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The Effect Board Characteristics On Enterprise Risk Management Disclosures: Evidence from State-Owned Enterprise In Indonesia

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ABSTRACT

The purpose of this study is to examine the effect of corporate governance, namely board characteristics on enterprise risk management disclosure. The research object of State-Owned Enterprises listed on the Indonesia Stock Exchange in 2018-2019, with a total sample of 40 annual reports with purposive sampling technique and multiple regression analysis. The results of this study prove that board size no effect on enterprise risk management disclosure, while board independence effect enterprise risk management disclosure. This shows that the commissioners understand and carry out their duties as an independent party in supervising, directing, and evaluating the implementation of corporate governance and corporate strategic policies so that Board Independence in State-Owned Enterprises in Indonesia functions properly.

Keywords: Board Size, Board Independence, Corporate Governance, Enterprise Risk Management Disclosure, Indonesia Stock Exchange

INTRODUCTION

The implementation of good corporate governance is not only the obligation of companies whose shares are listed on the Indonesia Stock Exchange. State-owned enterprises (SOEs) as the dominant business people and have a large market share in Indonesia have the same obligations. The results of the assessment of good corporate governance based on data from the Master Plan of SOEs showed that 13.76% of state-owned companies still need improvement in the implementation of good corporate governance. Some cases have shown poor corporate governance practices in SOEs in Indonesia. One of them is the profit mark-up made by the directors of Waskita Karya Company amounting to Rp. 400 billion from the 2004-2008 period. The manipulation of financial statements and corruption indicates the weak implementation of good corporate governance. This will harm the community that meets the needs of its goods or services by SOEs.

One important piece of information that is of particular concern to investors is the non-financial segment of the annual report, especially on corporate governance (Amran, Bin, & Hassan, 2009). Information related to corporate governance, such as internal control systems and risk management systems, can convince investors that organizations avoid accounting irregularities. According to (Lajili & Zeghal, 2005) disclosure of risk management provides guidelines for evaluating management effectiveness in dealing with high market volatility, business uncertainty, and its impact on the level of firm value, as well as the sensitivity of trading volume to risk.

In Indonesia, the increasing importance of implementing risk management has made every company begin to implement good corporate governance, including state-owned companies whose majority shares are owned by the government. Regulations regarding the implementation of good corporate governance in state-owned enterprises are contained in the SOE Ministerial Regulation No.PER - 01 / MBU / 2011. Following article 2 of the SOE Regulation No. PER - 01 / MBU / 2011, SOEs are required to implement good corporate governance consistently and sustainably by compiling a good corporate governance manual which includes a board manual, manual risk management, and internal control system, an internal control system, reporting mechanisms for suspected irregularities at the SOEs concerned, information technology governance, and ethical code of conduct.

Research on Enterprise Risk Management (ERM) in Indonesia itself is mostly conducted on companies in the financial sector. While researchers here are trying to research ERM with the object of all state-owned companies listed on the Indonesia Stock Exchange (IDX) because researchers believe that SOEs as a company whose majority shares are owned by the government must be able to maximize profits to increase state revenue.

Empirically, the effect of corporate governance such as board size and board independence on corporate risk disclosure has mixed results. Studies (Beasley, Clune, & Hermanson, 2005): (Elzahar & Hussainey, 2012) found no effect between board size and corporate risk disclosure, whereas (Abraham & Cox, 2007), (Lajili, 2009)) found no influence between board size and corporate risk disclosure. Studies (Lopes & Rodrigues, 2007), (Vandemaele, Vergauwen, & Michiels, 2009), (Elzahar & Hussainey, 2012) found no effect between board independence and corporate risk disclosure, while other studies found an influence between the two (Abraham & Cox, 2007), (Lajili, 2009), (Olveira, Rodrigues, & Craight, 2011), (Probohudono, Tower, & Rusmin, 2013).

