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# The Analysis of Corporate Governance on Integrity Financial Statements in Banking Companies Listed on The Indonesia Stock Exchange

The Analysis of  
Corporate Governance

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## Abstract

The integrity of financial statements is often questioned due to manipulation of accounting data, involving directors, commissioners, audit committees, and company owners. This study empirically demonstrates the impact of corporate governance - through board size, independent commissioners, audit committees, and institutional ownership - on financial statement integrity. Using quantitative methods, the study involved 37 banking companies listed on the Indonesia Stock Exchange from 2017 to 2022. The results show that board size, independent commissioner, audit committee, institutional ownership, and leverage do not affect the integrity of financial statements, but firm size does.

**Keywords:** Integrity Financial Statement (IFS), Good Corporate Governance (GCG), Board Size, Independent Commissioner, Audit Committee, Firm Size.

## Introduction

This study aims to assess how corporate governance variables affect integrity financial statements in Indonesia's banking sector. The integrity of financial statements is often questioned due to accounting data manipulation by directors, commissioners, audit committees, and company owners, as seen in the cases of PT. Kimia Farma and Bank Lippo (Muammar et al., 2018). Such manipulation involves CEOs, audit committees, and external auditors (Marlinda et al., 2022), indicating dishonesty in the preparation of financial statements (Mulyadi et al., 2022). Conflicts of interest between the report preparers and business owners, investors, or creditors are often the main cause (Amalia et al., 2024).

Good Corporate Governance (GCG) is needed to prevent resource misuse by management (Okoye et al., 2020). A lack of GCG implementation can lead to conflicts of interest and harmful business practices, negatively impacting company performance and stock prices (Putri, 2023). Although regulations have introduced corporate governance mechanisms, companies can still manipulate financial statements (Hasnan et al., 2020). Various studies have examined the impact of corporate governance factors on the integrity of financial statements, with mixed results. Some studies find that audit committees positively influence financial statement integrity (Amalia et al., 2024; Mulyadi et al., 2022), while others show no significant effect (Srikandhi & Suryandari, 2020; Abbas et al., 2021; Muammar et al., 2018).

Similarly, some research indicates that independent commissioners affect financial statement integrity (Abbas et al., 2021; Nurdiniah & Pradika., 2017), but other studies find no significant impact (Marlinda et al., 2022; Ulfa & Challen, 2020). Institutional ownership also shows varied results, with some studies finding a positive influence (Mulyadi et al., 2022; Muammar et al., 2018), while others do not find a significant effect (Meiryani et al., 2023; Putri, 2023; Marlinda et al., 2022). Previous research shows varied results and limited literature on the impact of corporate governance on financial statement integrity in the banking sector.



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Similar studies by Qonitin and Yudowati (2019) and Amalia et al. (2024) highlight a focus on the mining and manufacturing sectors. Qonitin and Yudowati examined the impact of corporate governance mechanisms and audit quality on financial statement integrity in mining companies listed on the Indonesia Stock Exchange. Amalia et al. explored factors affecting the integrity financial statement with company size as a moderating variable. In contrast, this study concentrates on the banking sector, incorporating board size as an independent variable and firm size and leverage as control variables. This approach addresses gaps identified in previous studies by broadening the sectoral and variable contexts under examination.

It aims to fill the literature gap by examining the influence of board size, independent commissioners, audit committees, and institutional ownership on the integrity of financial statements in Indonesian banking, using data from banking companies listed on the IDX for the period 2017-2022. The author focused on banking institutions due to cases of financial statement manipulation in Indonesian banks, such as the Bank Century (2008), Bank Lippo (2002), Bank Bali (1999), and PT Bank Bukopin Tbk (2020). Another reason is that the integrity of financial statements underpins public trust. Banks manage public funds, and depositor confidence depends on the transparency and accuracy of financial information. Without integrity, the risk of distrust and mass withdrawals (bank runs) may increase, threatening the stability of both the individual bank and the overall banking system.

## **Literature Review**

### *Agency Theory*

Agency theory shows the conflict of interest between capital owners (principals) and managers or directors. Agency conflicts occur when an owner hires an agent to do duties and provides him with decision-making power, according to Jensen and Meckling (1976). Independent commissioners, board size, and shared ownership structure are used in this idea to reconcile management and owner interests. Fama and Jensen (1983) note that agency costs related to agent asset management can affect corporate performance, therefore lowering them can boost performance (Kyere & Ausloos, 2020). In agency theory, balancing agency costs with management compliance and financial statement integrity is difficult.

