Corporate Governance and Voluntary Disclosures: A Story about Corporate Transparency from Indonesia

Abstract
This study examines the impacts of corporate governance attributes on Indonesia Stock Exchange (IDX) listed companies' voluntary disclosures. Year-ending 2012 annual report disclosures of 100 IDX listed companies are analyzed using a disclosure index. The results show a low level of voluntary disclosures (25.97%). The highest level of communication is on information regarding companies' strategies and goals. The regression analysis shows that board size is a positive and significant predictor of voluntary disclosure practices. Agency theory thus partially explains the variability of these disclosure practices. The main implication of the findings is that the number of commissioners determines the strength of the board of commissioners in pushing the board of directors to be more transparent.
Key Words: Corporate governance, voluntary disclosures, Indonesia, agency theory

1. Introduction

It is widely known that corporate governance and transparency now become corporations' critical pillars to professionally and sustainably operate. The business history clearly shows that accounting scandals and corporate collapses happened around the globe due to the absence of corporate governance and the lack of transparency. One of the most popular cases is the Enron scandal which also causes the fall of one of the biggest accounting firms in the world, Arthur Andersen. In 2002, Arthur Andersen's license was revoked by U.S. regulators as this accounting firm was involved in the Enron scandal (Radebaugh *et al.*, 2006).

Financial scandals also occurred in Indonesia, an emerging Asian country which is currently struggling with corruptions. One of the examples is the case of PT Bank Lippo Tbk. In 2002, the management of PT Bank Lippo Tbk provided different versions of financial statements to the public and to the management of the Jakarta Stock Exchange (JSX)[1](Sumantyo, 2003). On one side, PT Bank Lippo Tbk reported a 98 billion Rupiah net profit to the public. On the other side, a 1,300 billion Rupiah net loss was reported by the management of PT Bank Lippo Tbk to the management of JSX. This scandal resulted in significant decreases in this company's stock prices

Indonesian companies are expected to implement good corporate governance and increase the level of transparency. In Indonesian Corporate Governance Guideline, it is stated that weak corporate governance practices and lack of transparency had caused the Asian 1997/1998 monetary crisis and frauds (Komite Nasional Kebijakan Governance, 2006). To prevent the presence of such problems, the Indonesian National Committee for Governance Policy urges firms to follow the corporate governance principles written in the guideline. Good corporate governance practices should promote transparency and thus information asymmetry between companies and their stakeholders can be reduced (Radebaugh *et al.*, 2006).

Voluntary disclosure is one of the key aspects within the growing complexity of an emerging market but research on such disclosures in emerging economies is still relatively little (Alfraih and Almutawa, 2017). Indonesia itself is an emerging country whose economy and capital market are growing (The World Bank, 2017). This nation's Gross Domestic Product (GDP) has increased from 857.00 US dollars in 2000 to 3,603.00 US dollars in 2016. As Indonesia is an emerging nation with an impressive economic growth, it is considered

[1] The Jakarta Stock Exchange was finally merged with the Surabaya Stock Exchange in 2007 and the merged stock exchange was named as the Indonesia Stock Exchange (IDX)(IDX, 2014).

important to examine voluntary disclosure practices in this nation, particularly by looking at the possible impacts of corporate governance attributes on those practices.

This study provides several contributions. Firstly, it provides insights into the voluntary disclosure practices in an emerging nation, Indonesia, after the establishment of the Indonesian Financial Service Authority (OJK) in 2011. The main purpose of the establishment of OJK includes monitoring corporate governance practices and transparency (Pemerintah Republik Indonesia, 2011). Secondly, this study captures the effectiveness of corporate governance attributes in increasing transparency in annual reports. Thirdly, this study examines various corporate governance attributes. It is thus expected that this study can provide a comprehensive picture about corporate governance practices in Indonesia.

