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BOARD OF COMMISSIONERS' CHARACTERISTICS TOWARD FINANCIAL REPORTING'S QUALITY: NON-FINANCIAL ISSUERS LISTED IN INDONESIA STOCK EXCHANGE

Wiralestari[1]

Abstract: *Indonesia adheres two board systems. They are board of commissioners and board of directors who have authority and distinct responsible in accordance with their each functions. It is mandated by the statutes and regulations where policymakers are done by board of directors, while the monitoring are done by board of commissioners.*

The research aimed to testify how the mechanism of corporate governance which was the board of commissioners' characteristics affected on financial report's quality. The research conducted within 82 samples of non-financial corporates which were listed in Indonesia Stock Exchange. The data analysis of hypothesis testing applied descriptive analysis and multiple regression analysis by using SPSS version 20.

The research discovers that board of commissioners' characteristics does not affect significantly toward financial reporting's quality. It shows that board of commissioners are less efficient in monitoring financial reporting's quality.

Keywords: *Board of Commissioners, Financial Reporting's Quality*

1. INTRODUCTION

In Indonesia, the issue of corporate governance started to emerge after having a long period of economic crisis in the year of 1998. Many parties stated that the long process of economic crisis restoration in Indonesia were caused by the insubstantial corporate governance which was applied in Indonesia's corporates.

One of the factors that caused the insubstantial of good corporate governance implementation was board of commissioners' monitoring aspects. In practice, board of commissioners' members in Indonesia's corporates were often to ignore their basic functions as supervisor toward board of directors.

[1] Doctorate Candidate of Padjadjaran University, Bandung, Indonesia and Lecturer of Jambi University, Jambi, Indonesia. *Email: aquarius.ra83@yahoo.com*

The governance structure in Indonesia adhered two tier system. It was the system originated from Europe where policymakers and supervisors were distinguished by their functions. The function of policymakers was obtained by board of directors, while the function of supervisor was obtained by board of commissioners.

As stated by Regulation Number 40 year 2007 on Limited Company, board of commissioners are the organ of the company in charge of monitoring generally or specifically in accordance with the statutes and in charge of advising directors. The Public Oversight Board (1995) in USA affirmed that board of commissioners played an important role in the process of financial reporting.

Board of commissioners were in charge of supervising financial reporting in order to produce good quality of financial reporting. Corporate governance depicted the procedures of improving the quality of financial report. It obliged board of commissioners' role to suppress profit manipulation and assured by giving precise information about corporate operation (Young, 1998).

Several previous empirical researches mentioned that several board of commissioners' characteristics affected on financial reporting's quality which was measured by the level of discretionary accruals. The characteristics were competency, independency and effectiveness of the function (Gerety and Lehn, 1997; BRC, 1999; Chtourou et al, 2001). Board of commissioners were in charge of monitoring financial reporting's process in order to produce a good quality of financial reporting.

Several empirical assessments informed that companies in England and United States indicated board of commissioners influenced in earnings management and the quality of financial report. It also indicated that board commissioners' characteristics influenced in producing financial report's quality. Independent board of commissioners could reduce earnings management by managers (Beasley, 1996; Peasnell et all, 2004). Dechow (1996) investigated the characteristic of corporate governance and Beasley (1996) investigated the correlation between board of commissioners composition and the fraud of financial report. Based on those elaborations, the researcher interested in analyzing the effect of board of commissioner' characteristics toward the quality of financial reporting.

2. LITERATURE REVIEW

Based on agency theory, the agent who acted as a party that managed a company had more information about company's capacity, the work environment and the entire company. On the other hand, the principal didn't have enough information

about the agent's performance (Jensen and Meckling, 1976). Hence, the agent had to signal the principal about the company's state. The signal could be done by revealing financial information. As said by Sloan (2001), financial information was the first, independent and true source. It was also the communication about performance of the company's manager.

Based on agency theory, it can be concluded that company's management had an important role in improving financial reporting's quality (Kangarlouei, 2013: 16). It was emphasized by Cohen at al (2004) that one of the most important function of corporate governance was verifying the quality of financial reporting's process.

2.1 Board of Commissioners' Competency and Financial Reporting's Quality

Cadbury (1992) recommended board of commissioner's adequate educational background would determine quality and expertise. Intelligence and tabulation of information would affect depth control which was given by board of commissioners. The commissioners who had an adequate educational background, sufficient experience, quality, capacity, discretion and analytical sharpness would enhance board of commissioners' credibility in monitoring the executives.

