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Article

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Cogent Business & Management

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Suggested Citation: Nguyen, Hong Thi Xuan; Pham, Huyen Thu; Dao, Nhung Thi; Nguyen, Nga Thi (2022) : Impact of characteristics of the board of directors on the truthfulness of financial statement information of listed firms in Vietnam, Cogent Business & Management, ISSN 2331-1975, Taylor & Francis, Abingdon, Vol. 9, Iss. 1, pp. 1-12, <https://doi.org/10.1080/23311975.2022.2148870>

This Version is available at:

<https://hdl.handle.net/10419/289363>

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To cite this article: Hong Thi Xuan Nguyen, Huyen Thu Pham, Nhung Thi Dao & Nga Thi Nguyen (2022) Impact of characteristics of the board of directors on the truthfulness of financial statement information of listed firms in Vietnam, Cogent Business & Management, 9:1, 2148870, DOI: [10.1080/23311975.2022.2148870](https://doi.org/10.1080/23311975.2022.2148870)

To link to this article: <https://doi.org/10.1080/23311975.2022.2148870>



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Received: 16 September 2022
Accepted: 03 November 2022

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Reviewing editor:
Collins G. Ntim, Accounting,
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ACCOUNTING, CORPORATE GOVERNANCE & BUSINESS ETHICS | RESEARCH ARTICLE

Impact of characteristics of the board of directors on the truthfulness of financial statement information of listed firms in Vietnam

Hong Thi Xuan Nguyen¹, Huyen Thu Pham^{1*}, Nhung Thi Dao¹ and Nga Thi Nguyen²

Abstract: Truthfulness in accounting creates a significant concern for academics, practitioners, regulators, and the press. This study investigates the influence of the Board of Directors (BOD) characteristics on the truthfulness of accounting reports. The research uses quantitative methods to test hypotheses with a sample of 747 listed companies from 2008 to 2020. The results illustrate that the frequency of meetings of the Board of Directors, Board expertise, and Board independence positively influence the truthfulness of the financial reporting. At the same time, the duality of the BOD negatively affects the truthfulness of the financial reporting. Based on the findings, the study recommends developing an appropriate corporate governance system to increase the truthfulness of financial reporting for listed firms in Vietnam.

Subjects: Financial Accounting; Management Accounting; Corporate Governance

Keywords: board of directors; the truthfulness of financial reports; listed companies; Vietnam

Subjects: G30; G32; M41

1. Introduction

The truth and ethics in accounting as complex matters attract the attention of researchers and practitioners worldwide. The wake of accounting scandals at global companies like WorldCom or Xerox presents an intention to hide the actual financial performance (Goncharov, 2005). The bankruptcy of these large companies causes a higher demand for assurance of the accounting report quality. The financial statements' truthfulness affects the accurate information that stakeholders need to know. In developing countries like Vietnam, the truthfulness of financial reporting is relatively low due to the high rate of firms involving the difference in pre and post-audit profit. Even some audited financial statements submitted to the Stock Exchange still have misstatements that postulate a considerable problem of useful information to investors. For instance, the Vietnamese State Securities Committee, in 2022, fined the securities code ACM an amount of VND 150 million according to Decree No. 156/2020/ND-CP for disclosing misstatements in the financial statements of the year 2020 (Bui, 2022).

In accounting, financial statements provide accounting information that needs to be truthful and appropriate. The truthfulness of accounting information reflected that accounting information is complete, neutral, and free from material misstatement (Jonas & Blanchet, 2000; Kieso et al., 2014). The lack of truthfulness refers to several accounting terms such as misleading, errors, false,

and fraud in financial reporting that are part of earnings management or accounting manipulation (Siddiqui & Ahmed, 2020). Material errors and fraud cause less truthfulness in financial reporting, which is detrimental to the decisions of information users. Some previous researchers, such as Qiu et al. (2019), Badertscher and Burks (2011), and Zhang et al. (2018) argue that companies do a restatement of financial reportings to adjust the accounting information that results in a variance in pre-audit and post-audit profit. Thereby, the restatement of financial reporting reveals less truthful information for decision-making.

