The Role of Supervision on Internal Control Disclosure

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Abstract. The internal control system is an important aspect that is needed in every organization to fulfill the organization's goals and targets. With this importance, Otoritas Jasa Keuangan sets certain rules for public companies to disclose the internal control system that is being applied in their business environment in the annual report. This research analyzed how supervision within the company affects internal control disclosure. The function of supervision is conducted by the board of commissioners and the audit committee in each company. The variables that are chosen in this research are the board of commissioners size, the audit committee size, and the audit committee meetings. The results prove that the board commissioners' size and the audit committee meetings positively impact the internal control disclosure. On the other hand, audit committee meetings were found not to affect the internal control disclosure.

Keywords: The audit committee meetings, The audit committee size, The board of commissioners size, Good corporate governance, The internal control disclosure

1 Introduction

The principle of good corporate governance is an integral aspect that is very important for a company to be adaptive to the dynamic environment. Without the principle of good corporate governance, unwanted problems can occur, which can even harm the existence of the company. To prevent this problem from occurring continuously, each company needs to have and adopt the principle of good corporate governance.

Good corporate governance certainly cannot be separated from the internal control aspects designed in a company. The application of a good internal control framework certainly brings many benefits to a business establishment's effectiveness. Internal control applied in a company also ensures the achievement of targets and goals to be achieved by the company [1]. However, internal control does not fully guarantee that agency problems will not occur. An effective internal control framework is needed to prevent problems for the company.

One of the problems that can occur in a company without adequate internal control is the occurrence of fraud committed by the company's management. One of the accounting fraud scandals that occurred that has shocked the public is the fraud that was perpetrated by WorldCom. Seeing this, of course, it can be seen that a formal provision is needed to prevent this from happening again in the future. Therefore, President George W. Bush at that time authorized the Sarbanes-Oxley Act [2]. The ratification of the Sarbanes-Oxley Act at that time certainly had a big impact until now, where there are standards and standard rules that provide direction for companies in designing good corporate governance, complete presentation in reports published by companies, and ensuring corporate accountability [3].

In Indonesia, several accounting scandals occurred, in which companies manipulated the presentation of financial statements. This case shows that government regulations are also important to increase accountability and transparency in the presentation of financial statements and company annual reports, in which one of the important elements required in the published annual report is a specific section of the companies' internal control system. This has become an obligation for each public company to publish that information. One of the government's attempts to ensure that there is an adequate internal control framework within each company is by using the regulation about the internal control information exposure in annual reports.

The process for each company to inform the internal control system in the annual report certainly cannot be separated from the parties who have authority within the company, starting from the Board of Commissioners, Directors, and the Audit Committee. Each party has a significant role in ensuring good governance exists in the business operation process. OJK has also established regulations governing parties within the company to ensure good corporate governance issues are being implemented. It is hoped that with the role of each party who obeys the regulations of the OJK, and functions effectively, it is hoped that good governance will increase, where one of the factors that can be observed is the internal control within the company.

Along with this concern, this research is structured to find the impact of the Board of Commissioners size, the Audit Committee size, and the audit committee meetings toward the internal control disclosure by the Indonesia Stock Exchange-listed companies from 2019 to 2020. The objective is to discover the outcome of the board of commissioners size, the size of the company's audit committee, and the number of company audit committee meetings toward internal control disclosure.

ICBAE 2022, August 10-11, Purwokerto, Indonesia

DOI 10.4108/eai.10-8-2022.2320974

2 Literature Review

2.1 Internal Control Disclosure

The Financial Services Authority also conducts an assessment of good corporate governance applications, one of which is related to the internal control disclosure by companies. This is done with the objective to assess and ensure that an adequate internal control framework has been implemented in every public company's business operations.

Referring to a copy of the Surat Edaran Otoritas Jasa Keuangan Nomor 16/SEOJK.04/2021 concerning the Public Companies' Annual Report Form and Content, it is stated that the internal control disclosed in the annual report shall at least contain financial and operational controls, along with compliance issues on government's regulations, and also evaluates the internal control system effectiveness and statements from BOC & BOD about the internal control system sufficiency.