### *Financial Reporting Integrity*

Financial reporting integrity is the ability to disclose a company's genuine financial situation without major inaccuracies. Integrity-based financial statements must be reliable and relevant (Amalia et al., 2024). Following accounting standards and considering internal and external integrity considerations can help organizations ensure their financial statements accurately reflect their financial status to stakeholders.

### *Good Corporate Governance*

A controlled and organized business connection among all stakeholders is called good corporate governance (Lestari et al., 2024). Good corporate governance guides and manages firms to accomplish sustainable and successful commercial goals. Accounting with integrity is typically related to corporate governance, as it is regarded to provide high-quality financial reports (Hasnan et al., 2021). Several factors determine excellent governance:

#### *Board Size*

Research by Dalton and Dalton (2010) indicates that board size, determined by the total number of commissioners in a company, can influence the efficiency of oversight and decision-making, thereby impacting the integrity of financial statements. Board size is

significant because it can affect company performance; larger boards generally possess more collective experience and expertise (Nguyen et al., 2015). However, Yermack (1996) argues that smaller boards tend to have higher market values, reflecting greater efficiency and effectiveness in oversight. Boards of medium or small size with effective audit committees are likely to enhance financial statement integrity by reducing the likelihood of restatements due to errors or fraud (Abbott et al., 2004). An optimal board size can improve oversight and decision-making effectiveness, ultimately influencing the integrity of financial statements.

**H<sub>i</sub>:** Board size has a significant effect on the integrity of financial statements.

#### *Independent Commissioner*

Independent commissioners are board members with no personal or financial connections to the company's management, providing unbiased oversight and mitigating conflicts of interest. They are not involved in daily operations and do not have relationships with company leaders. Their presence strengthens corporate governance by ensuring that board decisions are made objectively, benefiting shareholders and stakeholders without managerial influence. This role is crucial for enhancing financial statement integrity and corporate governance (Kim et al., 2023; Tanujaya, 2022). Marlinda et al. (2022) emphasize that board independence significantly impacts corporate financial performance by promoting transparency and accountability. Fama and Jensen (1983) assert that independent commissioners reduce agency problems and enhance managerial oversight, positively affecting financial statement integrity. Klein (2002) found that companies with more independent commissioners experience less earnings manipulation and produce more reliable financial reports. Byrd and Hickman (1992) demonstrated that independent boards reduce the risk of opportunistic management behavior, improving financial statement integrity.

**H<sub>i</sub>:** Independent Commissioner significantly affects the integrity of financial statements.

#### *Audit Committee*

An effective audit committee contributes to high-quality financial reporting by providing stringent oversight and ensuring compliance with accounting standards. According to Al-Shaer and Zaman (2016), audit committees that meet frequently and have members with financial expertise are associated with a reduction in earnings management cases and higher quality financial reports. The primary role of the audit committee is to assist the board of commissioners in performing oversight functions within the company, enhancing transparency and the integrity of financial reports, and overseeing both internal and external audit processes. Members of the audit committee must possess various skills to detect signs of fraud in financial statements (Waromi et al., 2024). With tighter oversight, the audit committee helps reduce errors and fraud in financial statements, ensuring that the reports produced are of high integrity. Research by Abbott et al. (2004) supports this view, finding that the frequency of audit committee meetings and the expertise of its members are correlated with a reduced likelihood of financial statement restatements, an indicator of higher financial report integrity. Beasley (1996) adds that companies with more active and competent audit committees tend to have more reliable financial reports and are less vulnerable to fraud. DeZoort et al. (2002) also found that a strong audit committee can enhance investor confidence in the company's financial statements.

