INTERNATIONAL JOURNAL ON ECONOMICS, FINANCE AND SUSTAINABLE DEVELOPMENT
E-ISSN: 2620-6269

IJEFSD

Available online at www.researchparks.org

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Vol. 5 No. 9 | Sep 2023

Corporate Governance and Financial Statement Fraud in the Nigerian Oil and Gas Sector

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A B S T R A C T

The study examined corporate governance characteristics and financial statement fraud in Nigerian oil and gas corporations has been explored in this study. In order to emphasize the conflicting results in the literature, the empirical review examines earlier research works on corporate governance and financial statement fraud. The study uses secondary data extracted from the annual reports of nine (9) oil and gas companies listed on the Nigeria exchange group from 2012 to 2021. To determine the possibility of financial statement fraud, the technique uses panel least squares analysis while the Beneish M-score model was used to measure financial statement fraud. The results demonstrate that board gender diversity and board audit committee do not significantly affect financial statement fraud, whereas board financial expertise and audit committee do. The study recommends the importance of corporate governance in preventing financial statement fraud as well as suggestions for putting into place effective governance mechanisms, coordinating incentives, enhancing transparency, and promoting an ethical workplace culture.

A R T I C L E I N F O

Article history:
Received 27 Jul 2023
Received in revised form 28 Aug 2023
Accepted 29 Sep 2023

Keywords: corporate governance; financial statement fraud; board financial expertise; board audit committee; board gender diversity.

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Peer review under responsibility of Emil Kaburuan.

Introduction

The financial report of a company presents its financial position and performance in a methodical manner. This financial report provides information regarding the entity's financial condition, financial performance, and cash flow. The majority of users of the report rely on this information to make informed economic decisions (Sanad & Al-Sartawi, 2021). The occurrence of fraud has been documented throughout human history in relation to organized entities. The elimination of certain phenomena has proven to be challenging in various aspects of human society and civilization. Deception is a deliberate action aimed at achieving personal benefits or causing harm to another party (Anichebe, 2019). Instances of large corporations including Arthur Anderson, WorldCom, Wirecard, Cendant, and Luckin Coffee, collapsing worldwide due to fraudulent activities have been documented (Craja, Kim & Lessmann, 2020). The private sector in Nigeria is susceptible to fraudulent activities, as evidenced by recent incidents of financial statement fraud. Notably, several bank fraud cases resulted in the dismissal of five Chief Executive Officers, while Cadbury engaged in stock value manipulation. These are just a few examples of such occurrences with others like; Oceanic Bank (NIG), Skye Bank, and Diamond Bank of Nigeria, have been identified as having faced significant challenges in recent years (Anichebe, 2019, Uwuigbe, Olorunshe, Uwuigbe, Ozordi, Asiriuwa, Asaolu & Erin, 2019).

The maintenance of transparency, accountability, and integrity in a company's operations is contingent upon the effective implementation of corporate governance. Alabdullah, Ahmed and Kanaan-Jebna, (2022) stated that the establishment of efficient corporate governance frameworks is crucial in preserving the trust of investors, safeguarding the welfare of stakeholders, and maintaining ethical principles. Notwithstanding the adoption of rigorous governance mechanisms, occurrences of financial statement fraud persist, resulting in significant detriment to entities and their interested parties (Alabdullah, Ahmed, & Kanaan-Jebna, 2022).

The effectiveness of corporate governance practices plays a pivotal role in ensuring the accuracy and transparency of financial reporting within organizations. One crucial aspect of this governance structure is the financial expertise held by the members of the board of directors (Subair, Salman, Abolarin, Abdullahi & Othman, 2020). According to Subair, Salman, Abolarin, Abdullahi and Othman (2020), financial expertise encompasses a deep understanding of accounting principles, financial analysis, and reporting standards, enabling board members to critically assess financial statements and ensure their accuracy. The presence of board members with such expertise is believed to act as a safeguard against financial statement fraud, a concern that has garnered significant attention in the realm of corporate governance (Mousavi, Zimon, Salehi & Stępnicka, 2022). Furthermore, Leng (2023) stated that the board of directors holds a critical responsibility in overseeing the financial operations and reporting of an organization. Central to this oversight is the board's audit committee, a dedicated body tasked with ensuring the accuracy and integrity of financial statements (Kamarudin & Ismail, 2014). The audit committee serves as a crucial gatekeeper, facilitating independent and objective assessments of the financial information presented to stakeholders (Leng, 2023). In line with the above, Handoko and Olivia (2022) noted that discussions on corporate governance have expanded to encompass the concept of board diversity, including gender diversity among board members. Acknowledging the diverse perspectives and experiences that a gender-diverse board can bring, researchers and practitioners have turned their attention to exploring the potential implications of gender diversity on various aspects of organizational performance and integrity (Ibadin & Ehigie, 2019).

