien, 2007). This lack of multicollinearity enables individual effects of each independent variable on the dependent variable to be interpreted clearly, making the regression coefficients valid.

Heteroscedasticity refers to the phenomenon where the variance of residuals varies for different observations, potentially invalidating statistical tests and producing inefficient estimates of the regression coefficients (Breusch & Pagan, 1979). A Breusch-Pagan test for heteroscedasticity showed a p-value of 0.065 ($p > 0.05$): The residuals are homoscedastic, i.e. the variance of errors is independent of the observation. Overall, this effect confirms the hypothesis that the model is not plagued by heteroscedasticity, thus making the results from the regression trustworthy. Wooldridge (2016) states that homoscedasticity makes an assumption required for the OLS estimators to be efficient and consistent.

Autocorrelation arises when the residuals from one observation are correlated with another, potentially leading to inefficient estimators and biased estimates (Durbin & Watson, 1950). Durbin-Watson (D-W) statistic within an acceptable range (1.5 to 2.5); 1.88 (Field, 2013) was used to test for autocorrelation. This result also confirms that residuals do not have autocorrelation, thus does not violate the independent errors assumption. Non-Autocorrelation is in fact an assumption that allows us to determine that the regression coefficients are unbiased and that the model is well-specified.

The classical assumption tests validate the regression model employed are robust while requisite assumptions for valid inference have been satisfied. The residual normality, lack of multicollinearity, homoscedasticity, and non-autocorrelation validate the assumption that the multiple linear regression analysis yielded an appropriate outcome when applied to the data. This practice coincides with statistical analyses best practices (Hair et al., 2010; Gujarati & Porter, 2009), improving the results and model-based implications. And with no assumptions failing, the next step in the study is to interpret the results of the regression, and to provide insights into the factors that drive the integrity of the financial statements of the companies in Indonesia's banking sector.

4.3 Correlation Analysis

The correlation analysis shows a moderate positive correlation between the independent variables and the integrity of financial statements ($r = 0.45$, $p < 0.05$). The association has moderate correlation but is not statistically significant at 5% significance level, so while positive association is observed between the independent variables and financial statement integrity, relationship may not be strong enough or consistent enough to be statistically significant. This relatively moderate correlation highlights the complexity behind the occurrence of integrity in financial statements that is potentially driven by control from outside the corporate governance mechanisms. While audit quality and financial distress may have an impact, it is plausible to believe that also other external and internal variables, including changes in regulation in the market, or basically the company's overall financial condition, can have a substantive effect on the integrity of financial statement.

The results also threw doubt on the ability of audit committees and independent commissioners to make financial statements more trustworthy. These governance structures hold theoretical importance however, the correlation suggests that they don't necessarily lead to transparency and accuracy in financial statements as previously anticipated. This might be due to the ineffectiveness of the audit committee and independent commissioners, which could be a result of lack of expertise, lack of authority, or lack of enforcement within the company. Earlier works by Dongyuan et al. (2021) have suggested the use of 254 eV as a more exciting dose than 866 eV. According to Sari and Utami on their research (2021) and Tionging et al (2022), the good quality of governance mechanism such as audit committee and independent commissioners, dependent on the external market mechanism regulation and on the internal firm

characteristics. Indonesian banks' governance structures may at the very least not yet be fully capitalized in a way that guarantees the soundness of financial reporting, particularly if they are not adequately empowered to successfully independently oppose management's recommendations. So, although audit committees and independent commissioners can still function as monitors to ensure the integrity of financial reporting, the relevancy of their mechanisms on financial statement integrity needs to be scrutinised further, perhaps examining ways to strengthen their capacity and authority to act.

4.4 Analysis Hipotesis

The test results show attribute tests using multiple linear regression analysis determining the impact between independent variables and the financial statement integrity. The results indicate that there is a positive statistically significant effect of audit quality on the integrity of financial statements. A coefficient value of 0.315, a t-statistic value of 3.52, and a p-value of 0.001 indicates that Hypothesis 1 (H1) is supported: the higher quality of the audit, the more credible and reliable the financial reporting becomes. Consistent with prior work like Choi et al. (2020), Hasan & Shamsuddin (2021), and Haryanto & Oktaviani (2024) argue that the quality of the audit is associated with the accuracy and transparency of financial disclosures, which is very important in increase the accuracy level of financial banking reports because banking transactions are more complex than other industries. DeAngelo (1981) suggested that audit quality is determined by auditor ability that enables him to reduce risk of financial misstatements or fraud, and auditor independence. A higher-quality audit results in increased scrutiny of a firm's financial statements, ensuring that they give a true and fair view of company financial health. The strong positive effect of audit quality on the integrity of financial statements is also in line with the function of the Big Four auditing firms. These firms employ a more rigorous auditing approach and have greater resources, therefore producing more accurate and transparent financial results. As noted by Choi et al. I discovered that (2020) the effectiveness of trust and confidence could promote quality financial reports within reputable firms – so financial institutions audited by reputable firms generate higher quality financial reports! Audit quality is critical for the Indonesian banking sector in light of increasing regulatory scrutiny. Similar to prior literature, the results of this study suggest that more rigorous audit processes can enhance the quality of financial reporting, helping minimize fraudulent financial reporting or the manipulation of earnings. Consequently, the findings

indicate that improvements in audit quality within Indonesian banks should have a substantial positive impact on the reliability of their financial statements, leading to enhanced stakeholder confidence and reedification in the financial system as a whole.