**H<sub>i</sub>:** Audit Committee significantly affects the integrity of financial statements.

#### *Institutional Ownership*

Institutional ownership refers to the shares held by financial institutions such as pension funds, insurance companies, and investment firms. This type of ownership plays a crucial role in corporate governance and performance. Due to their significant

and long-term investments, institutions have a strong incentive to monitor and influence company management. With better resources and easier access to information, institutions can more effectively oversee management, reduce opportunistic behavior, and enhance operational efficiency. McConnell and Servaes (1990) found a positive relationship between institutional ownership and firm value, as measured by Tobin's Q, indicating that institutional ownership can enhance firm value by reducing agency problems and improving managerial oversight. Gillan and Starks (2003) also state that stringent institutional oversight reduces managerial opportunistic behavior. Cheng and Reitenga (2009) note that institutional ownership curbs earnings management, as institutions prefer financial reports that reflect true performance. Cornett et al. (2007) found that firms with high levels of institutional ownership tend to have better financial reports and lower risk of manipulation.

**H<sub>4</sub>:** Institutional Ownership significantly affects the integrity of financial statements.

### ***Control Variable***

#### *Leverage*

Leverage refers to the use of borrowed funds to finance a company's assets with the expectation of increasing returns to shareholders, playing an important role in the company's capital structure and influencing managerial decisions and financial performance. Leverage can enhance potential returns through the tax shield mechanism, where interest expenses are deductible from taxes. However, high leverage also increases bankruptcy risk because the company must regularly meet its debt obligations, especially during periods of declining income. Beneish (1999) found that companies with high leverage are more likely to manipulate earnings to meet debt covenants and avoid violations. Research by DeFond and Jiambalvo (1994) also indicates that highly leveraged companies frequently manipulate earnings to avoid covenant breaches. High leverage can intensify external pressure from creditors to ensure accurate and transparent financial information. Creditors monitor management to ensure that financial reports reflect true performance, allowing them to make informed financing decisions (Jensen & Meckling, 1976). Watts and Zimmerman (1986) also suggest that creditors have incentives to scrutinize the financial statements of highly leveraged companies to protect their interests. This creditor oversight can enhance the integrity of financial reporting.

#### *Firm Size*

Company size is a key variable in financial and accounting studies, influencing various operational and reporting aspects. Measured by indicators such as total assets, annual revenue, number of employees, or market capitalization, this study uses total assets. Larger companies have more resources, can better withstand financial uncertainties, and are more competitive. They access capital markets at lower costs due to lower credit risk and higher credibility (Dang et al., 2018). They also face and must manage diverse risks (Darmansyah et al., 2024). Additionally, larger companies usually have effective internal control systems, ensuring compliance with financial reporting standards and reducing internal control weaknesses. They are scrutinized more by market analysts and the public, promoting financial report integrity (Doyle et al., 2007). They can also hire major Public Accounting Firms (PAFs) for high-quality audits. Research by Francis et al. (2013) found that companies audited by large PAFs report more conservative accruals and less earnings manipulation. Moreover, larger companies face stricter regulatory oversight, compelling them to maintain high financial reporting standards.

### **Methodology**

Here we explain the statistical analysis of empirical data for research indicators and variables. The research hypotheses guided our panel data regression model. This study

uses associative quantitative methods. This study will examine each variable's effect. Board Size, Independent Commissioner, Audit Committee Size, Institutional Ownership, Leverage, and Firm Size are independent and control variables. Study dependent variable: financial statement integrity.

### Population and Sample

This analysis covered all Indonesia Stock Exchange-listed banks from 2017 to 2022. Purposive sampling was used in this investigation. Banking companies listed on the Indonesia Stock Exchange from 2017 to 2022 and publishing annual reports sequentially are sampled in this study. These requirements are met by 37 companies with comprehensive variable calculation indicator information. Population and sampling are in Table 1.

**Table 1.** Population and Sampling

Sampling Criteria	Jumlah
Total banking companies on IDX	48
Companies without complete data on the variables examined	-11
Companies that are sampled	37
Number of years observed	6
Final sample (37 companies x 6 years)	222

The Revinitif database provides secondary quantitative data, with some manually obtained from the company's annual report to complete it. From 2017 to 2022, this data comes from net income after tax, total depreciation, cash flow, assets, liabilities, board size, audit committees, independent commissioners, and independent commissioners.

### Description of Variables and Measurement Indicators

This section describes the study variables. This category includes dependent, independent, and control variables. Our corporate governance proxies and measures and their relevance to financial statement integrity will also be listed. Based on theoretical and empirical investigations (Christensen et al., 2010; Ehikioya, 2009), variables are chosen.

