



Strengthening Corporate Governance: The Interaction of Audit Committee and Company Characteristics in Fraud Prevention

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Abstract

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Financial reporting fraud is a critical concern in corporate governance, emphasizing the importance of strong oversight by audit committees as well as an understanding of organizational characteristics that contribute to fraud risk. This study explores the impact of audit committee features independence, financial expertise, meeting frequency, and tenure alongside company traits such as leverage, firm size, managerial ownership, and growth rate, on the occurrence of financial reporting fraud. Employing the Systematic Literature Review (SLR) method, relevant studies were gathered, assessed, and synthesized from academic sources available through Google Scholar. The findings reveal that audit committees that are independent, financially skilled, and actively engaged play an important role in lowering fraud risk, although overly long tenure may compromise their independence. Furthermore, firms with higher leverage and rapid growth are generally more prone to fraud, while the effects of firm size and managerial ownership vary depending on the context. Ultimately, the integration of effective audit committee oversight with company characteristics that reinforce sound governance is essential to reducing financial reporting fraud.

1. Introduction

Financial reporting fraud represents a major challenge in corporate governance. It refers to intentional material misstatements designed to deceive stakeholders and result in losses. Within financial reporting, fraud occurs when certain figures are manipulated to portray a healthier financial condition, thereby misleading shareholders or creditors. Such practices are often driven by information asymmetry between management, acting as agents, and owners of capital, serving as principals. According to agency theory, the principal–agent relationship is a contractual arrangement in which agents are tasked with managing the company for the benefit of principals. However, differing objectives frequently cause conflicts: management typically seeks personal gain, such as higher compensation, while principals aim for maximum returns. These conflicting interests encourage opportunistic actions by management, including financial reporting fraud, which in turn undermines report quality and erodes investor trust (Kurniasih & Sari, 2024).

The audit committee serves as a vital corporate governance mechanism aimed at mitigating the risk of financial reporting fraud. Functioning as an internal supervisory body, it supports the board of commissioners in ensuring the effectiveness of internal control systems, evaluating potential company risks, and safeguarding the integrity of financial reporting. Additionally, the audit committee bridges communication between management and external auditors, thereby promoting transparency and compliance with prevailing regulations. The effectiveness of this committee is strongly influenced by its characteristics, which include member independence, financial expertise, meeting frequency, and tenure

length. Prior research suggests that audit committees composed of independent members with sound financial knowledge are generally more effective in reducing fraud risk. Furthermore, holding regular meetings and having adequate tenure can strengthen their oversight role (Ifeanyichukwu & Ohaka, 2019). Beyond audit committee attributes, company-specific factors also contribute to fraud vulnerability. Managerial ownership, leverage, firm size, and growth rate each shape management's incentives and opportunities to manipulate financial statements. For example, high leverage may pressure management to present stronger financial positions, while firm size and growth may create both opportunities and risks. Thus, the interplay between audit committee characteristics and company attributes plays a decisive role in preventing financial reporting fraud (Lastanti, 2020).

Prior research indicates that a high leverage ratio tends to increase managerial pressure to engage in fraudulent practices. Similarly, firms with larger sizes or rapid growth are often inclined to manipulate earnings in order to uphold their reputation and satisfy market expectations (Nawafly & Alarussi, 2019). While many scholars have explored the impact of audit committees on financial reporting quality, the findings remain inconsistent (Aisyah et al., 2023). Some evidence demonstrates that independent audit committees composed of members with financial expertise can help curb fraud; however, other studies suggest that this effectiveness is not always assured, particularly when company characteristics do not foster strong supervisory systems. These mixed results highlight the importance of conducting further research that integrates both audit committee attributes and company-specific traits when analyzing the potential for financial reporting fraud (Dahlan, 2022). In line

with this gap, the present study seeks to examine the influence of audit committee characteristics on financial reporting fraud, investigate the role of company characteristics in shaping fraud risk, and explain how their interaction contributes to the effectiveness of oversight in maintaining credible financial statements.

2. Methods

This research employs a qualitative design with the Systematic Literature Review (SLR) method to analyze how audit committee characteristics and company attributes affect financial reporting fraud. The SLR approach is selected because it enables the structured and systematic identification, assessment, and synthesis of relevant studies. Through this method, data are gathered from a wide range of academic sources, including journals, articles, and scholarly publications, that discuss the relationships among these variables. The objective is to present a comprehensive summary of existing empirical evidence while uncovering research gaps that could guide future investigations. The SLR process in this study includes several stages: defining research questions, setting inclusion and exclusion criteria, conducting systematic searches, selecting eligible studies, extracting data, and synthesizing results. The inclusion criteria cover studies that address audit committee features such as independence, financial expertise, and meeting frequency as well as company characteristics such as firm size, leverage, and ownership structure in relation to financial reporting fraud.

