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PROCEEDING

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"ASIA EMERGING ECONOMY TOWARD GLOBAL ECONOMIC INTEGRATION"

Organized by

Faculty of Economics
Sriwijaya University

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Joint Organizer:

UKM | IPB | UNSYIAH | UNPAD | UNIB | UMS

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PANEL OF REVIEWERS

Greetings from Dean of Faculty of Economics, Sriwijaya University

Dear participants of the Miicema 13th - 2012 Conference,

On behalf of the Faculty of Economics, Sriwijaya University, we would like to welcome you to Palembang, Indonesia for the Miicema 13th Conference, 18th-20th October 2012.

We are excited organize our thirteeth Miicema conference in Palembang at Sriwijaya University. Sriwijaya University is States University in South Sumatera, has 10 faculties and 2 campuses. One is located at Bukit Besar in Palembang and another campus is located on 712 ha area of Indralaya, Ogan Ilir. This conference is really support us to be a “world class university”.

The conference bring together scolars and practitioners who interested to present theirs papers in area of economics, management and accounting. Participants found an excellent opportunity for presenting new research, exchanging information and discussing current issues. We believe that this conferences will improve further the development of knowledge in our fields. This opportunity could be used as a way to broadening their international networks.

We regret that we were unable to accept more paper than we have. In this conference, 163 papers were presented. In addition, based on the contribution of the paper to the field, the Miicema Committee has selected three papers for the best paper award.

Finally, I would like to thank our sponsors for their generous financial support and valuable collaboration. I would also thank all of the presenters, participant, board members, and keynote spreakers.

I hope you enjoy the conference and wish a pleasant and memorable stay in Palembang.

Best Regards,
Dean of Economic Faculty,
Sriwijaya University

Prof. Syamsurijal AK, Ph.D

MESSAGE FROM CONFERENCE CHAIR

Welcome to The 13th Malaysia-Indonesia International Conference on Economics, Management and Accounting (MIICEMA) 2012

The Malaysia-Indonesia International Conference on Economics, Management and Accounting (MIICEMA) aims to stimulate interest in economics, management and accounting research and to encourage discussion on those related issues with special reference to ASEAN countries. The conference has been held for 13 times in this year. As time goes on, the number of MIICEMA members increase and it also tries to broaden the scope of collaboration to include academic matters amongst others.

The 13th MIICEMA 2012 is hosted by Faculty of Economics, Sriwijaya University in collaboration with UKM, IPB, UNPAD, UNSYIAH, UNIB, UMS, UNJ, UNILA, UPI (YAI) AND STIE (YAI). of MIICEMA and. The association aims to play supportive role in promoting Palembang as an international city.

MIICEMA has been successfully organizing annual conferences in collaboration with those higher learning institutions mentioned. The support from academicians, researchers and business practicioners is clearly evident from the increasing numberof papers received by organizers this year. This year a total of more than 220 abstract and 163 full papers were received and most of them will be presented.

I would like to thank and congratulate the Rector of Sriwijaya University, Dean of Faculty of Economics for their support, Ministry of Finance of Republic of Indonesia for their support financially, South Sumatera Government, Palembang City Municipal and other sponsors i.e PT. BUKIT ASAM, PT. SEMEN BATURAJA, PT. PUSRI, BANK MANDIRI, BANK SUMSELBABEL, BANK BNI, MITRA ADIGUNA, AJB BUMIPUTERA, for their finance support. Last but not least I would like to thank to paper writers, participants and organizing commitee for your support.

Isnurhadi, Ph.D
Conference Chair
October, 2012

PANEL OF REVIEWERS

Editors:

1. **Isnurhadi**
2. **Zulkarnain Ishak**
3. **Kitima Tamalee**
4. **Hasni Yusrianti**

CORPORATE GOVERNANCE IN BANKING AND FINANCE INDUSTRY: THE ROLE OF SUPERVISORY BOARD

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ABSTRACT

This study aims to investigate the relationship between supervisory board independence, size, multiple directorship, shareholding and audit report lag in banking and finance industry in Indonesia. Due to different characteristic of Banking and finance industry and uniqueness of banking and finance industry in Indonesia, it is expected to contribute to corporate governance literature. Agency theory is used as underpinning theory to build these relationships. By using the 61 companies for 2005 to 2010, we find that the supervisory board independence, size and board shareholding significantly influence the audit report lag. In addition, profitability which is measured by ROA also affects the audit report lag. The theoretical and practical contributions are discussed in detail.
Keyword: Corporate Governance, Supervisory Board, and Audit Report Lag

