

## The Role of Corporate Governance and Size of the Firm on Internal Control Disclosure

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### Article's History:

Received 13 April 2023; Received in revised form 27 Mei 2023; Accepted 5 Mei 2023; Published 1 Juni 2023. All rights reserved to the Lembaga Otonom Lembaga Informasi dan Riset Indonesia (KITA INFO dan RISET).

### Suggested Citation:

Manap, A., Nugroho, M. R. A., Saepullah, A., Yusnidar., & Sekianti, A. (2023). The Role of Corporate Governance and Size of the Firm on Internal Control Disclosure. JEMSI (Jurnal Ekonomi, Manajemen, Dan Akuntansi), 9 (3). 655 – 659. <https://doi.org/10.35870/jemsi.v9i3.1120>

### Abstract:

This study examines how internal control disclosure is impacted by corporate governance and firm size. The size of the board of commissioners, the makeup of the independent board of commissioners, management vs institutional ownership, the size of the audit committee, and the degrees in accounting or finance held by audit committee members are all factors in corporate governance. The study's sample is the portion of the banking sector that was traded on the Indonesia Stock Exchange between 2015 and 2021. In this study, 29 companies were included in the sample, and observations were made over a period of 7 years. Purposeful sampling was employed as the sampling approach. To process their data, researchers employ multiple regression analysis. The findings of this study suggest that internal control disclosures are influenced by firm size and level of accounting or finance education. Internal control disclosures are unaffected by the size of the audit committee, the make-up of the independent board of commissioners, management ownership, institutional ownership, or the number of commissioners.

**Keywords:** company size, corporate governance, and internal control disclosure.

### Introduction

The financial reporting cases that occurred at the Enron and Worldcom companies involving the Arthur Andersen Public Accounting Firm several years ago showed weaknesses in internal supervision and control. Weaknesses in internal supervision and control in cases involving Enron, WorldCom, and Arthur Andersen's Public Accounting Firm resulted in

a loss of trust from investors and a decline in stock prices in various countries such as America, Europe, and Asia. In response to the American company's accounting dispute, the Sarbanes-Oxley Act of 2002 (SOX 2002) was eventually passed (Abeysekera, 2010).

The fact that SOX has a part devoted to internal control concerns regarding financial reporting and information disclosure is one of its key features. Internal control is a significant aspect of corporate governance in Indonesia. Although this is the case, a sizable portion of Indonesian businesses have not disclosed any flaws in their internal control over financial reporting. Internal control makes it feasible to monitor and manage internal business activities more effectively and to improve corporate accountability. When certifying financial reports on a monthly, yearly, or quarterly basis, management is expected to disclose all material flaws in internal control in line with Section 302. A company's internal control system architecture and operational procedures must be evaluated for effectiveness in financial reporting, and this evaluation must be disclosed in the annual report, per Section 404. Reporting on internal control is essential if the organization is to continue to exist (Alsaeed, 2006).

If corporate governance and internal control of a company are running effectively, then fraud and errors in company activities can be detected, which can increase investor confidence. Using excellent corporate governance principles would also ensure timely and accurate information disclosure, clarification of the roles and duties of company organs, and compliance with legal requirements. The board of commissioners, whose responsibilities include overseeing operations and performance as well as offering guidance to the directors to ensure that it is carried out properly, plays a significant role in the implementation of corporate governance. Furthermore, the effectiveness of internal control within the corporation reflects the effectiveness of the audit committee, the board of commissioners, and the general framework for control within the company (Cormier et al., 2010).

The audit committee, whose major responsibility is to support the board of commissioners in carrying out the oversight function of the company's performance, is another corporate governance structure that influences information disclosure. The Capital Market Supervisory Agency's resolution No. 29 from 2004 and Bank Indonesia's rule No. 8/14/PBI/2006 both led to the creation of the audit committee. Examining the company's internal control system, ensuring the correctness of information disclosure, and increasing the effectiveness of the audit function are the main objectives of the formation. It is hoped that as the audit committee grows, so will the requirements for the company's information disclosure. The efficacy of internal control at the organization is positively impacted by the audit committee's size. The disclosure of information is impacted by the presence of an audit committee. The information disclosed is unaffected by the audit committee's size (Linsley & Shrives, 2006).

The degree of information sharing may be influenced by the audit committee's effectiveness. The quality of the audit committee, which is shown by the accounting or finance members' educational backgrounds, affects how well the committee performs its duties. This is consistent with earlier studies that discovered a relationship between information disclosure and audit committee quality. Previous studies that revealed no impact of audit committee caliber on information sharing came to different conclusions. According to a previous study, having a background in finance or accounting had no obvious influence on information sharing. This researcher will reassess the effects of business size and corporate governance on internal control disclosure in light of the description.

