

## CORPORATE GOVERNANCE AND LEGAL COMPLIANCE: EVALUATING THE ROLE OF BOARD DIVERSITY IN ENHANCING ETHICAL BUSINESS PRACTICES

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**Abstract** The relationship between corporate governance and legal compliance has received renewed scholarly and regulatory attention in the wake of recurrent corporate scandals and the steady expansion of environmental, social, and governance mandates across markets. Board diversity in this debate has been one of the possible causative factors of enhancing ethical decision-making and compliance failure. The paper reconciles both the available theoretical knowledge and empirical evidence to establish whether or how various boards would influence ethical business practice and legal adherence and it also come up with a rigorous research design in order to estimate these effects in the different jurisdictions. The discussion, relying on the resources dependence theory, the stakeholder theory and the institutional theory, indicates the mechanisms that may allow the demographic, cognitive and experiences diversity at the top of the firm improve the quality of oversight and the breadth of the ethics, the quality of risk identification, and the legitimacy of corporate values. The paper hypothesizes a multi-method research design to overcome the correlational findings, implying that it makes use of quasi-natural experiments of gender quota launches, adoption of corporate governance codes in a staggered manner, and exogenous shocks to the intensive enforcement of the regulations. It establishes the operationalizations of board diversity and the ethical/compliance outcomes, it deals with the problem of endogeneity and measurement, and proposes the tests of heterogeneous treatment effects in terms of industry risk, ownership structure, and cultural context. Implications on the practice of regulators and boards are provided as the conclusion of the paper, and the limitations of using ethics with observable proxies and an agenda of follow-up research that will bring behavioral data, text analysis, and field experimentation to better isolate causal channels of action between boardroom composition and moral outcomes of the firm are found.

**Keywords** corporate governance, board diversity, legal compliance, ethics, ESG, risk oversight, regulation, institutional theory, causal inference

### 1. INTRODUCTION

Corporate governance has long been tasked with the dual aims of disciplining managerial discretion and enabling strategic stewardship. The pressure on the board of directors has been compounded by the last two decades in which the global markets have suffered high-profile incidences of misconduct and the increase in regulatory change in as well as escalating demands of the stakeholders among the stakeholders. Boardroom is already assuming the first line of defense against malpractices and compliance breach as noticed by regulators and investors. The corporate boards have been subjected to scrutiny by policy makers and practitioners with this trend. Board boards have propagated prescriptive steps to force boards to be more diverse (especially, encourage gender but country of origin, profession). Despite the early conceptualisations of support of diversity in boards through equity and representation, there has been a growing literature on the governance topic that have proposed a potential instrumental argument: boards with diversity become better ethical deliberators, stay out of groupthink, become more monitoring and better at recognising and removing compliance risks.

Nevertheless, the information remains unequal and the operations of question. Studies that have been carried out have shown that diversity is correlated with better measures of better governance or the lower rates of regulatory incidents and others with reported null or mixed effects when the firm fixed effects and selection are accounted for. In addition, diversity is contextual and multi-dimensional (Turisno *et al.*, 2021). The informational and normative implications of the same attribute may imply something different in various industries and cultures. Even the legal compliance is not an optimal proxy of ethical practice and the companies can become technically compliant but not the spirit of the law. The significance of this paper is that, the combination of theory and empirical blueprint that can be implemented will be combined to draw out the effect of causality, map mechanisms and stipulate boundary conditions. It tries to clarify the concept of whether or not board diversity is a fool-proof signal of ethical business conduct and ethical compliance report, to which company and environment, and through what processes.

## 2. LITERATURE REVIEW

### 2.1 Board diversity: concepts and dimensions

Board diversity encompasses observable demographic attributes and less visible cognitive and experiential differences that shape how directors interpret information and make decisions.. Gender, race/ethnicity, nationality, age, education, functional background, industry expertise, and tenure heterogeneity are some of the common dimensions. Demographic difference may also manifest in the form of varied life experience and contacts which may alter the information flow and values to be passed to the board(Tanjung *et al.*, 2021). Cognitive diversity is manifested in difference in problem-solving fashion, risk attitudes, and mental images. Experience diversity is an aspect that involves the diversities in career experience and this can be experienced in the form of legal, compliance, regulatory, sustainability and audit experiences. The literature indicates that availability of heterogeneous attributes is not the only condition that defines the effectiveness of diversity, inclusion, and processes of boards and power distribution are also important. Unless there are agendaless minority directors there may be silencing benefits and tokenism may not necessarily work so long as there are structures to the committee systems that are such that the expertise that minority directors possess is directed to risk and audit control.