1. INTRODUCTION

In the new global economy, corporate governance becomes a central issue since a decade ago. Corporate governance means that a set of relationships among a company's management, its board, its shareholders and other stakeholders (Chiang and Lin, 2007). Issue of corporate governance arose when there are separate of control and ownership. In addition, manager who is not the owner controlling the company asset, whereas stockholder who has the company asset can not control them. Therefore, this situation induces the conflict of interest between manager and stockholder (Berle and Means, 1932). The stockholder interest is their wealth in long run or profit maximization in short run whereas perquisite consumption and job security may be included as manager's objectives (Belkhir, 2009). To solve the conflicts, there are corporate governance mechanisms: internal and external mechanism. The example of internal corporate governance mechanism is role of board of director and whereas role of external auditor is example of external mechanism. .

It is becoming increasingly difficult to ignore the case of Enron due to the weak of corporate governance. In addition, low degree of implementing the corporate governance principle would bring to the lower accounting quality and company performance. In fact, it would impact on the fraud and corruption. Banking and finance industry is a unique industry due to highly regulated industry. Especially banking and insurance, this type of companies have the complexity of activities and higher asymmetry of information. The important of bank in economic system has been discussed in the economic and finance text book. Bank plays a significant role in economic system as intermediaries' institutions. In addition, banks are claimed as highly leverage firm since bank deposit customer money. Based on this situation, bank is highly regulated compared to other companies in order to have higher responsibility for its customer and reducing risk.

Based on the banking and finance characteristics which are far difference compared to other industry, corporate governance mechanism has a special framework. One of corporate governance mechanism is internal mechanism through role of board of director (supervisory board). Therefore, board becomes a key mechanism to monitor manager's behavior and to reduce the asymmetry information and agency problem. Agency costs issues raise particularly important research and policy questions regarding the banking and finance industry. The study of banking and finance industry can provide practical implication to support the corporate governance reform in developing country. The governance of financial institution has received relatively little attention in the academic literature (Juras and Hinson, 2008). In addition, there is a little empirical research on financial services institution with two tier board system like Indonesia. The previous study on audit report lag (audit delay) has been focused company characteristic, such as profitability, leverage and etc. there is a lack of study emphasizes on the role of supervisory board on audit report lag in banking and finance industry, especially in Indonesia. The Indonesian government has recently been starting to promote corporate governance in 2001. The goal of corporate governance is to give guideline for directors how to manage companies more efficient and effective.

The purpose of our paper is to analyze the effectiveness of the boards of directors in monitoring and advising managers in the bank and finance industry. Our underlying idea is that several characteristics of the board of directors (size, composition or functioning) might reflect directors' motivation and their ability to effectively monitor and advise managers. We expect that bank with boards that are more effective in monitoring and advisory terms are better governed, and that higher financial reporting quality. Specifically, to investigate whether board independence, board size, multiple directorship and board shareholding influence the audit report lag. This study is organized as follows. In section 2, it discusses the motivation of the study. Theoretical aspect and Hypothesis development is presented in section 3. Section 4 provides method and results. Section 5 describes the conclusion and limitation of the study.

2. MOTIVATION OF THE STUDY

This study tries to investigate the effect of supervisory board role and audit report lag in Indonesia. Zaitul (2010) concluded that there are 36 cases (from 174 cases) late submitting company financial report (20.69%) of companies listed in banking and finance industry. Despite, the percentage of late reporting is the lowest compared to other industry, this industry should not report the financial statement late because this industry is heavily regulated industry. Besides, there is a lack of research focus on the role of supervisory board in the financial reporting process. Previous study did not focus on corporate governance mechanism such as role of supervisory board.