The selection of SOEs as the research subject is based on the reason that good corporate governance is an important issue as it is for private companies. The importance of this is further strengthened by the explanation of the aims and objectives of establishing SOEs in article 2 of Law no. 19 of 2003 concerning SOEs, namely that in addition to obtaining profits, SOEs also organizes public benefits in the form of providing goods and/or services of high quality and adequate for the fulfillment of the lives of many people. Adequate implementation and disclosure of good corporate governance practices will ensure the protection of the interests of the wider community.

This study can contribute to the government as a reference in determining policies regarding risk management disclosure of SOEs companies listed on the Indonesia Stock Exchange to increase investor confidence. For company management, this study can provide information and understanding of corporate risk management disclosures to help improve risk management disclosure practices in the company and realize good corporate governance.

Based on the background description above, the purpose of this study is to examine the extent to which corporate governance can affect enterprise risk management disclosure. The main question of this research is whether the corporate governance mechanism represented by board size and board independence can influence enterprise risk management disclosure. The purpose of this study is to obtain empirical evidence of the effect of corporate governance on corporate risk management disclosure.

LITERATUR REVIEW

According (Jensen & Meckling, 1976) an agency relationship occurs when the principal assigns a task to a second party or agent to carry out tasks according to the principal's interests. Assigning this task involves giving up the authority to make decisions. The principal is the owner of the company whose job is to provide all the funds or facilities needed for the company's operations, while the agent is someone who is selected and then contracted to be given the authority to manage the company as best as possible. Based on this theory, agents are assumed to be rational individuals, have personal interests, and try to maximize their interests. When the two related parties try to maximize their respective interests, a conflict of interest arises, where the agent is likely to prioritize his interests over the interests of the principal. This is because agents have an interest in maximizing their welfare in addition to optimizing principal profits.

Agency theory is used in this study to understand the disclosure practices of risk management in the company. The agent as the party who knows more about the condition of the company should practice risk management disclosure. This is because risk information is important information that can influence principal judgments about future circumstances faced by the company. The main objective of risk management disclosure is to reduce information asymmetry that occurs between agents and principals. Principals need information related to risks to improve their judgment in decision making. Besides, the practice of risk management disclosure is also able to avoid the company from conflicts of interest between agents and principals through monitoring by principals to agents by observing the extent to which agents carry out risk management disclosure practices. (Amran et al., 2009) stated that risk management is used by companies to manage their risks or to seize opportunities related to achieving company goals. Risk management disclosure is a strategy that holistically evaluates all risks faced by a company (Beasley et al., 2005). The enterprise risk management disclosures make the management of uncertainty related to risks and opportunities more effective with the aim of increasing value. Therefore, a proper risk management structure can help manage business risk more effectively and disclose risk management results to organizational stakeholders.

According to agency theory, a larger board of commissioners combines a variety of business expertise which results in a more effective supervisory role in the board so that it will reveal more risk information in the company's annual report (Singh, Mathur, & Gleason, 2004). A large number of boards, the more effective the supervisory role is so that it can increase the company's risk disclosure (Elzahar & Hussainey, 2012).
The results of previous research (Abraham & Cox, 2007), and (Lajili, 2009) found the effect between board size and risk disclosure. Based on the description above, the hypothesis that can be

developed is **H_1: The Board size is positively associated with enterprise risk management disclosure.**

According to agency theory, the supervisory function of the board of commissioners is to ensure that company management meets the interests of shareholders. Independent commissioners are expected to provide independent advice to commissioners appointed by the company. It is hoped that a greater proportion of independent commissioners can perform their supervisory functions more effectively so that it can affect the quality of accounting reporting and increase corporate risk disclosure (Fama & Jensen, 1983).

The results of previous research on the influence between board independence and risk disclosures found a significant positive effect (Abraham & Cox, 2007) (Lajili, 2009) (Olveira et al., 2011) (Probohudono et al., 2013). Based on the description above, a hypothesis can be developed: **H_2: The Board of independence is positively associated with enterprise risk management disclosure.**

METHODOLOGY

This research is a type of causal research, which aims to test the hypothesis about the effect of one or several independent variables on the dependent variable. The hypothesis proposed in this study was tested using quantitative research methods, namely conducting regression testing in the form of descriptive statistics and multiple regression analysis. The data obtained in this study will be processed using Statistical Product and Service Solutions. The framework regarding the relationship between each variable can be seen in Figure 1. To perform the test, it is necessary to explain the measurement of the variables used in the study, namely the enterprise risk management disclosure variable, the board sizes, and board independence.