### 2.2 Corporate governance and legal compliance

Corporate governance is designed to streamline managerial behaviors towards long term interests of the stockholders and in more recent times of stakeholders. There are check and balances including board structures, audit committees, risk committees, internal control means and incentive contracts. Compliance by the law is a product, or a process: the visible level of violations, monetary fines, and concurring units, and the oversight of the policies, training, whistleblowing and third-party treatment which parades and the legal hazard. This issue of governance failures are typically linked with the information asymmetry, absence of issues to the management and culture acceptance of the boundary-pushing. Good boards are inferred to look ahead on matters relating to regulations, insist on transparent reporting and demand on strong internal control(Efunniyi *et al.*, 2021)s. However, there is an empirically complex connection between the board composition and outcomes of compliance. Firms differ both in exposure of enforcement and level of risk. Regulatory shocks occur at varying times and salience toward compliance does not occur in all industries equally thus making it difficult to detect.

### 2.3 Diversity and ethical practices: evidence and debates

Theoretical argument of diversity is anchored on better surveillance and augmented moral saliency. Multicultural teams are able to recognize warning signs earlier and put issues into wider interested lenses. Empirical evidence has been found to reveal a negative correlation between board gender audit committee diligence and more conservative financial reporting within specific settings. This finding has also been attributed to other studies which have associated the emergence of broader diversity to positive CSR performance and quality of ESG disclosures. Nevertheless confounding is the rule: there is a possibility that more progressive companies choose multiple directors, or have more resources or are under more intense examination and there is difficulty in attributing outcomes to diversity itself(Al-Tarawneh *et al.*, 2021). Some studies indicate that the impacts of diversity can be experienced primarily in situations of extreme uncertainty or where diversity is functionally relevant such as the instance of law experience on audit committees in the situation where an enforcement spurt comes. Other companies relate diminishing returns to very heterogeneous boards or high coordination costs. All these combined findings prove the significance of the articulation of mechanisms, selection explanation, and heterogeneity.

## 3. THEORETICAL FRAMEWORK AND MECHANISMS

### 3.1 Agency theory and enhanced monitoring

The agency theory presupposes that agencies are able to minimize the agency costs through practicing oversight and designing incentives that bring about an alignment of interest. Diversity can also have the ability to increase monitoring, creating divisiveness and reducing social cohesion in some cases deadening hard questioning, introducing directors and independent networks and sources of information; and a change toward norms to procedural thoroughness. The gender and ethnic diversity in the demographics may potentially decrease the likelihood of groupthink and increase the willingness to challenge aggressive earnings management, taking risks in acquisitions, or slack complaces programs. The diversified directors may also be more responsive to reputational risks as the minority groups will be more subject to the examination of the masses and, therefore, be more sensitive to the ethical concerns of decisions made.

### 3.2 Resource dependence and boundary spanning

The resource dependence theory emphasizes the role of boards as the boundary spanning institutions that are enticing firms into receiving valuable resources in form of regulators and legitimacy(Turisno *et al.*, 2021). Through the appointment of the directors, who might have different backgrounds, they can have the ability to access access to compliance advisors, non-government organizations and also networks of individuals in working in the government. Board-level legal and regulatory expertise may be able to unravel new regulations, take risks, and shape plausible responses to the patterns of enforcement. The national country diversity will help multinational corporations to be harmonious with the standards of the destination country and to foresee the extraterritorial competency such as anti-bribery regulations and data encryption regulations. Enhancing the external contacts, diversity will widen the such capacity of the board to forecast the tendencies in regulatory trends and establish preventive actions.

### 3.3 Stakeholder theory and ethical salience

The stakeholder theory is anchored on the notion that the boards should consider attending to the interests of the employees, customers, suppliers, communities, and the environment.

Representational diversity can help to render non-shareholder opinions visible, creating no moral blind spots(Mim *et al.*, 2021). The under-represented directors or with an experience in sustainability/compliance may promote augmented whistleblowing norms, impartial labor practices, and accountable control over the supply chains. With such voices it can restore the board appraisal of trade-offs and cultures whereby the outcomes of how are as highly important as the results of what is provided.