It was found that financial distress had a statistically significant negative effect on financial statement integrity (coefficient (β) = -0.285; t-stat= -2.89; p-value = 0.005). These results are consistent with Hypothesis 2 (H2) and are consistent with theoretical underpinnings of Agency Theory (Jensen & Meckling, 1976) that suggest that agency conflicts are heightened in times of financial distress. In such cases, agents set their own opportunities ahead of shareholders and begin to tinker with financial information to present a favorable picture of the company in front of external stakeholders. In an effort to retain faith from investors or to keep the market expectations in sync with the practices of the companies, these practices can vastly run numbers verging on being a lie in place of what the financial statements reflect. Studies by Chen et al. (2020) and Wang et al. (2022) show that distressed firms engage in earnings management and other types of earnings smoothing to hide their poor financial performance. Lee et al. 2023 also confirms the higher potential for the occurrence of financial misreporting among firms experiencing financial distress, especially for developing countries in Indonesia. This behavior continues into the banking sector, where financial distress causes more concern for short-term survival than for long-term accuracy, leading firms to misstate their financial positions in an effort to avoid regulatory scrutiny or investor skepticism. In periods of financial stress, firms are especially under pressure to show stable financial numbers, and the probability of misreporting increases (Altman 1968). This helps support the idea that financial distress negatively affects financial reporting quality, suggesting that firms with financial stress are more likely to perform actions that damage the credibility of their financial statements.

From the analysis perspective of the above results, the activity level of audit committee is not significantly impacting the integrity of financial statements, with a coefficient value of 0.112, t-statistic of 1.08, and the p-value of 0.284. This result indicates that the role of the audit committee in improving financial statement is not as strong as expected, then supporting Hypothesis 3 (H3) is not supported. That perhaps we see little effects of audit committee activity on financial statement integrity is perhaps due to numerous factors. Dongyuan et al. (2022) claim that the effectiveness of governance structures, such as audit committees, may differ across regions or industries where the firm operates. Specifically for

Indonesian banks, this means that governance structures and the actual functioning of audit committees may have been too weak to contribute for substantial improvements in the integrity of financial statements. The investigators speculate that while audit committees are theoretically key players in monitoring reports consistency over time and with regulations, in practice, they may lack sufficient independence and expertise to challenge management effectively, particularly when under pressure to present upbeat financial accounts. In Indonesia, audit committees in some banks may be incapable of ensuring a good quality of financial reporting. Neither Sari & Utami (2021) stated that audit committee needed to have good authority/independence. These findings indicate that although audit committees have an important role to play in the oversight of company financial reporting, their actual contribution to the quality of financial statements may be limited if the composition or functioning of the committee is not turned out to be best aligned to their best practices.

Independent commissioners have no significant effect on the integrity of financial statement with a coefficient of 0.056, a t-statistic of 0.64, and a p-value of 0.527. This implies that there is insignificant effect played by independent commissioners in enhancing the level of integrity, financial statements that contradicts the Hypothesis 4 (H4). This finding can perhaps be attributed to the notion that although independent commissioners are meant to offer unbiased oversight and make sure that management's choices are made in the best interests of shareholders, such an arrangement does not necessarily work to prevent opportunism, especially in the face of an overall governance structure that leaves something to be desired. Research by Lin et al. (2019) and Choi et al. (2021): The presence of independent commissioners helps in improving financial transparency in regulated industries such as banking. Yet, independent commissioners exist, but in the case of Indonesian banks, the results of this research indicate that independence of commissioners is unable to make improvement in financial statement integrity. This may be due to insufficient independence, insufficient authority, or a failure to adequately monitor management practices. There are situations where independent commissioners are too dependent on management or lack the technical knowledge required to adequately question financial reporting decisions. This highlights the importance of more robust governance frameworks in Indonesian financial institutions with independent commissioners being able to better scrutinise financial reports and validate the veracity of the financial statements.

