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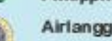 De La Salle University, Manila, Philippines

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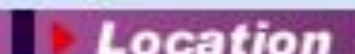

THE INFLUENCE OF CORPORATE GOVERNANCE TOWARD FINANCIAL RISK DISCLOSURE

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ABSTRACT

This study aims to know and analyze whether the board of comissioners, the number of meeting by commissioners, the composition of the independent comissioners and Audit committees, the number of Audit committee meetings and institutional ownership have a positive influence on the level of financial risks disclosure or not. In this study, the financial risk disclosures is Measured by a Wallace index. Population used is banking companies listed in the Indonesian Stock Exchange from 2009 to 2011. The sample selection uses purposive sampling method. It is obtained 72 data met the criteria. Then, the Data Analysis Technique uses multiple linear regression. The result of the study shows the board of comissioners, the number of meeting by commissioners, the composition of the independent comissioners and Audit committees, the number of Audit committee meetings and institutional ownership have a positive influence on the level of financial risks disclosure. Meanwhile, the board size has no significant influence on the financial risk disclosure. Therefore, Simultaneously, the board size, the number of board meetings, the proportion of independent Commissioners, the proportion of the independent audit committee members, the number of audit committee meetings, and institutional ownership have a significant influence on the financial risk disclosure.

Keywords:* *the board of comissioners, the number of meeting by commissioners, the composition of the independent comissioners and Audit committees, the number of Audit committee meetings and institutional ownership and financial risks disclosure.

A. INTRODUCTION

A company is established by the main goal to obtain maximum profits with minimum expenses. In Fact, an investor is faced into the fact that *" a high risk bring about high return"* which means if we want to get good results, we will face high risks as well. Thus, a company is expected to be able to reduce financial risks and provide solutions to minimize it as low as possible. Financial risks are associated with financial instruments involving interest and exchange rates; *commodity* and *financial instrument price;* market price index and the level of credit that will happen in the future. While

the disclosure of financial risks is associated with the disclosure of the existing risk such as management and policy risk related to the financial risk. According to Djoko Suhardjanto and Dewi (2010), financial risks is classified by PBI No: 5/8/PBI/2003, PSAK 50 (revised in 2006), P3LKEPPBANK (2008) and IFRS 7 (2008). A risk occurs because of the uncertainty, so it can be detrimental. If a risk is not managed properly, there will be a loss that could destroy the company. Therefore, for every company, it is required to have a *good corporate governance* system. This study aims to analyze the influence of corporate governance toward financial risks disclosure by the reference of the journal by Djoko Suhardjanto and Dewi (2010). *Corporate governance* is proxified by the commissioners, the number of commissioners, the composition of the independent comissioners, Audit committees, and the number of meeting by Audit committees.

Currently, *corporate governance* is worth to be studied because of the happening of fraud and downturn in business caused by the fault of the management boards in managing the company. In addition,The crisis is caused by a weak *corporate governance* implemented by companies, especially companies in Indonesia. The Independent Audit committees have positive influence on the level of financial risk disclosure (Ho and Wong, 2001). In addition, according to Li, *et al.* (2008) and Ettredge, *et al.* (2010), the number of meeting by Audit committee positively influences the level of financial risk disclosure. Due to the different findings of previous studies, so, it is necessary to re-examine about the influence *of corporate governance* toward the level of corporate financial risk disclosure. In this study, researchers add the institutional ownership variables on the independent variables by the expectation that it can influence the level of financial risk disclosure. Moreover, the additional reason to add more variable is the institutional ownership will affect the company's board of management in leading the company as the institutional ownership has a significant role in the company. Then, the formulation of the problem in this study is whether the board of comissioners, the number of meeting by commissioners, the composition of the independent comissioners and Audit committees, the number of Audit committee meetings and institutional ownership have a positive influence on the level of financial risks disclosure or not. The purpose of this study is to determine and analyze the influence of the board of comissioners, the number of meeting by commissioners, the composition of the independent comissioners and Audit committees, the number of Audit committee meetings and institutional ownership toward the level of financial risks disclosure.