2. Theoretical framework and hypotheses development

This study uses agency theory as the underlying theoretical framework as voluntary disclosures are arguably able to solve an agency problem. Agency theory explains voluntary disclosure practices in terms of manager (agent) and owner (principal) relationships (Scott, 2015). In these relationships, there is a delegation of authorities from the principle to the agent to undertake operational activities, including using financial resources and making decisions, on behalf of the principal (Jensen and Meckling, 1976). As a consequence of this delegation, the agent provides financial information through financial statements for the principal.

The separation of ownership and management in the agency relationship potentially results in the presence of information asymmetry between shareholders and managers (Scott, 2015). Although ‘standard’ financial statements consisting of statement of financial position, statement of comprehensive income, cash flow statement, statement of changes in equity, and explanatory notes have been published by companies, arguably, the information asymmetry always presents. This is because managers as insiders of the companies’ management have better knowledge regarding the daily management activities and thus they always have the information advantage.

As the ‘standard’ financial statements may not sufficiently inform shareholders about companies’ performance, it is considered important for managers to undertake certain actions so that they can gain trust and continuous investments from shareholders. This is where the role of voluntary disclosure comes into play. Through voluntary disclosures, important information beyond the limited ‘standard’ accounting information can be communicated and thus the information asymmetry problem can be reduced (Scott, 2015). The use of agency theory in this study is reflected in the following hypotheses development.

Companies in Indonesia adopt a two-tier system in which supervision and executive functions are separated (Bezemer *et al.*, 2014). In such a system, the board of commissioners has the authority to supervise and control the board of directors’ actions. The presence of independent commissioners within the board of commissioners is needed so that objective and professional advices can be obtained by the board of directors. Such advices help minimize the presence of agency conflicts. Prior studies show that the greater proportion of independent commissioners within the board results in the higher level of voluntary disclosures (e.g. Al-Janadi *et al.*, 2013). As such, a directional hypothesis is proposed:

H1: There is a positive relationship between independence of board and the level of voluntary disclosures in annual reports

Usually, a greater number of members in the board of commissioners can provide a more effective supervision and monitoring process to the directors (Primastuti and Achmad, 2012).

Such a condition can minimize the presence of agency problems. The board of commissioners is also considered as having more power to push directors to voluntarily provide more information when it has more members in the board. Prior studies have documented a positive association between board size and the level of voluntary disclosures (e.g. Nandi and Ghosh, 2013). The following hypothesis is thus predicted:

H2: There is a positive relationship between board size and the level of voluntary disclosures in annual reports

The presence of managerial ownership can reduce the agency costs (Jensen and Meckling, 1976). This is because, through such an ownership, some managers who have shares within companies are considered as the shareholders of companies and thus they can 'feel' the needs and the expectations of shareholders on companies' activities and information disclosures. Companies with a greater proportion of managerial ownership usually provide more voluntary information. Such a relationship has been documented in some prior studies (e.g. Primastuti and Achmad, 2012). The following hypothesis is therefore proposed:

H3: There is a positive relationship between the proportion of managerial ownership and the level of voluntary disclosures in annual reports

The existence of audit committee is vital as this committee helps ensure that the financial statements are fairly presented in accordance with the generally accepted accounting principles, audits are undertaken in accordance with generally accepted auditing standards, and the management follows up the audit results (Komite Nasional Kebijakan Governance, 2006). To professionally do this function, an audit committee should be dominated by independent members. Li *et al.* (2008) document a positive relationship between independence of audit committee and voluntary disclosure practices. The following hypothesis is therefore proposed:

H4: There is a positive relationship between independence of audit committee and the level of voluntary disclosures in annual reports

3. Research methodology

A sample of 100 companies was randomly selected from a population of 450 companies listed on the Indonesia Stock Exchange (IDX) in 2012 (IDX 2012). Data for all variables were collected from 2012 annual reports. The dependent variable in this study, voluntary disclosures, is measured by a disclosure index. If an item listed in the index checklist is disclosed in the annual report, a score of one is awarded. In contrast, a score of zero is awarded if the item is not disclosed. The disclosure index for each sample company is then calculated by dividing the total score awarded to the company with the maximum number of items listed in the disclosure index checklist, which are 17 items. The details of the items are presented in Table 1.

