Jurnal Pengurusan 39(2013) 83 - 92

Corporate Governance and Voluntary Disclosure Practices: Evidence from a Two Tier Board Systems in Indonesia

(Amalan Tadbir Urus dan Pendedahan Sukarela: Bukti dari Sistem Dua Lembaga Pengarah di Indonesia)

Romlah Jaffar
Dina Mardinah
Azlina Ahmad
(Faculty of Economics and Management, Universiti Kebangsaan Malaysia)

ABSTRACT

Lack of effective corporate governance mechanism and disclosure transparency frameworks have been partly blamed for the 1997-1999 East Asia economic crises. Consequently, Indonesia, together with many countries across the globe have been actively reviewing and improving their corporate governance and transparency mechanisms. Theoretically, corporate governance mechanism is designed to monitor and evaluate decisions made by managers in the management of a company to reduce agency cost and information asymmetry between the shareholders and the management. The main objective of the study is to examine the effect of corporate governance mechanism on the level of voluntary disclosure in Indonesia, a country that has adopted a two-tier board system. The two-tier board system is considered a better system compared to one tier board system since all members of the board are non-executives. Therefore, the board members are more independent and objective in supervising and monitoring the performance of executive managers. This study investigates four corporate governance variables which are expected to influence the level of voluntary disclosure; (1) composition of independent members of Board of Commissioners (BOC), (2) composition of family members on the BOC, (3) audit quality, and (4) managerial ownership. The sample consists of companies listed on Bursa Saham Indonesia for the year ended 2008. The influence of corporate governance on the level of voluntary disclosure is analyzed using multiple regression method. As expected, the results show that the compositions of independent BOC and auditor's quality have a positive and significant relationship with the level of voluntary disclosure. Meanwhile, the composition of family members on the BOC has negatively influenced the disclosure. The results suggest that the corporate governance structure in a two-tier board system, specifically in Indonesia, is not significantly different from a one tier board system in influencing the level of voluntary disclosure.

Keywords: Corporate governance; voluntary disclosure; board of commissioners

ABSTRAK

Kekurangan mekanisme tadbir urus korporat yang berkesan serta kerangka pelaporan yang kurang telus telah dikatakan antara penyebab kepada krisis ekonomi di Asia Timur pada tahun 1997-1999. Oleh itu Indonesia, bersama dengan beberapa negara lain di seluruh dunia, telah mengkaji dan memperbaiki mekanisme tadbir urus korporat serta ketelusan secara aktif. Secara teorinya, mekanisme tadbir urus korporat dibangunkan untuk memantau dan menilai keputusan yang dibuat oleh pengurus dalam pengurusan syarikat bagi mengurangkan kos agensi dan ketaksamarataan maklumat antara pemegang saham dengan pihak pengurusan. Objektif utama kajian ini adalah untuk mengkaji kesan tadbir urus korporat kepada tahap pendedahan maklumat sukarela di Indonesia, sebuah negara yang mengamalkan sistem dua lembaga pengarah. Sistem dua lembaga pengarah adalah sistem yang lebih baik berbanding sistem satu lembaga pengarah kerana semua ahli lembaga pengarah adalah bukan eksekutif. Oleh itu, ahli adalah lebih bebas and objektif untuk menyelia dan mengawal prestasi pengurus eksekutif. Kajian ini mengkaji empat pembolehubah tadbir urus korporat yang dijangka mempengaruhi tahap pendedahan sukarela; (1) kebebasan ahli Lembaga Pengarah Komisoris (ALP), (2) komposisi ahli keluarga dalam ALP, (3) kualiti audit, dan (4) pemilikan saham oleh pihak pengurusan. Sampel kajian terdiri daripada syarikat yang tersenarai di Bursa Saham Indonesia pada tahun 2008. Kesan tadbir urus korporat terhadap pendedahan secara sukarela telah diuji dengan menggunakan kaedah regresi berganda. Seperti yang dijangkakan, hasil kajian menunjukkan komposisi ahli ALP yang bebas dan kualiti audit berhubungan secara positif dan signifikan dengan tahap pendedahan sukarela. Sementara itu, komposisi ahli keluarga dalam ALP berhubungan secara negatif dengan tahap pendedahan tersebut. Dapatan menunjukkan bahawa struktur tadbir urus korporat dalam sistem dua lembaga pengarah, khususnya di Indonesia, tidak jauh berbeza daripada sistem satu lembaga pengarah dalam mempengaruhi tahap pendedahan sukarela.

Kata kunci: Tadbir urus korporat; pendedahan sukarela; lembaga pengarah komisoris

INTRODUCTION

Lack of effective corporate governance mechanism and disclosure transparency framework in majority of capital markets and companies has been partly blamed for the 1997-1999 East Asia economic crises. Among the weaknesses identified include weak financial structure of many companies, over-leveraging, lack of transparency in disclosure and accountability, existence of a complex system of family control companies and little or no effective laws to ensure that controlling shareholders and management treat small investors fairly and equitably (Khoo 2003). Consequently, many countries across the globe have been actively reviewing and improving their regulatory framework, in particular corporate governance and transparency mechanisms. The concept of corporate governance was initially introduced in Indonesia in 1999 with the establishment of the National Committee on Corporate Governance (NCCG) (KNKG 2006) to develop the Indonesian Code of Corporate Governance. In 2000, the NCCG published the Indonesian Code of Corporate Governance (Code) which was later revised in 2006. The main objective of the Code is to maximize corporate and shareholders' value by enhancing transparency, accountability, reliability, responsibility, and fairness; to encourage the management of companies to behave in a professional, transparent, and efficient manner; and, to encourage shareholders and members of the Board to make decisions and to act in compliance with the prevailing regulations.

