Financial Risk and Management:
An International Journal
Volume 2, Number 1, 2023

Risk Governance and Audit Committee Effectiveness in Preventing Financial Misconduct

Muhammad Dafa Bagus Efendi[1]

[1] Universitas Diponegoro, Semarang, Indonesia

Abstract

Article history:
Received: January 12, 2023
Revised: February 25, 2023
Accepted: April 10, 2023
Published: June 30, 2023

Keywords:
Audit Committee Effectiveness,
Corporate Governance,
Financial Misconduct,
Risk Governance,
Systematic Literature Review.

Identifier:
Zera Open
Page: 14-28
https://zeraopen.com/journal/frmij

This study explores how risk governance structures and audit committee effectiveness work together to prevent financial misconduct. Using a systematic literature review, it synthesizes evidence on board-level risk mechanisms such as risk committees, chief risk officers, and enterprise risk management and audit committee characteristics, including independence, financial expertise, diversity, size, and meeting frequency. The review shows that sound risk governance is linked to more disciplined risk taking and stronger monitoring, while effective audit committees are associated with lower earnings management, fraudulent reporting, corruption, and aggressive tax behaviour. The strongest deterrent to misconduct emerges when broad risk governance frameworks are closely aligned with active and independent audit committees that translate risk information into rigorous oversight of financial reporting and compliance. The study concludes that these two mechanisms act as complementary lines of defence and calls for further research on their interaction across sectors and emerging risks such as cyber-fraud.

1. Introduction

Risk governance has become a central concern in the aftermath of repeated corporate scandals, regulatory fines, and high-profile cases of financial fraud. Weak oversight of risk and control functions allows opportunistic behavior, earnings manipulation, and other forms of financial misconduct to go undetected, undermining investor confidence and threatening financial stability. Recent empirical evidence from banking and capital markets shows that stronger risk governance structures such as dedicated risk committees and empowered chief risk officers are associated with lower risk-taking and more effective risk management, particularly in emerging market settings (Abid et al., 2021; Nguyen & Dang, 2022). At the same time, risk governance frameworks are increasingly linked to the prevention of cyber fraud and other technology-driven misconduct, as boards are pressured to broaden their oversight beyond traditional financial risks (Erin et al., 2020).

Within this broader risk governance architecture, the audit committee plays a pivotal role as a specialized monitoring body responsible for overseeing financial reporting quality, internal control systems, and the work of internal and external auditors. Studies document that audit committee characteristics such as independence, financial expertise, size, and meeting frequency are positively associated with stronger risk management and better firm performance, suggesting that well-designed committees enhance the board's ability to identify and mitigate risk (Musallam, 2020; Nguyen, 2021). When audit committees are active and sufficiently expert, they can challenge management judgments, improve the quality of financial disclosures, and strengthen coordination with risk management and internal audit functions, thereby narrowing the space for managerial misconduct.

A growing body of evidence specifically links audit committee effectiveness to the mitigation of fraudulent financial reporting and other forms of financial misconduct. Research in both developed and emerging markets finds that audit committees with a higher proportion of members possessing accounting or financial expertise, longer tenure, and more frequent meetings are associated with a lower likelihood of fraudulent financial reporting or financial statement fraud (Nurliasari & Achmad, 2020; Ruchiatna et al., 2020; Sijabat & Tamba, 2021). Further, indicators of audit committee effectiveness such as independence, activity level, and the quality of interaction with auditors have been shown to reduce the potential for fraudulent financial statements and strengthen the deterrent effect of governance mechanisms (Purwiyanti & Laksito, 2022). These findings suggest that the audit committee is a critical line of defense against financial misconduct.

Despite these advances, prior literature tends to examine risk governance mechanisms and audit committee attributes in isolation focusing either on bank-wide risk governance and risk taking behavior, or on audit committee characteristics and financial reporting fraud. There is still limited integrated evidence on how the broader risk governance framework interacts with audit committee effectiveness to prevent financial misconduct across different forms, from cyber-related fraud to earnings manipulation (Erin et al., 2020; Abid et al., 2021; Nguyen & Dang, 2022). This study therefore investigates the interplay between risk governance structures and audit committee effectiveness in preventing financial misconduct. By synthesizing and extending existing empirical findings, it aims to clarify the conditions under which risk governance arrangements and audit committee design jointly strengthen control environments, enhance detection and deterrence of misconduct, and contribute to more robust financial integrity.