2.2 The Board of Commissioners Size

According to the regulations set by the OJK, namely the Peraturan Otoritas Jasa Keuangan Nomor 33/POJK. 04/2014, the board of commissioners is a member of the company whose task is to supervise following the rules of association that have been set. In addition, the BOC also needs to think some recommendations and direction for the BOD. It is hoped that with the bigger size of the BOC, the existing supervision is sufficient in supporting the disclosure of internal control.

Research conducted by [4] and [5] shows that a positive effect is given by the Board of Commissioners size on how the companies disclose their internal control system. As the supervision increases on the Board of Directors and the company's achievement, the internal control disclosure will be increased.

H1: The size of the Board of Commissioners affects the Internal Control Disclosure.

2.3 The Audit Committee Size

Referring to Peraturan Otoritas Jasa Keuangan Nomor 55/POJK.04/2015, the Audit Committee is accountable to the Board of Commissioners and is obligated to accommodate and succor the duties of the Board of Commissioners. In Indonesia, a rule has been set that every company is obligated to own an audit committee with the lowest size of three members. One primary responsibility of an audit committee is to assess the internal controls implemented in the company. Therefore, referring to this responsibility, it is hoped that with the growth of the audit committee size, the exposure of the existing internal controls will be more integral.

Research conducted by [6] shows that audits within a company also encourage nonmandatory exposure in annual reports. However, the research conducted by [7] explains that the audit committee proportion does not affect the exposure of internal control in annual reports. In accordance with the results of research by [8] where the hypothesis the audit committee size gives a positive impact on internal control disclosure is rejected. Theoretically, the bigger the audit committee size, the more influential the supervision will be, which will increase the disclosure of internal control information.

H2: The Audit Committee Size affects the Internal Control Disclosure.

2.4 The Audit Committee Meetings

Meetings held by the audit committee have a major influence in evaluating the company's performance and the assessment of the internal controls executed in the company business environment [9]. POJK No. 55/POJK.04/2015 also regulates the meetings that are held by the Audit Committee, where meetings are done at least once every three months. This meeting is carried out to accomplish the duties of the audit committee, namely assessing the appropriateness of the financial reporting process and also the internal control disclosure in the annual report, following what is stated in POJK No. 29/POJK.05/2020 Article 28A paragraph 2.

Meetings as a means to assist the Audit Committee in assessing the existing internal control within the company, wherewith the increasing number of meetings, it is hoped that the assessment of internal control will also increase, which also will expand the company's internal control disclosure.

Based on research by [10], it is proven that the audit committee meetings give a positive impact on internal control information information exposure. Therefore, the developed hypothesis is supported by the existing theory, so the hypothesis related to this is that the audit committee meetings also support the internal control disclosure.

H3: The number of Audit Committee Meetings affects the Internal Control Disclosure.

2.5 The Board Commissioners Size, the Audit Committee Meetings, and the Audit Committee Size and Internal Control Disclosure

Based on the explanation for each independent variable and its relationship to the dependent variable above, the hypothesis that is generated is that the board of commissioners size, the audit committee size, and the audit committee meetings give a major influence on the internal control information exposure. In conforming with the role played by both the Board of Commissioners and the Audit Committee is to maintain the principle of good corporate governance, in which internal control is an important aspect of it.

H4: The Board of Commissioners Size, The Audit Committee Size, and The Audit Committee Meetings affect simultaneously the Internal Control Disclosure.

3 Research Methodology

3.1 Research Method

Causal research is research that assesses the relation and impact that is given by the independent variable on the dependent variable [11]. This study used the causal research approach in developing the hypothesis. To maintain objectivity in assessing the internal control disclosure among the company's annual report, this research used some specific indicators to prevent biased results from the disclosure of the company's internal control.