The adoption of good corporate governance mechanisms by a company is pertinent since it can help reduce agency cost and therefore, ensuring that managers act in the best interests of shareholders (Haniffa & Cooke 2002). Moreover, the adoption of good governance mechanisms would also strengthen the internal control of companies and provide intensive monitoring to curb opportunistic behaviours and reduce information asymmetry (Leftwich et al. 1981). Under such an intensive-monitoring environment, managers are not likely to withhold information for their own benefits, which lead to improvement in disclosure comprehensiveness and quality of financial reporting (Ho & Wong 2003).

Past studies have documented evidence that good corporate governance practices can positively increase the corporate transparency practices via the increase in the level of voluntary disclosure (for examples see, Haniffa & Cooke 2002; Ghazali & Weetman 2006; Ho & Wong 2003; Gul & Leung 2004; Eng & Mak 2003; Chau & Gray 2002; Arcay & Vazquez 2005; Wang et al. 2008; Donnely & Mulcahy 2008). Specifically, past studies have found that independence of directors (Ho & Wong 2001) and quality audit (Wang et al. 2008) have a positive effect on the level of voluntary disclosure. Past studies also have found that composition of family members on the board (Haniffa & Cooke 2002) and management ownership (Eng & Mak 2003) negatively influences the level of voluntary disclosure.

However, these findings need to be carefully interpreted, and cannot be generalized across countries since different countries may have different regulatory and corporate governance mechanisms, especially with regards to board system. Presently, there are two types of board system adopted by countries around the world; the one tier board system, and the two-tier board system. Examples of countries that adopt the one tier board system are Malaysia, Hong Kong and the US. Examples of countries that adopt a two-tier board system are Indonesia, Netherland and Germany. All of the studies that have been previously mentioned have examined the impact of corporate governance practices on the level of voluntary disclosure in countries that adopted a one tier board system. Examples include a study in the UK by Jungman (2006), Malaysia by Haniffa and Cooke (2002) and Ghazali et al. (2006), Hong Kong by Ho and Wong (2001), Singapore by Eng and Mak (2003), China by Wang et al. (2008), Saudi Arabia by Alsaeed (2006) and Ireland by Donelly and Mulcahy (2008). However, the relationship between corporate governance practices and the level of voluntary disclosure in countries implementing the two tiers board system has not been fully investigated. Therefore, the unique corporate governance framework in Indonesia provides an opportunity to extend earlier works on the relationship between corporate governance practices and the level of voluntary disclosure. The relationship between these two variables is expected to be stronger in a two tier board system since all members of board are nonexecutive. They can execute their duties more effectively and demand more voluntary disclosure to outside investors (Donelly & Mulcahy 2008). Consequently, the agency cost will be lower in a two tier board system.

Specifically, the purpose of this study is to investigate the corporate governance characteristics of Indonesian companies and their influence on the level of voluntary disclosure. As expected, the results show that independent composition of the Board of Commissioners (BOC) and audit quality have a positive and significant association with the level of voluntary disclosure. Meanwhile, the composition of family members has negatively influenced the disclosure. The findings provide further insight and understanding on the relationship between corporate governance practices and the level of voluntary disclosure, specifically in a country that adopts a two tier board system.

The remaining of this paper is organized as follows. The next section looks at the institutional background in Indonesia followed by a review of the literature, hypothesis development, research methodology and findings. Finally, conclusions and implications of the study are presented in the last section.

INSTITUTIONAL BACKGROUND

TWO-TIER BOARD SYSTEM IN INDONESIA

The Indonesian Company Law of 1995 is the most important framework for the current legislation on corporate governance in Indonesia. Under the Law, a company is a separate legal entity with two tiers board consisting of the Board of Directors (BOD), and the Board of Commissioners (BOC). Each member of the BOC and BOD is appointed by shareholders during the company's Annual General Meeting (AGM).

The BOC consists of affiliated commissioners and independent commissioners (KNKG 2006). Affiliated commissioners are family members of major shareholders or business associates of major shareholders or the company, while independent commissioners are members with no family or business ties to major shareholders or the company. All BOC members are non-executive as they cannot hold any executive duties in an organization. The role BOC is to supervise and advise the BOD on the running of the company. The BOC is also required by the Law to carry out, in good faith and with full responsibility, its duties in the best interests of the company. Furthermore, the BOC has to keep an eye on the effectiveness of Good Corporate Governance practices under which the company operates and make changes as needed. In ensuring that members of the BOC are able to perform their duties independently and objectively, they are prohibited from holding any executive role. Additionally, by virtue of the Company Law, each member must also disclose any equity interests that they or their family have in the company or other companies.

On the other hand, the BOD is fully responsible for the management of the company. Each member of the BOD is fully and personally liable if he/she is at fault or fails to perform his/her tasks in good faith and with a full sense of the responsibility for the interest and business of the company. The BOD must administer the company's books of accounts, prepare and submit to the AGM an Annual Report and annual financial statement as well as establish and maintain a Register of Shareholders and Minutes of the AGM. By virtue of Article 87 of the Company Law, each member must also disclose any shareholding interests held by them respectively or by his/her family in the company or other companies. The two tier board systems adopted in Indonesia and the one tier board system adopted by other countries is depicted in Figure 1 as follows.