Chtourou et al. (2001) asserted that the board who had higher position and had no experience as board member tended to be associated with profit management. Beasley (1996) said that the whole characteristics of board of commissioners had an important influence in the quality of financial reporting. Specifically, independent and experienced commissioner affected on the decline in revenue-increasing earnings management.

Hypothesis: Board of commissioners' competency affects financial reporting's quality.

2.2 The Presence of Independent Commissioners and Financial Report's Quality

The issue of independent board was one of the most discussed in academic literature of corporate governance. Independency is needed due to objectivity in assessing and deliberating problem by the board. One of the first research on the importance of independent board was Fama and Jansen's research (1983). In line with them, independent non-executive commissioners had bigger incentive in monitoring management's activities and protecting shareholders' assets.

Dechow at al (1996) conducted a research on companies in Security of Exchange Commission (EXC) who were allegedly violated GAAP and the reported profits

were overstatement. They found that the structure of corporate governance engaged an important role in controlling earnings management. Specifically, they discovered that the companies who had done a violation had board of directors which were dominated by inside board of directors. It unveiled the negative correlation of outsider director composition in earnings management.

Hypothesis: *The presence of independent board of commissioners affects financial reporting's quality.*

2.3 The Effects of Activity/Meeting Frequency toward Financial Reporting's Quality

Tricker (1994) described board of commissioners' activities consisted on management roles, internal monitoring (accountability role and strategic formulation) and external monitoring (monitoring and policymaking). Those activities involved appointing CEO, advising, authorizing business selections, strategies, monitoring work performances and protecting shareholders' interests.

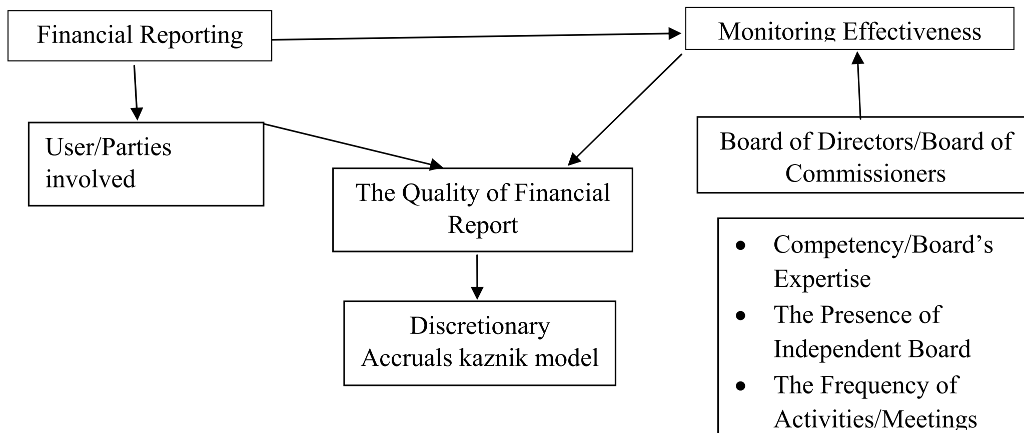
Cadbury (1992) stated that board of commissioners' duties were establishing corporate objectives, approving strategies and plans in achieving the goal, authorizing corporate policies, appointing chief executive, monitoring and establishing executive team in order to strengthen company's performance. By doing those duties actively, it could prevent violation by executives. The boards who were more active tended to do the duties in accordance with shareholders' interests (Vafeas, 2000). They also put more effort in monitoring financial report's integrity.

Xie at al. (2003) affirmed that the boards who were barely had meetings most likely to have time merely signing management plan and listening to presentations. Hence, there would be limited time to focus on financial problem such as earnings management. It indicated that the boards' activities reflected on work performance and it was an important factor in obstructing earnings management. Carcello et al. (2002) said that the high frequency of meetings could cause higher audit cost due to the demand of wider audit from the auditor that could increase audit's quality. In addition, Chen at al. (2006) affirmed that the high frequency of meetings could prevent manipulation by reason of the board more incentive in identifying and solving the problem regarding the quality of financial report.

Hypothesis: The frequency of activities/meetings affects the quality of financial reporting.

Moreover, Johnson et al (2002) said that work performance, size, leverage and growth also affected the quality of financial reporting. Based on the elaboration of previous frameworks, research paradigm was formulated and it showed the

correlation between board of directors and financial reporting's quality. Hence, it will be used as observation variable in this research model.