3.2 Population and Sample

The order of public companies listed on the IDX is taken from the website idx.co.id. Within the list in the year 2020, there are a total of 716 companies listed on the IDX. This research used the systematic sampling technique [11]. The sampling process of the companies is taken based on serial numbers with certain multiples chosen randomly, in this study the companies with the serial number of multiples of 22. If the selected company does not publish an annual report, then the company with the serial number closest to the company without an annual report was chosen, with a total of 64 company samples which consist of 32 public companies in each period.

3.3 Data Analysis Technique

The technique that is used for analysis in this research is multiple regression analysis by using Excel to find the impact of the board commissioners' size, the audit committee size, and the audit committee meetings on the internal control disclosure. The indicators for each variable that has been analyzed are explained below.

The size of board commissioners is measured by the frequency of people that are part of the board commissioners of a company within one year. The audit committee size is measured by the frequency of people that are members of the audit committee within one year. The audit committee's meetings are measured by the frequency of meetings that are done by the audit committee within one year. Lastly, the internal control disclosure is measured using eight indicators, which are objective, management responsibility, effectivity, control activity, limitation, internal audit, external audit, and internal control framework. Each indicator is given a score of one if it is being informed in the annual report, otherwise, the score is zero.

Table 1. Variables Operationalization

Variable	Indicator	Measurement Scale
The Size of Board Commissioners (POJK Nomor 33/POJK. 04/2014)	The number of board commissioners of a company within one year	Ratio
The Size of the Audit Committee (POJK Nomor 55/POJK.04/2015)	The number of the audit committees of a company within one year	Ratio
The Audit Committee Meetings (POJK Nomor 55/POJK.04/2015)	The frequency of audit committee meetings of a company within one year	Ratio
Internal Control Disclosure (SEOJK Nomor 16/SEOJK.04/2021)	Using the internal control disclosure index scoring, the indicators of scoring are as follows: 1. Purpose / Objective 2. Management Responsibility 3. Effectivity 4. Control Activity 5. Limitation	Ratio

Variable	Indicator	Measurement Scale
	6. Internal Audit 7. External Audit 8. Internal Control Framework For each indicator disclosed, a score of 1 is given, otherwise 0.	

Based on each indicator above, Figure 1 shows the research model.

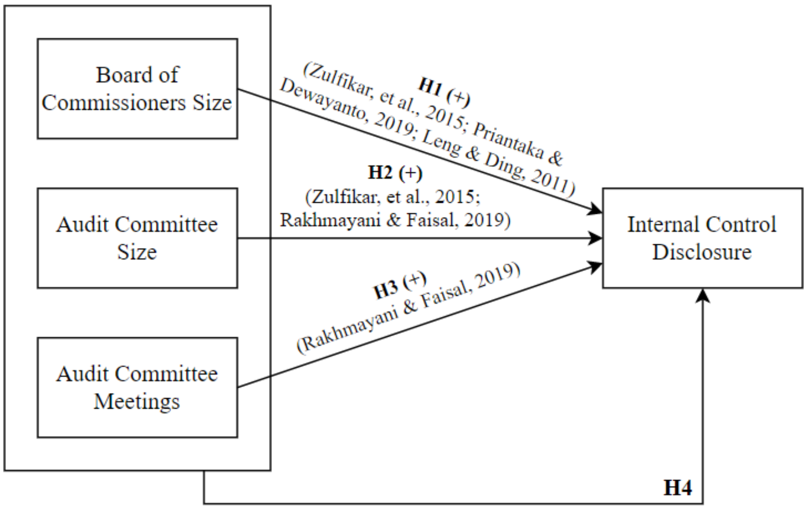

Fig. 1. The research model.

Each line represents the hypothesis that has been developed in the previous section. The model of this study follows the principles proposed by [12] regarding agency theory which is also cited in several studies related to internal control disclosure [7], [13]. The agency theory is landed on the existence of an arrangement in the midst of the principal and the agent, in which the principal contracts the agent to act on his behalf. It is also emphasized that both parties are equally focused on generating as much profit as possible so that agents can behave wrongly following the interests that only profit them while managing the business owned by the principal. This surely raises agency problems or also known as agency problems.