B. THEORETICAL FRAMEWORK AND HYPHOTESIS DEVELOPMENT

The Correlation of BOC Size and Financial Risk Disclosure

Every company has a different number board of commissioners. According to Syakhroza (2004), the size of board of comissioners influence the quality of decisions and policies made to streamline the goals achievement of a company. A larger size board of comissioners will be able to provide better opportunities and be involved in coordinating committee established by the board of commissioners which is aimed to reveal the company's financial risk, so the hypothesis proposed is as the following:

H1: *The size of the board of commissioners positively influence financial risk disclosure*

The Correlation of the Number BOC Meeting and Financial Risk Disclosure

The board of Commissioners *meeting* is a meeting that is able to boost the effectiveness of the company. The BOC *Meeting* will raise the communication between the board of directors and the internal control function, so that the boards can be more effective in carrying out their duties. According to Raghunandan, Rama, Yatim (2009) in Setyarini (2011), The frequent number of meetings by the board of commissioners will make the boards much more effective to carry out their duties and functions, so that the implementation of *good corporate governance* can be realized. The more frequent *meetings* held by commissioners will enhance the company's financial risk disclosures. The correlation of the Number BOC Meeting and Financial Risk Disclosure in agency theory is proven by the convening of the board of commissioners meetings with members of the company. Thus, it will lessen the financial risks disclosure of the company.

H2: *The number of BOC meetings positively influence sfinancial risk disclosure.*

The Correlation of the Independent Commissioners and Financial Risk Disclosure

The Independent commissioner is an important component in the disclosure because it serves as a watchdog behavior of management firms. According to Pembayun and Indira (2012), the independent commissioner is representative of the *shareholder,* they do not have an affiliate relationship as an employee within the company but they have a high demand of quality control for the company to implement *good corporate governance.* The independent commissioner, in the agency and signal theory, is not affected by the management of the company. Yet, they encourage companies to make disclosures to the broader *stakeholder.* The wider proportion of independent comissioners will make a manager of the company to be more effective in monitoring the company's disclosure.

H3: *The composition of independent commissioners positively influences financial risk disclosures.*

The Correlations of Independent Audit Committee and Financial Risk Disclosure

The Audit committee is a committee formed by the purpose of monitoring and managing the company. By the presence of independent Audit committee within the company, it is expected to reduce the company's losses and encourage investor confidence toward the company's financial risk disclosures. The composition of the Independent Audit committee in agency theory is the member of supervisors which link the owner of the company as *principals* and management of the company *as agents* and minimize information *asymmetry.* Furthermore, the Audit committees also have the task related to company's internal control system. The composition of the independent Audit committee positively influences the level of risk disclosure associated with companies' financial status (Nasution and Setiawan (2007), Li, *et al.* (2008), and Cety & Suhardjanto (2010). Based on the description, the hypothesis is formulated as follows:

H4: *The independent Audit Committee positively influences financial risk disclosure.*

The Correlation of the Number of Audit Committee Meetings and Financial Risk Disclosure

The Audit committee is a committee tasked to oversee the company's performance, so it is necessary to conduct supervision or regular meetings within the company. By the high frequent meetings, the monitoring and supervision will be more effective and also decrease the problems occur in decisions making related to companies' financial risk disclosure. Based on the findings by Rahmat *et. al* (2008), Anggraini (2010), and Khairunnisa (2010), it concludes that there is no significant

correlation of the number of meetings by the audit committee of the company's and financial risk disclosures. However, it differs with the finding by Wulandari (2010), she evokes that the audit committee meeting frequency positively influence the company's financial risk disclosures. This occurs when more frequent meetings held by the audit committee is expected to lessen the financial risk of a company, so that the company will be more frequent to disclose financial risk of the company to investors. Based on the description, the hypotheses is formulated as the following:

H5: *The number of meetings of the audit committee has a positive influence on the level of financial risks disclosure.*