Table 1: Voluntary Disclosure Items Used as the Disclosure Index Checklist

No	Voluntary Disclosure Items
1	Explanations on companies' strategies and goals
2	Explanations on the impacts of strategies on corporations' future outcomes
3	Authority and responsibility within corporations
4	Prediction of next year's cash flow

5	Research and development programs
6	Analysis on competitors
7	Equal opportunities for employees from different ethnic backgrounds and religions
8	Problems faced in the employee recruitment process and policies for solving those problems
9	Information about senior managers, which can encompass their names, experiences, and responsibilities
10	Policies for ensuring the continuity of management
11	Summary of financial statistics for the last six years
12	Money spent on employees, which can encompass salary and wages
13	Information about value added
14	Expected financial returns from project(s)
15	Current and future impacts of inflation on assets
16	Possibility of litigation by other parties in the future
17	Information about parties who attempt to have substantial corporate ownerships

This study also examines industry type and company size as control variables. The measurement techniques for the independent variables and control variables are based on prior studies' approaches (e.g. Primastuti and Achmad, 2012; Suhardjanto *et al*., 2012; Sandy and Lukviarman, 2015; Liu, 2016; Cahaya *et al.*, 2017) and are presented in Table 2.

Table 2: Measurement Approach of the Independent and Control Variables

Independent Variables	Control Variables	Measurement	Type of Data
Independence of board		Percentage of independent commissioners in the board	Continuous
Board size		Number of commissioners in the board	Continuous
Managerial ownership		Percentage of managerial ownership in the share capital structure	Continuous
Independence of audit committee		Percentage of independent audit committee members in the audit committee	Continuous
	Industry type*	1 = high profile industry 0 = low profile industry	Categorical
	Company size	Total assets	Continuous

Note: * High profile industries include companies with more consumer visibility and a high level of political risk due to the nature of their operations (Cahaya *et al.*, 2017). Industries like agriculture, mining, and chemicals are classified as high profile whereas industries like finance and services are classified as low profile.

4. Statistical results

Results of the descriptive statistics for the continuous independent and control variables are presented in Table 3. The proportion of independent commissioners in the board ranges from 16.67% to 75% with the mean of 40.29%. The mean of board size is about 4 people. On average, the proportion of managerial ownership within IDX listed companies' share capital structures is around 10%. The average proportion of independent audit committee members is nearly 35%. It is also shown that company size as measured by total assets ranges widely from 115,772 million Rupiah to 94,955,970 million Rupiah with a mean of about 12,909,528 million Rupiah. For the categorical variable, it was found that 55% of sample companies are categorized as high profile whereas 45% are classified as low profile.

Table 3: Descriptive Statistics of Continuous Independent and Control Variables

Variable	*Minimum*	*Maximum*	*Mean*	*Standard Deviation*

Independence of board (%)	16.67	75	40.29	11.72
Board size (number of commissioners)	2	10	4.34	1.76
Managerial ownership (%)	0.01	73.91	10.15	17.43
Independence of audit committee (%)	25	75	34.73	7.12
Company size (total assets in million Rupiah)	115,772	94,955,970	12,909,528	22,666,483

The descriptive statistics of voluntary disclosures is reported in Table 4. The mean of voluntary disclosure level for all sample companies is 25.97%. Thus, on average, IDX listed companies disclose around 4 voluntary disclosure items (out of 17 items) in their annual reports. This finding suggests that overall voluntary disclosure practices of Indonesian companies are low.

Table 4: Descriptive Statistics of Voluntary Disclosure Practices

Dependent Variable	Minimum (%)	Maximum (%)	Mean (%)	Standard Deviation (%)
Voluntary disclosure index (%) of all 100 sample companies	5.88	52.94	25.97	13.01

A closer analysis shows that explanations on companies' strategies and goals are mostly disclosed with 63% of sample companies report this information. This suggests that IDX listed companies attempt to obtain trusts from current and potential shareholders by carefully informing them about companies' potential ability to achieve the corporate goals. Such information potentially increases companies' good image in front of the eyes of shareholders

Hypotheses 1 to 4 were tested by using multiple regression. Classical assumptions consisting of multicollinearity, normality, outliers, and homoscedasticity (see Hair et al. 1998), have been checked and it was found that all of the assumptions were met. The results of multiple regression, displayed in Table 5, can therefore be analyzed.