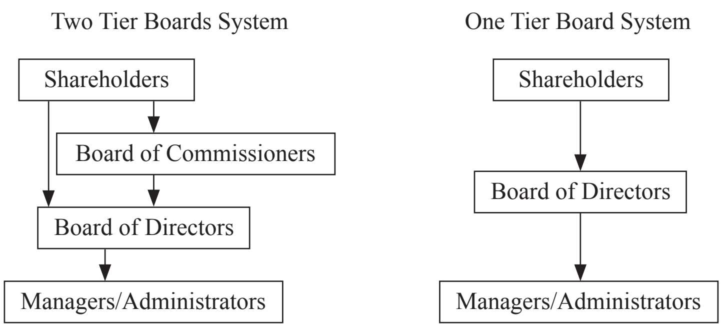

FIGURE 1. Two-tier and one tier board systems

According to Jungmann (2006), the two-tier governance structure is considered better since all members of the BOC cannot hold any executive position and are not involved in the operations of the company. Thus, they can be more independent and objective in supervising and monitoring the performance of the BOD. This is a contrasting scenario to the one tier governance system in which members of the BOD can hold executive and non-executive positions. Under these circumstances, it is perceived that members of the BOD cannot be completely objective and independent in monitoring and assessing the performance of the management team, since they may also be a part of the management team. This study is carried to investigate whether the different role played by BOC members in a two tier board system can significantly influence the level of voluntary disclosure. This result would provide an additional understanding of how different governance mechanism (one tier or two tier system) is different or similar in the relationship between corporate governance characteristics and voluntary disclosure practices of a company.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

INDEPENDENCE OF BOC AND THE LEVEL OF VOLUNTARY DISCLOSURE

The effectiveness of a board in monitoring the management is determined by its composition, independence, and size (John & Senbet 1998). Fama and Jensen (1983) suggest that the higher the composition of the independent directors, the more effective it will be in monitoring managerial opportunism. Additionally such companies can be expected to have more voluntary disclosures. Forker (1992) finds that the presence of independent members on boards enhanced financial disclosure quality and reduced the benefits of withholding information. Therefore, a higher percentage of independent directors on the board results in more effective execution of duties and greater demand of voluntary disclosure to outside investors (Donelly & Mulcahy 2008) as well as reduced agency cost and information asymmetry between principals and agents of the firm (Chen & Jaggi 2000).

In Indonesia, because members of the BOC are non-executive members, they are expected to be more effective monitors compared to the BOD members in a one tier board system. However, in certain instances, members of the BOC in Indonesian companies may not be completely independent since they are appointed due to their affiliation with major shareholders, or with the company itself. However, their level of 'independence' is still expected to be higher than the level of 'independence' of BOD in a one tier system.

Past studies have found evidence of a positive relationship between the composition of independent directors and the level of voluntary disclosure (Ghazali & Weetman 2006; Ho & Wong 2001; Chen & Jaggi 2000; Cheng & Courtenay 2006; Donnelly & Mulcahy 2008; Arcay & Vazquez 2005). Therefore, this study also predicts that the composition of independent directors in the BOC would have a positive impact on the level voluntary disclosure of Indonesian companies as stated in Hypothesis 1 as follows:

H_1 Composition of independent directors in BOC is positively related to the level of voluntary disclosure

QUALITY OF AUDITORS AND LEVEL OF VOLUNTARY DISCLOSURE

The main role of external auditors is to monitor and ensure that the management has complied with the rules and laws of the home country (Kurniawan & Indriantoro 2000). Auditing reduces information asymmetries between management and external stakeholders as it allows an independent external party to verify the validity of the content of financial statements (Wang et al. 2008). This external independent process is particularly important to corporate governance and the oversight of companies (Francis et al. 1999). In addition, external auditors also inspect and evaluate the annual report and provide quality assessment of companies' disclosure (Barako et al. 2006). Moreover, according to Gul and Leung (2004) auditors that are concerned about preserving their reputation will strongly encourage clients to provide a more comprehensive disclosure.

Past studies have shown a strong correlation between audit firm size and audit quality (Francis et al. 1999; Krishnan 2003). A higher quality audit is associated with higher likelihood of discovering material errors and irregularities and having discovered these errors, the higher likelihood of reporting them. According to Wallace et al. (1994), companies represented by big international audit firms are likely to provide quality disclosure in their annual reports than companies who are not. Furthermore, auditors of bigger sized audit firms are more knowledgeable and skillful and are more capable of limiting and reducing opportunistic behavior of the firm's managers (Francis et al. 1999; Krishnan 2003).

Studies by Gul and Leung (2004) and Agca and Onder (2007) find a positive relationship between auditor quality and the level of voluntary disclosure of large-sized organizations. This finding is supported by O'Sullivan et al. (2008) and Wang et al. (2008). In line with previous findings, this study expects audit quality to have a positive impact on the level of voluntary disclosure by Indonesian companies, hypothesized as follows:

H_2 Quality of the auditors is positively related to the level of voluntary disclosure.

COMPOSITION OF FAMILY MEMBERS ON BOC AND LEVEL OF VOLUNTARY DISCLOSURE

Family owned businesses and family ownership are very common in the East Asia region (Chau & Gray 2002). Hence, having family members on the BOD or BOC is also a common occurrence. According to Ghazali and Weetman (2006), having family members on the board can reduce agency problems since family members are likely to have good knowledge about their firms' activities, which enables them to provide superior monitoring of managers (Ghazali & Weetman 2006). Moreover, family members with equity interest in companies tend to have much longer investment horizons as compared to other investors. Thus, families help mitigate myopic investment decisions by managers (Kwak 2003).

The presence of family members on the BOD is believed to have an impact on the practice of voluntary disclosure (Haniffa & Cooke 2002). Since family members may have easier access to internal information, the need for additional reporting and disclosure will be less. This will result in a low voluntary disclosure by management. Past studies have reported a negative relationship between the presence of family members on the BOD and the level of voluntary disclosure in countries that adopted a one tier board governance system such as Hong Kong (Ho & Wong 2001) and Malaysia (Haniffa & Cooke 2002). This study predicts that the nature of the relationship between the compositions of family members on the Indonesian BOC with the level of voluntary disclosure will also be negative. The hypothesis is stated as follows:

H_3 Composition of family members in the BOC is negatively related to the level of voluntary disclosure.