The Correlations of the Institutional Ownership and Financial Risk Disclosure

Institutional ownership is ownership of company shares by institutional investors outside of the company. In agency theory, institutional ownership influence the company's financial risk disclosures, it is revealed by the *principals,* in this case is the institutional ownership, who is trying to influence the management (as agency) in managing the internal desires of the company because it has a quite big shares. The study by Bushee *et. al.* (2003), Bouri & Khlifi (2007), Matoussi and Chakroun (2008) in Primastuti and Ahmad (2012) finds that institutional ownership negatively influences the company's voluntary disclosure. Meanwhile, according to Rouf and Al Harun (2011), and Kumala Dewi (2008) in Purwandari (2012), it proves that institutional ownership has a positive influence on the level of corporate financial risk disclosure. Thus, the hypothesis can be formulated as follows:

H6: *Institutional Ownership has a positive influence on the level of financial risk disclosure.*

In addition to using dependent and independent variables, this study is also controlled by *leverage* and *profitability* variables.

C. RESEARCH DESIGN

Independent Variables **Dependent Variables**

The Size of Board of Comissioners
The number of comissioners meeting
The composition of independent comissioners
The composition of audit independent committee
The number of audit committees
The Institutional ownership

Financial Risk Disclosure

Control Variables
- Leverage
- Profitability

Figure 1

D. RESEARCH METHODS

Independent Variables

In this study the independent variable is the financial risks disclosure. Based on the study by Sanchez, Dominguez, and Alvarez (2010) in Primastuti and Ahmad (2012), the financial risk disclosure is measured by using *Wallace* index by comparing the number of answered questions with the number of all possible answered questions. In a financial statement disclosure, the disclosed items are scored by 1 and the undisclosed items in the financial statements are scored by 0. The Measurement of financial risk disclosure is done by summing the scores in every financial statement disclosures. To calculate the level of financial risk disclosure quantity in this study uses the following equation:

$$Financial_Inf = \frac{\text{Number of disclosure items disclosed by the Company}}{\text{The expected number of items disclosed by the company}}$$

Dependent Variable

The size of the Board of Commissioners

The size of the Board of Commissioners is the total number of board members owned by the company (Dalton, 1999; Nasution and Setiawan, 2007; and Abeysekera, 2008) in Suhardjanto & Afni 2009). The size of the Board of Commissioners can be calculated by as follows:

The size of the Board of Commissioners = total number of the board of commissioners

The Number of Meetings of the Board of Commissioners

The number of commissioners meeting is the number of meetings held by the board of commissioners within a year (According to Brick & Chidambaram, 2007; Ettredge, *et al.,* 2010; and Sutaryo, *et al.* 2010). According Primastuti and Ahmad (2012), the number of meetings of the board of commissioners can be calculated as follows:

The number of meetings *of the board of commissioners = total meetings held by commissioners for a year*

The Composition of the Independent Commissioners

The composition of the independent commisioners is the percentage of the independent board of comissioner members with total number of corporate board of comissioner members (Primastuti and Ahmad (2012). According to Primastuti and Ahmad (2012), the composition of the independent comissioners can be calculated by using the following formula:

$$\text{The composition of independent commissioners} = \frac{\text{the number of independent comissioners}}{\text{Total number of the board of commissioners}}$$

The Composition of the Independent Audit Committee

The composition of the Independent audit committee is the percentage of the independent audit committee members with the total audit committee within the company (Pembayun and Januarti, 2012). Therefore, According to Pembayun and Januarti (2012), the formula used to calculate the composition of the independent audit committee is as follows:

$$\text{The Composition of the Independent audit committee} = \frac{\text{The Number of the independent audit committee}}{\text{Total members of the audit committee}}$$

The Number of the Audit Committee Meetings

The number of audit committee meetings is related to how many meetings held by the audit committee in a year (Ettredge, *et al.,* 2010). In accordance with the number of commissioners meetings, the frequency of meetings should be clearly structured and known by the Committee. Based on the study by Pembayun and Januarti (2012), the formula used to calculate the number of audit committee meetings is:

The number of meetings of the audit committee = total number of meeting held by audits committee in a year

Institutional Ownership

Institutional ownership is the percentage of shares owned by a financial institution such as insurances, banks, and other institutional ownership (Purwandari and Purwanto 2012). Based on the study by Dewi (2008) in Purwandari and Purwanto (2012), the formula to find out institutional ownership is calculated by the following way:

Institutional ownership = Total shares of institution

Control Variables

This study uses *leverage* and profitability as its control variable by the purpose to control the variables of financial risk disclosure.

Leverage

Leverage is the ratio used to calculate the company's ability to repay its debts, either short or long term debt. The higher the *leverage of* the company shows the higher risk in the payment of debt causing more complexities in revealing the financial statements. In the opinion of Purwandari & Purwanto (2012), *leverage* is calculated in the following way:

$$Leverage = \frac{Total\ debt}{Total\ equity}$$

Profitability

Another control variable used in this study is profitability. Profitability is the company's performance appraisal used to determine the company's profit. Profitability variable is measured by using *return on assets* (ROA), the indicator proposed refers to the study by Arum Purwandari and Purwanto (2011). While, the formula used to calculate ROA is as follows:

$$ROA = \frac{Income\ after\ Tax}{Total\ Assets}$$

Population and Sample

The population of this study is the banking companies listed and *go public* in the Indonesian Stock Exchange by the period of 2009 to 2011. This study uses *purposive sampling technique* with the following criteria: the *go pulic* banking companies, having published their *annual reports* on the Indonesian Stock Exchange and gaining positive earnings by the period of 2009 – 2011; and banking companies disclosing complete information related to the variables proposed in this study.

The data used in this study is a secondary data in the form of quantitaive measured by using *a numerical scale* which is derived from the annual reports of banking companies during the period of 2009 -2011 from *the website* of the Indonesian Stock Exchange (www.idx.co.id). In addition, The data used in this study is secondary data in the form of annual reports of the *go public* companies on the Indonesian Stock

Exchange (www.idx.co.id)by the period of 2009 to 2011. The analysis techniques used include statistical analysis, the classical assumption, multiple regression equation models and hypothesis testing.

E. FINDINGS AND DISCUSSION

Research Description

By using purposive sampling technique, it is obtained the sample of 24 companies as explained in table 1 below.

Table 1
Sampling Criteria

No.	Description	Amount
1.	Banking companies listed on the Indonesian Stock Exchange in the range of 2009-2011	31 companies
2.	Companies that do not have complete data for the study	7 companies

Descriptive Statistics

In this descriptive statistics, the average number of commissioners in this study is 5.40. It means that the average number of commissioners in this study consists of 5 people. Moreover, the smallest number of commissioners in this study is 2 people, while the biggest is 9 people.

The number of the board of commissioners meeting in the study shows that the average of commissioners meeting is 12.47, which means that in a month the commissioners conduct regular meetings. The minimum percentage of the number of meetings by the board of commissioners obtained in this study is 3, while the maximum percentage is 47.

The average composition of the independent commissioners is 0.523771. It means that, the number of the composition of the independent board is 52.37 percent of the commissioners owned by the company. Briefly, the lowest score of the independent board is 28.57 percent, while the highest is 100 percent.

The average composition of the independent audit committee is 0.5956. Thus, the average composition of the independent audit is 59.56 percent. The minimum variable of the independent audit committee composition is 33.33 percent, while the maximum of it is 100 percent.

The average number of the audit committee meetings is 10.39, so it can be assumed that the company's audit committee conducts regular meetings as much as 10 times in one year. The minimum of the audit committee meetings is 3 times, while the maximum of it is 37 times.

The average number of Institutional ownership variable is 72.84 percent. This shows that the average number of institutional ownership measured by the percentage of shares owned by institutions is compared to the total number of outstanding shares in the banking company studied during the period 2009-2011 as 72.84 percent. The lowest percentage of the institutional ownership is 11.36 percent and the highest percentage of institutional ownership is 99.98 percent.