The literature search is conducted using reputable academic databases via Google Scholar to ensure comprehensive and representative coverage. Through the

SLR method, this study aims to map the relationship patterns between audit committee characteristics, company attributes, and financial reporting fraud, while identifying factors that may strengthen or weaken these connections. Moreover, this approach helps uncover inconsistencies in prior research, which may stem from variations in geographic context, study periods, or methodological approaches. It also reveals research gaps, such as the limited focus on developing countries or insufficient attention to specific aspects of audit committees. Employing a qualitative approach with SLR is deemed suitable as it not only delivers an in-depth synthesis but also aids in developing new theoretical or conceptual frameworks. In this way, the study enriches the literature on corporate governance and financial monitoring, while offering practical insights and policy recommendations for practitioners and regulators to minimize financial reporting fraud.

3. Reults

3.1. The determinant of Audit Committee Independence, Expertise, and Meeting Frequency on Fraud Prevention

Audit committee characteristics are essential in ensuring transparency and accountability within corporate financial reporting. A well-functioning audit committee can significantly reduce the likelihood of financial reporting fraud by exercising strict oversight of managerial practices. One of the most important traits that determine an audit committee's effectiveness is the independence of its members. Independence allows members to perform their supervisory role objectively, free from managerial influence or other vested interests. According to

Oussii & Boulila (2021), a higher proportion of independent audit committee members is strongly associated with a lower risk of financial reporting fraud. Individuals without financial or personal ties to the company are generally more critical in reviewing financial reports, enabling them to detect possible manipulations early (Lastanti, 2020). Beyond independence, financial expertise is another vital attribute. Audit committee members with backgrounds in accounting or finance possess the technical skills needed to grasp the complexity of financial statements and to identify potential fraud-related risks effectively.

Such expertise enables audit committee members to assess whether financial statements comply with established accounting standards. For instance, members with strong financial knowledge are better equipped to identify irregular transactions or patterns that may signal earnings manipulation. Prior research has shown that audit committees with financially skilled members tend to be more effective in mitigating fraud compared to those without such expertise (Alhababsah, 2022). Another critical factor is the frequency of audit committee meetings, which strengthens the effectiveness of oversight. Committees that convene regularly, at least twice a year, gain more opportunities to thoroughly review financial reporting issues. Regular meetings also allow continuous monitoring of developments, assessment of internal audit findings, and prompt responses to emerging concerns. Moreover, higher meeting frequency demonstrates the audit committee's dedication to fulfilling its supervisory responsibilities, thereby helping to lower the risk of financial reporting fraud.

Nevertheless, holding meetings too frequently without a clear and substantive agenda can diminish the audit committee's efficiency and effectiveness (Eriandani et al., 2020). Another factor influencing committee performance is the tenure of its members. Longer-serving members typically possess a stronger grasp of the company's operations and conditions, which enables them to carry out more thorough oversight. Their accumulated experience allows them to detect patterns or irregularities in financial reporting that newer members may miss. On the other hand, overly extended tenures may create potential risks, as prolonged interactions with management could weaken members' independence and objectivity, thereby heightening the likelihood of fraud (Khudhair et al., 2019).

In addition to the previously mentioned factors, the size of the audit committee also plays a role in determining its effectiveness. Committees with an ideal composition, usually three to five members, are generally more efficient in coordination and decision-making. If the committee is too small, it may lack sufficient resources to carry out thorough oversight, while an overly large committee may encounter coordination challenges and reduced focus. Research evidence indicates that audit committees of balanced size are more capable of identifying and preventing financial reporting fraud. Within the framework of corporate governance, the characteristics of the audit committee influence not only internal monitoring but also signal to external parties such as investors and regulators the quality of a firm's financial reporting. Audit committees that are independent, competent, and actively engaged tend to strengthen market trust in the reliability and integrity of financial statements.

On the other hand, ineffective audit committees can create opportunities for fraudulent activities, which may negatively impact both the company and its stakeholders (McLaughlin et al., 2021). Independence, financial expertise, meeting frequency, and tenure are crucial, interconnected factors in mitigating financial reporting fraud. Organizations must ensure their audit committees embody these characteristics to strengthen oversight, while regulators can utilize such insights to establish more stringent governance standards. Future studies are encouraged to examine how these elements interact across various contexts, including developing economies and specific industries, to generate more comprehensive understanding.