Prior research has explored the mechanisms of governance and the likelihood of financial statement fraud in Nigeria. However, there is a dearth of empirical studies that specifically investigate the

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influence of corporate governance mechanisms on the likelihood of financial statement fraud occurring within the Nigerian oil and gas industry, with a lot of studies focused on the financial sector of the economy. Anichebe (2019) and Uwuigbe et al. (2019) contend that a comprehensive analysis of corporate governance mechanisms necessitates an examination of multiple factors. Certain mechanisms, which may appear to be disparate, have the potential to be interrelated, either directly or indirectly, and can have varying effects on both the incidence and probability of fraudulent activity. Hence, the present research utilizes a multifaceted examination of diverse corporate governance mechanisms to ascertain the amalgamation of corporate governance mechanisms that exerts a robust influence on the probability of financial statement fraud in companies operating in the oil and gas industry, which are enlisted on the Nigerian exchange group. The variables for corporate governance to be explored in this study are board financial expertise, board audit committee, and board gender diversity.

Literature Review

Board Financial Expertise and Financial Statement Fraud

According to Anichebe (2019), the concept of Board financial expertise pertains to the aptitude and competencies possessed by members of a board, which empower them to proficiently supervise a firm's financial reporting and accounting procedures. In contrast, financial statement fraud refers to the deliberate manipulation of financial data with the aim of misleading stakeholders. Numerous scholarly investigations have delved into the correlation between board financial proficiency and the occurrence of financial statement fraud. It has been observed that firms with a higher proportion of directors possessing financial literacy exhibit a decreased tendency to engage in fraudulent activities (Mousavi, Zimon, Salehi & Stępnicka, 2022; Subair, Salman, Abolarin, Abdullahi & Othman, 2020). Fraudulent behavior can be influenced by additional factors, including but not limited to corporate culture, internal controls, and external pressures. In general, the presence of board financial proficiency plays a crucial role in mitigating the occurrence of financial statement fraud. However, it is imperative to supplement this aspect with additional measures such as robust internal controls and a corporate culture that prioritizes ethical conduct. Flowing from the foregoing, we hypothesize that:

Board financial expertise in Nigerian oil and gas companies has no significant effect on financial statement fraud ($H0_1$).

Board Audit Committee and Financial Statement Fraud

Mousavi, Zimon, Salehi, and Stępnicka (2022) have observed that the board audit committee holds significant importance in an organization. According to them, the recently introduced corporate governance code mandates public companies to establish independent audit committees. This step is aimed at assisting organizations in augmenting the independence and integrity of their financial statements. According to Kamarudin and Ismail's (2014) research, a proficient board audit committee serves as a mechanism for mitigating earnings management within organizations. The audit committee of the board of directors assumes a critical function in the reduction of financial statement fraud in corporations. To optimize the efficacy of board audit committees in augmenting the caliber of financial statements, it is imperative that said committees comprise a minimum of three members, with the majority of them being selected from a cohort of autonomous non-executive directors. According to Leng (2023), the effectiveness of a committee may be impacted if it lacks an adequate number of directors to fulfill their duties. The significance of an autonomous audit committee lies in its capacity to furnish impartial evaluation and discernment, while also proficiently overseeing the actions of management. Based on the foregoing, we hypothesize that:

Board audit committee in Nigerian oil and gas companies has no significant effect on financial statement fraud ($H0_2$).