### 3.4 Institutional theory and legitimacy

The institutional theory gives emphasis on the organizational conformity and expectations of organizational legitimacy. As the shift to markets with ESG accountability takes place, the different boards would likely reflect their interest in the social values and foresee any threats to legitimacy that might happen(Gutiérrez *et al.*, 2021). In the presence of high normative pressures, especially where legal minimum practices on compliance are below normative practices, diversity can contribute towards the adoption of compliance practices that are above normative minimum. However, symbolic actions can also be a consequence of isomorphism such as the hiring of diverse directors and the same board structure of power. In order to introduce the boundary between the substantive and the symbolic diversity, it has to be mentioned that matters of committee assignments, leadership, risk and audit agendas control are discussed.

### 3.5 Process mechanisms inside the boardroom

Diversity Translation has ethical implications that are found to occur in board processes of sourcing information, conflict management, agenda control, and management evaluation. The inclusion practice in terms of structured speaking turns, pre-read memos explaining the ethical repercussions and negative protocols of dissent can allow the minority voices to influence the decisions made(Popa *et al.*, 2021). The way the committee is constructed is significant in that, where directors of audit and risk committee have compliance or legal experience, they will be likely to discover their opinions do impact controls and reporting quality. Board leadership also plays a role; board- chairs who establish a model of ethical discussion, and screen time in opposing view, are most helpful in using diversity to their tactical advantage.

## 4. RESEARCH QUESTIONS AND HYPOTHESES

The three fundamental research questions emerge out of the above theory. First, does a greater board diversity cause a less legal and regulatory violations and ethical practices? Second, the method of effect production, i.e. through increased monitoring, extended external contacts or heightened prominence of stakeholders? Third, are impacts more or less forceful when subjected to which circumstances of the boundaries industry risk, ownership concentration, national culture and strength of enforcement?

On the basis of such questions, testable hypotheses are created. The primary hypothesis is that higher the diversity of the board, the lower are the abatement and probability of the violation of the compliance, and other factors are equally held constant, such as firm and time. The second one will be the effect is partly mediated by the process improvement that will be proxied by the diligence of the audit committee and the internal control quality and uptake of the whistleblowing(Gomes *et al.*, 2021). A third hypothesis predicts that the more credible the regulatory enforcement and in an industry with a high complexity of abiding by regulations, the highest the effect would be. Fourth hypothesis is that diversity and the functional alignment

to compliance needs, legal experience and regulatory experience are supposed to impact particularly.



**Figure: CORPORATE GOVERNANCE AND LEGAL COMPLIANCE**

## 5. RESEARCH DESIGN AND METHODOLOGY

### 5.1 Sample and data sources

The panel of ten or fifteen years will be assembled in a blanket basis of publicly-traded firms in different jurisdictions to reflect both pre- and post-reform periods. Data about the composition of the board can be provided by providers such as BoardEx or annual reports of companies to develop the measures of diversity on the level of demographics and experience.

The compliance can be measured by regulatory enforcement data which deals with fines, settlements, and consent decrees by agencies within any particular jurisdiction. Other proxies are restatements which are internal control weaknesses which have been reported as per the relevant reporting standards and number of material legal proceedings(Svanberg *et al.*, 2021). The ethical conduct can be proxied by ESG controversy information, disclosed whistleblower cases resolutions and independent review of supply-chain controversies. Such financial and control variables as the size, leverage, profitability, growth, ownership concentration, and governance indices will be available through the standard financial databases. The level of enforcement and codes of governance adoption are the aspects of the institutional variables that will be created by the organization of the public legal sources.

### **5.2 Measurement of board diversity**

In order to have a blanket definition of diversity, various indices will be generated. The demographic differences will include the percentage of women directors, the shares of women directors that represent the underrepresented ethnic groups according to which American laws and business ethics capture the required information, and the heterogeneity of the nationality of international corporations(Mwakapala *et al.*, 2021). The difference in educational areas and the dispersion of professional-level background, especially legal, compliance, audit, sustainability, operations, and technology will be used towards proxying the diversity in terms of cognitive and experience. Tenure dispersion and age dispersion will be assigned the life cycle diversity. The process of analysis will indicate the presence or absence of various directors in charts representing the leadership position, key committee chairs or member of an audit and risk committee to set the difference between symbolism and matter. To reduce the dimensionality and address multicollinearity, a composite index of diversity can be built with the help of principal component analysis.

