

CORPORATE GOVERNANCE, DISCLOSURE AND ITS EVIDENCE IN INDONESIA

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PART 2

Abstract

One principle of corporate governance is disclosure and transparency. This principle stipulates that relevant and reliable disclosure is made on all material matters regarding the corporation. By applying this principle, information asymmetry can be reduced and thus negative consequences of adverse selection and moral hazard problems can be minimized. This paper assesses the extent of regulation on disclosure in Indonesia and reviews the evidence on the disclosure level among publicly listed companies in Indonesia. In Indonesia, private mechanism to control the negative consequences of information asymmetry is not effective since the role of board of directors/ commissioners and banks/creditors is minimum in monitoring the firms' actions. Further, the capital and labor markets are not well developed. Without proper regulation, the amount of information produced by these companies, as expected, is inadequate. In recent years, there has been significant improvement in the regulation of disclosure in Indonesia. Badan Pengawas Pasar Modal (Capital Market Monitoring Agency) has issued a number of rules that enforce disclosure and that protect the interest of minority shareholders. The accounting standards are harmonized with the International Accounting Standards while the due process in preparing the standards has been intensified. Empirical evidences, however, find that in general the disclosure level among publicly listed companies in Indonesia is low. Even for mandatory disclosure, the compliance rate is not satisfactory. This low level of disclosure despite the enhancement of disclosure requirement by the regulating bodies suggests that the enforcement of the regulation needs to be improved. The paper concludes with some policy recommendations to improve the disclosure level in Indonesia.

Keywords: *Corporate Governance, Disclosure, Indonesia, Regulation, Financial Statements, Annual Report*

Regulation on Disclosure Policy in Indonesia

This section reviews and analyzes the regulation on disclosure policy in Indonesia with particular emphasis is given to publicly listed companies. It touches the development of accounting standards in Indonesia and discusses disclosure policy in the banking industry as an illustrative case.

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Regulations that govern companies' disclosures in Indonesia includes:¹

- Law No. 3 of 1982 regarding Company Registry.
- Government Regulation No. 64 of 1999 regarding annual financial statement.
- Badan Pengawas Pasar Modal (Bapepam) rules for publicly listed companies.

Under the Company Registry Law, companies must provide information accessible to public which among others include the name of the company, the

date of incorporation, the company's products and main line(s) of business, personal details of the members of the board of directors and commissioners, and the amount of capital authorized, placed and paid-in. Unfortunately some weaknesses arise in the implementation of the law. Among other things, there is a lack of monitoring and measures taken to ensure that companies report the required information in an appropriate and timely manner.

The government regulation No. 64 of 1999 expands the base of companies required to submit their financial reports available to the public. In the past only listed companies are required to report their audited financial statements. Under the new regulation, companies required to file audited financial statements among others include those that issue a debt instrument or that have a total assets or net assets in excess of 25 billion rupiah. This regulation can be considered as a major step in improving transparency and accountability in Indonesia.

Bapepam has numerous rules related to financial and non-financial disclosure. Some examples are: Planning and Conducting the General Meeting of Shareholders (Bapepam Rule IX.1.1), Disclosure of Information that Must Immediately be Made Public (Bapepam Rule X.K.1), Report on the Use of Funds Received from Public Offering (Bapepam Rule X.K.4).

Bapepam Rule VIII.G.2 specifies in detail materials that must be included in the annual report. These include:

- a. General description
Provide general description of the company, such as products or services offered, description of directors and commissioners, the

1. The following 3 paragraphs are excerpt from Ikatan Akuntan Indonesia (2000)

- company's development, and so on.
- b. Special description
This section covers stock price information, location and type of fixed assets, dividend policy, realization of the use of funds from public information, other material information.
 - c. Summary of important financial data
Five year comparison of sales, gross profits, operating income, net income, outstanding shares, earnings per share, net working capital, total assets, total liabilities, return on assets, return on equity, current ratio, debt to equity ratio, and other relevant financial information.
 - d. Management discussion and analysis
The management should discuss and analyze financial and other information with the emphasis on material changes that have occurred since the last annual report.
 - e. Financial statements
Financial statements should be prepared to the current accounting standards.