Board Gender Diversity and Financial Statement Fraud

According to research, boards that are diverse in terms of gender have a tendency to display improved decision-making procedures and heightened levels of accountability. According to Probohudono, Lubis, Nahartyo, and Arifah (2022), female directors frequently offer distinct viewpoints, backgrounds, and communication approaches during board deliberations. This can result in more comprehensive assessments of financial data and heightened vigilance towards possible fraudulent activities. Gender diversity fosters a range of perspectives and cognitive diversity, which in turn enhances the depth of financial statement analysis and promotes a heightened emphasis on ethical considerations. According to Ibadin and Ehigie (2019), Handoko and Olivia (2022) noted that there is a positive correlation between gender diversity on corporate boards and the promotion of ethical leadership as well as a robust ethical corporate culture. Female directors frequently give precedence to ethical conduct, integrity, and transparency in the implementation of corporate governance policies. The existence of these individuals can potentially result in the development of institutional principles that discourage deceitful behaviors and foster a climate of moral behavior. Consequently, the probability of financial statement fraud is diminished as a result of the establishment of elevated ethical norms and the cultivation of a dedication to adherence. Drawing from the foregoing we hypothesize that:

Board gender diversity in Nigerian oil and gas companies has no significant effect on financial statement fraud (Ho_3).

Uwuigbe et al. (2019) discovered that there exists an insignificant correlation between corporate governance variables, namely audit committee independence and board structure, and financial statement fraud. The findings indicate that the aforementioned governance variables may not exert significant impact in mitigating the incidence of financial statement fraud within the non-financial firms examined in Nigeria.

In their study, Mat-Zin and Marzuki (2019) conducted an analysis on the effects of the recent modifications made to the Malaysian Code on Corporate Governance (MCCG) 2017. Their research specifically centered on the areas of board diversity and board remuneration, with the aim of assessing their potential in mitigating fraudulent financial reporting (FFR) occurrences in Malaysia. The findings of their investigation revealed that board diversity and board remuneration are significant corporate governance factors that can effectively deter fraudulent financial reporting in Malaysia.

The research study executed by Ibadin and Ehigie (2019) investigated the correlation between corporate governance factors and the manipulation of financial statements within the Nigerian context. The research employed the Beneish model as a tool for forecasting the probability of financial statement manipulation. Additionally, the study explored the influence of board composition, board gender composition, audit committee composition, and board dominance on the aforementioned manipulation. The research revealed that a rise in the ratio of non-executive and female directors on the board augmented the probability of identifying, averting, and scrutinizing financial statement manipulation.

The study conducted by Subair, Salman, Abolarin, Abdullahi, and Othman (2020) investigated the impact of board characteristics, such as board independence, board expertise, and board diligence, on the probability of financial statement fraud in publicly traded manufacturing companies in Nigeria. The study's results suggest that board independence, board expertise, and board diligence exert a statistically significant and negative impact on the log odds of financial statement fraud in Nigerian manufacturing firms.

The analysis conducted by Amah and Ekwe (2021) revealed that financial statement fraud is positively and significantly influenced by board independence, board composition, and ownership structure. A negative correlation has been observed between the incidence of financial statement fraud and the frequency of board meetings. Moreover, it has been found that the quantity of risk management, gender diversity, and the potency of the audit committee exhibit favorable and noteworthy impacts on financial statement fraud.

A similar study conducted by Mousavi, Zimon, Salehi, and Stępnicka (2022) evaluated the impact of corporate governance mechanisms on the incidence of fraudulent activities and money laundering in the financial statements of companies that are publicly traded on the Tehran Stock Exchange. The findings of the research revealed that certain board characteristics, namely independence, financial expertise, industry expertise, and board effort, were found to have a statistically significant and adverse effect on fraudulent financial reporting and money laundering.