2. Literature Review

Risk governance has become a central pillar of corporate governance as boards are increasingly expected to oversee complex risk profiles and prevent misconduct. Empirical evidence shows that formal risk governance mechanisms such as dedicated risk committees and empowered chief risk officers can significantly curb excessive risk-taking. Abid et al. (2021) document a negative and significant association between risk governance mechanisms and bank risk-taking in Asian commercial banks, with the effect being stronger in privately owned banks than in state-owned banks. Their findings also indicate that robust risk governance improves performance in privately owned banks, suggesting that effective risk oversight can align managerial incentives with prudent risk behaviour and long term value creation.

Complementing this view, Karyani et al. (2020) construct a risk governance disclosure index for ASEAN 5 banks and show an increasing trend in disclosures related to risk structures and practices. Although overall risk governance and board level structures do not have a clear positive impact on profitability, the study finds that management level risk governance structures can have a significant (and sometimes negative) effect on return on assets due to implementation costs. These results suggest that the design and resourcing of risk governance arrangements matter: risk oversight that is merely symbolic may not reduce risk or misconduct, while well designed mechanisms can strengthen control but may also impose short term cost pressures. Malik et al. (2020) further show that the existence and quality of a risk committee within enterprise risk management frameworks are positively associated with firm performance, highlighting the role of specialized board level risk oversight in integrating risk considerations into strategic decision making.

Within this broader risk governance architecture, the audit committee is a key monitoring mechanism to prevent financial misconduct. Research on audit committee composition indicates that expertise and diversity shape its effectiveness in constraining opportunistic reporting. Zalata et al. (2018) find that audit committee financial expertise is associated with lower earnings management, and that gender diversity among financial experts can further strengthen monitoring quality. In the Indonesian context, Mardjono and Chen (2020) provide evidence that stronger audit committee characteristics, together with independent commissioners, are linked to lower levels of earnings management, suggesting that an active and competent audit committee can reduce the scope for managerial manipulation of accounting numbers.

More recent studies examine the audit committee's role in addressing more severe forms of financial corruption and fraud. Gorshunov et al. (2021) introduce the notion of a "quad-qualified" audit committee director combining financial, industry, governance, and monitoring expertise and show that firms with at least one such director experience a substantially lower likelihood of financial corruption. This finding underscores that audit committee effectiveness depends not only on formal independence, but also on the depth and breadth of members' competencies. Similarly, Nugroho and Diyanty (2022), using the fraud hexagon framework, find that audit committees can mitigate the impact of stimulus, opportunity, and capability on fraudulent financial statements in Indonesian non-financial firms, although they are less effective in constraining rationalization, ego, and collusion. Their results imply that audit committees are particularly important in reducing structural and situational drivers of fraud (such as weak controls and performance pressure), even if they cannot fully address all behavioural dimensions of misconduct.

The literature also links audit committee effectiveness to broader patterns of executive misconduct and aggressive financial behaviour. Schnatterly et al. (2018) synthesize evidence on CEO wrongdoing and argue that governance mechanisms, including board and committee oversight, shape the pressure, opportunity, and rationalization conditions under which misconduct occurs. In line with this, García-Meca et al. (2021) show that internal audit committees can moderate the positive relationship between CEO narcissism and tax aggressiveness: in firms with stronger audit committees, narcissistic CEOs are less able to translate their personal risk preferences into aggressive tax strategies. Taken together, these studies indicate that effective audit committees operate as a critical component of risk governance by narrowing the opportunity set for financial misconduct, enhancing the credibility of financial reporting, and reinforcing the alignment between risk taking, compliance, and long term firm value.