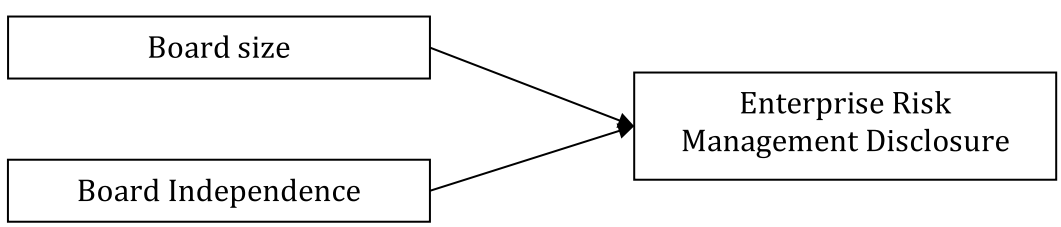

Figure 1 Schematic Research

Source: Developed by researchers

ENTERPRISE RISK MANAGEMENT DISCLOSURE

Enterprise Risk Management Disclosure in this study is measured using an index of the total score of disclosure items based on ISO 31000 dimensions which include 5 dimensions, namely mandate, and commitment, planning framework, implementing risk management, monitoring, and continuous improvement following ISO 31000 component standards. using dummy variables, that is, each ERM item that is disclosed is given a value of 1 and a value of 0 if not disclosed. Each item will be added together to obtain the overall ERM index of each company. Information regarding ERM disclosures is obtained from annual reports and company websites. The calculation of the ISO 31000 Dimensi Enterprise Risk Management Disclosure Index (ERM) is formulated as follows:

$$\text{ERM index} = \frac{\text{Number of items disclosed}}{\text{25 disclosure items}} \quad (1)$$

Board Size

The size of the Board of Commissioners is the number of members who serve on the Board of Commissioners (Abeysekera, 2010). The large size of the Board of Commissioners is more effective when compared to a small size of the Board of Commissioners (Abeysekera, 2010). The Board size is measured by the number of members of the Board of Commissioners owned by the company, both from within and outside the company (Ntim, Lindop, & Thomas, 2013). The board size can be calculated using the following formula:

$$\text{Board size} = \text{Number of Members of the Board of Commissioners} \quad (2)$$

Independence Board

Independence board are measured by the proportion of independent commissioners to the total members of the board of commissioners (Abeysekera, 2010). Independence board can be calculated using the following formula:

$$\text{Independence Board} = \frac{\text{Proportion of independent commissioner}}{\text{Total board of Commissioners member}} \quad (3)$$

The population in this study includes all state-owned companies listed on the Indonesia Stock Exchange 2018 - 2019, which includes a total of 20 companies. The sample was obtained by using the purposive sampling technique. The final sample used in this study was 40 annual reports. The data collection method in this study uses secondary data taken from the annual reports of SOEs listed on the Indonesia Stock Exchange in 2018-2019. Secondary data collected were obtained from the website www.IDX.co.id and the websites of each sample company. The multiple regression equation for testing the hypothesis in this study is:

$$ERMD = \alpha 0 + \beta 1BOARDSIZE + \beta 2BOARDINDEP + \varepsilon \quad (4)$$

Where:
ERMD : Enterprise Risk Management Disclosure
BOARDSIZE : Board Size
BOARDINDEP: Board Independence,
$\alpha 0$: constant,
$\beta 1 ... \beta 2$: regression coefficient, and
ε : error term.

FINDINGS

Description of Data

Overall, there are 40 observational data on the annual reports of SOEs in Indonesia for 2018-2019. Table 1 below describes the descriptive statistics of the research variables. Information regarding the descriptive statistics includes minimum, maximum, mean, and standard deviation values.