To take this into control, several costs need to be incurred to prevent and minimize the occurrence of agency problems, namely supervision costs, engagement costs, and residual losses [12]. Supervision costs are costs incurred to monitor the behavior of agents, for example by conducting audits within the company. Engagement costs are costs borne by agents for them to take action that is in the interests of the principal. While residual losses are costs incurred by the principal regarding how there will always be a distance between the principal and the agent, it is impossible for the interests of the agent to always align with the interests of the principal.

To reduce high agency costs, companies will increase voluntary disclosures, one of which is the disclosure of internal controls implemented within the company. This is seen as an effort to minimize agency costs because disclosure is voluntary [14]. Therefore, this study emphasizes the hypothesis that the board of commissioners size, the audit committee size, and audit committee meetings will produce a major effect toward the internal control disclosure.

4 Result and Discussion

4.1 Descriptive Statistical Analysis

Table 2. Descriptive Statistical Analysis Results

	SzBoC	***SzAC***	***ACM***	***ICDI***
Mean	4.21875	3.015625	6.6875	3.390625
Standard Deviation	1.7317644	0.519223703	4.238429628	1.549369431
Minimum	2	0	2	0
Maximum	10	5	20	6
Count	64	64	64	64

The following data above is the descriptive analysis of the data processed. For the board of commissioners size, the largest value is 10, and the smallest value is 2. The board of commissioners size itself has an average value of 4.219. As for the audit committee size variable, the largest value of the entire sample of existing companies is 5, with the smallest value being 0. The average value itself has a value of 3.016. The audit committee meetings have a maximum value of 20, while the smallest value is 2, with an average of 6.69. The last, namely the dependent variable, disclosure of internal control, of the 8 indicators assessed in this study, the maximum number is 6, while the minimum value is 0, and has the average of 3.39.

4.2 Multiple Linear Regression Analysis

Table 3. Regression Test Result

Regression Statistics	
Multiple R	0,571995006
R Square	0,327178286
Adjusted R Square	0,293537201
Standard Error	1,30226579
Significance F	0,0000254
Observations	64

Rooting from the statistical regression test results, the adjusted R square is worth 0.293537201. Adjusted R Square explains the measurement of the influence given by all variables studied simultaneously on the dependent variable. Referring to Table 3, the significance value of F is much smaller than 0.05, which means it is less than the alpha value of 5%, where the alpha value indicates an acceptable error limit.

Table 4. Partial Test Result

	Coefficients	**Standard Error**	**t Stat**	**P-value**
Intercept	-0,337192666	1,004041979	-0,33584	0,738166694
SzBoC	0,457955974	0,099220204	4,615552	0,000021147
SzAC	0,642499451	0,320695714	2,003455	0,049650853
ACM	-0,021192001	0,040296503	-0,5259	0,600894948

Table 4 shows that the p-value from the audit committee meeting variable has a value that is bigger than 0.05, which is equal to 0.601 so it does not pass the partial test. Meanwhile, the variable of the board of commissioners size and the audit committee size has a p-value that is smaller than the alpha value, which is 5%, with the size of the board of commissioners having a p-value of 0.000002 and for the audit committee size is 0.0497, so these variables passed the partial test.

The resulting equation based on this research is as follows:

$$ICDI = -0.337 + 0.458\ SzBoC + 0.6425\ SzAC - 0.0212\ ACM + e \quad (1)$$

Description:

ICDI = Internal Control Disclosure Index

SzBoC = The Board of Commissioners Size

SzAC = The Audit Committee Size

ACM = The Audit Committee Meetings

e = error

4.3 Internal Control Disclosure

Regarding internal control disclosure, the largest control disclosure score of the 8 indicators used in this study is a total score of 6 from Vale Indonesia Tbk in 2019 and 2020, respectively, and by Indonesia Paradise Property Tbk in 2019.