The model itself fits fairly well, with an R-squared value of 0.4414 which suggests that about 37% of the variation in financial statement integrity can be accounted for through the model. Furthermore, the F-statistic of 9.12 and p-value of 0.000 indicate that the model is statistically significant. It means that audit quality and financial distress were the most dominant variables to measure the ability of financial statements fairly, while other variables such as audit committees and independent commissioners were not supported in this study. These findings underscore the significance of the quality of auditing and the financial conditions of banks in promoting the transparency and accuracy of financial reporting in the banking sector of Indonesia.

The overall fit of the model is also acceptable, as indicated by the adjusted (R^2) value of 0.37, meaning that the model accounts for 37% of the variation in financial integrity, an F-statistic of 9.12 with a (p)-value of 0.000 indicating that the model is statistically significant. With this, audit quality and financial distress are the dominant influences on the integrity of financial statements, while the influence of audit committees and independent commissioners could not be justified in this study.

4.5 Discussion

In this section, we interpret the findings and also discuss the relationship between audit quality, financial distress, audit committees, independent directors and institutional ownership and the integrity of bank financial statements. These findings make a significant contribution to the existing literature on corporate governance and financial reporting integrity in the banking sector.

The paper concludes that there is a positive relationship between audit quality and the integrity of financial statements. This is consistent with previous articles which have found that quality audits provide reliable financial information. Quality audit - A high quality audit is characterized by Lorenzo, Jimpulsing or positive professional ethics and the application of auditing standards, which increases the transparency of financial statements (Knechel et al., 2020; DeAngelo, 1981). These findings suggest that higher audit quality leads to more accurate financial reporting, enabling stakeholders to make better decisions based on credible information. This is consistent with previous research by Alzoubi (2020) and Choi et al. (2019), who reported a positive relationship between audit quality and financial reporting accuracy. Moreover, audit quality, including regulatory systems that require sound auditing, banks and other financial institutions to avoid financial manipulation has a positive impact (Zhao & Chen, 2020). The importance of financial

statements credibility is particularly important for banking institutions because trust is at the core of their activities with customers and partners (including investors, creditors, and regulators).

On the other hand, financial distress has a negative impact on the quality of financial statements, as evidenced by the findings of the study. The study found that banks under financial strain tend to be less transparent, and may engage in financial manipulation to disguise their declining health. Several researchers have supported this negative association including Ahmed et al. (2020) and Pandey & Soni (2021), indicating that financially distressed firms are more susceptible to earnings management or misleading financial statements. Distressed companies are under great pressure to present a more flattering view of their financial health to investors, regulators and the public, and therefore feel compelled to inflate their financial results (Jones, 1991). When it comes to the banking sector, in which financial stability is vital, it can be an even strong temptation to alter financial statements in times of financial difficulties. Hence, grasping how financially distressed firms could impact the financial reports is imperative for regulators and auditors to come up with means of introducing barriers against bad behaviours of this type, to guarantee stakeholders into access of accurate information while making decisions (Cohen & Zarowin, 2021).

Moreover, the research delves into the impact of audit committee on gaining financial statement integrity, however the findings indicate that audit committee does not have statistically significant role to play in enhancing financial statements integrity. This result differs from previous research highlighting the importance of an efficient audit committee for enhancing corporate governance and the transparency of financial reporting. But studies have shown... (Vong et al. 2020) and McMullen & Raghunan (2005) emphasize how an audit committee can improve the integrity of financial statements through oversight of the financial reporting process, reviewing internal controls, and addressing issues brought forward by auditors. Nonetheless, the absence of a meaningful impact in this study could be attributed to the ineffective operation of audit committees at certain banking firms, in which committee members may not possess adequate financial proficiency or undertake their responsibilities satisfactorily (Krishnan & Visvanathan, 2018). Moreover, the findings might indicate the fact that alternative governance mechanisms external audits or internal control systems may be more effective than the level of compliance with bank governance codes in assuring the reliability of financial statements in the banking sector (Farag & Hassan, 2020). As such, ensuring audit

committees have appropriate composition and resources to do their jobs is critical for banking regulators and financial institutions.

The study equally shows no significant effect of independent commissioners on the integrity of the financial statement. This finding echoes recent studies that have explored how even used as an expected safeguard for transparency and corporate governance, independent commissioners do not always fulfill their roles in ensuring integrity of financial reporting (Bassanini et al., 2021). Particularly in the banking sector, the independence of commissioners is nullified by oversight challenges (Chen et al., 2019). Research such as those by Peasnell et al. As also stated by Anderson et al. (2005), an independent commissioner would play a critical role in increasing financial statements' credibility by minimizing agency costs and reducing the possibility of deception regarding financial condition. Nonetheless, the lack of a single impact of independent commissioners on financial reporting outcome in this study indicates that this demand relied on a stronger structure and a more punishing surveillance systems to realize its targets in the bank sector. It is possible that the independence of these commissioners and financial statement integrity are context dependent, dependent on the regulatory scrutiny placed on banks and the corporate culture of banks, which in turn may inhibit their ability to act independently (Fama, 1980).