3.2. Contribution of Leverage, Firm Size, and Managerial Ownership in Financial Governance

Company characteristics significantly influence the likelihood of financial reporting fraud, serving as a complement to the role of audit committees in corporate governance. A key factor is the firm's leverage level, which indicates the proportion of debt relative to equity. Companies with high leverage frequently experience intense pressure to fulfill financial commitments, including interest and principal payments. This situation may lead management to distort financial statements, such as overstating profits or hiding losses, in order to portray stronger financial performance. While intended to sustain creditor and investor confidence, such practices ultimately heighten the risk of financial reporting fraud (Kinyua & Ochieng, 2022).

Firm size also plays an important role in shaping the risk of financial reporting fraud. Large organizations, with substantial assets and intricate operations, are

generally subject to closer oversight from regulators, analysts, and the public. This heightened scrutiny often pushes them to exercise greater caution in ensuring that financial reports comply with accounting standards and regulations. Nonetheless, the complexity of their operations can create openings for fraudulent behavior. Complicated organizational structures and large transaction volumes may enable management to disguise manipulations, such as accelerating revenue recognition or omitting expenses. Therefore, although large companies possess the resources to enforce sound governance practices, the potential for fraud remains if internal controls are inadequate (Ruwanti et al., 2019). Another factor with a dual impact on financial reporting fraud is managerial ownership. When managers own a considerable portion of shares, their objectives tend to align more closely with those of shareholders, thereby minimizing agency conflicts. In such cases, managers are driven to safeguard the credibility of financial reports to protect the value of their own holdings. On the other hand, overly high managerial ownership can give rise to new issues.

When managerial ownership becomes dominant, managers gain significant influence over corporate decision-making, which can undermine external monitoring bodies like audit committees or boards of commissioners. Under such circumstances, management may circumvent governance mechanisms or manipulate financial statements with minimal opposition (Danso et al., 2021). Another critical risk factor is the company's growth rate. Firms experiencing rapid expansion often face pressure to continuously deliver strong financial results to satisfy investors and market expectations. This situation can drive management to adopt aggressive

accounting strategies, such as early revenue recognition or postponing expense reporting, thereby heightening the likelihood of fraud. Moreover, the fast-paced evolution of operational structures in high-growth firms can make it harder for internal controls to identify irregularities in financial reporting (Yuwono & Aurelia, 2021).

The interaction between company characteristics and the audit committee plays a vital role in minimizing the risk of financial reporting fraud. An independent and skilled audit committee can counterbalance risks linked to certain company traits, such as high leverage or concentrated managerial ownership. For example, in firms with significant debt, an active audit committee can oversee financial reporting to prevent manipulation aimed at meeting repayment obligations. Likewise, in large organizations with complex activities, a committee equipped with financial expertise is better positioned to detect fraudulent practices concealed within intricate transactions. On the other hand, favorable company attributes, such as proportionate managerial ownership, can strengthen the effectiveness of audit committees (Mallingu et al., 2020).

Factors such as leverage, firm size, managerial ownership, and growth rate play a pivotal role in shaping the likelihood of financial reporting fraud. To address these risks, companies need to strengthen internal governance mechanisms, particularly audit committees, to offset vulnerabilities associated with these characteristics (Queiri et al., 2021). Policymakers can also use these insights to design regulations that foster transparency and accountability, for instance by imposing restrictions on managerial ownership or issuing oversight frameworks for firms with

high debt levels. Additionally, future studies should examine how company characteristics interact with external elements, including regulatory environments and corporate culture, in reducing the risk of fraudulent financial reporting.

4. Conclusion

Audit committee attributes and company characteristics are critical in reducing the risk of financial reporting fraud. Factors such as independence, financial expertise, frequency of meetings, and member tenure are central to strengthening oversight of financial disclosures. A skilled and independent audit committee can identify potential irregularities early, while regular meetings and appropriate tenure contribute to more effective monitoring, though overly extended tenure may compromise objectivity. Conversely, organizational attributes such as leverage, size, managerial ownership, and growth rate shape the likelihood of financial reporting fraud. Highly leveraged and fast-growing companies often experience pressure that drives report manipulation, while large firms despite being subject to closer external scrutiny remain vulnerable due to their operational complexity. Managerial ownership presents a dual effect: when balanced, it can reduce agency conflicts, but when excessive, it may undermine oversight mechanisms.

The interaction between a well-functioning audit committee and company attributes that foster sound governance is vital in reducing the risk of financial reporting fraud. Integrating strong internal supervision from the audit committee with transparent organizational structures enhances the credibility of financial reporting. Accordingly, firms should prioritize having independent and skilled audit

committees, while regulators can design policies to mitigate risks linked to factors such as excessive leverage or concentrated managerial ownership. This research highlights the need for a comprehensive corporate governance approach to safeguard accountability and transparency in financial reporting.

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