The adjustment and restatement of financial statements involve the intervention of corporate governance, including the Board of Directors (BOD), because firm managers are responsible for preparing financial statements (Dechow et al., 2010). The truthfulness of financial statements depends on the BOD because they manage and control the financial reporting process (Norwani et al., 2014). Due to various reasons, such as pressure, opportunity, and attitude (Cressey, 1953; Irwandi et al., 2019), managers tend to disclose financial statements dishonestly for their purposes. The misconducted financial statements cause market value losses and reputational losses (Amiram et al., 2018) that affect the effectiveness of capital markets. There are diverse factors impacting the truthfulness of the financial statement; however, the effect of BOD characteristics has received much attention in recent decades. Several studies show that good corporate governance will lead to high-quality financial statements (Cohen et al., 2004; Watts & Zimmerman, 1986). However, there is an inconsistency in findings and a difference in the characteristics of BOD in previous studies, such as turnover, overconfidence, and gender (Habib & Hossain, 2013), CEO age (Huang et al., 2012)

A lot of studies examine the effect of the board's characteristics on the truthfulness of financial statements; however, few studies focus on developing countries like Vietnam. The diverse methods in previous studies in many contexts show inconsistent findings. This study examines the influence of the BOD characteristics on the truthfulness of a financial statement in Vietnam, a developing country, using the FGLS method. The findings aim to reinforce the effect of BOD characteristics on the truthfulness of financial reporting as a governance and control factor (Dechow et al., 2010). The study also proposes some recommendations to enhance the truthfulness of financial statements in Vietnamese-listed companies. The structure in the next parts includes the literature review, methodology, results and discussion, and conclusion.

2. Literature review

2.1. The truthfulness of financial reporting

Financial statements are the product as an output of the accounting information system, reflecting in a strict structure the financial position and financial results of the firms (Kieso et al., 2014). Financial statement information must be helpful for decision-making to respond to changes in the business environment (Healy & Wahlen, 1999). The quality of accounting information can be measured by completeness, neutrality, and free from material error (Beasley, 1996; Dechow et al., 1996; Willekens,). The studies related to the truthfulness of accounting information are, therefore, indirectly carried out in two directions. One is that accounting information is considered truthful when no earnings management exists. The other is that the financial statements are free of material misstatements (Botosan, 2004). According to Zack (2012), financial statement error/fraud is a misstatement of the financial position of a business that is accomplished through misrepresentation of the amount or disclosure of information in the financial statements. The truthfulness of financial reporting is highly appreciated when the company has no errors in its financial statements. In Vietnam, the Vietnamese Standard on Auditing No. 320 (VSA 320) states that fraud/error in preparing financial reporting information is considered material if the lack of such information or its accuracy will affect the economic decisions of users (The Ministry of Finance, 2012). Material misstatement, therefore, is understood to be not truthful financial statements.

Some researchers identify material misstatements based on the restatement of financial statements (Badertscher & Burks, 2011; Qiu et al., 2019). The Vietnam Association of Certified Public Accountants (VACPA) introduced a guidebook of (IAASB, 2022) for Vietnamese auditors that argue errors and fraud in financial statements are determined by the difference in profit before and after the audit work whether profit is adjusted up or down.

$$\text{Profit variance ratio} = \frac{\text{Profit after the audit} - \text{profit before the audit}}{\text{Profit before the audit}} \quad (1)$$

Kinney and Martin (1994) and VACPA guidelines suggest that if the profit variance ratio is less than 5%, it is considered not material; more than 5% is considered material. Thus, some studies use a rate of 5% in the profit variance as a threshold of fraud in financial reporting (Kinney & Martin, 1994; Nguyen et al., 2018), while others use a threshold of 10% in the profit variance (Tran et al., 2021). This study uses material misstatement to measure the truthfulness of accounting information in a negative relationship.

2.2. Board of directors and its effect on the truthfulness of financial reporting

According to agency theory, the BOD represents shareholders to supervise the activities in the firms, playing an important role in controlling the agency issue (García-Sánchez et al., 2015). Dechow et al. (2010) summarize six financial reporting quality group factors, and the BOD characteristics are classified into governance and control groups.