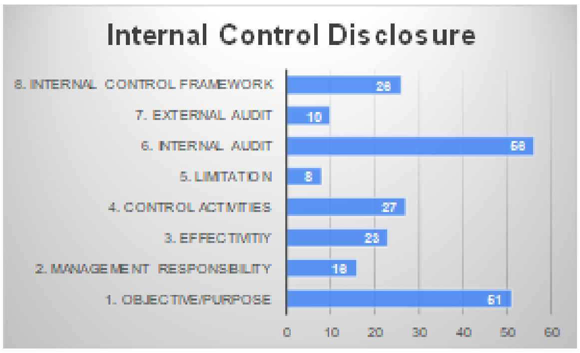

Fig. 2. Internal Control Disclosure Index.

Figure 2 above shows that of the total 64 companies sampled in this study, 79.69% of companies have disclosed the first indicator, namely the purpose of the company's internal control system. 25% of companies have disclosed that the internal control system is the management's responsibility and 36% of companies have disclosed how effective the internal control system has been.

There are 42% of companies have disclosed the control activities implemented by the company, and 12.5% of companies have disclosed the limitations of the implemented internal control system. The sixth indicator, namely statements related to the internal audit, was disclosed by 87.5% of companies, the highest number of all existing indicators. As with the seventh indicator, statements related to external audit, in which the company's internal control system is audited by an external auditor, are only disclosed by 15.63% of companies. Finally, the indicator of disclosure of the internal control framework used by the company was disclosed by 40.63% of the company.

4.4 The Board of Commissioners Size affects Internal Control Disclosure

The regression analysis explains that the board of commissioners size passed the partial test, which is statistically proven to positively affect the internal control exposure. Furthermore, referring to the equation obtained in this study, the size of the impact given by the board of commissioners size is 0.458 or about 45% for each increase of the board of commissioners proportion. According to this, the decision for this hypothesis is accepted, namely that the board of commissioners size has a positive impact toward the internal control disclosure.

In line with [4] which proves the board of commissioners proportion produces a positive impact on the internal control disclosure by the company. The role of the board of commissioners is very important as a supervisor of a company, one of which is to ensure that the internal control framework established by the company is adequate.

Referring to POJK No. 33/POJK.04/2014, the board of commissioners has the authority to give supervision and provide advice about what needs to be improved associating with the policies and business activities. In order for a business to run effectively, an adequate internal control system is required. This proves that the board of commissioners has a responsibility in monitoring the internal control system executed.

4.5 The Audit Committee Size affects Internal Control Disclosure

The regression results show that the audit committee size affects positively the exposure of the company's internal control. The magnitude of the effect resulting from each growth in the size of the audit committee according to the previously discussed equation is 0.6425 or about 64% of the value of internal control system informed in the annual report. It can be concluded that H2 is also accepted after passing the partial test and has a positive impact on the scope of internal control disclosure.

These results contradict the research conducted by [7], [10] where the results stipulate on how the audit committee size does not give an effect on the internal control disclosure. This inconsistency may be caused by the units of analysis that are used in the study, where the research conducted by [7] focuses on the banking sector and the period taken is from 2010 to 2012. As a matter of consideration, POJK 55 which regulates the audit committee was issued in 2015, so many companies have followed the regulation during the period when this research was conducted, namely from 2019 to 2020.

The audit committee's duty is significantly important in helping the board of commissioners function in monitoring the company. The audit committee monitors regularly to establish that the company's financial and performance information is effective and efficient, moreover, it can be accounted for. This is ensured by the existence of internal control within the company.

Referring to POJK No. 55/POJK.04/2015, one of the requirements to be a part of the audit committee is to have a complete understanding of the financial statements, the company's business operations, and the audit process that is done in the business environment. The audit process also includes how the internal control system is audited by the company's internal audit unit; therefore, the audit committee also gives a significant contribution in overseeing the phases of implementing the internal audit of the company's control system.