MANAGEMENT OWNERSHIP AND THE LEVEL VOLUNTARY DISCLOSURE

Ideally, managers choose investment project that will maximize shareholders wealth (Jensen & Meckling 1976). Sometimes, this is not the case as managers may have conflicting objectives and use companies' resources to increase their own wealth at the expense of shareholders' wealth. Equity ownership by management could help mitigate such conflict and align interests of management and shareholders (Warfield et al. 1995). Thus, the extent of managerial ownership affects the degree of congruence between the interests of owners and management (Jensen & Meckling 1976). The fundamental problem lies in the fact that there exists imperfect information between managers and shareholders, which creates a moral hazard problem, since shareholders cannot verify whether the good performance is due to luck or hard work. Therefore, reporting of financial information is one way to monitor manager's activities (Hossain et al. 1994).

The reporting of voluntary information in annual reports is under the discretion of the management. There will be less need for detailed reporting if managers hold considerable percentage of ownership in the companies, as they can obtain the information needed directly from the organization. As stated by Jensen and Meckling (1976), the greater the percentage of stocks owned by top management, the more likely it will be that they will make decisions consistent with maximizing shareholders' wealth. Existing literature provides evidence of the negative relationship between ownership by managers and the quality of disclosure (Gelb 2000; Eng & Mak 2003: Ghazali & Weetman 2006). Eng and Mak (2003) for instance, examine the relationship between ownership structure and board of director composition with the level of voluntary disclosure. The ownership structures are based on ownership by the management, block ownership and government ownership. The results show that management ownership relates negatively with the level of disclosure. Ghazali and Weetman (2006) also find that companies with high proportion of shares held by their executive directors disclose less voluntary information in their annual reports. These findings suggest that when management shareholding is high, the level of voluntary disclosure is low. In line with previous findings, this study expects managerial share ownership to have a negative relationship with the level of voluntary disclosure as stated in Hypothesis 4 as follows:

H_4 Level of management ownership is negatively related to the level of voluntary disclosure.

METHODOLOGY

This study uses secondary data obtained from annual reports of Indonesia companies listed on Bursa Saham Indonesia (the stock exchange of Indonesia). Data reported in the 2008 annual report are gathered since it is the most recent annual report available online. Specifically, data collected from annual reports are data on voluntary disclosure, composition of independent directors on the BOC, number of family members on the BOC, type of external audit, and other related financial information.

MEASUREMENT OF VARIABLES

The level of voluntary disclosure is determined based on 85 voluntary disclosure items proposed by Meek and Roberts (1995). The items have been used in previous studies to investigate the level of voluntary disclosure in Asian countries such as in Singapore and Malaysia (Eng & Mak 2003; Haniffa & Cooke 2002; Ghazali & Weetman 2006). In addition, this study also reviews 35 voluntary disclosure items recommended by the Capital Market Supervisory Agency of Indonesia (BAPEPAM 2006). The combined items by Meek and Roberts (1995) and BAPEPAM are piloted to ascertain the suitability of the items to disclosure by Indonesian companies. Specifically, ten[1] annual reports of selected Indonesia companies are reviewed and subsequently, 28 disclosure items are removed. The disclosure items removed are considered inappropriate or irrelevant. Additionally, items listed as mandatory disclosure items based on listing and accounting standards requirements, are also eliminated. This brings the final number of 80 items that make up the final disclosure items.[2]

The level of voluntary disclosure is measured based on disclosure score index. Past studies have used two types of disclosure score indexes; weighted index and unweighted index (Chau & Gray 2002). The weighted disclosure index is used when certain items are considered more important than others and therefore given a higher score (Alsaeed 2006). On the other hand, the unweighted disclosure index is used when each disclosure item is considered equally important, thus given the same scores (Luo et al. 2004). The application of weighted disclosure index poses addition problem due to subjectivity involved in determining the importance of each item. Therefore, this study uses the unweighted disclosure index approach. Moreover it has been proven that, statistically there is no significant difference between the weighted and unweighted disclosure index (Chau & Gray 2002).

A score of 1 is given if a particular disclosure item is disclosed and a score of 0 is given if the item is not disclosed. If a particular disclosure item is not relevant to a sample company, a 'non applicable' (NA) symbol is given to indicate that this particular disclosure item will not be included to calculate the total disclosure index. The voluntary disclosure index is calculated based on the ratio of total possible items disclosed by the company divided with all the possible disclosure items. The level of disclosure index (DI) for each company is calculated as follows:

$$DI = \frac{1}{N_j} \sum_{t=1}^{nj} X_{ij}$$

where DI = Disclosure Index,
N_j = Total possible disclosure items, and
X_{ij} = Actual number of possible items.

Other variables of interest are the composition of independent directors on the BOC, audit quality, composition of family member on the BOC, and managerial ownership of a company. The composition of independent directors on the BOC is measured based on the proportion of independent directors divided by the total number of BOC (Nugrahadi 2008). Information on the proportion of independent directors on the BOC is obtained from the annual reports.