## **Literature Review**

### **Internal Control Disclosures**

Internal control disclosure is a disclosure that shows how effective internal control is within a company and is included in the annual report of the corporation. The Bank of Indonesia's regulation number 11/25/PBI/2009 states that internal control disclosure is necessary disclosure. Banking businesses are required to report the whole internal control system when identifying risk exposure and implementing risk management. By outlining the internal controls that must be put in place, a firm may increase the accuracy of its financial reporting and provide investors a greater understanding of its overall business plan. Disclosure of internal control becomes a very important disclosure for companies, especially in the banking industry, where the main basis of its business activity is trust. This is because the disclosure of internal controls can increase the company's worth and the stakeholders' trust, in this case, consumers' and investors', to encourage further investment in order to uphold and increase the sustainability of the operations of the organization (Qu et al., 2013).

## **Corporate Governance**

Corporate governance, according to the Indonesian Institute for Corporate Governance (2013), is a set of practices that guide and regulate a business to ensure that its operations fulfill stakeholder expectations. In this idea, two things are highlighted. The first is the significance of shareholders' rights to accurate and timely information, and the second is the obligation of the firm to provide all information about the company's performance, ownership, and stakeholders as soon as possible, accurately, and transparently. Corporate governance is a framework for leading and controlling a firm, as well as a way to reassure the fund suppliers of a company that they will receive a return on their investment (Yana & Kusumastuti, 2013).

## **Company Size**

A measure of a firm's size is its company size. The company's size is displayed, whether it is large or tiny. A company's challenges will become more complex as it grows in size, necessitating the need for specific monitoring. In order to improve controls' efficacy and the quality of disclosure, large, powerful firms typically concentrate their research efforts on the creation of internal controls. It is vital to reveal more information on internal control since large companies involve a growing number of stakeholders in order to satisfy those stakeholders' needs (Zureigat, 2010).

## **Methodology**

In order to prove the validity of the hypothesis, this deductive study evaluates the applicability of a certain theory. All banking firms listed on the Indonesia Stock Exchange between 2015 and 2021 make up the sample for this study. The purposive sample approach was used to conduct the study's sampling. Quantitative data, which are secondary data, are used in this study. Quantitative data are measured using ratio scales. During the years 2015 through 2021, the researchers combined the data into an annual report that was listed on the Indonesia Stock Exchange (IDX). The IDX-controlled website [www.idx.co.id](http://www.idx.co.id) served as the study's data source. Also, researchers compile relevant data for their research topic from a variety of sources, such as books, journals, and the internet. The direction of the association between the dependent and independent variables is measured in this study using multiple regression analysis, which uses two or more variables (Ghozali, 2013). The data analysis methods employed are descriptive statistics, the conventional assumption test, and hypothesis testing. The descriptive statistical testing, conventional assumption testing, and hypothesis testing for this study were all carried out using SPSS (Statistical Software for Social Sciences) version 21 software.

## **Case studies**

The updated  $R^2$  value is 0.088, or 8.8%, in line with the findings of the previously mentioned coefficient of determination test. This demonstrates that only 8.8% of the independent variables, such as company size, board of commissioners size, independent board of commissioners composition, institutional ownership, audit committee size, and audit committee accounting or financial educational background, can explain the dependent variable, internal control disclosure. The operational decision variables studied by Sun (2015), which have an impact on the disclosure of internal control, account for the remaining 91.2% of the explanations. The stock exchange variables and the type of auditor, according to research by Fang and Sun (2008), and factors related to organizational complexity, significant organizational change, and investment in an internal control system, according to research by Leone (2007), also have an impact on the disclosure of internal control. The low value of adjusted  $R^2$  shows that the independent factors have a limited capacity to explain the dependent variable.

The  $t$  value is 2.380, and the multiple linear coefficient test findings indicate a significance level of  $0.018 < 0.05$ . This indicates how the size of the company affects internal control disclosure. The findings of this study differ from those of Mensah's (2013) study, but they are in agreement with Hunziker's (2013) study (2016). So, it is clear that a company's internal control disclosures will be more robust the higher its total market value of shares and book value of debt, which indicate the state of the company's finances. Hunziker (2013) and Chow and Wong-Boren (1987) both note that large businesses typically profit from information disclosure.

At a significance threshold of  $0.721 > 0.05$ , the results of the multiple linear coefficient test indicate that the  $t$  value is 0.357. This demonstrates how the disclosure of internal control is unaffected by the size of the board of commissioners. The findings of this study concur with those of Mensah (2016) and Leng and Ding (2011), but not with those of Zulfikar et al. (2015) and Hunziker (2015). (2013). This variable's investigation has had no impact. This demonstrates that the effectiveness of reporting internal controls at financial institutions is unaffected by the number of members on the board of commissioners. The number of commissioners on the board, according to Mensah (2016), has no influence on how well information is given or how transparent it is. It will be challenging to agree on the extent of disclosure because of the large number of board of commissioners members that have been identified, which will lead to many differences of opinion among each member in accepting the recommendations that have been made in disclosure by the audit committee (Andayani, 2013). This study contradicts other research's findings that a sizable board of commissioners can enhance the quality of internal control disclosure (Hunziker, 2013).