4.6 The number of the audit committee meetings affects Internal Control Disclosure

The results of regression analysis prove that the meetings that are held by the audit committee are not statistically proven to have a negative effect on the internal control exposure in the annual report. This is because the audit committee meeting variable does not pass the partial test, with a p-value greater than 0.05. Therefore, the hypothesis that the audit committee meetings give positive contribution on the exposure of internal control is rejected.

This results contradict [10] which elucidates the audit committee meetings have a favorable impact on the disclosure of internal control. Previous research [10] takes the time of 2016, in which POJK Number 55/POJK.04/2015 has just been inaugurated. In POJK No. 55/POJK.04/2015 specifies regarding the audit committee meetings should be held at least once every three months. This regulation also has an impact on holding meetings where previously there was no formal regulation, meetings were held according to the needs of each company. With these formal rules, several audit committees within the company can hold meetings as a formality, no longer following the company's needs in performing the function of supervision and reporting to the board of commissioners. This may lead to how the meetings held by the audit committee do not give an impact on the disclosure of internal control.

4.7 Factors affect the Internal Control Disclosure

The results explain and give prove that the board of commissioners size, the audit committee size, and the audit committee meetings are statistically proven to have a positive effect on the internal control disclosure. The proportion of the effect given is 0.293537201 or about 29.35%. This means that all the independent variables in this research have a simultaneous influence of 29.35% on the internal control information that are disclosed. In conclusion, this hypothesis is accepted.

Along the supervision, monitoring, and evaluation from the board of commissioners and the audit committee, supported by the frequency of meetings that are hosted by the audit committee, it will increase the disclosure of internal control by the company, where supervisors provide suggestions and input, in addition with corrective actions that should be taken by the directors and company management. This improvement also prompted the BOD and management to disclose improvements to the internal control system that are published in the company's annual report.

In addition, this hypothesis also shows the existence of 70.65% of other factors that affect the exposure of internal control, whereas, in several previous studies, these factors were institutional ownership, accounting and financial education background of the audit committee, the board of commissioners remuneration, and the education level of the board of commissioners, which were not included in this research.

4.8 Research Limitations

In this study, there were several limitations faced, including that some companies do not disclose the variables studied, where if the sample companies do not disclose these variables, they are given a score of 0. There is a sample of companies that reveal that the audit committee meeting is held more than 4 times, then it is given a score of 5. Some of the companies included in the sample list of this study did not have a specific section about the internal control system, then a score of zero is given as the total score of the Internal Control Disclosure Index. Because this study only focused on a specific section of internal control disclosures in the companies' annual reports. The assessment of internal control disclosures has used several specific indicators, but this does not eliminate completely the bias that may arise in the assessment of the information quality about the internal control system.

5 Conclusion

5.1 Conclusion

The function of good corporate governance, namely the existence of adequate supervision, plays a major and significant success in ensuring voluntary disclosure by agents, where one of the disclosures is the disclosure of the internal control system that is applied in the company. Supervision by the board of commissioners and audit committee is required on the disclosure of the internal control system in the annual report.

Based on the explanation above, several conclusions can be drawn from this research, namely, the board of commissioners size gives a positive contribution on the internal control information that is published by the company. This shows how important the BOC's supervision on the company's internal control system. The audit committee size also has a positive influence on the disclosure of internal control by the company, where the audit committee is obligated to accommodate assistance for the board of commissioners in giving supervision on the management. Meetings held by the audit committee are statistically proven to have no impact on the internal control information disclosure. Lastly, the board of commissioners, the audit committee size, and the audit committee meetings are statistically proven to have a simultaneous effect on the internal control system information that are disclosed, where all three have a supervisory function within a company.

5.2 Recommendation

Referring to the results of this study, there are several recommendations for future research because this study still has several limitations, so further researchers can add the number of companies studied and the number of annual report periods observed so it can help future studies in finding the patterns and developments in the disclosure of company internal controls. In addition, an assessment indicator for the disclosure of the company's internal control can also be added according to the regulations set by the OJK.

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