Governance and internal controls include bonding mechanisms, optimally elected by the agent at some cost, and monitoring mechanisms, optimally selected by the principal in the principal-agent relationship (Jensen & Meckling, 1976). And BOD in a company is established to monitor managers on behalf of their investors (Eisenhardt, 1989); thus, diverse characteristics of BOD are revealed in previous studies, such as CEO/CFO turnover, age, gender, tenure, qualification, BOD size, the meeting of BOD, and so on. Xie et al. () and Fathi (2013) illustrate that a large BOD will effectively promote the supervisory function with overarching control, gathering many opinions and experiences of managers. On the contrary, some researchers argue that the larger the board, the less effective the supervision (Jensen, 1993). Thus, the BOD size influences the truthfulness of financial statements. Based on the literature review, we develop a hypothesis:

H₁: The larger the board size, the lower the truthfulness of the financial statement.

Agency theory argues that independent members have an important role in ensuring the supervisory function of the financial reporting process. Independent members are highly appreciated for their objectivity, so in managing and monitoring operating activities, they maintain a neutral position and are not bound by their relationship with the BOD. The board with more independent directors tends to monitor and is thus expected to focus on better earnings quality (Alves, 2014). The independence of the BOD has a positive effect on the truthfulness of accounting information (Alves, 2014; Holtz & Sarlo Neto, 2014; Roden et al., 2016). Based on the literature review, we develop a hypothesis:

H₂: The more independent members in the BOD, the higher the truthfulness of its financial statement.

Loebbecke et al. (1989) and Roden et al. (2016) conclude that firms with a Chairman of the BOD concurrently holding the CEO position will have low integrity of financial statements. The same person holds supervisory and executive functions, weakening the BOD's role. This centralization issue raises concerns about the abuse of power for personal gain and the concealment of information by the adjusting entries of part-time individuals. Based on the literature review above, we develop a hypothesis:

H₃: A firm with the duality of the CEO and Chairman of the BOD will have lower truthfulness of its financial statement.

According to Gulzar and Zongjun (2011) and Alzoubi (2019), the BOD holding many meetings will improve the ability to monitor profit management. Depending on the size and characteristics of each business, the more meetings, the more the Board members have the opportunity to collect information and discuss as well as make decisive decisions. Many other studies supported this positive relationship, such as Yang et al. (2008) and Abbadi et al. (2016). But some studies have opinions in contrast with the results by Gulzar and Zongjun (2011) and Alves (2012) because the frequency of BOD meetings can be abnormally negatively associated with the quality of financial reporting (Qinghua et al., 2007). In this study, we postulate the following hypothesis:

H₄: The more board meetings the company has, the higher the truthfulness of the financial reporting.

The board's expertise characteristics are crucial factors influencing the financial reporting process. By having qualifications in accounting and finance, BOD members are expected to detect earnings manipulation behavior, thereby helping to generate quality accounting information (Qinghua et al., 2007). The studies by (Qinghua et al., 2007), Skousen and Wright (2006), and Abbadi et al. (2016) indicate the positive effect of BOD expertise on the quality of financial information. Thus, we also postulate a hypothesis:

H₅: The higher the percentage of BOD members majoring in accounting and finance, the higher the truthfulness of the financial reporting.

The diversity in the gender of BOD is an exciting matter. Female board members are related to better organizational outcomes; they enhance BOD decisions and facilitate tough board decisions deemed unpalatable by all-male board members. According to Gul et al. (2013), the moral justice case, arguing that it is the right thing to do, and the business case, arguing that it increases shareholder value, are the two reasons for the inclusion of females in the board. Studies on the influence of BOD gender on the process of financial statements have shown that female BOD members' participation positively affects the quality of financial statements (Kyaw et al., 2015; Thiruvadi & Huang, 2011). The characteristics of gender, as females tend to avoid risks, and accounting information deviation is considered a risk to the monitoring system (Habib & Hossain, 2013). We develop a hypothesis, as below:

H₆: The higher the percentage of female BOD members, the higher the truthfulness of the financial reporting.

Besides the characteristic of BOD, ownership structure, as a control variable also are considered in this study. Chen et al. (2006) argue that ownership characteristics appear less critical in explaining fraud; however, legal entity stockholders, such as parent SOEs, are positively related to fraud. Firms with foreign investors are less likely to face enforcement actions, so foreign investors monitor to help the firms they invest in deter fraud.

H₇: The higher the percentage of State ownership, the lower the truthfulness of the financial reporting.