Audit quality is measured by determining whether companies are audited by large audit firms (Big 4) or small audit firms (Non Big 4). A score of 1 is given if a company is audited by Big 4 audit firms and a score of 0 given if otherwise (Wang et al. 2006). To determine the audit quality in the Indonesian scenario, the study also incorporates companies that are audited by local audit firms (normally known as Juru Audit) that have an affiliation with the international Big 4 audit firms. The nature of their affiliation is shown as follows:

1. Juru Audit Purwanrtono, Suherman & Surga (affiliated to Ernest & Young)
2. Juru Audit Osman Bing Satrio (affiliated to Deloitte Touche Tohmatsu)
3. Juru Audit Siddharta and Widjaja (affiliated to KPMG)
4. Juru Audit Tanudireja, Wibisana & Partners (affiliated to Price Waterhouse Coopers)

In line with the Corporate Governance Codes issued by the NCCG, members of BOC may consist of independent commissioners and affiliated commissioners. Affiliated commissioners are directors who may have family relationship with major shareholders (KNKG 2006). In this study, the presence of family members on the BOC is measured based on the ratio of family members on the BOC to the total number of BOC members. This measure is often used in past studies to account for the family members on the board of directors (Ho & Wong 2001; Ghazali & Weetman 2006).

Management ownership is measured based on the percentage of direct ownership by the members of BOD. This measure has been used by previous studies to account for the managerial ownership (Eng & Mak 2003; Nugrahadi 2008). Information about management equity ownership is obtained from the annual reports.

There are other variables expected to influence the level of voluntary disclosure and have been frequently studied in the past. These variables are size, profitability and leverage which are incorporated as control variables in this study. Previous studies have used a number of proxies for size. This study uses total asset as a measure of size (Romlah et al. 2002). Profitability is based on the ratio between net income and total sales (Chau & Gray 2002), while leverage is measured based on total liabilities over total assets (Eng & Mak 2003).

ANALYSIS AND FINDINGS

The sample for this study is drawn from 212 companies listed on Bursa Saham Indonesia in 2008. The sample excludes 22 companies from the financial sectors as these companies have their own reporting requirements and would have different reporting incentives. Additionally, 86 companies are also excluded due to data downloading failure and incomplete data. This brings the final sample to 104 companies, representing six industrial sectors as detailed out in Table 1.

TABLE 1. Sample by industry

Industry	Frequency	Percentage
Mining	5	4.81
Basic	4	3.85
Property	28	26.92
Infrastructure	16	15.38
Trade & services	47	45.19
Miscellaneous	4	3.85
Total	104	100.00

Descriptive statistics for all variables used in the study are shown in Table 2. The average score for the dependent variable, the level of voluntary disclosure, is 48.6% with the highest level of 80.8% and the lowest level of 25.6%. This result is comparable to a study by Nugrahadi (2008) who reported an average score of 40.19% for level of voluntary disclosure in Indonesia for 2005. The increase in disclosure level suggests that there is generally an effort by companies to increase voluntarily disclosure, although disclosure of such information is not required by the BAPEPAM.

TABLE 2. Descriptive statistics of variables

Variables	Mean	Median	SD	Minimum	Maximum
DiscIndex	0.486	0.487	0.106	0.256	0.808
InBOC	0.407	0.400	0.162	0.000	1.000
FmBOC	0.584	0.600	0.166	0.000	1.000
MgtOwn	0.002	0.000	0.019	0.000	0.190
Size	13.238	13.475	2.307	8.180	18.33
Profit	0.035	0.050	0.293	-2.120	0.620
Leverage	0.413	0.420	0.313	0.001	2.160

Notes: Abbreviations DiscIndex = voluntary disclosure index, InBOC = composition of independent directors, FmBOC = composition of family member in the BOC, MgtOwn = managerial ownership, Size = total assets, Profit = net profit after tax/sales, and Leverage = total liabilities/total assets.

The average score for composition of independent members sitting on the BOC is 40.7% with the maximum and minimum score of 100% and 0%, respectively. This means that about 40.7% of the BOC members are independent commissioners while the rest are affiliated commissioners, who may have family or business ties with major shareholders of the companies or with the companies. This is confirmed by the composition of family members on the BOC which records an average of 58.4%. The lowest value of 0% indicates that there are companies with all non-independent members in the BOC while the highest score of 100% indicates that there are companies with all independent members on the BOC. Managerial ownership in Indonesian companies is very low with an average of only 0.2%. The highest and lowest percentage of managerial shareholdings is 19% and 0%, respectively.

The average scores for control variables are 13.283 for size, 3.5% for profitability and 41.3% for leverage. Table 3 shows 30 companies (28.85%) are audited by Big 4 audit firms while the remaining 74 companies (71.15%) are audited by the Non Big 4 audit firm.

TABLE 3. Samples audited by Big 4 and Non Big 4 audit firms

Type of Auditors	Frequency	Percentage
Big 4	30	28.85
Non Big 4	74	71.15
Total	104	100

The data are examined for normality and multicollinearity problems prior to regression analysis. All variables are examined for extreme values by analyzing their scatter plots and values of skewness, kurtosis, and standard deviations to test for normality. Based on the analysis, only two variables; the level of voluntary disclosure and company size are found to be normally distributed. Replacement of extreme values with the next value in the sequence as suggested by Tabachnik and Fidell (2001) is carried out to solve the normality problem of the variables. Pearson correlation result as depicted in Table 4 shows a high correlation of -0.942 between independence of BOC and family members on BOC. This value exceeds the cutoff point of 0.9 as suggested by Tabachnik and Fidell (2001).

TABLE 4. Pearson correlation results

	DiscIndex	InBOC	FmBOC	AUDIT	MgtOwn	Size	Profit	Leverage
DiscIndex	1							
InBOC	0.128	1						
FmBOC	-0.177	-0.942**	1					
Audit	0.339*	-0.059	0.037	1				
MgtOwn	0.115	-0.006	-0.227	-0.069	1			
Size	0.393**	-0.014	0.038	0.247	0.115*	1		
Profit	0.020*	0.048	-0.077	0.231*	0.039*	0.043*	1	
Leverage	0.096	0.028	-0.047	0.142*	0.118	0.091	-0.011	1

Notes: Abbreviations Disc Index = voluntary disclosure index, InBOC = composition of independent directors, FmBOC = composition of family member in the BOC, MgtOwn = managerial ownership, Size = total assets, Profit = net profit after tax/sales, and Leverage = total liabilities/total assets.