3. Methods

This study adopts a systematic literature review design to investigate how risk governance structures and audit committee effectiveness interact to prevent financial misconduct. The review focuses on scholarly journal articles and academic studies that examine risk governance mechanisms (such as board-level risk committees, chief risk officers, and enterprise risk management structures), audit committee characteristics (including independence, expertise, size, meeting frequency, and diversity), and various forms of financial misconduct such as earnings manipulation, fraudulent financial reporting, tax aggressiveness, and broader corruption. Relevant publications were identified through structured searches in major academic databases and Google Scholar using combinations of keywords related to risk governance, audit committees, corporate fraud, financial misconduct, and corporate governance.

The selection process involved several stages: initial identification based on titles and abstracts, screening for topical relevance to the interplay between risk governance and audit committee oversight, and a full text assessment to ensure that the studies provided empirical or conceptual insights into mechanisms that constrain misconduct. For each included study, data were extracted on research context, methodological approach, operationalization of risk governance and audit committee variables, and key findings regarding their impact on financial misconduct. The evidence was then synthesized using thematic analysis, grouping findings into core themes such as the design of risk governance structures, the composition and competencies of audit committees, and their joint influence on monitoring quality, control environments, and the deterrence of financial misconduct.

4. Results and Discussion

The synthesis of the reviewed studies shows that risk governance mechanisms are consistently associated with more disciplined risk-taking and, in many cases, better performance, but the effect is nuanced. Evidence from banks indicates that formal risk governance structures such as risk committees and empowered chief risk officers are linked to lower risk taking and improved performance, especially in privately owned institutions where governance incentives are stronger (Abid et al., 2021; Nguyen & Dang, 2022). These findings support the argument that clearly articulated risk oversight roles help align managerial behaviour with the firm's risk appetite and long-term value creation. At the same time, the use of risk governance disclosure indices in ASEAN banks reveals that while disclosures on risk structures and practices are increasing, the impact on profitability is not uniformly positive, partly because management level risk governance structures may raise implementation costs and temporarily depress returns (Karyani et al., 2020). This suggests that risk governance is not simply "more is better"; the design, depth, and resourcing of structures matter for translating governance inputs into real reductions in misconduct and excessive risk-taking.

The results also highlight the central role of the audit committee as a key monitoring mechanism within the broader risk governance architecture. Studies show that audit committee characteristics such as independence, financial expertise, size, and meeting frequency are positively associated with stronger risk management and better firm performance (Musallam, 2020; Nguyen, 2021). Research on composition further refines this picture: financial expertise and gender diversity in the audit committee are linked to lower earnings management, implying that knowledgeable and diverse members are better able to challenge opportunistic reporting practices (Zalata et al., 2018). Evidence from Indonesia indicates that when audit committees are stronger and work alongside independent commissioners, earnings manipulation is reduced, underscoring the importance of local institutional context in shaping how audit committee attributes translate into monitoring effectiveness (Mardjono & Chen, 2020). Collectively, these findings suggest that audit committees do not simply add a formal layer of oversight; their composition and activity level shape the quality of risk governance in practice.

A second group of findings connects audit committee effectiveness more directly to financial misconduct, including fraudulent financial reporting, corruption, and aggressive tax behaviour. Empirical studies in both developed and emerging markets show that audit committees with higher financial expertise, longer tenure, and more frequent meetings are associated with a lower likelihood of fraudulent financial reporting or financial statement fraud, particularly when committees are independent and actively engaged with auditors (Nurliasari & Achmad, 2020; Ruchiatna et al., 2020; Sijabat & Tamba, 2021; Purwiyanti & Laksito, 2022). Beyond traditional fraud measures, newer research introduces the idea of "quad qualified" audit committee directors, combining financial, industry, governance, and monitoring expertise, and finds that firms with at least one such director experience substantially lower financial corruption (Gorshunov et al., 2021). Using the fraud hexagon framework, other evidence shows that audit committees can mitigate structural drivers of fraud such as pressure, opportunity, and capability even though they are less effective in constraining behavioural factors like rationalization, ego, and collusion (Nugroho & Diyanty, 2022). These results indicate that the audit committee is particularly powerful in shaping the opportunity set and control environment for misconduct, even if it cannot fully eliminate all psychological drivers of wrongdoing.