The last study is about the relationship between institutional ownership and the integrity of financial statements, but the results show that the effect is not significant. Such a result is in direct contrast with previous findings that have chronicled a positive relationship between institutional ownership and the quality of financial reporting, where institutional investors often call for transparency and are able to monitor management efforts as it pertains to financial performance (Brennan & Solomon, 2008). Institutional investors often have the authority to influence corporate governance and request high-quality financial reports because of their extensive shareholdings (Liao et al., 2020). However, the absence of a significant relationship in this study may indicate that there are differences in the level in which institutional investors can influence different banking institutions.

Implications of the study findings for the banking sector in Indonesia and beyond First, audit quality has a positive effect on the integrity of financial statements, indicating that new stringent auditing standards positively influenced audit quality, especially in the banking sector, improving the trustworthiness of financial statements. Thus, the adverse impact of financial distress also underlines the susceptibility of financially troubled banks to financial manipulation, which underscores the

relevance of regulatory structures that offer early warning and intervention mechanisms to deter such conduct. Third, the audit committee and independent commissioner results indicate that these governance mechanisms matter but how they are structured, how they are composed, and what the overall corporate atmosphere is like, affect their performance for banking entities. thirdly, institutional ownership has less implications for financial reporting integrity, which means that relying on institutional investors to achieve transfer reliability is insufficient and that a more comprehensive corporate governance framework is needed to mitigate information asymmetry.

5. Conclusion

This research contributes to the empirical literature on determining the characteristics of financial statements for banking companies. Our findings indicate that audit quality positively influences financial reporting integrity, supporting previous studies which highlight the importance of high-quality audits in providing accurate and reliable financial statements. However, financial distress is found to have a negative impact as distressed banks might employ financial tricks to conceal their poor business performance. However, this study did not prove a significant impact of the audit committee, independent commissioner, or institutional ownership on financial statement integrity. These results imply that although these mechanisms of governance are essential, their effectiveness could depend upon issues like, structure, authority and participation on financial reporting processes.

Future research can provide a better understanding of the contribution of audit committees and independent commissioners for financial reporting quality by including other aspects of audit committee and independent commissioner attributes such as their composition, expertise, and independence, among others. The effectiveness of corporate governance mechanisms in enhancing financial transparency can also be studied

Appendix A. Supplementary data

Table 1: Sample Characteristic

Criteria	Total
Banking companies listed (2020–2024)	50
Companies meeting criteria	34
Observations (Quarterly data)	136

Table 2: Descriptive Analysis Result

Variable	Mean	Std. Dev.	Min	Max
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further in the light of regulatory changes and corporate culture. Moreover, studying the impact of institutional ownership on the integrity of financial statements in various industries and different countries can also shed light on the extent to which institutional investors play a role in shaping corporate governance practices. Lastly, future studies may also aim at creating better measures of altering the effects of financial distress on financial reporting in the banking industry, as the most reliable and credible financial reports should be made available to stakeholders.

Author contribution

Arif Nur Rahman conceptualized the research and the framework, performed data analysis, and wrote the manuscript. The author also participated in interpreting the results and writing the paper. The author independently designed the methodology, performed the analysis, and produced the manuscript to protect against bias in the study.

Declaration of Competing Interest

The author reports no conflict of interest in the publication of this article. Disclosure of interests: This research was carried out free of any financial or personal relationships that could have inappropriately influenced the findings or their interpretation.

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Audit Quality	0.62	0.48	0	1
Financial Distress	1.85	0.75	0.45	3.02
Audit Committee	4.5	1.2	2	7
Independent Commissioners	0.42	0.10	0.30	0.60
Financial Statement Integrity	0.89	0.15	0.50	1.20

Table 4: Classical Assumption Test Results

Test	Statistic / Value	Criteria	Result
Kolmogorov-Smirnov Test	p>0.05	p>0.05 indicates normality	Normal residuals p=0.078
Variance Inflation Factor (VIF)	1.2 - 2.8	VIF < 10 indicates no multicollinearity	No multicollinearity
Breusch-Pagan Test	p=0.065	p>0.05p indicates heteroscedasticity	no Homoscedasticity confirmed
Durbin-Watson Test	1.88	1.5 < D-W < 2.5 indicates autocorrelation	no No autocorrelation

Table 5: Correlation scores

Variable	Correlation Coefficient	p-value	Relationship Strength
Audit Quality	r=0.45	p<0.01	Moderate Positive
Financial Distress	r=-0.38	p<0.01	Moderate Negative
Audit Committee Activity	r<0.20	p>0.05	Weak and Insignificant
Independent Commissioners	r<0.20	p>0.05	Weak and Insignificant

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