3. THEORITICAL ASPECT AND HYPOTHESIS DEVELOPMENT

3.1. Supervisory board independence and audit report lag.

One of the board characteristics is board independence. The importance of the board independence is encouraged by the agency theory. Fama and Jensen (1983) argue that board independence can resolve the agency problem because they have an incentive to reduce the management opportunistic behavior. In addition, board Independence also helps in reducing management consumption of perquisites (Brickley & James, 1987). In fact, William and Shapiro (1979) conclude that board independence is important due to their experience and knowledge, external connection to industry and other companies, and the ability to interact with the management. From the resources dependence perspective, board independence can secure resources through external resources and have ability to insure the proper check and balance (Pfeffer and Salancik, 1978). However, board independence has disadvantages as argued by many authors, such as Goodstein et al. (1994), Bayersinger & Butler (1985), and Patton & Baker (1987). Goodstein et al. (1994) state that board independence may be detrimental to companies as they may stifle the company's strategic actions. Other argues that board independence may engulf the company in excessive monitoring and may lack the business knowledge to be truly effective (Bayersinger & Butler, 1985).

The role of the board of directors as a corporate governance mechanism in corporate financial reporting or accounting quality was suggested by several researchers, such as Cohen et al. (2004). In addition, Klein (2002) argue that board of directors has a primary responsibility of overseeing the company's financial reporting process and boards meet routinely with the company's accounting staff and external auditors to review financial statements, audit procedures, and internal control mechanisms. Defond and Jiambalvo (1996) conclude that board of director can influence the integrity of financial accounting process and has the responsibility to provide an independent oversight of management performance and to hold management accountable to shareholders for its actions. Thus, Cohen et al. (2004) argued that board composition somehow affected the accounting quality through integration with other corporate governance actors. In addition, Beasley (1996) found that the proportion of outside directors is lower in the companies that have problems with fraud compared to that of those who did not. Another author also supports the link between board independence and accounting quality (Klein, 1998; Peasnell, Pope, & Young, 2000). The effect of the board composition on timeliness of financial reporting has also been studied by a few researchers (Beekes et al., 2004; Abdullah, 2006). In addition, Zaitul and Hanim (2011) conclude that board independence significantly affect the timeliness of financial report in Indonesia. However, Zaitul and Putri (2012) find that there is no significant relationship between board composition and timely financial reporting in construction, real estate and property industry in Indonesia.

H1: Supervisory board independence has a negatively significant relationship with the audit report lag.

3.2. Supervisory board size and audit report lag

Board size is other characteristic of supervisory board. The size of supervisory board has been discussed much due to its impact on accounting quality or companies performance. Monks and Minow (1995) highlight that the matter of board size. Lipton & Lorsch (1992) suggest that larger (smaller) boards are able to commit more (less) time and efforts to overseeing management. There are two opposed contention about the board size. First, small board is prevalent based on several reasons: more effective coordination and processing problems and better decision making (Jensen, 1983), cost-effectiveness due to quick decision-making, the processing problem and being easily controlled by management and decreasing ability of the board to control management (Eiserberg, 1998). In addition, final decision of small board is less compromise and more extreme (Sah & Stiglitz, 1991), and less free riding (Jensen, 1983). Second, however, the large board has the advantage as well. Pfeffer (1987) points out that large board may advantage of company as they are providing diversity. Further, Haleblian & Finkelstein (1993) stated that the main benefit to having a large board is that a large number of directors on a board have more problem-solving capabilities. In addition, Mak and Rous (2000) claims that large board is often believed to be more capable of monitoring the action of top management because it is more difficult for CEO to dominate larger board.

There is no consensus of the number of board member in a company. However, several experts give the number, such as Jensen (1983) and Lipton and Lorsch (1992). Jensen (1983) mention the number is around seven and eight members, whereas Lipton and Lorch (1992) recommended around eight and nine members. However, Daily and Dalton (1993) propose that the number is much relying on external environment, the greater reliance on external environment, the bigger the number of board. The case of Indonesia company, the number of board is not regulated but the code of corporate governance just mention the sufficient size that suits the complexity of the business of the company by taking into account the effectiveness in decision-making (NCG, 2006). Several studies investigating the effect of board size and accounting quality has been carried out, such as Karamanou & Vafeas (2005), Beasley (1996), and Zaitul and Hanim (2011). Karamanou & Vafeas (2005) conclude that there is a significant relationship between update of management earnings forecast and board size. Further, Beasley (1996) find that there is a significant relationship between board size and the likelihood of financial statement frauds. His result shows that the bigger the size of board of directors, the likelihood of financial statement fraud also increases. Further, Zaitul and Hanim (2011) conclude that board size negatively influence the timeliness of financial report of Indonesia companies. Therefore, the board size is likely to affect the financial reporting process, hence the timeliness of financial reporting.

