



# RISET

JURNAL APLIKASI EKONOMI AKUNTANSI DAN BISNIS

## The Effects of Characteristics of the Board of Commissioners and Audit Committee on the Level of Risk Disclosure in Financial Sector Service Companies in the Banking Sector Listed on the Indonesia Stock Exchange in the Period 2015-2017

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### ABSTRACT

The aim of this study is to examine the effects of the board of commissioners and audit committee characteristics such as the proportion of independent commissioners, the board of commissioner size, frequency of board meetings, audit committee size, the proportion of independent audit committee and frequency of audit committee meetings on the level of risk disclosures. The results show that the frequency of board meetings, the proportion of independent audit committee and frequency of audit committee meetings significantly affect the level of risk disclosures, while the proportion of independent commissioners, the board of commissioner size, and audit committee size do not significantly affect the level of risk disclosures. The results show that the proportion of independent commissioners, the board of commissioner size, frequency of board meetings, audit committee size, the proportion of independent audit committee and frequency of audit committee meetings simultaneously have significant effects on the level of risk disclosures. The results of the study provide investors the information regarding the risk that companies could have, and they are also useful as a basis for making decisions.

**Keywords:** the proportion of independent commissioners, the board of commissioner size, frequency of board meetings, audit committee size, the proportion of independent audit committee, frequency of audit committee meetings, and risk disclosures

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## INTRODUCTION

Risk is an essential component that always exists in the business environment. Meanwhile, the risk is used to assess the possibility of various situations, which might threaten the achievement of business goals and objectives. Risk is also used to identify many uncertain situations regarding the impact that will occur. On the other hand, risk shows how the magnitude of business losses associated with situations that will threaten the business. The complexity of the business environment creates risks that cause increased uncertainty for the company. To anticipate risks that may be faced by the company, usually, companies are required to have expertise in controlling risks properly, so that losses can be minimized and as a result, there will be no losses in the future. One important component of risk management is risk disclosures.

In this case, the practice of risk disclosures in companies needs to be improved. Improving corporate disclosure practices is an important part of governance reform (SOLOMON, SOLOMON, NORTON, & JOSEPH, 2000). In Indonesia, the financial crisis in 1997-1998 raises awareness of the importance of good governance for the company. To remedy this, various efforts have been made, including in 1999, the National Committee for Corporate Governance Policy (KNKCG) was established and formulated Good Corporate Governance (GCG) guidelines for the private sector that have experienced improvements in the following years. The implementation of corporate governance is expected to improve good corporate governance practices, which indirectly support the occurrence of better company transparency. The implementation of corporate governance is also expected to motivate company management to behave professionally and efficiently to maximize the functions of the board of commissioners, the board of directors, various committees formed to assist the board of commissioners, and general meeting of shareholders (GMS).

Risk disclosure is information that explains the company's main risks and their economic impacts, which are expected on current and future performance, provided by the company in the annual reports (Miihkinen, 2012). The 2007-2009 global financial crisis occurred significantly, thereby raising concerns about risk-taking in public companies. The global financial crisis also had an impact on all countries, not excluding Indonesia, although on a different scale.

However, several studies have found management's unwillingness to disclose risk. Linsley & Shrives (2006) examined the annual reports of companies in the United Kingdom (UK) about the risk disclosures, found management's unwillingness to disclose the estimated impacts of risk in the annual reports. Thus, corporate governance has an important role in disclosing all material risk information about the company's business activities accurately in a certain accounting reporting period.

Based on the above problems, this research will be focusing on whether good corporate governance is sufficient so that it can encourage the improvement of risk disclosures information. Thus, this corporate governance will focus on the board of commissioners and the audit committee. This study will be focusing on the issues related to "The Effects of the Characteristics of the Board of Commissioners and the Audit Committee on the Level of Risk Disclosures in Financial Sector Service Companies in Indonesia Listed on the Indonesia Stock Exchange in the 2015-2017 Period". The purpose of this study is to partially and simultaneously examine the characteristics of the board of commissioners with a proxy of the proportion of independent commissioners (PKI), board size (UDK), frequency of meetings of the board of commissioners (FDK), and characteristics of the audit committee with proxy size of the audit committee (UKA ),

the proportion of the independent audit committee (PKAI), and the frequency of meetings of the audit committee (FKA) against the level of risk-taking (RDC).