The average of the leverage variables represented by *debt to total equity* is 88.99. This shows that the average *leverage* on banking companies surveyed in the

period 2009-2011 is 88.99 percent. The lowest leverage percentage is 75.16 percent leverage and the highest of it is 95.07 percent.

The average of Profitability variables which are provided by return on assets is 0.012 or 1.20 percent. This shows that the average profitability of the banking company studied at the period 2009 - 2011 is 1.20 percent. The lowest percentage of the profitability is -1.11 percent and the highest profitability is 3.26 percent.

The average of financial risk Disclosure variables is 0.947. So it can be assumed that the disclosure of financial risks in banking companies surveyed in the period 2009-2011 was 94.74 percent. Beside, the lowest percentage of the financial risk disclosures variable is 78.13 percent and the highest of it is 100 percent.

Hypothesis Testing
Table 2
Regression Equation Model

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.919	.055		16.745	.000
	Number of BOC	.000	.004	.034	.253	.801
	Meeting of BOC	.002	.001	.480	3.954	.000
	IC Composition	.119	.046	.285	2.581	.012
	Comp. of AC	.168	.057	.381	2.960	.004
	Meeting of AC	.000	.001	.122	.990	.026
	I.O	.001	.000	.339	2.920	.005
	Leverage	.000	.002	-.038	-.349	.728
	Profitability	-.459	.826	-.072	-.556	.580

FDR = 0,919 + 0,000 BSIZE + 0,002 MBOC + 0,119 IC + 0,168 CofAC + 0,000 MAC + 0,001 I.O + 0,000LEV – 0,459 PRO + e

Hypothesis Testing

The table shows that the significant level of commissioners board variable is 0.801> 0.05, which means that there is no significant influence on the financial risks disclosure. While variable of the number of meetings by the board of commissioners is 0.000, the composition of the independent commissioner is 0.012, the composition of the audit committee is 0.004, the number of audit committee meetings is 0.026 and

institutional ownership is 0.005. Then, the significant value of each variable is less than 0.05, meaning that it has significant positive influence on the financial risks disclosure.

F. DISCUSSION

Analysis on the influence of the independent board of commissioners toward Financial Risk Disclosure

Commissioners' board criterion is the total number of board members of the company. The findings show that board of comissioners has positive influence but not significant on the disclosure of financial risks. It is assumed that a company has no official benchmark of a good number of commissioners because the effectiveness performance cannot be determined by using number of commissioners. This is possible because the presence of many commissioners will likely make it difficult to obtain agreement on supervision. These findings are in line with the research that has been done by Primastuti and Ahmad (2012) which states that the number of commissioners has no significant influence on the wider of strategic disclosure. Yet, the findings of this study are not in line with the study by Suhardjanto and Dewi (2010).

Analysis on the Influence of the Number of Board Commissioners Meetings toward Financial Risk Disclosure.

In this study, the number of meetings of the board of commissioners has significant positive influence on the disclosure of financial risks. It indicates that the more the number of commissioners meeting, the more effective the commissioners in carrying out its duties and functions to enable the creation of good corporate governance will be. The more often the commissioners held a meeting; it can enhance the company's financial risk disclosures. The findings of this study is in line with the study Suhardjanto and Dewi (2010) which suggests a positive correlation of the boards of commissioners meeting and the level of financial risk disclosures. However, this study is not in line with Ratnasari's research (2011) which shows that the number of meetings of the commissioner board is not positively related to the level of voluntary disclosure.