Herwidiyatmo (2000), the chairman of Badan Pengawas Pasar Modal or Bapepam – the Capital Market Monitoring Agency -, suggests that the detail required in the annual report is claimed to be comparable to the highest international standards of disclosure. Bapepam has also issued several rules to protect the interest of minority shareholders. For example, it issued rules requiring approval by independent shareholders in the case of conflict of interest transactions. Bapepam Rule IX.E.1 specifies written disclosure documents that must be provided to shareholders prior to the meeting to approve conflict of interest transactions.

With support from Bapepam, the Jakarta Stock Exchange, in collaboration with Ikatan Akuntan Indonesia (IAI) and Asosiasi Emiten Indonesia (AEI) are developing presentation and disclosure guidelines for publicly listed companies in 22 industries. The guidelines are based on among others, Bapepam rules, industry regulations, and generally accepted accounting standards.

The development of accounting standards in Indonesia is the responsibility of the Accounting Standards Commit-

tee, which is a part of IAI. In order to add the credibility of its accounting standards, in 1994 the committee decided to harmonize its accounting standards with the International Accounting Standards issued by the International Accounting Standards Committee (IASC). By the end of 2001, there are more than 60 PSAK (Statements of Financial Accounting Standards) in effect and they covered almost all business transactions and events relevant to companies in Indonesia. Some of the standards even regulated transactions or events that have not been addressed by the IASC.²

To improve the quality of accounting standards, the Committee enhances the due process procedures in developing the standards. The due process for example includes requiring standards to be exposed to the constituents for comments before they are approved.

Annual Report in the Banking Industry³

Annual report is the primary means utilized by the management to communicate financial condition and other information to investors, creditors, and other stakeholders. Management's accountability is served by the report and further it indicates the effectiveness of management in fulfilling the company's goal.

Bank Indonesia and Bapepam regulate mandatory disclosure requirements in the annual report for publicly listed banks in Indonesia. Regulation by Bank Indonesia applies not only to publicly listed banks but also to all banks operated in Indonesia. On the other hand, as described earlier, annual report disclosure requirements by Bapepam apply to all publicly listed companies and thus are not industry specific. For publicly listed banks, this double disclosure requirements by Bapepam and the central bank can create confusion since the requirements are not totally the same.

Information required by the central bank to be disclosed at least includes the following information:

a. General information

Directors and their vitae, ownership structure, organization structure, main

activities, bank strategies and management policies, products and services offered, social activities, bank development, targets in the future, information technology.

b. Financial statements for the past two years

Audit opinion, balance sheet, income statement, retained earnings statement, commitments and contingencies, cash flow statement, notes to financial statement.

c. Items need attention

Credit analysis, such as % of credits by industry, credits given to related parties, collectibility of credits, loans that include domestic and overseas loans.

In general, information required by Bapepam and Bank Indonesia to be disclosed is similar. Unlike Bapepam, however, the central bank does not require management to discuss and analyze the performance of bank in the past two years. On the other hand, the central bank requires detail information on ownership structure that includes directors' ownership while Bapepam does not.

To enforce publication of the annual report, the central bank provides a sanction to banks that fail to publish or are late in publishing the annual report. In addition, the central bank informs the public with the list of banks that have not submitted the annual report.

Accounting Standard for Banks⁴

On March 2000, IAI issued the new accounting standard for Banks, which will be applied to financial statements in year 2000. The old accounting standard (Pernyataan Standar Akuntansi Keuangan (PSAK) No. 31) which was issued on September 1994 was considered not providing adequate disclosure with regard to bank's exposure to various types of risk.

Rossetta conducts a study to investigate the adequacy of the old and the new accounting standards with respect to risks faced by banks. She compares the accounting standards to a guideline

2. Examples are accounting standard for mutual funds, for joint operating activities other than joint ventures, for real estate, and for Islamic financial institution.

3. This part is excerpt from Irwanto, Evaluasi Pengungkapan Informasi Laporan Tahunan Bank Go Publik 1998, Thesis, Master in Accounting Program University of Indonesia, 2000.