#### a. Dependent Variable

Financial reporting integrity is accurately presenting the company's finances. Transparent, accurate reports are deemed trustworthy. Unreliable reports, like overstatement, hurt users (Hardiningsih, 2010). SFAC No. 2 requires fair, objective, and honest financial reporting. Financial statements are checked for integrity using the accounting conservatism index to ensure accuracy. Net income before unusual items gives accrual accounting conservatism (Suwardjono 2014: 566). Accounting conservatism is calculated as:

$$\text{CONACC} = \frac{\text{Nii}t + \text{DEP}it - \text{CFO}it}{\text{TA}}$$

Description:

- CONACC<sub>it</sub> : Accounting Conservatism Value
- Niit : Net Income in year t
- DEP<sub>it</sub> : Depreciation and amortization of company i in year t
- CFO<sub>it</sub> : Cash flow from activities of company i in year t
- TA : Total Assets of the company i in year t

The CONACC formula measures accounting conservatism and financial statement integrity. This formula detects conservatism when accruals are negative, meaning net income is lower than operating cash flow, indicating caution in reporting and avoiding earnings manipulation. By measuring the difference between net income and operating cash flow, this formula enhances the transparency and credibility of financial state-

ments, helping financial statement users make better decisions.

b. Independent Variables

In this study, the independent variable is the corporate governance mechanism which is mentioned in several variables. Consists of:

1. Board Size

Corporate board size refers to the number of board members. There is some evidence to suggest that a large board size results in better decision-making compared to a small board size, thus leading to high financial performance (Williams et al., 2005).

Board size = Number of board of commissioners on company's board

2. Independent Commissioner

Members of the Board of Commissioners who are referred to as independent commissioners have no affiliation with the Board of Directors, other commissioners, or controlling shareholders, and have no other relationship that may hinder their ability to act independently in the interests of the company (OJK, 2015). According to Klein (2002), the formula is as follows:

$$\text{Independent Commissioner} = \frac{(\text{Number of independent commissioners})}{(\text{Number of all members of the board of commissioners})}$$

3. Audit Committee

The audit committee consists of the board of commissioners responsible for auditing and overseeing internal control processes and financial reporting. The audit committee consists of at least one independent commissioner and two other members from outside the company or public company concerned (OJK, 2015).

Audit Committee = Number of audit committee on company's board

4. Institutional Ownership

According to Suaidah (2020), the number of institutional shares is compared to the total outstanding shares. These institutions can be government, private, domestic, or international organizations.

$$\text{Institutional Ownership} = \frac{\text{Number of shares owned by the institution}}{\text{Total shares}} \times 100\%$$

*Control Variables*

In their studies, researchers such as Christensen et al. (2010) and Ehikioya (2009) use leverage and firm size as control variables. Rodriguez-Fernandez (2016), Weir et al. (2002), and Essen et al. (2013) have also examined their relevance. These variables are calculated in the following way:

a. Leverage

$$\text{Leverage} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

b. Firm Size

Firm size = Logarithm of total company assets

*Regression Model*

The following panel regression model was created to evaluate the effect of Board Size, Independent Commissioner, Audit Committee Size, and Institutional Ownership on Financial Statement Integrity.

$$\text{IFS} = \alpha + \beta_1\text{BS} + \beta_2\text{ICR} + \beta_3\text{AC} + \beta_4\text{IOP} + \beta_5\text{Lev} + \beta_6\text{FZ} + \epsilon$$

Description:

IFS = Integrity Financial Statement

BS = Board Size

ICR = Independent Commissioner

ACS = Audit Committee

IOP = Institutional Ownership

Lev = Leverage  
 FZ = Firm Size  
 $\alpha$  = Constant of the regression equation  
 $\beta$  = Regression Coefficient  
 $\varepsilon$  = Error

*Data Analysis Technique*

To assess the effect of good corporate management on financial statement integrity, we test the hypotheses using panel data regression. After descriptive statistical analysis, the best-fit model is selected: a common effects model (CEM), a fixed effects model (FEM), or a random effects model (REM), by Chow, Hausman, and Lagrange Multiplier (LM) tests. The Chow test determines between CEM or FEM ( $p < 0.05$  for FEM), the Hausman test between FEM or REM ( $p < 0.05$  for FEM), and the LM test between CEM and REM if Chow selects CEM ( $p < 0.05$  for REM). Once the model is selected, we check the classical assumptions. If the heteroscedasticity test shows  $p < 0.05$ , there is a heteroscedasticity problem; otherwise, homoscedasticity. A multicollinearity problem exists if the Variance Inflation Factor (VIF)  $> 10$ .