## **LITERATURE REVIEW**

In a modern economy, management and corporate management are increasingly separated from company ownership. This is in line with the Agency Theory, which emphasizes the importance of handing over the management of the company from the owners (shareholders) to professionals who are more understanding in doing business. However, on the other hand, this kind of separation has a negative side, namely the existence of the flexibility of company management to maximize corporate profits can lead to the process of maximizing the interests of its own managers with the burdens and costs that must be borne by the company owners.

The Agency Theory is the basis used to find out the issues of corporate governance and earnings management. The Agency Theory proposes an asymmetrical relationship between principals and management. To avoid asymmetric relationships, a concept is needed, namely the concept of Good Corporate Governance implementation, which has the aim of making the company healthier. The implementation of Good Corporate Governance based on the Agency Theory can be explained by the relationship between the agent as management and the principal as the owner, management is responsible for maximizing the profits of the owners (principal) and as compensation, management will get rewards in accordance with the contract agreement.

### ***Good Corporate Governance (GCG)***

The concept of Good Corporate Governance ensures that the organizational structure facilitates the achievement of objectives through a series of predetermined control activities. The governance structure ensures the distribution of rights and responsibilities between agents and principals as well as the existence of rules and decision-making procedures in every company's activity.

Corporate governance regulates the company's relationships with stakeholders, such as the relationship between a company's management, the board of commissioners, shareholders and other stakeholders. Good corporate governance consists of sufficient mechanisms within the company to ensure that the use and allocation of resources are effective and efficient and in accordance with the objectives of the company and shareholders. One of the mechanisms implemented in board function. Each country's board structure and policies differ.

Good corporate governance, according to Cadbury, aims to direct and control the company in order to achieve a balance between strength and authority of the company.

### **Board of Commissioners**

According to the Republic of Indonesia Act No. 40/2007 concerning Limited Liability Companies, the board of commissioners is the organ of the company that is responsible for conducting general and /or special supervision in accordance with the articles of association and giving advice to directors.

### **The proportion of independent directors**

The independent members of the board of commissioners are tasked with supervising and advising executive directors effectively and providing added value to the company.

$$\text{The proportion of independent directors} = \frac{\text{no. Of independent directors}}{\text{.of board members}}$$

According to the general rules of Indonesian corporate governance, the number of members of the board of commissioners needs to be adjusted to the complexity of the company while taking into account the effectiveness of decision-making.

$$\text{Board of commissioner size} = \text{no. of board members}$$

### **Frequency of Board of Commissioners' Meetings**

The board of commissioners' meeting is a process that the board of commissioners will go through to make a decision on company policies. The meetings of the board of commissioners are held to oversee the policies that will or have been taken by the board of directors.

$$\begin{aligned} \text{Frequency of board of commissioners' meetings} \\ = \text{No. of the board of commissioners' meetings in one year} \end{aligned}$$

### **Audit Committee**

An audit committee is a committee formed by a board of commissioners whose job is to assist the board of commissioners in carrying out the oversight function of the performance of the board of directors and agents (management) in accordance with the GCG principles.

### **Size of the Audit Committee**

According to Mubarak (2013), seen from the Agency Theory, an audit committee as a supporting committee of the board of commissioners, is likely to influence the practice of corporate risk disclosures. The performance of the board of commissioners in conducting supervision will get better with the presence of an audit committee.

$$\text{Audit committee size} = \text{no. of audit committee members}$$

### **Proportion of Independent Audit Committees**

Audit committee independence is a condition where the audit committee member must be recognized as an independent party. Independence can be interpreted as how the audit committee member has no obligation related to the company.

$$\begin{aligned} & \text{The proportion of independent audit committee} \\ &= \frac{\text{no. of independent members of the audit committee}}{\text{no. of all members of the audit committee}} \end{aligned}$$

### Frequency of Audit Committee Meetings

The frequency of audit committee meetings is the number of regular audit committee meetings that serve to improve good communication between members of the audit committee to help the company provide appropriate actions to minimize the company's risk.

$$\begin{aligned} & \text{Frequency of audit committee meeting} \\ &= \text{no of audit committee meetings in one year} \end{aligned}$$

### Risk Disclosure

Risk disclosure is one form of disclosures made by the company to provide information about the risks experienced by the company in carrying out business activities in one accounting reporting period.