Theoretical Review

The interaction between owners (shareholders) and agents (management) of a corporation is commonly examined within the framework of agency theory.The agency theory was developed by Jensen and Meckling in 1976. It offers insights into potential interest conflicts between the two parties as well as the strategies employed to align their interests. Several important factors are at play when applying agency theory to corporate governance and financial statement fraud (Ali, 2020). One of the major problems that agency theory attempts to solve is the knowledge gap between shareholders and management. In order to make prudent decisions, shareholders rely on the financial statements created by management. Financial statement fraud can, however, result from the manipulation or misrepresentation of this information (Panda & Leepsa, 2017). Additionally, corporate governance practices are essential in reducing agency issues. The board of directors serves as the main regulating the management's operations on behalf of the shareholders. By providing supervision, holding management accountable, and balancing their interests with those of shareholders, effective corporate governance structures and procedures can lessen the possibility of financial statement fraud (Hasnan, Mohd-Razali, & Mohamed-Hussain, 2020). Researchers and practitioners may learn more about the fundamental causes of financial statement fraud and create measures to reduce these risks by employing agency theory. In order to achieve this, it is necessary to put in place efficient corporate governance systems, align incentives, improve openness and disclosure, and promote an ethical workplace culture. This study is anchored on the agency theory.

Methodology

The study employed an ex post facto research design. A total of nine (9) oil and gas companies listed on the Nigeria exchange group from 2012–2021 were used as the population and sample size, employing the census sampling technique.

The use of a census sample technique was determined by a number of characteristics that improve the study's thoroughness, applicability, and viability. Nigeria's oil and gas industry is crucial to the nation's economy and significantly affects its financial markets. The study intends to offer useful insights into the occurrence and probable factors related with fraudulent financial reporting within a crucial sector by concentrating on this particular industry. A significant opportunity for gathering pertinent financial data and identifying probable trends or patterns in fraudulent financial reporting exists from 2012 to 2021. This period of time spans numerous economic cycles and enables a thorough examination of potential

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changes in fraudulent activity over the years.

The study employed the panel least squares for data analysis as it uses the same assumptions as other least square methods. This method is used to avoid multicollinearity and maximize forecast accuracy. Panel least squares allow more data utilization than conventional least squares.

This study employed the Beneish M-score model to investigate the correlation between board financial expertise and other independent variables when scrutinizing financial statement fraud. Özcan (2018) explains that the Beneish model employs a set of eight financial ratios derived from a company's accounting data to assess the likelihood, or high probability, of earnings manipulation. In the event that the M-Score is below -2.22, it is improbable that the company is involved in fraudulent activities. Conversely, if the M-Score exceeds -2.22, it is probable that the company is engaged in fraudulent activities.

The linearly/econometrically form of the model for this study is expressed below:

$$\text{FSF}_{it} = a_0 + a_1\,\text{BFE}_{t} + a_2\,\text{BAC}_{it} + a_3\,\text{BAC}_{it} + a_4\text{FSIZE}_{it} + \varepsilon_{it} \quad \text{--} \qquad (i)$$

Where:

FSF = Financial statement fraud

BFE = board financial expertise

BAC = board audit committee

BAC = board gender diversity

Control Variable

FSIZE = Firm Size

i = firm 1 to 9 for the nine (9) sampled firms.

t = year 2012 to 2021

$\boldsymbol{a_0} - \boldsymbol{a_4}$ are variables coefficients to be estimated.

$\boldsymbol{\varepsilon}$ is the stochastic element that represents all other undefined influences on returns to equity and returns to assets.

Panel Co integration

$$\text{FSF}_{\boldsymbol{it}} = \boldsymbol{a_1} + \boldsymbol{a_2}\sum_{\mathbf{t-1}}^{\mathbf{n}} \boldsymbol{\Delta}\text{FSF}_{\boldsymbol{it-1}} + \boldsymbol{a_3}\sum_{\mathbf{t-1}}^{\mathbf{n}} \boldsymbol{\Delta}\text{BEF}_{\boldsymbol{it-1}} + \boldsymbol{a_4}\sum_{\mathbf{t-1}}^{\mathbf{n}} \boldsymbol{\Delta}\text{BAC}_{\boldsymbol{it-1}} + \boldsymbol{a_5}\sum_{\mathbf{t-1}}^{\mathbf{n}} \boldsymbol{\Delta}\text{BAC}_{\boldsymbol{it-1}} + \boldsymbol{a_6}\sum_{\mathbf{t-1}}^{\mathbf{n}} \boldsymbol{\Delta}\text{FSIZE}_{\boldsymbol{it-1}} + {}_{\boldsymbol{\varepsilon}} --- (\boldsymbol{ii})$$