H2: Supervisory board size has a significant relationship with the audit report lag.

3.3. Supervisory multiple directorship and audit report lag

The third board characteristic is multiple directorships. It refers to a board member who sits on more than one board. In the literature, multiple directorships also called board busyness, board commitment. Kiel (2006) points out that multiple directorship add values to the company in three ways. First, they can act as a co-optive mechanism to extract resources and obtain support from external stakeholders. Second, board members serve as boundary spanners providing channel for communicating information from or to the external environment. Third, boards are thought to play an important role in enhancing organizational legitimacy. In addition, Richardson (1987) claims that there are some benefits of multiple directorship: (i) they serve as an influential source of information and (ii) and they serve as a mechanism for control. In brief, multiple directorships could offer additional insights into the outcome of other companies, facilitating comparisons (Dahya et al., 1996) as well as enhancing control.

In contrast, Dooley (1969) and Mariolis (1975) suggested that good corporate performance has nothing to do with the directors having multiple directorships. Multiple directorships are also seen as devices for inter-corporate collusion and inter-organizational elite co-optation and corporation (Pfeffer & Salancik, 1978). Similarly, Mace (1986) argued that multiple directorships may encourage directors to pursue their own objectives at the expense of other shareholders. Vicknair, Hickman, & Carnes (1993) argued that multiple directorships may lead to a situation where very few are wiling to 'rock the boat' which, in turn, will have adverse implications on the independence of the board. Shivdasani & Yermack (1999) concluded that multiple directorships are consistent with the interest of shareholders and increase the probability of accounting frauds. In recent years, there has been an increasing amount of studies about multiple directorship and accounting quality. Abdelsalam & Street (2007) found that there is a significant relationship between the multiple directorship and timeliness of corporate Internet reporting. In another major study, Zaitul and Hanim (2011) and Zaitul and Putri (2012) documented that there is no significant relationship between timeliness of financial report and timely financial reporting respectively.

H3: Multiple directorships have a significant relationship with the audit report lag.

3.4. Supervisory board shareholding and audit report lag

The fourth board characteristic is board shareholding. It refers to the board having stock in the company. Thus, boards are encouraged to have their own portion of ownership in the corporation. In addition, the rationale to invite board of directors, especially-non executives, to have a small portion of ownership in the corporation to reduce the gap between the board's interest and the interest of shareholders, as well as the corporation (Jensen & Meckling, 1976). Monks & Minow (1995) stated that the board of directors should become effective, not just because they have no economic ties to the company beyond their job as board members, but because they are significant shareholders. Regarding to board shareholding and accounting quality, there are two perspective explaining the phenomena, managerial entrenchment hypothesis and agency theory (Niu, 2006). Under the managerial entrenchment hypothesis, managers may have more incentive to exercise discretions in accounting reporting and therefore, monitoring and disciplining would be more difficult for directors with ownership in the firm (Morck et al., 1988). In addition, Morck et al. (1988) added that high board ownership would cause the moral hazard and asymmetric information problem between management or directors and investors. Therefore, board ownership may negatively affect the accounting quality and thus the timeliness of financial reporting.

Under the agency theory, Jensen & Meckling (1976) argued that managers with lower firm ownership would have an incentive to manipulate the accounting figures in order to relieve the constraints imposed by an accounting-based compensation contract. In addition, Jensen (1989) states that outside directors with the small number of stocks they are holding can effectively monitor and discipline the managers. Therefore, the board ownership is positively associated with the accounting quality. Jensen (1993) concludes that outside board shareholding has a positive relationship with the degree of the internal control problem. Most firms use the stock option compensation to increase the director's equity holding. With board ownership, it will reduce the opportunistic behavior and therefore reduce the agency costs. Further, Hambrick & Jackson (2000) stated that many firms require their boards to increase its ownership. With the same analogy, board shareholding can also affect the financial reporting quality. Further, Niu (2006) suggested that board shareholding can affect the financial reporting quality. Previous study by Zaitul and Hanim (2011) find the negatively significant effect of board shareholding on timeliness of financial reports.