According to the findings of the multiple linear coefficient test, the significance level is  $0.296 > 0.05$ , and the  $t$  value is 1.048. This demonstrates that internal control disclosures are unaffected by the makeup of the independent board of commissioners. This study's findings support those of Zulfikar et al. (2015) and Leng and Ding (2011), however they diverge from Mensah's (2016). This variable's lack of influence in the research indicates that the independent commissioner's supervision role has not been effective. There is no possibility to increase the disclosure of information about internal control by increasing the number of independent commissioners, claim Zulfikar et al. (2015). Due to the founders' and largest shareholder's significant control over the business, the board of commissioners' independence in conducting monitoring is reduced (Results of the Asian Development Bank Survey, 2004; Zulfikar et al., 2015). This study's findings differ from those of earlier studies, which found that an independent board of commissioners could promote information transparency and disclosure quality (Mensah, 2015).

According to the findings of the multiple linear coefficient test, the significance level is  $0.300 > 0.05$ , and the  $t$  value is 1.040. This demonstrates that managerial ownership has no impact on the disclosure of internal controls. The findings of this study concur with those of Zulfikar (2015) and Eng and Mak (2003), although they disagree with those of Hunziker (2013). Research on this variable has no effect; this indicates that the low percentage of managerial ownership in banking companies in Indonesia makes management have no control in determining what information will be disclosed because the policies and controls are owned by the majority owner. According to Eng and Mak (2003), lower managerial ownership can increase disclosure. This happens because of management's opportunistic actions to maximize personal interests, so that management tends not to disclose company information (Jensen and Meckling, 1976). The findings of earlier studies, which claim that stockholder-owned business management can enhance the quality of financial reporting by voluntarily disclosing internal control information, are not applicable to this study (Hunziker, 2013).

According to the outcomes of the multiple linear coefficient test, the acceptable level of significance is  $0.53 > 0.05$  and that the  $t$  value is -1.948. This illustrates that the disclosure of internal controls is not significantly influenced by institutional ownership. The findings of this study concur with Mensah's (2016) research, but they do not concur with Zulfikar's (2015). The lack of an impact of research on this factor suggests that the independent commissioner's monitoring duty has not been successfully carried out. Corporate governance, monitoring, and management incentives that result in internal control cannot be effectively influenced by state organizations or administration, claim Leng and Ding (2011).

At a significance threshold of  $0.726 > 0.05$ , the results of the multiple linear coefficient test indicate that the  $t$  value is -0.351. This shows that the audit committee's size has no bearing on how internal control information is shared. This study's findings concur with those of Mensah (2016), Zulfikar et al (2015), Leng and Ding (2011), and Leng and Ding (2011), but not with those of Ho and Wong (2001). Studies on this topic show that there is no correlation between the size of the audit committee and the accuracy of the internal control disclosures of the company. According to reports, Indonesian businesses only established audit committees to follow the rules established by Capital Market Supervisory Agency Number IX.I.5 of 2004. Nevertheless, in reality, audit committees at companies have no impact on how much information those companies provide (Khomsiyah, 2005).

The  $t$  value is 2.697, and the multiple linear coefficient test findings indicate a significance level of  $0.008 < 0.05$ . This demonstrates how it affects how internal control information is disclosed. This study's findings concur with those of Zulfikar et al. (2015) and Dewayanto (2015) but not Femiarti and Dewayanto (2012). This illustrates how the accounting or financial training of the audit committee can enhance the disclosure of the company's internal controls. An appropriate

illustration of how corporate governance influences internal control disclosure is the audit committee's accounting or financial background (Zulfikar et al., 2015). Members of the audit committee with financial knowledge can be crucial to better monitoring the financial reporting process and spotting serious misstatements (Dewayanto, 2015).

## Conclusion

The research's conclusions provide credence to the following claim: Several regression tests' findings suggest that internal control disclosure is influenced by the company's size. The findings of the multiple regression test demonstrate that the number of commissioners on the board has no bearing on whether an internal control disclosure is made. The findings of the multiple regression test indicate that internal control disclosures are unaffected by the makeup of the independent board of commissioners. The results of several regression models suggest that managerial ownership has no impact on disclosures of internal controls. Institutional ownership has negligible effect on disclosures of internal controls, according to multiple regression analysis. Multiple regression analysis demonstrates that the audit committee's size has no impact on internal control disclosures. Multiple regression analysis shows that the audit committee's accounting or financial education has an impact on the disclosure of internal control.

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