To overcome this problem and to answer the research objective, the two highly correlated variables are separated and tested in two different regressions. In the first regression analysis (Model 1), the FmBOC variable is omitted, while in the second regression (Model 2), the InBOC variable is omitted. This method enables us to test for the acceptance and rejection of both hypotheses.

The result of the two regression analysis is presented in Table 5. In general the results show that three tested variables (independence of BOC, family member on BOC, auditor quality) have significant relationships with the level of voluntary disclosure. The managerial ownership variable is found to have no influence on the level of voluntary disclosure.

The positive and significant effect of the variable independence of BOC (p = 0.098), provides a moderate support for H1. This suggests that the more independent the BOC the better the level of voluntary disclosure. The finding is consistent with Ho and Wong (2001), Barakko et al. (2006), and Donelly and Mulcahy (2008) who find a positive and significant relationship between the compositions of independent BOD members and the level of voluntary disclosure. The results imply that independent BOC members on the board enables the board to execute its role more effectively by demanding greater voluntary disclosure by management (Chen & Jaggi 2000; Ghazali & Weetman 2006), thus reducing information asymmetry and agency problems. This phenomenon should be more apparent in Indonesia since all BOC members are non-executive. Therefore, BOC members are expected to provide more effective monitoring compared to BOD members in a one tier board system. Additionally, this finding is also consistent with the agency theory suggestion that corporate governance practices serve as a complement to the level of voluntary disclosure. Meaning, companies that practices good governance (for example,

TABLE 5. Results of regression analysis

Variable	Model 1 Coefficient (t value)	Model 2 Coefficient (t value)
Constant	0.217 (3.511)***	.338 (5.299)
InBOC	0.148 (1.672)*	-
FmBOC	-	-.123 (-2.141) **
Audit	0.261 (2.698)**	.066 (3.048) **
MgtOwn	-0.020 (-0.216)	.309 (.604)
Size	0.329 (3.557)***	.015 (3.574)***
Profit	-0.034 (0.366)	-.028 (-.850)
Leverage	0.069 (0.753)	.003 (.105)
F value	5.294	5.813
Adjusted R²	0.226	.219

Notes:
Model 1; $DiscIndex = \beta_0 + \beta_1 InBOC + \beta_3 Audit + \beta_4 MgtOwn + \beta_5 Size + \beta_6\ Profit + \beta_7 Leverage + \varepsilon$;
Model 2; $DiscIndex = \beta_0 + \beta_2 FmBOC + \beta_3 Audit + \beta_4 MgtOwn + \beta_5 Size + \beta_6\ Profit + \beta_7 Leverage + \varepsilon$; All variables are as defined in Tables 2 and 4. Asterisk *** significant at 0.001, ** significant at 0.05, and * significant at 0.1

have higher independent BOD/BOC), would also have a high level of voluntary disclosure (Ho & Wong 2001). The positive relationship between independence of BOC and the level of voluntary disclosure indicates that independent board members serve as a complement to the high level of voluntary disclosure.

The results also show that family membership on the board has significantly and negatively influenced the level of voluntary disclosure (p = 0.035). This finding is consistent with finding from previous studies that proposed family members can have easier access to internal information. Therefore, the need for additional reporting and disclosure will be less (Haniffa & Cooke 2002). This result has provided a justification to support H3.

The audit quality shows a positive and significant influence on the level of voluntary disclosure, in both Models 1 and 2. This indicates that disclosure by companies that are audited by Big 4 audit firms is higher compared to disclosure by companies that are audited by Non Big 4 audit firm. This finding indicates that quality audit serve as a complementary role to enhance corporate governance mechanism to increase the level of voluntary disclosure (Ho & Wong 2001). This finding is consistent with Gul and Leung (2004), Agca and Onder (2007), Wang et al. (2008), and O'Sullivan et al. (2008). Gul and Leung (2004) also suggest that auditors who are concerned about preserving their reputation will strongly encourage clients to provide a more comprehensive disclosure. Therefore, H2 is supported.

The effect of managerial ownership on the level of voluntary disclosure is found to be insignificant. This implies that hypothesis H3 is not supported. The direction of the relationship, however, supports the findings by Eng and Mak (2003) who find that managerial ownership has a negative and significant effect on the level of voluntary disclosure. Findings by Eng and Mak (2003) are based on agency theory that suggests that voluntary disclosure levels are low when managerial ownership is high. Sabariah (2007) suggests that voluntary information in annual reports is under the discretion of the management. There will be less need for detail reporting when managers have considerable percentage of ownership in companies, as they can get the needed information directly from the organization. The insignificant result could be due to the very low level of managerial ownership in Indonesian companies, in line with the findings of Nugrahadi (2008).

Of the three control variables included in this study, only size shows a positive and significant ($p < 0.001$) influence. The result suggests that those bigger companies would be more likely provide higher level of voluntary disclosure. This finding supports previous findings by Ho and Wong (2001), Eng and Mak (2003), Gul and Leung (2004), Arcay and Vazquez (2005), Barako et al. (2006), and Donelly and Mulcahy (2008).

Another control variable, profitability, shows a negative but insignificant influence on voluntary disclosure which is consistent with Chau and Gray (2002), Eng and Mak (2003), Alsaeed (2006), Barako et al. (2006) and Nugrahadi (2008) but inconsistent with Haniffa and Cooke (2002), Agca and Onder (2007), Gul and Leung (2004) and Wang et al. (2008) who find a positive and significant relationship. The negative and insignificant relationship can be due to lack of awareness among companies in developing economy to provide additional disclosure beyond what is required by the regulation. Additionally, financially poor companies tend to disclose more information to balance the negative effect from the poor performance (Sabariah 2007). Finally, leverage is found to have a positive but insignificant relationship with the level of disclosure, consistent with Ho and Wong

(2001), Cheng and Courtenay (2006), Chau and Gray (2002), Eng and Mak (2003) and Wang et al. (2006). This positive relationship shows the high agency cost companies tend to disclose more in order to reduce agency problem.