H4: Board shareholding has a significant relationship with audit report lag.

4. METHOD AND RESULTS

In order to examine the issue, I analyze a sample of 61 Indonesian banking and finance companies from 2005 to 2010. Board independence would be measured by the ratio of independent directors relative to the total directors in the board (Lefort & Urzua, 2008). Thus, supervisory board size is measured by the number of supervisory board in a company. Further, multiple directorship use the proxy of ratio of directors who sit in other companies as a board of directors relative to the total number of directors in a company (Abdelsalam & Street, 2007). Board shareholding is measured by percentage board that have share. Therefore, the number of observation in this study is 366 company-years. The regression analysis is used to reject the hypotheses. The research model as follow:

$$ARL_{it} = a + \beta_1 BI_{it} + \beta_2 BZ_{it} + \beta_3 MB_{it} + \beta_4 SBS_{it} + \beta_5 LCS_{it} + \beta_6 LROA_{it} + e$$

ARL = Audit Report Lag
BI = Board Independence
BZ = Board Size
MB = Multiple Directorship
SBS = Board Shareholding
LCS = Natural Logarithm of Company Size
LROA = Natural Logarithm of Return on Asset

The step of regression analysis is started from outlier, normality, multicollinearty, heteroskedasticity and fitness of model and t test. To test the outlier data, we use the Grubb's extreme Studentised deviated test (Grubb, 1969). The Grubb test uses the formula (Z value) below.

$$Z = \frac{|\text{ Mean} - \text{Value }|}{SD}$$

Every case is calculated for Z value and thus compared the Z table. Any Z value of case is greater than Z critical value, it is considered as outlier and therefore, it would be remedy by replacing it with second highest value. In addition, the procedure will be repeated till no further outlier is detected. The result of outlier test indicates that several cases are claimed as outlier data and thus we remedy by using technique proposed by

Grubb (1969). Once the data is free from outlier, we then test for univariate normality by using the skewness and Kurtosis. Hanifa and Hudaib (2006) argue that skewness and kurtosis of 1.96 and 3 respectively is considered as normal. The skewness and kurtosis of variable stay in that range except for company's age and return on asset (ROA). Therefore, these variables are transformed to the natural logarithm. The next procedure is to test the multicollinearity. We apply the VIF to detect the multicollinearity problem. The result show that there is no correlation among the independent variables since the value of VIF is less than 2. However, the heteroskedasticity problem detected using the white test. The result indicate that Obs*R-squared is 32.78982 with probability 0.2041 which is greater than 0.05. Since the probability is greater than 0.05, there is no heteroskedaticity problem.

Descriptive statistic show that the minimum and maximum audit report lags is 14 days and 113 days respectively with the means of 69 days. The average board independence in banking and finance industry is around 42.73%. Thus, the percentage is quite high compared to the minimal requirement suggested by capital market authority (at least 30%). Further, the average number of board in banking and finance industry are four members. In addition, 50.64% of supervisory board is also a board member in other companies. The means of board shareholding is 55.77% which indicate that more 55% of board member has the share in the company. The average of company asset is IDR 18 trillion with the average of ROA is 3.15%.

To answer the hypothesis, multiple regressions are applied (panel least square) and the result is shown in table 2 (in appendix). The model of fitness is adequate because the F significant value is lower than 0.01. This implies that model is very feasible and can proceed to next analysis. In general, the independent variable can explain dependent variable quite high due to value of R square (21.74%). Out of four hypotheses proposed in this study, only one variable are rejected (multiple directorship) and the rest are accepted. In addition, one of control variable is accepted (ROA-return on asset) and another one is rejected (CA-company asset).

The effect of board independence on audit report lag is negative which means that the higher the composition of board independence in a company, the shorter the audit report lags. In addition, it means that board independence has a role in external auditing process or financial reporting process. Board independence may have initiatives to have the better internal control system and financial accounting system, and to select the higher quality accounting staff and audit firm. As consequences, external audit does the audit process efficient and effective and finally the audit report can be signed on time. In another word, board independence could reduce the opportunistic reporting behavior. In brief, the finding is consistent with agency theory (Jensen and Meckling, 1976). Compared to the previous study, this finding support the study of Beaslwy (1996), Klein (1998), Peasnell, Pope, & Young (2000) and Zaitul and Hanim (2011). However, the finding is not consistent with study of Zaitul and Putri (2012).