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Operationalization of Variables

Table 1. Definition and measurement of variables

S/N	Variables	Definition	Type	Measurement	Authors	Apriori
1	FSF	Financial Statement fraud	Dependent	An M-Score value of less than -2.22 indicates a low probability of fraudulent activity within the company, and is assigned a value of 1. Conversely, an M-Score value greater than -2.22 suggests a higher likelihood of fraudulent activity, and is assigned a value of 0.	Özcan (2018)	
2	BFE	board financial expertise	Independent	A binary variable is used to indicate if a board member has financial experience. Financial experts on the board must have at least five years of experience as qualified professional accountants with ACA, FCA, or ACCA qualifications.	Authors Measure ment	+
3	BAC	board audit committee	Independent	A binary (Dummy) variable assigns 1 if the audit committee meets more than five times a year and 0 otherwise.	Ibadin and Ehigie (2019)	+
4	BAC	board gender diversity	Independent	The annual calculation of the proportion of female board members, expressed as a percentage of the total number of board members.	Authors Measure ment	+
5	FSIZE	Firm Size	Control	natural logarithm of the total assets of the firm		+

Source: Researchers' compilation (2023)

Results and Discussion of Findings

Table 2: Descriptive Statistics

Variables	Mean	Std.Dev	Maximum	Minimum	Skewness	Kurtosis	P-value (Jaque Bera)
FSF	-1.24	6.63	36.59	-9.38	4.78	26.9	0.00
FSIZE	15.33	1.16	17.26	12.8	-0.37	2.58	0.29

BFE	0.59	0.13	0.88	0.33	0.11	2.56	0.66
BAC	0.09	0.11	0.37	0.00	1.01	3.00	0.00
BGD	3.75	0.80	6.00	1.00	-0.84	5.59	0.00

Source: Authors computation (2023) from E-views 10.0

Table 2 shows that FSF's mean value is -1.24, exceeding Beniesh (1999)'s benchmark of -2.22. The sampled corporations may have fictitious financial statements. The observed standard deviation reveals that the sampled enterprises' FSF vary significantly. The natural log of FSIZE is 15.33, implying the selected corporations have similar total asset sizes. BFE has a 0.59 mean and 0.13 standard deviation. These findings show that the studied businesses' boards had financial expertise on average.

Table 3: Panel Unit Root Test

Variables	**Panel Unit Root Test**			
	Levin, Lin & Chu (assuming common unit root process)			
	Levels		**1st Diff**	
	Stat	**Prob**	**Stat**	**Prob**
FSF	0.68	0.75	6.36	0.01
FSIZE	-9.31	0.00	-7.11	0.00
BFE	-1.32	0.37	-5.03	0.00
BAC	1.45	0.92	-2.99	0.001
BGD	1.55	0.71	4.91	0.00

Source: Authors computation (2023) from E-views 10.0

Table 3 shows panel unit root test results. The Levin, Lin, and Chu test determines variable stationarity statistically. FSIZE is stationarity at levels, while FSF, BFE, BAC, and BGD are non-stationary. First difference gave the non-stationary variables stationarity.

Table 4. Panel Co-Integration Test

Pedroni cointegration test ****common AR coefficients (within dimensions)***				
	Statistics	**p-value**	**Weighted statistics**	**p-value**
Panel v	-0.71	0.76	-0.94	0.82
Panel rho	1.66	0.95	2.04	0.97
Panel PP	-14.36	0.00	-5.26	0.00
Panel ADF	-2.65	0.00	-0.30	0.37
**individual AR coefficients (between dimensions)*				
Group rho	2.98	0.99		
Group PP	-11.97	0.00		
Group ADF	-1.95	0.02		
***Kao residual cointegration test**				
Test Statistics = -6.64 (0.00)				

Source: Authors computation (2023) from E-views 10.0

Table 4 shows that panel co-integration suggests long-term relationships between dataset variables. The null hypothesis of no co-integration is tested at 5% significance. If homogeneous autoregressive coefficients are fulfilled, the Pedroni test shows co-integration. Across-dimension autoregressive coefficients yielded similar findings. The PP and Group ADF figures indicate co-integration. The Kao test rejected the null hypothesis of no co-integration at 5%.