Table 1 Descriptive Statistics

Variables	Min	Max	Mean	Std. Deviation
Board Size	3,0000	11,0000	5,3500	2,5270
Board Independence	0,4444	0,6667	0,6165	0,0656
ERM Disclosure	0,6400	0,7600	0,6800	0,0425
Valid N (listwise)	40			

Source: Secondary data are processed

Table 1 shows the average level of enterprise risk management disclosure in SOEs in Indonesia of 68.00% with a maximum value of 76.00% and a minimum of 64.00%. These results indicate that the awareness of SOEs in Indonesia is quite high regarding the importance of disclosing corporate risk as one of the keys to creating value and competitive advantage for the company. Descriptive statistics of independent variables: The average number of commissioners is 5 people and the mean proportion of independent commissioners is 61.65%.

Multiple Regression Analysis

The results of multiple regression after testing the classical assumptions can be seen as follows. Table 2 shows that the value of R Square (R2) is 34.90% and the Adjusted R Square is 31.40%. Based on the Adjusted (R2) value, it can be concluded that 31.40% of ERM disclosures can be explained by independent variables, the remaining 59.60% is explained by other factors outside the model.

The table shows the calculated F value of 9.928 with a probability of 0.000 (p-value <0.050). Because the F value is greater than 4,000 and the probability is less than 0.050, this regression model shows the Goodness of Fit Model so that the regression model can be used to predict enterprise risk management disclosure and can show that the independent variables jointly affect enterprise risk management disclosure.

Table 2 Results of Multiple Regressions

Variable	Coefficient	t	p-value
(Constant)	0,481	6,263	0,000
Board Size	-0,002	-0,620	0,539
Board Independence	0,338	3,133***	0,003
R-Square	0,349		
Adjusted R-Square	0,314		
F	9,928		
Sig	0,000		

Notes: Significance at: *0,10, **0,05, and ***0,01 levels.

The variable that has a significant effect on the level of enterprise risk management disclosure is the board independence at a significance level of 0.01, while the board size does not affect enterprise risk management disclosure.

The board size (ρ-value = 0.539 and coefficient = -0.002) shows that the board size does not affect enterprise risk management. This result is consistent with research conducted by (Elzahar &

Hussainey, 2012) which states that there is no effect of board size on corporate risk disclosure. This insignificant result is probably because of the larger the board size, the greater the chance of internal conflict. This causes board members to be ineffective in supervising the implementation of corporate risk disclosures.

Board independence (ρ-value = 0.003 and coefficient = 0.338) shows that the proportion of independent commissioners has a significant positive effect on enterprise risk management disclosure. The positive coefficient of the proportion of independent commissioners shows the positive influence of the proportion of independent commissioners on corporate risk disclosure. These results indicate that the greater the proportion of independent commissioners, the higher the corporate risk disclosure.

This indicates that the commissioners understand and carry out their duties as an independent party in supervising, directing, and evaluating the implementation of corporate governance and corporate strategic policies so that the role of the independent commissioner in SOEs in Indonesia functions properly. The results of this study are following the results of research (Abraham & Cox, 2007) and (Probohudono et al., 2013) where the proportion of independent commissioners has a significant positive effect on corporate risk disclosure

CONCLUSION

From the research results obtained, it can be concluded that the board size does not affect enterprise risk management disclosure in Indonesia. These results indicate that the size of the Board of Commissioners is only the fulfillment of existing regulations. Also, the large size of the board of commissioners creates coordination and communication problems between board members so that the commissioners are not maximal in carrying out their functions.

The board of Independence affects enterprise risk management disclosure in Indonesia. These results indicate that the greater the proportion of independent commissioners, the higher the company's risk disclosure. This indicates that the commissioners understand and carry out their duties as an independent party in supervising, directing, and evaluating the implementation of corporate governance and corporate strategic policies so that the role of independent commissioners in state-owned companies in Indonesia functions properly.

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