4. This part is excerpt from Hilda Rossetta, The Role of Accounting Standard in Preventing Risk Shifting by Banks, Working Paper, University of Indonesia, 2000.

Table 1
The Disclosure Score of a Sample of Publicly Listed Companies*

Description	Actual score / maximum score
1. Background information	44.25%
2. Summary of financial performance	84.9%
3. Non-financial information	17.7%
4. Projected information	4.4%
5. Management discussion and analysis	55.7%
Overall score	41.9%

* Processed from J. Gunawan, Table IV.3, page 45-46

developed by Basle Committee on Banking Supervision, Bank for International Settlements. The type of risks that should receive adequate disclosure includes Credit Risks, Market Risks, Liquidity Risks, and Operational and Legal Risks.

Her analysis indicates that the old accounting standard (PSAK No. 31) had major limitation in providing qualitative information to enhance banks' transparency regarding risks. Of the total 20 disclosure items, only 3 items are required to be disclosed. For liquidity risks, banks were not required to provide any qualitative information at all. On the other hand, only four disclosure items are not required to be disclosed in the new accounting standard and three of these undisclosed items are related to market risks. Thus, the new standard significantly improves the disclosure of banks' exposure to risks. To apply the new standard, however, is quite complicated, so the next issue is the extent of banks' compliance to the new accounting standard.

The Disclosure Level of Publicly Listed Companies in Indonesia

This section provides some further empirical evidence regarding the level of disclosure of publicly listed companies in Indonesia. First, it reviews a study that documents the disclosure level of a sample of publicly listed companies in Indonesia. Then it reviews two studies that investigate the disclosure level of publicly listed banks and insurance companies. To measure the disclosure level, these studies develop a score that shows the amount of information disclosed in the annual report.

The first study⁵ employs a disclosure score that is developed by Botosan (1997). The score contains a list of mandatory and voluntary information disclosed in the annual reports of publicly listed companies in the United States. The disclosure list consists of five parts as follows:

- Background information, such as general description of the business, statement of objective, principle products and markets, and competitive environment
- Summary of financial performance
- Non-financial information, such as number of employees, average compensation, market share, unit

- sold, unit selling price, growths in unit sold
- Projections, such as forecasted market share, sales forecast, profit and cash flow forecast
- Management discussion and analysis such as change in sales, change in net income, change in expenses, change in market share.

Each part consists of some items which are given a score of zero if it is not disclosed, a score of one if it is disclosed, and a score of two if the disclosure is accompanied by some quantitative information not disclosed in the financial statements. In total there are 35 disclosure items with the total maximum score of 75.

The number of samples is 104 out of 274 corporations that were listed in the Jakarta Stock Exchange in 1998 and the annual reports examined are those for year 1998.

The following table provides the average overall disclosure score and the average disclosure scores for each part of disclosure. The score is calculated as the actual score divided by the maximum score. Overall, the disclosure score is low, with only 41.9% of disclosure items are adequately explained in the annual report. This low score is mainly due to extremely low disclosures on Non-financial and Projected Information, the majority of which are voluntary disclosures. The average score for Summary of Financial Performance is relatively high since Bapepam requires the information to be disclosed. However, the scores for Background Information and Man-

agement Discussion and Analysis are rather low even though most of the disclosure items are mandatory.

Thus, it can be concluded that publicly listed companies in Indonesia tend to disclose only mandatory information and even for this information, some items are not disclosed.

The study further finds that the level of disclosure is positively affected by firm size and financial leverage. Larger firms have higher private incentive to disclose since they make contracts with various parties. In addition, public demand on disclosure for large firms tends to be higher than for small firms while the relative cost of disclosure is lower. Firms with higher leverage generate higher agency costs and to control these costs, they are forced to disclose more.

The second study conducted by Irwanto (2000) examines the degree of compliance to mandatory disclosure requirement in the annual reports of publicly listed banks.⁶ He develops two disclosure lists, one is based on Bank Indonesia's rule and the other is based on Bapepam's. The disclosure list based on Bank Indonesia's rule consists of three parts (General Information, Management Report, and Items Need Attention) and the total number of disclosure items is 43 items. For Bapepam rule, the disclosure list consists of four parts (General Description, Special Description, Summary of Financial Data, and Management Discussion and Analysis) and the total number of disclosure items is 49 items. Each item is scored zero if it is not disclosed and is scored one if it is disclosed.