**Analysis and Discussion**

*Description of Statistical Analysis*

Table 2 shows sample variable descriptive statistics. The average IFS value is -0.006, ranging from -0.31 (Bank Ganesha, 2021) to 0.17 (Bank Capital Indonesia, 2022). This suggests that Indonesian banking organizations' IFS are typically good, while some are not. The average board size (BS) is 4.98, ranging from 2 to 10 (Bank Jago, 2018). An average ICR of 0.56, a median of 0.50, a minimum of 0.28, and a maximum of 1.00 apply to 56% of independent commissioners (Bank Jago, 2019). The Audit Committee (AC) averages 3.57, ranging from 2 to 8 (Bank Jago, 2018). The median is 0.80, the minimum is 0.01 (Bank Mestika Dharma, 2019), and the maximum is 1.00 (Bank Maspion Indonesia, 2022). The maximum leverage is 0.98 (Bank Panin Dubai Syariah, 2017), and the minimum is 0.33 (Bank Jago, 2021). Firm Size averages 13.69, median 13.49, lowest 11.82, and maximum 15.30 (Bank Jago, 2018; Bank Mandiri, 2022).

**Table 2.** Descriptive Statistics

	Mean	Median	S.D.	Min	Max
<b>IFS</b>	-0.006	0.002	0.06	-0.31	0.17
<b>BS</b>	4.98	4.00	2.14	2.00	10.00
<b>ICR</b>	0.56	0.50	0.12	0.28	1.00
<b>AC</b>	3.57	3.00	1.20	2.00	8.00
<b>IOP</b>	0.68	0.80	0.30	0.01	1.00
<b>Lev</b>	0.83	0.85	0.08	0.33	0.98
<b>FZ</b>	13.69	13.49	0.75	11.82	15.30

**Table 3.** Panel Specification Test Summary

	IFS p-values	Results
<b>Chow test</b>	0,9156	Pooled
<b>Hausman test</b>	0,662861	Pooled
<b>Heteroscedasticity test</b>	0,071106	There is no heteroscedasticity problem

Two of the three-panel specification tests favored the Pooled model, as seen in Table 3. This study contains legitimate data because the heteroskedasticity test shows no difficulties with the model. Table 4 shows that the regression model's independent variables have no significant correlations because the multicollinearity test VIF values are less than 10.

The p-value (F) of 0.376119 indicates that the applied regression model is not statistically significant and has low explanatory power. This means that the independent variables

do not significantly explain the variation in financial statement integrity. This contrasts with the mining sector study by Qonitin and Yudowati (2019), which showed a p-value (F) of 0.004144, indicating stronger significance. The Adjusted R-squared value of 0.004806 indicates that the independent variables in this model explain only about 0.48% of the variation in financial statement integrity. This is much lower compared to the manufacturing sector study by Amalia et al. (2024) and the mining sector study by Qonitin and Yudowati (2019), which showed Adjusted R-squared values above 24%. Therefore, the governance factors examined in Indonesian banking companies have very limited ability to explain the variation in financial statement integrity.

**Table 4.** Pooled OLS test of IFS

	Coefficient	Std. error	t-ratio	p-value	Collinearity (VIF)
<b>Constant</b>	-0.293056	0.102394	-2,862	0,0046***	
<b>BS</b>	-0.00219415	0.00304808	-0,7198	0,4724	2,353
<b>ICR</b>	-0.0182606	0.0348354	-0.5242	0.6007	1,085
<b>AC</b>	0.000703487	0.00434487	0.1619	0.8715	1,519
<b>IOP</b>	-0.00120090	0,0141762	-0,08471	0,9326	1,065
<b>Lev</b>	0.0432023	0,0544090	0,7940	0,4281	1,166
<b>FZ</b>	0.0197381	0,00850082	2,322	0,0212**	2,273

Note(s): \*\*\*, \*\*, and \* represent the significance level of the test results at 1%, 5%, and 10%.