The relationship between board size and audit report lag is significantly negative. Thus, it implies that the more number of boards in company, the shorter the audit report lags. The larger board would reduce the audit report lag. Thus, larger board have diversity in term of education, ethnic, background and etc. thus, this diversity bring value to company in term of connecting to the external environment, communication and etc. This capability of communication to external result with selecting the higher quality audit firm and therefore, fasten the external audit process. In addition, this diversity of board result the diversity of ideas, such as idea to recruit the accounting staff, to increase the effectiveness of internal audit and etc. therefore, it help to shorten the external audit process. This finding supports the resources dependence theory and study of Karamanou & Vafeas (2005), Zaitul and Hanim (2011) and Beasley (1996).

The fourth hypothesis is accepted which means that the more board has share, the longer the audit report lag. Board with shareholding may be difficult for them to monitor and discipline the financial reporting process, especially external auditing process. In addition, high board ownership would cause the moral hazard and asymmetric information problem between management or board and investors. This type of problem slower the auditing process and thus longer the audit report lag. This finding is not consistent with the contention of Jensen (1983): board ownership increase the accounting quality. This finding is also not consistent with finding of Zaitul and Hanim (2011).

Return on asset (ROA) negatively influences the audit report lag. It indicates that profitable companies tend to have shorter audit report lag. This finding is consistent with Ashton et al (1980) which point out that profitable company would release their financial report sooner. The finding supports the signal theory, which posits that managers have an incentive to release good news earlier than bad news. Another reason is that profitable companies do not need more time to be audited compared to unprofitable companies. Besides, an unprofitable position might be related to financial pressure, which could create a demand for higher audit work to verify the value of net assets and to confirm that the company is a going concern. Meanwhile, higher profitable companies could mean that the company is less concerned with individual overheads and probably could more easily afford a better audit. The above reasons may bring the profitable companies to have shorter audit report lag.

5. CONCLUSSION AND LIMITATION

The role of boards as a mechanism for corporate governance of banks and finance companies take on special relevance in a framework of limited competition, intense regulation, and higher informational asymmetries due to the complexity of the banking and finance industry business. Thus, the board becomes a key mechanism to monitor managers' behavior and to advise them on strategy identification and implementation. However, there is a limited study focus on the role of supervisory board and audit report lag. This study use 61 bank and finance companies listed in Indonesia Stock Exchange (IDX). Four hypotheses are tested in this study. Three hypotheses are accepted and another one is rejected. Supervisory board independence, size and shareholding significantly affect the audit report lag. The limitation of study is not without limitations. Limitation and avenues for future research are as follow. First, this study only focuses on four board characteristics and there are several other characteristic, such as board diversity. Second, this study uses the audit report lag as one of accounting quality aspect and there is other aspect of accounting quality such as value relevance, conservatism and etc. Finally, this study does not consider the IFRS which has just been implemented in Indonesia.

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Appendix

Table 1
Descriptive statistics

Variable	Mean	SD	Min	Max
ARL	68.6311	18.97938	14.00	113.00
BI	.4273	.17951	.00	1.00
BZ	4.0464	1.80730	1.00	10.00
MB	.5064	.25592	.00	1.00
BS	.5577	1.31721	.00	4.77
CS	1.8365E7	4.30663E7	179.00	1.77E8
ROA	3.1460	5.14012	-12.90	19.62

Table 2
The Result of Regression

	Coefficient	P-value	VIF
Constant	6.052.383	0.0000	
BI	-1.003.242	0.0415	1.081
BZ	-0.163209	0.0000	1.566
MB	2.801.108	0.4311	1.055
BS	3.697.802	0.0004	1.010
CS	0.764049	0.2032	1.587
ROA	-0.590318	0.0028	1.112
F statistic	16.617		
R^2	0.217		
Obs*R-squared	0.2041		

Dependent Variable; ARL

This certificate is presented to

Zaitul

in recognition of his/her participation as

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