Table 1. Variables in the research model

Variables name		Variable	Measurement
The truthfulness of financial reporting	FI	Dependent variable	Variance of profit before and after the audit work
BOD size	BD_SIZE	Independent variables	The number of members of the BOD
Board independence	BD_IND		The number of major shareholders in the BOD
Duality	BD_DUAL		BD_DUAL = 1 if the chairman and CEO are the same people; otherwise, 0.
BOD meeting	BD_MEET		The number of BOD meetings in a year
BOD expertise	BD_PRO		Percentage of BOD members majoring in finance and accounting
BOD gender	BD_GEN		Percentage of female members in the BOD
Ownership structure	OWN	Control variable	Percentage of capital owned by the State

3. Methodology

Based on a review of the literature and hypotheses development, the research model is proposed as below.

$$FI_{i,t} = \beta_0 + \beta_1 BD_SIZE_{i,t} + \beta_2 BD_IND_{i,t} + \beta_3 BD_DUAL_{i,t} + \beta_4 BD_MEET_{i,t} + \beta_5 BD_PRO_{i,t} + \beta_6 BD_GEN_{i,t} + \alpha_5 OWN_{i,t} + \varepsilon_{i,t}$$

The variables measurement is presented in Table 1.

The dataset was collected from the financial statements of listed companies on the Vietnamese Stock Exchange from 2008–2020, excluding financial firms (Vietnam issue separate regulations for financial firms). The financial data, including the pre-audit and post-audit data, was provided by Fiin Group (<https://fiingroup.vn/>), and non-financial data, such as corporate governance, was collected from Vietstock and the corporate website. After processing data quality, the unbalance panel sample consists of 8,082 observations of 747 listed companies. The research employed Stata 14.2 software to perform analysis. The analysis included descriptive statistics, correlation and multicollinearity tests, and hypotheses tests with FEM, REM, and general least squares (FGLS).

Table 2. Descriptive statistics of variables

Variable	Obs	Mean	Std. Dev.	Min	Max
FI	7,043	133.2186	7005.887	−195,636.4	511,199
BD_SIZE	8,082	5.304751	1.588007	0	18
BD_IND	3,165	.309434	.4304657	0	1.609438
BD_DUAL	8,082	.2139322	.4101049	0	1
BD_MEET	7,888	2.051182	.676779	0	4.356709
BD_PRO	7,888	.1205821	.1679738	0	1
BD_GEN	7,888	.1652308	.1814422	0	1
OWN	8,082	.2018708	.2451944	0	.97

4. Results and discussion

4.1. Examining the research model

Statistical data on the factors in the research model are as Table 2:

The correlation between variables is shown in Table 3. This table shows that the correlation coefficient between the independent variables in the model has no pair greater than 0.5. Therefore, there is little possibility of multicollinearity among the independent variables in the model.

The study examines the multicollinearity of variables in the research model based on the acceptable threshold of the variable (Tolerance) and the VIF coefficient. The results of the regression analysis show that the variance exaggeration factor VIF is less than 2, so it is possible to reject the hypothesis that the model has multicollinearity (Table 4).

The study tests to choose an appropriate regression model between OLS and FEM by employing the F test and the Hausman test before analyzing factors affecting the truthfulness of financial reporting. As a result, the FEM model was selected for further tests. The results are shown in Table 5.

After selecting the REM Model, the authors examined the model's defects, including series correlation by the Wooldridge test and verification of variance by the Wald test. The test results are summarized and presented in Table 6.

The selected REM model appears to have defects of the research model, such as the variance of the error change and series correlation. Thus, the study uses the feasible general least squares method—(FGLS) to solve the above defects to ensure the obtained estimate is stable and efficient.

4.2. Testing hypotheses

The research team performed feasible generalized least squares (FGLS) for the overall model, with the results shown in Table 7.

As can be seen in Table 7, at a 90% confidence level, there are four factors affecting the truthfulness of financial reporting, including board independence, the duality in the BOD, BOD meetings, and BOD expertise. The hypotheses H_2 , H_3 , H_4 , and H_5 are accepted, while hypotheses H_1 , H_6 , and H_7 are rejected. The results of the testing hypotheses are summarized in Table 8.

The acceptance of hypothesis H_2 indicates the effect of board independence on the financial reporting process. Board independence (BD_IND) positively influences the difference between post-audit and pre-audit profit information (Coef. = 257.0061, sig. = 0.019). The finding reinforces the influence of board independence on the truthfulness of financial reporting that previous researchers, such as Alves (2014) and Holtz and Sarlo Neto (2014), are shown. The existence of independent members in the BOD, such as a board with more independent directors, tends to increase the controls and focus on better earnings quality (Alves, 2014). Thus, the more independent members in the BOD, the higher the truthfulness of its financial reporting of listed companies.