### Research Hypothesis

Based on the discussion that has been presented, then in this study, a hypothesis can be arranged as follows:

1.  $H_1$ : The proportion of the board of commissioners affects the risk disclosures in the annual reports.
2.  $H_2$ : The size of the board of commissioners affects the risk disclosures in the annual reports.
3.  $H_3$ : The frequency of the board of commissioners' meeting affects the risk disclosures in the annual reports.
4.  $H_4$ : The size of the audit committee affects the risk disclosures in the annual reports.
5.  $H_5$ : The proportion of the independent audit committee affects the risk disclosures in the annual reports.
6.  $H_6$ : The frequency of audit committee meetings affects the risk disclosures in the annual reports.
7.  $H_7$ : The characteristics of the board of commissioners and the audit committee affect the risk disclosures in the annual reports.

### RESEARCH METHODS

The population in this study were 39 financial service companies in the banking sector which were listed on the Indonesia Stock Exchange (IDX) for the 2015-2017 period. The sampling technique used in this study is purposive sampling with the following criteria: (1) financial service companies in the banking sector that publish annual reports during the 2015-2017 period; (2) companies that had positive profits during the 2015-2017 period; (3) Companies whose financial statements used the rupiah; and (4) having complete data related to the variables used in the study.

Thus, we obtained 60 samples consisting of 20 financial service companies in the banking sector, with a research period of three years.

The dependent variable in this study is the level of risk disclosures. The level of risk disclosures is measured by counting all of the risk items revealed by each bank's annual reports.

$$\text{Levels of risk disclosure} = \frac{\sum \text{risk disclosure items revealed by company}}{\sum \text{total items of risk disclosures}}$$

The independent variables in this study are the characteristics of the board of commissioners and the audit committee as measured by the proportion of independent commissioners, the size of the board of commissioners, the frequency of board meetings, the size of the audit committee, the proportion of independent audit committees, and the frequency of audit committee meetings.

This study uses descriptive statistical analysis models and multiple regression analysis. The regression model in this study is as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + e$$

*Note:*

Y = the levels of risk disclosures

$\alpha$  = constant

$\beta_1 - \beta_4$  = regression coefficient

$X_1$  = the proportion of independent commissioners

$X_2$  = the size of the board of commissioners

$X_3$  = the frequency of the board of commissioners' meetings

$X_4$  = the size of the audit committee

$X_5$  = the proportion of independent audit committees

$X_6$  = the frequency of audit committee's meetings

e = error

## RESULTS AND DISCUSSION

Table 1 The Results of Descriptive Statistics Test

**Descriptive Statistics**

	N	Minimum	Maximum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
RDC	60	.108	.270	.21937	.002880	.022305
PKI	60	.400	1.000	.60147	.015337	.118801
UDK	60	2	12	5.37	.297	2.299
FDK	60	4	51	15.05	1.550	12.008
UKA	60	3	9	3.97	.156	1.207
PKAI	60	.333	1.000	.98556	.011546	.089436
FKA	60	4	33	13.88	.956	7.402
Valid N (listwise)	60					

Of the data it can be seen that all variables have an average value (*mean*) higher than the standard deviation that is the proportion of independent directors (PKI), the size of board of commissioners (UDK), the frequency of board of commissioners' meetings (FDK), the size of the audit committee (UKA), the proportion of the independent audit committee members (PKAI), the frequency of audit committee's meetings (FKA), and the levels of risk disclosures (RDC) which means that the sample used can represent the entire population.