3. RESEARCH METHODOLOGY

The present research employed secondary data which were indirectly given to the data collector. The target population of the research was non-financial companies which were listed in Jakarta Stock Exchange. The total population was 451 non-financial issuers listed in Jakarta Stock Exchange. The data collection method was Probability Sampling. Hence, the sample of the research consisted of 82 companies.

The dependent variable of the research was financial reporting's quality. The research employed discretionary accrual proxy which used Kaznik model.

The independent variable of the research was board of directors' (board of commissioners) characteristics which covered the presence of independent board, board's expertise/competency, board's size and the frequency of activities/meetings. In the present research, the proxy employed the percentage of independent board which was owned by board of commissioners in order to measure independent board. The board's expertise/competency was measured by examining the percentage of the board who had accounting/finance skill. The board's measurement was measured by examining the percentage of board of commissioners which were owned by the corporate. Meanwhile, the frequency of activities/meetings were measured by examining the percentage of meetings which were done by board of commissioners.

The control variable of the research was the size of the corporate which was proxied by asset logarithm. DeFond and Jiambalvo (1994) stated that the size of the company correlated positively with earnings management. The bigger the size

of the company was, then the more of company's motives to manage earnings management. One of the motives was to assure investors' interests by producing good financial performance.

Leverage was proxied by total liabilities to total assets. Dechow at al (1996) uttered that nearly in debt-corporate was more likely to do earnings management. The higher ratio of credit/equity was, the closer the corporate to limits of agreement and credit regulations. The higher the credit limit was, the higher possibility of violation in credit agreement and expenses. The manager would have to choose accounting method that could raise profit. Hence, it could turn down credit limits and reduce technical error expenses.

The corporates' sales growth measured how well a company in maintaining its economic position whether its industry and the whole economic activity (Weston & Copeland, 1992). The company's sales growth was measured by examining the sales growth of company's operational in a year (Lai, 2005). Sales growth was calculated from the total sales in year t minus sales year t-1 divided by the total sales year t.

4. FINDINGS

4.1 The Impact of Competency toward Financial Report's Quality

The result of the research indicated that board of commissioners' competency didn't reflect on financial reporting's quality. It was because there were many companies in Indonesia owned commissioners in the board who didn't have competency/ expertise in accounting/finance. The commissioners in the board who had expertise/competency in accounting/finance did not fully know and understand company's financial situation deeply. Moreover, the commissioners did not have time to monitor the company effectively because they did not work full time and many of them were board member in more than one company (Bintang, 2012).

4.2 The Impact of Independent Commissioners toward Financial Report's Quality

The findings of the research was consistent with the research findings which were done by Bradbury et al (2006), Siregar and Utama (2005). The high proportion of independent commissioners did not affect financial reporting's quality significantly. Here are the explanation to it. Firstly, the appointment of independent commissioners by the company were probably done to fulfil the regulation but it was not meant to maintain good corporate governance in the company.

Secondly, the minimum requirement of independent board of commissioners

was 30% and it was not high enough for the independent commissioners in policymaking. If the proportion of independent commissioners was the majority (>50%), it probably would be more effective in monitoring the company. However, if the appointment of independent commissioners was not based on company's necessity other than just for the regulation, the board of commissioners' proportion did not need to be added. It would be enough to fulfil the minimum requirement (30%). The board's effectiveness in a longer term were also needed to be considered (Siregardan Utama, 2005).

4.3 The Impact of The Commissioners' Activities/Meetings Frequency toward Financial Report's Quality

The frequency of board's activities/meetings did not affect financial reporting's quality. It could be triggered when the commissioners' meetings did not have enough time to hear out a presentation but they only had time to sign a management plan and they could not effectively monitor the company's financial report (Xi et al, 2003). Furthermore, Vafeas (2002) stated that the high frequency of activities was a reaction of failed performance. It was triggered by the ignorance of the commissioners toward the real condition of the company and lack of identifying and solving problems regarding financial reporting's quality.

5. CONCLUSION

- Board of commissioners' competency did not affect financial report's quality significantly. It was because some of factors. Firstly, lack of understanding of company's financial situation and real company's condition. Secondly, there were number of commissioners who worked part time. Finally, they were also members of board who worked for more than one company.
- The presence of independent commissioners did not affect financial reporting's quality significantly. Because firstly, the appointment of independent commissioners was merely as a requirement of good corporate governance. Secondly, the composition of independent commissioners who were minority caused an adversity in policymaking and monitoring.
- The frequency of commissioners' meeting did not affect financial reporting's quality significantly. It shows the failure of commissioners' performance which showed inability in identifying and solving problems regarding financial reporting's quality. Hence, the management were capable of doing earnings management.

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