He examines the 1998 annual report of all publicly listed banks that published their annual report. Out of 32 banks only 15 banks published annual reports. The rest did not publish annual reports since these banks were either liquidated or taken over by the government.

The following table provides the aver-

5. Juniati Gunawan, Analisis Tingkat Pengungkapan Laporan Tahunan pada Perusahaan yang Terdaftar di Bursa Efek Jakarta, thesis, Master in Accounting Program University of Indonesia, 2000.

6. Irwanto, *op. cit.*

Table 2
The Mandatory Disclosure Score of Banks - the Central Bank*

Description	Actual Score / Maximum Score
1. General information	76.2%
2. Management report	59.2%
3. Items need attention	50.9%
Overall score	58.3%

* Processed from Irwanto, Table 4.2 and 4.3, page 99-100

Table 3
The Mandatory Disclosure Score of Banks - Bapepam*

Description	Actual Score / Maximum Score
General description	73.3%
Special description	34%
Summary of financial data	66.7%
Management discussion and analysis	54.7%
Overall score	58.8%

* Processed from Irwanto, Table 4.4, 4.5 and 4.6, page 101-103

age overall disclosure score and the average disclosure scores for each part of disclosure where the disclosure list is based on the central bank. The score is calculated as the actual score divided by the maximum score.

The results indicate that overall only 58.3% of the required information is disclosed. The score ranges from as high as 81.4% (Bank BNI) to as low as 25.6% (Bank Interpacific and Bank Global Internasional). Information under Items Need Attention has the lowest score (50.9%). This includes disclosure on derivative transactions (reported only by 20% banks) and disclosure on the amount collected from written-off credits (20%). Information under Management Report that receives low scores among others are: cost of fund (reported only by 1 bank) and ownership of the management, commissioners, and stockholders in affiliated companies (4 banks).

The following table presents the average overall disclosure score and the average disclosure scores for each part of disclosure where the disclosure list is based on Bapepam. The score is calcu-

lated as the actual score divided by the maximum score.

Consistent with the previous results, the overall disclosure score is low. Information under Special Description has the lowest score. Some items that are not disclosed at all are: Materials about Investment, Expansion, Divestment or Acquisition. Items that receive the most disclosures include: Management Address, Financial Performance in the Past Five Years (in term of sales, gross profit, operating income and net income), and Business Activities.

In summary, the findings suggest that generally the degree of compliance of publicly listed banks to the central bank's rule and Bapepam is rather low.

Fitriany conducts a study to investigate the disclosure level of financial statements of fire and loss insurance companies which are publicly listed in the Jakarta Stock Exchange.⁷ The findings also show that the overall disclosure score of these companies is relatively low (less than 60%). Interestingly, the study finds that auditors play a role in determining the disclosure level. In one case, the disclosure score of one insurance company dropped after it switched auditor. Further investigation revealed that the former auditor participated in the development of accounting standard for insurance companies and therefore completely understood the standard. This suggests that comprehension of disclosure requirements plays a major factor in determining the extent of disclosure.

The foregoing studies directly computed the disclosure level of publicly listed companies in Indonesia. Pricewaterhouse did a survey to institutional investors in Singapore, asking their perception on the standard of disclosure and transparency in a dozen countries in the Asia-Australia region.⁸ The survey

finds that Indonesia ranks very low in the perceived standard of disclosure, consistent with the findings of the studies.

Conclusion and Recommendation

One principle of corporate governance is disclosure and transparency. This principle stipulates that relevant and reliable disclosure is made on all material matters regarding the corporation. By applying this principle, information asymmetry can be reduced and thus negative consequences of adverse selection and moral hazard problems can be minimized. As a consequence, the cost of capital decreases and the value of the firm increases. A credible disclosure may also increase investors' confidence and result in better capital allocation in the economy.