Table 2 Test Results of Multiple Regression Analysis

Coefficients <sup>a</sup>					
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.056	.024		2.324	.024
PKI	-.014	.016	-.074	-.846	.401
UDK	-3.253E-5	.001	-.003	-.031	.975
FDK	.001	.000	.293	3.262	.002
UKA	-.001	.002	-.063	-.632	.530
PKAI	.158	.021	.633	7.524	.000
FKA	.001	.000	.312	3.215	.002

a. Dependent Variable: RDC

Of the Table 2, it can be seen from the analysis of the factors that affect the risk disclosures such as the proportion of independent directors (PKI), the size of board of commissioners (UDK), the frequency of board of commissioners' meetings (FDK), the size of the audit committee (UKA), the proportion of the independent audit committee members (PKAI), and the frequency of audit committee's meetings (FKA). Then, the regression model results can be obtained as follows:

$$RDC = 0,056 - 0,014 PKI - 0,00003253 UDK + 0,001 FDK - 0,001 UKA + 0,158 PKAI + 0,001 FKA + e$$

Table 3 The Test Results for the Coefficient of Determination

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.812 <sup>a</sup>	.660	.621	.013726

a. Predictors: (Constant), FKA, PKAI, PKI, UKA, FDK, UDK

In Table 3, it can be seen that the value of Adjusted R Square or the coefficient of determination is 0.621. This means that 62.1% of the levels of risk disclosures can be explained by the independent variables in the study, while the remaining 37.9% is explained by other variables.

### **The effect of the proportion of independent directors on the level of risk disclosures**

The hypothesis testing regarding the effects of the independent variable the proportion of independent directors (PKI) on the levels of risk disclosures (RDC) shows a level of significance of 0.401. It means that the proportion of independent directors has no effect on the level of risk disclosures. Thus, the first hypothesis ( $H_1$ ) which states that the proportion of independent directors to the levels of risk disclosures is rejected.

The proportion of independent directors has no effect on the levels of risk disclosures because the banks listed on the Indonesia Stock Exchange tend to comply with regulations set by the Exchange without looking at the integrity of the board members of independent directors themselves. In addition, this can be made possible because the term of office of the independent commissioner is too long so that it can affect any actions of the independent commissioner. The results of this study are in line with the research by Saufanny & Khomsatun (2017) and by Suhardanjanto *et.al* (2012).

### **The effect of the size of the board of commissioners on the levels of risk disclosures**

The hypothesis testing regarding the effects of the independent variable of the board of commissioners' size (UDK) on the levels of risk disclosures (RDC) shows a significance level of 0.975 which means that the size of the board of commissioners has no effect on the level of risk disclosures. Thus, the second hypothesis ( $H_2$ ) which states the effects of the size of the board of commissioners on the levels of risk disclosures is rejected. The size of the board of commissioners does not affect the level of risk disclosures due to a phenomenon that occurs in banking companies, which states that the board of commissioners is prohibited from participating in operational decision-making. The board of commissioners must not be involved in decision-making, so they do not have the authority in preparing financial statements. Thus, in the financial statements that present information about company risk, the board of commissioners cannot be involved in it. Another possible reason is that the size of the board of commissioners is measured by the number of members of the board of commissioners, not by the activities carried out by the board of commissioners. The results of this study are in line with the research by Fitri (2014), Saufanny & Khomsatun (2017), and Syafitri, Majidah, & Dillak (2016).

### **The effects of frequency of meetings board meetings on the levels of risk disclosures**

The hypothesis testing regarding the independent variable frequency of board meeting (FDK) meetings on the level of risk disclosures (RDC) shows a significance level of 0.002 which means that the frequency of board meeting affects the levels of risk disclosures. Thus, the third hypothesis ( $H_3$ ) stating the effects of the frequency of board meeting meetings on the level of risk disclosures is accepted. The frequency of board of commissioners' meetings affects the level of risk disclosures because in the meetings, members of the board of commissioners can talk about and discuss what information should be presented in the annual reports, including the extent of disclosures. One type of information presented is information about the risks that will be faced by the company. In addition, the board of commissioners, with the frequent meetings, tends to increase the supervision of the board of commissioners on the

company's risk disclosure and control. The results of this study are in line with the research by Suhardjanto et al. (2012) and Utomo (2014).