### *Discussion*

This study revealed no independent Financial Statement Integrity factors. The independent variable hypothesis that board size, independent commissioner, audit committee, and institutional ownership affect financial statement integrity fails. For corporate governance, Linck et al. (2008) propose large boards. OJK Regulation No. 55 / POJK.03 / 2016 mandates the board to be large enough for the bank's complexity and needs but not to improve financial statement integrity. Bank boards below OJK have considerable control and little oversight. Reduced monitoring makes board size irrelevant to financial statement accuracy. More boards ease management supervision and improve operations, claim Dewi & Dewi (2018). Board size does not affect financial statement integrity, per Xie et al. (2003). Financial statement integrity is not improved by more independent commissioners. POJK Regulation 55 of 2016 exempts independent commissioners from banking. A non-banking commissioner verifies financial statements. Management's selfishness prevents independent commissioners from improving financial statement integrity, resulting in investor-pleasing financial report fraud (Srikandhi & Suryandari, 2020). Results demonstrate that POJK 55 / POJK.04 / 2015 requires an audit committee to preserve financial statement integrity but does not change it. Financial statement fraud firms increase audit committee meetings after detection (Nasir et al., 2019). This frequency increase prevents financial statement fraud. To maintain financial statement integrity, audit committees monitor, oversee, and communicate with management. Routine meetings encourage audits, fraud prevention, and accountability. Audit committee meetings are only required every three months per POJK 55/POJK.04/2015. Audit committee sessions and financial statement integrity decrease. Audit committees are legal formalities, explain Yendrawati and Hidayat (2021). Audit committees must help preparers communicate to prevent fraud and improve financial statements. Management monitoring may grow with institutional ownership. Gillan and Starks (2003) discovered investor goals affect institutional ownership. Institutional ownership may value short-term advantages over financial statement integrity. Risqurrahman et al. (2020), Totong & Majidah (2020), Cahyaningtyas & Abbas (2022), and Lesmono & Setiyawati found no impact from institutional factors. Prudent leverage ratio limitations in Bank Indonesia rule 14/15/PBI/2012 protect Indonesian banks' accounts. Leverage does not affect financial statement integrity, assert Nurdiniah & Pradika (2017) and Wardhani & Samrotun (2020). The study found



that firm size considerably affects financial statement integrity. Larger companies have greater resources and complex operations to build strong internal controls and governance. Large companies must maintain stakeholder trust through financial statements. Public companies present their financial accounts more carefully, which affects financial statement integrity. Large companies can cover agency fees. Firm size influences financial statement integrity, according to Akram (2018), Permatasari (2020), and Sri (2023).

## Conclusions and Recommendations

This study explores the influence of corporate governance mechanisms such as board size, independent commissioners, audit committees, and institutional ownership on financial reporting integrity in the Indonesian banking sector. The study also includes leverage and company size as control variables. The results indicate that board size, independent commissioners, audit committees, and institutional ownership do not significantly affect financial reporting integrity, while company size shows a significant influence. The research underscores the complexity of corporate governance mechanisms and their varied impacts on financial reporting integrity, providing crucial insights into the dynamics of corporate governance and its influence in the Indonesian banking sector. Challenges in the study include difficulties in accessing data and the limited availability of similar research in Indonesia. For future research, exploring additional variables such as the size of public accounting firms and independent ownership is recommended to deepen understanding and enhance efforts to uphold the reputation and integrity of financial reporting in Indonesian banking companies. The study's findings have several key implications. Firstly, there is a need to reevaluate governance policies, particularly OJK regulations like Regulation No. 55/POJK.03/2016 and POJK No. 55/POJK.04/2015, to ensure banking companies comply with board size requirements and qualifications for independent commissioners. Policies should also enhance the frequency and effectiveness of audit committee meetings to improve financial reporting transparency and accountability. A comprehensive approach is needed for institutional ownership to focus on long-term interests and financial statement integrity. Although leverage is well-regulated, further research is necessary to develop better policies. The findings also suggest that larger companies have stronger internal controls and more accurate financial reporting, which smaller and medium-sized enterprises should emulate. Policymakers should consider revising existing regulations and developing new ones to improve the integrity of financial reporting.

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