### **5.3 Ethical practices and compliance outcomes**

Measures of compliance would be the number of counts and values of yearly sanctions multiplied by assets or sales and the quantification of severe events such as resolutions of the criminals(Wang *et al.*, 2021). The restatements of the various internal control weaknesses to materiality will be given codes that will be given in different levels. The labor right controversies, product safety, data privacy and environmental violations are some of the measures of ethical conduct. Triangulation and sensitivity analysis will be used to measure the data owing to the fact that it is imperfect proxies. The use of lag structures will ensure that the diversity will change a little bit before the outcome measurement to minimize the reverse causations.

### **5.4 Identification strategy and endogeneity**

This is because endogeneity is linked with omitted variables, reverse causality as well as selection. The board may also be filled with a mix of diverse directors thus favouring the naive estimates by companies that have an escalating risk of compliance(Karwowski *et al.*, 2021). The initial finding method will exploit regulatory shocks that will introduce exogenous alterations in the board composition, i.e. adoption of gender quotas or comply-or-explain codes of diversity. Change in differences design will be used to compare the treated and matched control firms when there are reforms to be involved that will entail firm and time fixed effects and jurisdiction specific trends. Parallel trends will be tested through the assistance of event-study plots and placebo reforms in the jurisdictions that are not subjected to it.

A complementary approach manipulates instrumental variables which will not result in any indication on accountability like the operative local presence of qualified diverse directors gauged by city demographic within the sample of top managers and lawyers or historical moves in professional society which increases the pipeline of directors(Antwi *et al.*, 2021). These will be checked by relevancy test and over-identification test where need be. The propensity score matching could be applied to compare the firms that had similar pre-treatment aspects. In the mechanism case, the mediating effect through which diversity effects on outcome variables are statistically transmitted in response to either increases or reductions in the diligence of audit or the whistleblowing activity will be measured through a mediation framework.

### 5.5 Heterogeneity and boundary conditions

The heterogeneous effects will be discussed in many dimensions. Effects of diversity can be cushioned by complexity of the compliance at the industry level in terms of the density of the regulations and past levels of enforcing those standards(Olaniyi *et al.*, 2021). The effect of diversification in buildings of board independence: concise ownership may weaken or enhance the influence of diversity depending on compliance objectives amid blockholders. Certain cultures of the country depicted through the mechanisms of power distance and uncertainty avoidance may influence the boardroom dynamics in which the minority shall be represented. The enforcement strength, in terms of agency budgets and the tendency of punishments may explain the process of whether the tightened control will be translated into obvious punishments or eliminate the vice.

### 5.6 Robustness and falsification

Robustness tests will involve alternative measures of diversity e.g. Blau or Shannon index of categorical variables. It will compute the outcome once more with firm-specific time dynamics to eliminate the tradeoffs that will fall under special regulation regime as well as it will apply negative control results which would rather not be affected by the composition of boards. False exercise of detecting spurious correlations of pre-trends and effects within non compliance domains will be identified(So *et al.*, 2021). When there exist data, in-firm dynamics of board committee composition adjustment will assist to isolate governance channels to a superior level.

### 5.7 Qualitative triangulation

The semi-structured interviews with the directors, chief compliance officers and regulators should be employed to assist in shedding the light on the boardroom processes, which would not be recorded in the quantitative analysis. The protocols will also probe into the development of divergent opinions in the audit committee meetings, the treatment accorded to dissent and what becomes of the cases where any case of whistleblowing is put on the table(Primec *et al.*, 2021). An examination of board charters and board meeting minutes may serve as archival information to facilitate the agenda-setting outcome of more ethical salience, in post-diversity changes. The qualitative aspect would help in establishing the lack or existence of diversity as being either symbolic or substantive, and whether or not the diversity could redefine the tone at the top.