Table 5: Results of Multiple Regression

Variable	Predicted Sign	Coefficient	*P*-value	Tolerance	VIF
(Constant)		0.165	0.053		
Independence of board	+	0.152	0.194	0.865	1.156
Board size	+	0.020	0.009***	0.925	1.081
Managerial ownership	+	-0.095	0.202	0.971	1.029
Independence of audit committee	+	-0.155	0.392	0.969	1.032
Industry type (control variable)	+	0.016	0.565	0.824	1.214
Company size (control variable)	+	0.0000000001108	0.845	0.980	1.020
Model Summary					
Adjusted R-Square	0.061				
Standard Error of the Estimate	0.12609				
Regression Model (Sig.)	0.065*				

***significant at 1 percent level; **significant at 5 percent level; * significant at 10 percent level

The regression model is significant at a moderate level (p-value 0.065). The value of adjusted R-square is 0.061, showing that the variation of voluntary disclosures is explained by the variation of explanatory variables in the model as much as 6.1%. One independent variable, which is board size, was found to be highly significant (*p*-value is smaller than 1% significance level). The coefficient of this independent variable is positive, supporting the argument in Hypothesis 2 which posits that there is a positive relationship between board size and voluntary disclosures. The other hypothesized variables and the control variables are not significant.

5. Discussion

The important finding of this study was that board size was a positively significant predictor of voluntary disclosure practices. This finding is consistent with past studies (e.g. Al-Janadi *et al.*, 2013; Nandi and Ghosh, 2013) and supports Hypothesis 2 that companies having more commissioners in the board voluntarily disclose more information in the annual reports. This finding implies that the number of commissioners reflects the strength of the commissioner board in supervising and monitoring the board of directors as well as pushing this board to undertake particular actions so that the presence of agency problems can be minimized.

Board independence is found to be statistically insignificant. This result is consistent with Alfraih and Almutawa (2017). A possible explanation for this finding is that the independence of commissioners in Indonesia is less than optimal due to the influence of family ownership structures (see Cahaya *et al*., 2017). Thus, there might be no ‘professional’ advice given by such less-independent commissioners to the board of directors of companies to provide more disclosures.

Managerial ownership is not a significant predictor of voluntary disclosures. A possible explanation for this result is that managers with share ownerships attempt to drive companies for their own hidden interests and thus ignore the interests of other shareholders. This might be because such managers have their own agenda and want to increase their own ‘wealth’. As managers understand well about companies’ inside managerial resources and infrastructure, it is easy for them to plan their own agenda for their own interests. In such a case, managers potentially decide not to disclose some information that may benefit other shareholders.

Independence of audit committee was found to be insignificant. A possible explanation for this insignificance is that the position of audit committee is not directly above the board of directors. Due to an audit committee’s position, both independent and non-independent members of an audit committee do not have sufficient power to push the board of directors to voluntarily disclose more information in the annual reports.

All control variables examined in this study, industry type and company size, were found to be insignificant. These results are consistent with Lokman *et al.* (2014). A possible reason for the insignificance of industry type is that all companies face transparency issues, regardless of the industry classification. Similarly, each company, regardless of the size, face transparency issues and need trusts from shareholders. Accordingly, all companies attempt to disclose all relevant information as much as possible so that they can well inform current shareholders and attract potential shareholders.

In summary, Indonesian listed companies provide a low level of voluntary disclosures. It appears that many companies attempt to inform shareholders regarding their ‘promising future path’ by explaining the possible link among goals and strategies. The variability of voluntary disclosures is partially explained by agency theory. This study provides important contributions to the literature by offering additional knowledge regarding the positively significant impact of board size on the level of voluntary disclosure practices in Indonesia.

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