CONCLUSION AND IMPLICATIONS

The main issue of this study is the effect of corporate governance mechanism on the level of voluntary disclosure in Indonesia, a country that adopts a two tier board system. Members of the BOC in a two tier board systems can exercise more control to monitor the performance of management since they are all non-executives. This scenario is in contrast to members of the BOD in a one tier board system since board members can be executive and non-executive members. The conflicting role can jeopardize the board's independence to evaluate the performance of the management (executive) since the board members are also a part of the management team.

The corporate governance factors examined in this study are the independent composition of the BOC, the composition of family members on the BOC, audit quality, and managerial ownership. This study predicts that the independent composition of BOC should strongly influence the voluntary disclosure level since members are considered more objective to execute their role as the monitoring mechanism of management actions. The results of the study show that the relationship has been moderate ($p = 0.098$). It indicates that although BOC members are not allowed to hold any executive post in a company that does not stop them to get involved in matters related the operation of companies. There are cases in which BOC members are next of kin or have business associations with major shareholders or with the companies. This is confirmed by the percentage composition of family members on the BOC at 58.4%. Therefore, the regulatory bodies in Indonesia need to reexamine and reconsider the current laws and regulations to ensure the BOC members are truly 'independent' so the members can effectively and objectively monitor performance of the executive managers.

The result also shows that audit quality has a positive and significant relationship with the level of voluntary disclosure. Meanwhile, tested separately, the level of family members on the board has influenced the disclosure negatively. The managerial ownership variable also shows a negative relationship, as hypothesized, but the relationship is not significant.

Further study needs to investigate in greater detail the relationship of managerial ownership and the level of disclosure. Currently, the level of managerial direct ownership is very low. However, as suggested by Nugrahadi (2008) the total direct and indirect ownership by management might be very high which could substantially influence the level of voluntary disclosure. Another option for future research is to further examine the effect of family ownership on the level of voluntary disclosure as Indonesia has been identified as one of the country with the highest family controlled firms in the world. This study employed sample of companies for the year of 2008 only and this may limit the generalization of the findings. Therefore, future research should be conducted longitudinally to incorporate many years of study and get better understanding of the research issue.

ENDNOTES

[1] Three of the selected annual reports are of companies that won the Annual Report Award (ARA) in 2008. The other three annual reports are of the companies that have been used in the study by International Standards of Accounting and Reporting (UNTACD 2008) and a further four annual reports are obtained from four main industries in Indonesia (manufacturing, hospitality, transportation and supermarket centers).

[2] Please refer to the authors for the final list of disclosure items.

REFERENCES

Agca, A. & Onder, S. 2007. Voluntary disclosure in Turkey: A study on firms listed in Istanbul Stock Exchange (ISE). *Problems and Perspectives in Management* 5(3): 241-251.

Alsaeed, K. 2006. The association between firm-specific characteristics and disclosure: The case of Saudi Arabia. *Journal of American Academy of Business Cambridge* 7: 310-321.

Arcay, M.R.B. & Vazque, M.F.M. 2005. Corporate characteristics, governance rules and the extent of voluntary disclosure in Spain. *Advances in Accounting* 21: 229-331.

Badan Pengawas Pasar Modal dan Lembaga Keuangan Departemen Keuangan Republik Indonesia (BAPEPAM). 2006. Keputusan Ketua Badan Pengawas Pasar Modal dan Lembaga Keuangan Nombor: Kep-134/BL/2006.

Barako, D.G., Hancock, P. & Izan, H.Y. 2006. Factor influencing voluntary disclosure by Kenyan companies. *Journal Compilation Blackwell Publising Ltd* 14(2): 107-123.

Bursa Saham Indonesia. 2010. Available at http://www.idx.co.id

Chau, G.K. & Gray, S.J. 2002. Ownership structure and corproate voluntary disclosure in Hong Kong and Singapore. *The International Journal of Accounting* 37: 247-265.

Chen, C. J. P. & Jaggi, B. 2000. Association between independent non-executive directors, family control and financial disclosure in Hong Kong. *Journal of Accounting and Public Policy* 19: 285-310.

Cheng, E.C.M. & Courtenay, S.M. 2006. Board composition, regulatory regime and voluntary disclosure. *The International Journal of Accounting* 41: 262-89.

Donnelly, R. & Mulcahy, M. 2008. Board structure, ownership, and voluntary disclosure in Ireland. *Journal Compilation Blackwell Publising Ltd* 16(5): 416-427.

Eng, L.L. & Mak, Y.T. 2003. Corporate governance and voluntary disclosure. *Journal of Accounting and Public Policy* 22: 325-345.

Fama, E. & Jensen, M. 1983. Separation of ownership and control. *Journal of Law and Economics* 26: 301-325.

Forker, J.J. 1992. Corporate governance and disclosure quality. *Accounting and Business Research* 22: 86.

Francis, J.R., Maydew, E.L. & Sparks, C. 1999. The role of big 6 auditors in the credible reporting of accruals. *Auditing: A Journal of Practice & Theory* 18(2): 18-34

Gelb, D.S. 2000. Managerial ownership and accounting disclosure: An empirical study. *Review of Quantitative Finance and Accounting* 15: 169-185.