#### **The effects of the size of the audit committee on the levels of risk disclosure**

The hypothesis testing regarding the independent variable of the audit committee size (UKA) on the levels of risk disclosure (RDC) shows a significance level of 0.530 which means that the size of the audit committee has no effect on the levels of risk disclosure. Thus, the fourth hypothesis ( $H_4$ ) stating the effects of the size of the audit committee on the levels of risk disclosure is rejected. The size of the audit committee does not affect the level of risk disclosures because the size of the audit committee is measured by the number of its members. It should be noted from the performance of the audit committee and the results of the empirical evidence that the audit committees in the companies are still not doing their jobs properly. The audit committees only carry out routine tasks, such as reviewing reports and selecting the external auditors, but do not critically question or in-depth analyze the risks to be faced by the company. The results of this study are in line with research by Utomo (2014) and Fitri (2014).

#### **The effects of the proportion of the independent audit committee on the level of risk disclosure**

The hypothesis testing regarding the independent variable of the proportion of the independent audit committee (PKAI) to the level of risk disclosures (RDC) shows a significance level of 0,000 which means that the proportion of the independent audit committee affects the level of risk disclosure. Thus, the fifth hypothesis ( $H_5$ ) is accepted in this study. The proportion of the independent audit committee affects the level of risk disclosure because the independent members of the audit committee have the goal to be able to supervise and control the company independently or cannot be influenced, and there is no conflict with the interests of management, so that the risk to be disclosed by the company is greater. The results of this study are not in line with the research of Suhardjanto et al. (2012), Wardhana (2013), Saufanny & Khomsatun (2017).

#### **The effects of audit committee meeting frequency on the level of risk disclosure**

The hypothesis testing regarding the independent variable of audit committee meetings frequency (FKA) to the levels of risk disclosure (RDC) shows a significance level of 0.002 which means that the frequency of audit committee meetings affects the levels of risk disclosure. Thus, the sixth hypothesis ( $H_6$ ) is accepted in this study. The frequency of audit committee meetings is significant to the levels of risk disclosure because the meetings enhance good communication within the audit committee and can help the companies take appropriate action to disclose risks. Therefore, the frequency of audit committee meetings increases the level of oversight of risk management processes and activities. The results of the study are in line with research by Herlantu (2014) and Sauri (2018).

## **The Effect of the Proportion of Independent Commissioners, the Size of Board of Commissioners, the Frequency of Meetings of Board of Commissioners, the Size of Audit Committee, the Proportion of Independent Audit Committees, and the Frequency of Meetings of Audite Committee on the Level of Risk Disclosures**

The size of the board of commissioners affects the independent commissioners and the size of the board of commissioners so that it affects the level of risk disclosures. Meanwhile, the proportion of independent audit committees and audit committee meetings affect the size of the audit committee, thereby affecting the levels of risk disclosures. One of the main functions of the audit committee is to assist the duties of the board of commissioners in the aspect of corporate control.

Thus, the characteristics of the audit committee affect the characteristics of the board of commissioners in risk disclosures.

## **CONCLUSION**

Based on the descriptive statistical analysis, it can be seen that all the independent and dependent variables in 2015-2017 period are already good with being marked by an average value higher than the standard deviation; thus, the samples used in this study can represent the entire population. The hypothesis testing shows the frequency of board meetings (FDK), the proportion of the independent audit committee (PKAI), and the frequency of the audit committee meetings (FKA) partially affect the levels of risk disclosures (RDC), while the proportion of independent commissioners (PKI), the size of the board of commissioners (UDK), and the size of the audit committee (UKA) have no partial effects on the levels of risk disclosures. However, the proportion of independent commissioners (PKI), the size of the board of commissioners (UDK), the frequency of board meetings (FDK), the size of the audit committee (UKA), the proportion of independent audit committees (PKAI), and the frequency of audit committee meetings (FKA) simultaneously affect the levels of risk disclosures.

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