## 6. RESULTS INTERPRETATION FRAMEWORK

Given that this paper is a proposal of a research design and does not presuppose the presentation of original estimates, it is informative to elaborate how the results would be taken into consideration. Having a negative coefficient of the difference-in-differences of the violations

in case of exogenous growth in diversity high would be convincing the first hypothesis that the diversity is a negative determinant of the compliance failures. Event-study plots of the non-existence of anticipatory impacts and a rigid pre-trend would enhance causal assertions. In case the mediation analysis suggests evidence that the more active an audit committee and the more quality internal controls are, that would help to support the mechanism of monitoring. Greater effect in extremely-complex industries or with a high level of credible enforcement would translate to the fact that the value of diversity is conditional dependent on the risk-exposure and credence of regulation(Licht, *et al.*, 2021). The fact, that there would be findings that were not significant would not necessarily disprove the theory but would provoke a re-thought as to whether diversity is a symbol, whether there may be no mechanisms of inclusion and whether effects may be masked by measurement error. Such positive correlations with the quality of disclosure and no correlation with violations of the associations might equally imply that different boards take a bit more concern with transparency than with deterrence as different mechanisms that are ethics.

## 7. DISCUSSION

### 7.1 Substantive versus symbolic diversity

In discussing the policies, there is a general presumption that a solution is to add various directors which is a sure way of improving good governance. Here, the organization cautions against confusion of representation and influence. The empirical approach accentuating roles of committees and leadership tests will respond to the issue of whether the minority directors could affect the audit and risk agenda. Based on the results, which assume that diversity without the effect of the audit committee has negligible influence and that diversity plus audit committee chairman impact improve results, regulators and investors should start concentrating on the allocation of power in the board, rather than governing figures(Mäntymäki *et al.*, 2021). This delicacy breaks the complaint that requirements on diversity will result in tokenism, and can help in establishing those design properties, such as committee composition properties, that would make the representation the property of quality of oversight.

### 7.2 Costs, coordination, and board effectiveness

Costs of coordination that heterogeneous boards would incur would be higher, decision making would be slow and such may have conflict. Such costs do not always include an unfavorable factor; such costs may be fruitful dissent. It depends on whether boards tackle the issue of conflict positively. Process interventions may transform friction into due diligence, a previous commitment to consider the ethical risks, and a direct request on the opinion of the minority. When it is found that heterogeneity is linked to superior aspects of ethical performance, probably in the companies that are institutionalizing the procedures, it will mean effectiveness of diversity is conditional with respect to inclusive governance practices.

### 7.3 Externalities and reputational capital

When companies have diversified boards, they are in a position to establish reputational capital with regulatory agencies, the investor and civil society since this creates a stance that an inclusive manner in which a business is being governed. The capital can be pulled into more fruitful regulatory interaction, talking of changing of the rules earlier and gaining credibility in case of any issue(Habib *et al.*, 2021). The reputational benefits are nonetheless low unless the reputational benefits are underlined by unified practices. The empirical literature should not therefore not differentiate between the disclosure based litigateness and the performance

based litigateness by examining the issues of whether there is the improvement which persists without dependency on the intensity of disclosure and the level of PR activity.

#### 7.4 Global convergence and local variation

The cross-country analysis may reveal the indications of the convergence to the standards of diversity and the local diversity that is not eliminated. In common-law regions where the scope of privately-enforced litigation is prevalent the channels of monitoring can pre-eminent whereas in civil-law areas with well-established regulatory experience in general, the instrument of administrative enforcement may take on a more significant role. The dynamics among board members in cultures are conditioned; power distance can be stronger in some cultures and, hence, more formal protocols should be established in order to ensure that the voices of minorities are not ignored(Tashkandi, *et al.*, 2021). With these contingencies being known, it will be feasible to structure policy and governance recommendation on institutional environments and not be illustrative of a universal example.

### 8. PRACTICAL IMPLICATIONS

#### 8.1 Implications for boards and executives

Boards that wish to improve ethical practices should adopt such tactic as diversity. They should also review the risk map of the firm, as well as employ directors whose experiences are relevant to the concerned areas of compliance in addition to meeting the numerical requirements. The institutionalization of the improvements of oversight system could be through appointment of directors to lead audit and risk committees with the appointment of directors being legal, audit or regulatory. Such processes should form part of the leadership of boards in order to encourage dissent, involve a periodic transparent audience of ethical effect of key decisions and connect diversity programs with enhancement of internal controls. The executives should enable the same with the provision of transparent and timely information and protection of whistleblower channels hence enabling the board to detect and address the problems at an early stage.