Gul, F.A. & Leung, S. 2004. Board leadership, outside directors expertise and voluntry corporate disclosure. *Journal of Accounting and Public Policy* 23: 351-379.

Ghazali, N.A.M. & Weetman, P. 2006. Perpetuating traditional influences: Voluntary disclosure in Malaysia following the economic crisis. *Journal of International Accounting, Auditing and Taxatio* 15: 226-248.

Ho, S.S.M. & Wong, K.S. 2001. A study of the relationship between corporate governance strutures and the extent of voluntary disclosure. *Journal of International Accounting, Auditing and Taxation* 10: 139-156.

Hossain, M., Tan, L.M.D. & Adam, M. 1994. Voluntary disclosure in an emerging capital market: Some empirical evidence from companies listed on the Kuala Lumpur Stock Exchange. *The International Journal of Accounting* 29(4): 334-351.

Haniffa, R.M. & Cooke, T.E. 2002. Culture, corporate governance and disclosure in Malaysian corporations. *Abacus* 38(3): 318-349.

Healy, P., Hulton, A. & Palepu, K. 1999. Stock performance and intermediation changes surrounding sustained increase in disclosure. *Contemporary Accounting Research* 16: 485-520.

Jensen, M.C. & Meckling, W.H. 1976. Theory of firm, managerial behaviour, agency cost and ownership structure. *Journal of Financial Economics* 3(4): 334-351.

John, K. & Senbet, L.W. 1998. Corporate governance and board effectiveness. *Journal of Banking and Finance* 22(4): 371-403.

Jungmann, C. 2006. The dualism of the one-tier and two-tier boards in Europe. *ECF* 4: 426-474.

Khoo, B.Y. 2003. Review of Corporate Governance in Asia: Corporate Governance in Malaysia. Available at http://www.adbi.org/files/2003.11.10.

Komite Nasional Kebijakan Governance. 2009. *Pemenang anual report award 2008*. Available at http://www.governance-Indonesia.com.

Komite Nasional Kebijakan Governance. 2006. *Pedoman Umum Good Corporate Governance Indonesia.* Jakarta: Komite Nasional Kebijakan Governance.

Krishnan, G.V. 2003. Audit quality and the pricing of discretionary accruals. *Auditing: A Journal of Practice and Theory* 22(1):109-126.

Kurniawan, B.M. & Indriantoro, N. 2000. *Corporate governance in Indonesia*. The second Asian round table on corporate governance. Organized by Organization for Economic Co-operation an Development, 31 May-22 June, Hong Kong and China.

Kwak, M. 2003. The advantages of family ownership. *MIT Sloan Management Review* 44(2): 12

Leftwich, R.W., Watts, R.L. & Zimmerman, J.L. 1981. Voluntary corporate disclosure: The case of interim reporting. *Journal of Accounting Research* 19: 50-77.

Luo, S., Courtenay, S.M. & Hossain, M. 2006. The effect of voluntary disclosure, ownership structure and proprietary cost on the return-future earning relation. *Pacific-Basin Finance Journal* 14: 501-521.

Meek, G.K. & Roberts, C.B. 1995. Factor influencing voluntary annual report disclosure by U.S., U.K. and continental European multinational corporation. *Journal of International Business Studies* 26: 555-573.

Nugrahadi, H. 2008. *Pengaruh tata kelola perusahaan terhadap pendedahan sukarela*. Unpublished Master Thesis, Universitas Gajah Mada Yogyakarta, Yogyakarta, Indonesia.

O'Sullivan, M., Percy, M. & Stewart, J. 2008. Australian evidence on corporate governance attributes and their association with forward-looking information in the annual report. *Journal of Management and Governance* 12(1): 5-35

Romlah, J., Takiah, M.I. & Nordin. M., 2002. An investigation of environmental disclosures: Evidence from selected industries in Malaysia. *International Journal of Business and Society* 3(2): 55-68.

Sabariah, J. 2007. *Kesan kualiti perolehan dan struktur pemilikan terhadap kualiti pelaporan maklumat: Kajian di Malaysia*. Unpublished Master Thesis, Universiti Kebangsaan Malaysia, Selangor, Malaysia.

Tabachnick, B.G. & Fidell, L.S. 2001. *Using Multivaraiate Statistics*. 4th edition. Needham Heights: Allyn & Bacon.

UNTACD. 2008. Review of the implementation status of corporate governance disclosure: An examination of reporting practices among large enterprise in 10 emerging markets. Geneva: Intergovernmental Working Group of Experts on International Standards of Accounting Reporting.

Wang, K., Sewon, O. & Claiborne, M.C. 2008. Determinants and consequences of voluntary disclosure in an emerging market: Evidence from China. *Journal of International Accounting Auditing and Taxation* 17: 14-30.

Wallace, R.S.O. & Naser, K. 1994. Firm-specific determinants of the comprehenshiveness of mandatory disclosure in the corporate annual reports of firms listed on the Stock Exchange of Hong Kong. *Journal of Accounting and Public Policy* 14: 311-368.

Warfield, T.D., Wild, J.J. & Wild, K.J. 1995. Managerial ownership, accounting choices, and informativeness of earnings. *Journal of Accounting and Economics* 20: 61-91.

Romlah Jaffar (corresponding author)
Faculty of Economics and Management
Universiti Kebangsaan Malaysia
43600 UKM Bangi, Selangor, MALAYSIA
E-Mail: romlah@ukm.my

Dina Mardinah
Faculty of Economics and Management
Universiti Kebangsaan Malaysia
43600 UKM Bangi, Selangor, MALAYSIA
E-Mail: alimjava@gmail.com

Azlina Ahmad
Faculty of Economics and Management
Universiti Kebangsaan Malaysia
43600 UKM Bangi, Selangor, MALAYSIA
E-Mail: azlina@ukm.my