Hypothesis H_3 (Coef. = -142.9774, sig. = 0.056) demonstrates the negative effect of duality in the BOD, where the chairman and CEO are the same people. The same person holding both two positions weakens the BOD's functions. The duality causes a power centralization issue that raises concerns about the abuse of power. This study concludes that listed companies with a Chairman concurrently holding the CEO position of the BOD will have low truthfulness of financial statements. This finding is consistent with previous studies by Loebbecke et al. (1989) and Roden et al. (2016).

Table 3. Correlation coefficient matrix

	FI	BD_SIZE	BD_IND	BD_DUAL	BD_MEET	BD_PRO	BD_GEN	OWN
FI	1.0000							
BD_SIZE	-0.0146	1.000						
BD_IND	0.0461	0.0458	1.0000					
BD_DUAL	-0.0139	-0.0742	0.0464	1.0000				
BD_MEET	-0.0657	0.1409	-0.0484	-0.1160	1.0000			
BD_PRO	-0.0311	-0.2074	-0.0479	0.0159	0.1187	1.0000		
BD_GEN	-0.0147	0.0214	-0.0728	-0.0306	0.0880	0.0261	1.0000	
OWN	-0.0082	-0.0579	-0.0467	-0.1423	-0.1745	0.0209	-0.0595	1.0000

Table 4. Multicollinearity test result

Variable	VIF	1/VIF
BD_MEET	1.11	0.903603
BD_SIZE	1.09	0.920924
BD_PRO	1.08	0.927814
OWN	1.07	0.934388
BD_DUAL	1.05	0.952913
BD_IND	1.02	0.980608
BD_GEN	1.02	0.983750
Mean VIF	1.06	

Table 5. F test and Hausman test results

Overall model	Inspection results	Conclusion
Step 1: Comparison between OLS and FEM	F test that all $u_i = 0$: $F(289, 2467) = 0.81$ Prob > $F = 0.9878 > 0.05$	OLS model selection
Step 2: Comparison between OLS and REM	$\text{Chibar2}(01) = 2.56$ Prob > $\text{chibar2} = 0.003$	REM model selection

Table 6. Results of testing the autocorrelation and variance of variance

Overall model	Inspection results	Conclusion
Verification of variance	$\text{chibar2}(01) = 2.56$ Prob > $\text{chibar2} = 0.003 < 0.05$	There is a phenomenon that the variance of the error changes
Test for the phenomenon of series correlation	$F(1, 268) = 6.580$ Prob > $F = 0.0109 < 0.05$	There is a phenomenon of series correlation

The acceptance of hypothesis H_4 reinforces the agency theory that dynamic BOD with many regular meetings can collect recommendations and opinions from members to supervise operating activities better. The frequency of BOD meetings (BD_MEET) has a negative effect on profit variance between the post-audit and pre-audit profit on the financial statements (coef. = -228.1713, sig. = 0.001). Many studies state that BOD holding many meetings will enhance the ability to monitor profit management, which results in the truthfulness of financial reporting (Abbadi et al., 2016; Yang et al., 2008). This research agrees with the finding by Qinghua et al. (2007) but is in contrast with the results by Gulzar and Zongjun (2011) and Alves (2012). As a result, the more BOD meetings in a year, the lower the profit difference between post-audit and pre-audit, which means the higher the truthfulness of the financial reporting.

The acceptance of hypothesis H_5 reveals a positive effect of BOD expertise (BD_PRO) on the truthfulness of accounting reports (coef. = 434.1258, sig. = 0.014). The board members majoring in accounting and finance positively influence the difference between post-audit and pre-audit profit on financial statements. This finding agrees with the result of Qinghua et al. (2007), Skousen and Wright (2006), and Abbadi et al. (2016). Accordingly, the higher the percentage of BOD members with expertise in finance and accounting, the lower the profit difference between the post-audit and the pre-audit, implying that the information in the financial statements is more accurate. With an average BOD size of 5 people, the mean of BD_PRO in Vietnamese listed companies is 0.1205821, and around 12,5% of total BOD members qualify for accounting and finance. Many firms have all BOD members without accounting and finance expertise, such as firms with stock