Regression Analysis

Table 5: Random Effect Model

Financial Statement Fraud as dependent variable			
Variable	**Beta Coefficient**	**t-statistic**	**P.value**
C	-16.29	-0.95	0.34
BGD	-0.44	-2.36	0.00
BAC	-3.42	-2.52	0.01
BFE	9.93	-2.48	0.10
FSIZE__NATURAL_LOG_	1.25	1.31	0.02
R-square	0.28		
Ajusted.R.square	0.21		
D-Watson	1.7		
F.stat	15.6		
Prob(f-stat)	0.00		
Hausman Test	Chi^2 = 4.75 (0.44)		

Source: Authors computation (2023) from E-views 10.0

The correlation between corporate governance and financial statement fraud in Nigerian publicly traded organizations can be seen using the regression summary above. The R-square demonstrates that factors affecting corporate governance contribute to 28% of variability in the dependent variable.

Although board financial expertise (BFE) is viewed positively, it is not deemed to be statistically significant. The study has amassed adequate data to refute the hypothesis that *financial expertise of the Board in Nigerian oil and gas companies does not exert a noteworthy impact on financial statement fraud (H01).* This is due to the presence of a robust correlation between board financial expertise and financial statement fraud among oil and gas companies that are listed on the Nigerian Exchange Group. This discovery aligns with the research conducted by Subair, Salman, Abolarin, Abdullahi, and Othman (2020).

The alterations made to the board audit committee (BAC) are expected to lead to a statistically significant reduction in the financial statement fraud (FSF) by -3.42, with a negative directionality, and a level of significance of 5%. Consequently, the null hypothesis positing that *Board audit committee in Nigerian oil and gas companies has no significant effect on financial statement fraud (H02)* is refuted. Our findings indicate a significant correlation between the board audit committee and financial statement fraud in firms listed in the oil and gas sector of the Nigeria Exchange Group. The findings of Amah and Ekwe (2021) align with that of this study.

The regression summary demonstrates that the board gender diversity coefficient is negative. According to this, a unit change in BGD will cause a change in FSF (Financial Statement Fraud) equal to the unit change's controlling coefficient, which in this case is -0.44. As a result, we find that there is no significant correlation between board gender diversity and financial statement frauds among oil and gas sector firms listed on the Nigeria Exchange Group since there is insufficient statistical evidence to reject the null hypothesis, we therefore accept that; *Board gender diversity in Nigerian oil and gas companies has no significant effect on financial statement fraud (Ho3).* This finding is in tandem the submission of Uwuigbe et al. (2019).

Conclusion and Recommendations

The present investigation's outcomes make a valuable addition to the extant body of knowledge on the subject of corporate governance and financial statement fraud in Nigerian oil and gas firms. The findings of the analysis indicate that the financial expertise of the board and the presence of an audit committee on the board are influential factors in preventing financial statement fraud. However, the study did not find a significant correlation between board gender diversity and the prevention of financial statement fraud. The findings underscore the significance of having board members possessing financial acumen and a well-functioning audit committee to augment the integrity of financial reporting. It is noteworthy that the outcomes of the research are limited to the Nigerian oil and gas industry and may not be readily transferable to other nations or sectors.

The study suggests the following recommendations based on the obtained results:

1. It is recommended that corporations prioritize the financial expertise of their board members by appointing directors who possess pertinent financial qualifications and experience. This measure is necessary to ensure the efficient supervision of financial matters.
2. Prioritizing the establishment and strengthening of board audit committees is imperative in enhancing financial statement integrity and preventing fraudulent activities.
3. It is recommended that regulatory bodies and industry associations persist in their efforts to endorse sound corporate governance practices and offer direction to enterprises in establishing efficient controls and mechanisms aimed at forestalling financial statement fraud.

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