Due to contracts that firms generate with various parties and due to capital and labor market pressures, firms actually have private incentive to disclose. However, this private incentive fails to generate optimal information because information has a characteristic of public goods and because there is market failure. This justifies central authority's intervention to regulate the required amount of information produced by these firms.

For publicly listed companies the extent of information asymmetry is substantial between majority shareholders who have access to private information and minority shareholders who have no access to such information. Private mechanism to control the negative consequences of information asymmetry is not effective since the role of board of directors/ commissioners and banks/ creditors is minimum in monitoring the firms' actions. Further, the capital and labor markets are not well developed. Without proper regulation, the amount of information produced by these companies, as expected, is inadequate.

In recent years, there has been significant improvement in the regulation of disclosure in Indonesia. Bapepam has issued a number of rules that enforce disclosure and that protect the interest of minority shareholders. The accounting standards are harmonized with the International Accounting Standards while the due process in preparing the standards has been intensified.

Empirical evidences, however, find that in general the disclosure level among

7. Fitriany, Analisis Kekucupan Pengungkapan Informasi pada Laporan Keuangan Perusahaan Asuransi Kerugian Go Public, Thesis, Master in Accounting Program University of Indonesia, 2000.

8. Pricewaterhouse Coopers (in collaboration with the Singapore Exchange), 1999 Survey of Institutional Investors.

publicly listed companies in Indonesia is low. Even for mandatory disclosure, the compliance rate is not satisfactory. This low level of disclosure despite the enhancement of disclosure requirement by the regulating bodies suggest that the enforcement of the regulation needs to be improved.

Recommendation

The followings are some programs that need to be done to enhance the level of disclosure and transparency among publicly listed companies in Indonesia.

The environment under which companies operate should be supportive in motivating these firms to be transparent and to apply the full-disclosure principle. The monitoring role of board of commissioners, including minority shareholders, needs to be strengthened. Minority shareholders legal rights and their protection also need to be improved. Majority shareholders (which mostly consist of family-based controlling shareholders) should be encouraged to diffuse their ownership. To broaden share ownership, participation by large domestic as well as foreign institutional investors such as pension funds and mutual funds should be encouraged. These institutions may insist on higher standards of disclosure in general. Thus, development of an institutional investor community is crucial to the promotion of the role of outside shareholders in monitoring firms. Further reforms in bankruptcy procedures and laws are required to strengthen the role of creditors in advising, monitoring, and supervising companies and managers and to protect creditors' rights. The investment community should also create a condition whereby transparent and fully disclosed companies are rewarded. For example, a survey can be conducted regularly to evaluate companies in term of their disclosure level and high-ranked companies are rewarded accordingly.

The government should continue or even accelerates the development of equity as well as debt markets. It should also review public listing, trading rules and supervision systems to improve the efficient operation of capital markets. Those related to disclosure, insider trading, and listing rules are of special importance.

In recent years, there has been tre-

mendous improvement in the disclosure regulation for public companies; however, it appears that the enforcement of those rules lacks behind. A recent effort by Bapepam, the Jakarta Stock Exchange, IAI and AEI to develop presentation and disclosures guidelines for public companies in 22 industries should be applauded, but it is necessary that Bapepam ensure that firms utilize the guidelines. Thus, Bapepam or other regulating bodies (such as the central bank) should enforce its mandatory disclosure regulation and monitor whether companies comply with the regulation. A sanction might even be given to companies that fail to follow the requirement.

Financial Statements is the primary mean on which investors rely to assess financial performance of a company. However, they can only be useful if they are relevant and reliable. The integrity of external auditors is very crucial in enhancing the credibility of financial statements. Auditors also play an important role in ensuring firms' compliance to accounting standards. In Indonesia, the auditing standards and the code of ethics have been harmonized with international-level standards. The due-process procedures in standards setting have also been refined. These standards and codes have to be understood by auditors; therefore it is imperative that IAI or other regulating bodies to formulate a policy aiming to improving the auditors' competence. Monitoring on the compliance or violation of standards or codes needs to be strengthened while sanctions should be clearly formulated to punish violation. **□**

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