The review also reveals that audit committee effectiveness interacts with top management characteristics in shaping financial behaviour. Synthesised evidence on CEO wrongdoing emphasises that governance mechanisms, including board and committee oversight, influence the pressure, opportunity, and rationalization conditions under which misconduct occurs (Schnatterly et al., 2018). Consistent with this, firms with stronger internal audit committees are less able to translate CEO narcissism into aggressive tax strategies, suggesting that robust committee oversight can counterbalance risky personality traits at the top (García-Meca et al., 2021). When these findings are viewed alongside evidence that risk governance structures constrain risk-taking (Abid et al., 2021; Nguyen & Dang, 2022), a more integrated picture emerges: risk governance and audit committee design jointly shape how managerial incentives, personality traits, and external pressures translate into either compliant or opportunistic behaviour.

Bringing together the risk governance and audit committee literatures, this review finds that the most effective prevention of financial misconduct occurs where broad risk oversight structures and specialised audit committee monitoring are well aligned. Risk governance frameworks that extend beyond traditional financial risks to cover cyber-fraud and technology driven misconduct provide boards with richer risk information and more comprehensive early warning signals (Erin et al., 2020). When this information flows into an active, expert, and independent audit committee, the committee is better positioned to scrutinize financial reporting, challenge management judgments, and coordinate with internal and external auditors, thereby strengthening both detection and deterrence of misconduct (Musallam, 2020; Nurliasari & Achmad, 2020; Nguyen, 2021; Purwiyanti & Laksito, 2022). However, evidence that some risk governance structures impose short term cost pressures or fail to improve profitability (Karyani et al., 2020) and that audit committees are less effective against certain behavioural fraud factors (Nugroho & Diyanty, 2022) highlights that design quality and contextual fit are crucial.

Overall, the findings suggest that risk governance and audit committee effectiveness should be viewed as complementary components of a multi layered control system. Structured risk governance arrangements constrain excessive risk taking and broaden the scope of oversight, while well designed audit committees translate this oversight into concrete monitoring of financial reporting, taxation, and compliance, thereby narrowing the opportunity for financial misconduct. At the same time, gaps in the existing evidence such as limited cross sector studies outside banking, and relatively few analyses that jointly model risk governance structures, audit committee characteristics, and various forms of financial misconduct indicate that further research is needed to fully understand how these mechanisms interact in different institutional and technological environments.

5. Conclusion

This study concludes that risk governance and audit committee effectiveness are mutually reinforcing mechanisms in preventing financial misconduct. Evidence across the reviewed literature shows that well-structured risk governance arrangements such as dedicated risk committees, empowered chief risk officers, and integrated enterprise risk management are associated with more disciplined risk-taking, improved monitoring, and, in many cases, better firm performance. At the same time, the quality of audit committee design and operation reflected in independence, financial expertise, diversity, activity level, and depth of competencies plays a critical role in constraining earnings management, financial statement fraud, corruption, and aggressive tax behaviour. Together, these mechanisms shape the control environment, reduce opportunities for opportunistic reporting, and enhance the credibility of financial information.

The review also highlights that formal structures alone are not sufficient. The effectiveness of risk governance and audit committees depends on how they are resourced, how information flows between them, and how they operate within specific institutional and cultural contexts. Poorly designed or symbolic risk governance may increase costs without materially reducing misconduct, while audit committees may be less effective in addressing behavioural drivers of fraud, such as ego, rationalization, and collusion. These nuances suggest that firms and regulators should focus not only on compliance with governance codes, but also on the substantive quality, independence, and integration of risk and audit oversight.