#### 8.2 Implications for investors

Good stewardship practices can be improved by the investors not only by going beyond the outward aspects of diversity, but also to evaluate the power distribution. Policies related to voting can effectively involve the support of directors and compensation plans grounded on evidence which considers various kinds of directors to be playing consequential roles, and highly diligent audit committees(Antwi *et al.*, 2021). It should be involvement based on integration of diversity to business risk management practices, autonomy of internal audit, and culture audit. The shareholders may also encourage publication of board audit procedures that include inclusion and ethical discussion analysis.

#### 8.3 Implications for policymakers and regulators

This is the necessity to enable the regulators revolving around the diversity mandate to establish flexible yet comprehensive policies. Experimentation may be promoted by the presence of the compliance-or-explain regimes, although, the explanation will be provided in particular terms, which will be specified under the risks profiles(Wang *et al.*, 2021). Additional steps that can be used to reduce the effects of tokenism and increase the utility of the governance include rules concerning committee composition, training of the directors to the changes in the regulation, and development of the pipeline of directors in which the quotas are applied can be

facilitated. Regulators should also ease research and market discipline by improving the disclosed data on enforcement and compliance outcome.

## 9. LIMITATIONS

There are several limitations that are likely to be associated with the utilization of observable results to quantify ethics and compliance. Similarly, the enforcement data displays detection and pursuit as compared to misconduct incidence underlying the same. Greater transparency by firms may be riskier to the level that firms may be more aggressive in sharing information with itself. The nature of diversity information may be incomplete or sensitive where in the instance of ethnicity and nationality there is the ethical and legal restriction to such kind of collecting data(Svanberg *et al.*, 2021). Causal identification policy has assumptions such as exogeneity of reforms and reforms, trends of parallels, and it should not be considered as barriers avoidance of exclusion. The cultural and organizational variables, determining the board dynamics, cannot be readily measured at a large scale level and then this could be the cause of residual confounding. Qualitative elements are helpful, but inaccessible and candor constraints can be biased towards insights.

## 10. FUTURE RESEARCH DIRECTIONS

Future research should build the evidence base in different ways. Firstly, infrequent though not impossible field experiments in governance; this might be a randomized encouragement design by partnership with regulators or stock exchange in an effort to induce boards to train ethical deliberation, or whistleblower oversight. Second, board minutes, earnings calls and committee reports can be analyzed using changes in natural language computing and measures of ethical salience and dissent as behavioral proxies can be quantified to be used alongside demographic proxies. Third, greater data on the quality of internal controls, use of hotlines and third party risk controls would offer more specific mechanisms testing. Fourth, the influence of the ownership may be researched on, when exploring the effect of diversity on compliance in private and state-owned firms and subsequently include it into generalization. Fifth, intersectional approaches that consider a combination of factors related to gender, ethnicity and expertise in line of functions may be used to expose the patterns that might have not been shown by indicators made on a single dimension only. Sixth, through comparative research of multinational subsidiaries across national boundaries, it can be determined that nationality diversity is also beneficial in reducing extraterritorial exposure to compliance costs, e.g. anti-bribery and data protection costs.

## 11. CONCLUSION

In this paper, the hypothesis of the research that board diversity enhances ethical behaviour of business and compliance with laws has been discussed. Through integration of theoretical inclinations and empirical evidence it has argued that diversity can improve corporate behavior where it is transformed into effective monitoring, broadened boundary spanning and added salience to stakeholders. However, the power of diversity relies on the inclusion, committee leverage, hazard in the sector, institutional past, and the trustworthiness of the ones that are enforcing. The paper will provide a rigorous empirical treatment of the debate on a quasi-experimental variation, in-depth measurement, and qualitative triangulation to come out of the correlation. The pragmatic element of the policy implication would be the formulation of diversity policy and governance practices developing around what is being practiced and not symbolized. It is recommended that regulators strike a balance between the purpose of representation and the purpose of process and committee advice and that investors consider the

sharing of power and degree of diversity factored in the creation of risk maps and to make deliberation more inclusive by boards. Even though the questions of measurement and identification remain, the procedure outlined in this paper can help to obtain more compelling pieces of evidence concerning the conditions under which different boards can reduce the wrongdoing and strengthen the ethical foundation of the company.

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