Analysis on the influence of the Independent Commissioner Composition toward Financial Risk Disclosure

The composition of the independent Commissioner is the percentage of the independent board members with a total number of board members in a company. In this study, the composition of the independent commissioner has significant positive influence on the financial risks disclosure, because if the proportion of independent Commissioner is higher, it can make managers more effective in overseeing the company's management and financial risk disclosures made anyway. A high reputation of independent board of Commissioner represents the corporate governance disclosures in the financial risk monitoring Systems of the Company. Associated with Financial risks, the pressures on management will also be massive to express. Thus, it can be said that the composition of the independent board of the company has a positive influence on the disclosure of financial risks within a company. The findings are in line with the study that has been done by Suhardjanto and Dewi (2010) which states that there is a positive correlation between independent board composition and the level of financial risks disclosure.

Analysis on the influence of the Audit Committee toward Financial Risk Disclosure

The composition of the audit committee is the percentage of independent audit committee members with the overall audit committee within a company. In this study, the composition of the audit committee has significant positive influence on the financial risks disclosure because the audit committee is a committee formed by the purpose to monitor and control the management of the company and information related to financial risk disclosure. If the duties and authority of the independent audit committee have worked well, they will help the company in reducing the financial risk of the company. The findings of this study are in line with the research done by Nasution and Setiawan (2007), Cety and Suhardjanto (2010), which prove that the composition of the independent audit committee has significant positive influence on the company's financial risk disclosures.

Analysis on the Influence of the Number of Audit Committee Meeting toward Financial Risk Disclosure

In this study, the number of audit committee meetings has significant positive influence on the disclosure of financial risks, because the presence of audit committee meetings is more frequent, the monitoring and supervision will run more effectively. In addition, the intensity of the meeting also serves to lessen the frequent problems occuring in the financial risk disclosure of the company. As mentioned in agency theory, the more frequent meetings of the audit committee is expected to reduce the occurrence of the financial risk of the company so that the company will do financial risk disclosure to their investors. These findings are in line with the study by Wulandari (2010) which states that the frequency of audit committee meeting has a positive influence on the financial risks disclosure.

Analysis on the Influence of Institutional Ownership toward Financial Risk Disclosure

Institutional ownership is the percentage of shares owned by a financial institution. In this study, there is a significant positive influence of the institutional ownership toward financial risks disclosure; it is because a large number of institutional ownership will make the company more cautious to financial risk disclosure. Furthermore, the company will be more concerned with the institutional interests of financial risks disclosure, so the higher the institutional is, the lower the financial risk disclosures are. In agency theory, institutional ownership has an influence on the company's financial risk disclosures. It is shown by the *principal;* in this case is the institutional ownership, which is trying to persuade the management as an agent to manage the internal interests of the company as a sizeable share. These findings are in line with the study Rouf and Al Harun (2011), which states there is a positive influence of institutional ownership on the disclosure of financial risks.

G. CONCLUSION

Based on the findings, then it can be concluded that the number of commissioners do not have a significant positive influence toward the financial risks disclosure. It is possible because there is no reliable parameter on the sufficient number of the commissioners of company, so that the effectiveness of performance cannot be determined by using the number of the board of commissioners. Meanwhile, the number of meeting by commissioners, the composition of the independent comissioners and Audit committees, the number of Audit committee meetings and institutional ownership have a positive influence on the level of financial risks disclosure. This

condition occurs because institutional ownership has an influence on the company's financial risk disclosure. It is shown by the *principals*, in this case the institutional ownership, is trying to influence the management of the agency in managing the internal interests of the company.

Limitations of this study is the board of comissioners, the number of meeting by commissioners, the composition of the independent comissioners and Audit committees, the number of Audit committee meetings, institutional ownership, leverage and profitability can reveal the financial risks disclosure by 32%. In addition, the sample used in this study is only 24 banking companies. Based on the finding of the study and the limitations of the study, then, the recommendation given is; if the investor want to invest they need to consider information related to the number of board meetings, audit committee, the composition of the board of commissioners, the audit committee and institutional ownership because it significantly influences the financial risk disclosure within the company.

Because of the limitations of the study, then further research may also invlove other corporate governance factors, such as managerial ownership, public ownership, and add the number of samples and time of study, so, perhaps, it may explain the financial risks disclosure better.

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