Overall, the findings position risk governance and audit committees as complementary lines of defence that, when properly aligned, can strengthen control environments, enhance early detection of irregularities, and deter financial misconduct. However, the limited number of studies that jointly analyse both mechanisms, especially outside the banking sector and in the context of emerging risks such as cyber-fraud and technology driven misconduct, indicates a clear agenda for future research. Further empirical work is needed to model the interaction between risk governance structures, audit committee characteristics, managerial behaviour, and different forms of misconduct, providing a more granular understanding of how governance architecture can be optimized to support robust financial integrity.

References

Abid, A., Gull, A. A., Hussain, N., & Nguyen, D. K. (2021). Risk governance and bank risk-taking behavior: Evidence from Asian banks. *Journal of International Financial Markets, Institutions and Money, 75*, 101466.

Erin, O. A., Kolawole, A. D., & Noah, A. O. (2020). Risk governance and cybercrime: The hierarchical regression approach. *Future Business Journal, 6*(1), 12.

García-Meca, E., Ramón-Llorens, M. C., & Martínez-Ferrero, J. (2021). Are narcissistic CEOs more tax aggressive? The moderating role of internal audit committees. *Journal of Business Research, 129*, 223–235.

Gorshunov, M. A., Armenakis, A. A., Harris, S. G., & Walker, H. J. (2021). Quad-qualified audit committee director: Implications for monitoring and reducing financial corruption. *Journal of Corporate Finance, 66*, 101854.

Handriani, E. (2020). Earning management and the effect characteristics of audit committee, independent commissioners: Evidence from Indonesia. *Research in World Economy, 11*(3), 108–123.

Karyani, E., Dewo, S. A., Santoso, W., & Frensidy, B. (2020). Risk governance and bank profitability in ASEAN-5: A comparative and empirical study. *International Journal of Emerging Markets, 15*(5), 949–969.

Malik, M. F., Zaman, M., & Buckby, S. (2020). Enterprise risk management and firm performance: Role of the risk committee. *Journal of Contemporary Accounting & Economics, 16*(1), 100178.

Musallam, S. R. (2020). Effects of board characteristics, audit committee and risk management on corporate performance: Evidence from Palestinian listed companies. *International Journal of Islamic and Middle Eastern Finance and Management, 13*(4), 691–706.

Nguyen, Q. K. (2021). Oversight of bank risk-taking by audit committees and Sharia committees: Conventional vs Islamic banks. *Heliyon, 7*(8).

Nguyen, Q. K. (2022). The impact of risk governance structure on bank risk management effectiveness: Evidence from ASEAN countries. *Heliyon, 8*(10).

Nugroho, D. S., & Diyanty, V. (2022). Hexagon fraud in fraudulent financial statements: The moderating role of audit committee. *Jurnal Akuntansi dan Keuangan Indonesia, 19*(1), 3.

Nurliasari, K. E., & Achmad, T. (2020). Pengaruh karakteristik komite audit terhadap kecurangan pelaporan keuangan (Studi empiris perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia periode 2015–2017). *Diponegoro Journal of Accounting, 9*(1).

Purwiyanti, D., & Laksito, H. (2022). The effect of audit committee effectiveness and potential fraudulent financial statements. *Jurnal AKSI (Akuntansi dan Sistem Informasi), 7*(1).

Ruchiatna, G., Midiastuty, P. P., & Suranta, E. (2020). Pengaruh karakteristik komite audit terhadap fraudulent financial reporting (The effect of audit committee characteristics on fraudulent financial reporting). *Jurnal Akuntansi, Keuangan, dan Manajemen (JAKMAN), 1*(4), 255–264.

Schnatterly, K., Gangloff, K. A., & Tuschke, A. (2018). CEO wrongdoing: A review of pressure, opportunity, and rationalization. *Journal of Management, 44*(6), 2405–2432.

Sijabat, J., & Tamba, R. A. (2021). Empirical study of the effect of the audit committee characteristics on fraudulent financial reporting. *International Journal Reglement & Society (IJRS), 2*(3), 125–135.

Zalata, A. M., Tauringana, V., & Tingbani, I. (2018). Audit committee financial expertise, gender, and earnings management: Does gender of the financial expert matter? *International Review of Financial Analysis, 55*, 170–183.