Table 7. FGLS model results

FI	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
+						
BD_SIZE	-27.75673	33.0744	-0.84	0.401	- 92.5814	37.0679
BD_IND	257.0061	109.6895	2.34	0.019	42.0186	471.9937
BD_DUAL	-142.9774	100.7112	-1.92	0.056	-340.3677	54.4130
BD_MEET	-228.1713	70.7271	-3.23	0.001	-366.7938	-89.5487
BD_PRO	434.1258	304.6741	2.42	0.014	103.2762	163.0244
BD_GEN	-89.64205	250.3942	-0.36	0.720	-580.4057	401.1216
OWN	-305.9285	82.229	-1.12	0.262	-840.6612	228.7845
_cons	795.9857	240.8633	3.30	0.001	323.9022	1268.0691

(*, **, *** have statistical significance at 10%, 5%, 1%)

Table 8. The impact direction of factors

No.	Variables	Expected	Results
1.	Size of BOD	+	Not meaningful
2.	Board independence	+	+
3.	Duality	-	-
4.	Frequency of BOD meetings	+	+
5.	BOD expertise	+	+
6.	Gender of the BOD	+	Not meaningful
7.	Ownership structure	-	Not meaningful

code ACC, ACL, AMD, ASM, BTP, and so on. To enhance the truthfulness of financial reporting, firms need to focus on recruiting BOD members expertising in accounting and finance, and allocate budget for financial training.

The results reject hypotheses H₁, H₆, and H₇. Three factors, the size of the board (BOD_SIZE), the gender of the BOD (BOD_GEN), and the ownership structure, do not have a statistically significant effect on the truthfulness of financial reporting.

5. Conclusion and policy implication

BOD's characteristics are a factor in a group of corporate governance factors that are considered a compelling drive to improve the quality of accounting information and increase the truthfulness of financial reporting. This study investigates an aspect of corporate governance through an analysis of the influence of BOD characteristics on the truthfulness of financial statements. Panel data from 747 listed firms from 2008 to 2020 show that four traits of the BOD (independence, meeting frequency, duality, and expertise) influence the truthfulness of financial statements in Vietnam. This study provides implications to policy-makers interested in improving the governance function to raise the truthfulness and credibility of financial reporting. The findings inform regulators that designing governance structures disregarding the characteristics of the CEO/CFO may not reach desired benefits. Based on the results, the study has proposed recommendations to activate the BOD's performance that aims to improve the truthfulness of financial statements.

The first recommendation is strengthening the independence and reducing the duality of the BOD members. With a positive relationship between independent members and the truthfulness of financial reporting, listed companies should increase the proportion of independent members,

which ensures the regulation of independence according to Enterprise Law. As a supervisor, independent members are expected to make less biased, limit conflicts of interest, protect minority shareholders, and implement advisory functions. The presence of independent members is also considered evidence of the publicity and transparency of listed firms. However, the current regulations are universal, so firms need to develop specific policies for the reality of their segments. Moreover, reducing the duality of the BOD members may make fewer centralization issues and abuse of power for personal gain.

The second recommendation is to increase the number of BOD members majoring in accounting and finance. Board members with accounting and finance experts are highly appreciated in performing the supervisory function because of their professional experience. So the firms need to pay more attention to the selection of members of the BOD towards individuals with expertise in finance and accounting and working seniority. However, this attention should be balanced with the ratio of independent members, so at least one member with experience and expertise in financial accounting is required.

The last suggestion focus on determining the frequency of the BOD meetings. There should be a clear assignment of tasks for the members of the BOD, in which there must be an independent member responsible for supervising the preparation and information disclosure. Independent members of the BOD must hold regular meetings without the participation of managers or BOD executive members to enhance communication and information among independent members of the BOD. It is necessary to appoint a senior independent BOD member to lead the group of independent BOD members to strengthen their supervisory ability. To overcome the above problems, independent BOD members must meet at least quarterly, four times a year.

Funding

The authors received no direct funding for this research.

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Disclosure statement

No potential conflict of interest was reported by the author(s).

Citation information

Cite this article as: Impact of characteristics of the board of directors on the truthfulness of financial statement information of listed firms in Vietnam, Hong Thi Xuan Nguyen, Huyen Thu Pham, Nhung Thi Dao & Nga Thi Nguyen, *Cogent Business & Management* (2022), 9: 2148870.

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