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Procedia Economics and Finance 2 (2012) 157 – 166

Procedia

Economics and Finance

www.elsevier.com/locate/procedia

2nd Annual International Conference on Accounting and Finance (AF 2012)

Corporate governance mechanism and the level of internet financial reporting: Evidence from Indonesian companies

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Abstract

The purpose of this study is to find empirical evidence whether corporate governance mechanisms (ownership structure, independent commissioners, and audit committee characteristics) affect the level of voluntary disclosure of Internet Financial Reporting (IFR). Populations used in this study are all of 420 Indonesian companies listed in Indonesian Stock Exchange (IDX) in the period of 2010. The sample of this research is determined using purposive sampling method. There are 95 companies fulfill the criteria. Data were analyzed using multiple regression analysis. The result indicates that among corporate governance mechanisms, only audit committee meeting frequencies influence voluntary disclosure of IFR.

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Keywords: Internet Financial Reporting; corporate governance; ownership structure; independent commissioners; audit committee

1. Introduction

Full disclosed information plays an important role in representing management's transparency and accountability in conducting the business. Traditionally, entities use a paper-based reporting system to share any information to their stakeholders [1]. During these two past decades, internet becomes an alternative media used by entities to disseminate any information to their stakeholders. This alternative media is a paperless-based reporting system and is often called as Internet Financial Reporting (IFR) [1]. IFR is one example of entities' voluntary disclosure. In certain developing countries such as Indonesia, this type of disclosure has not been formally regulated [2]. Entities adopt IFR based on certain motives, such as to publish a more up-date information, to increase efficiency and effectiveness [3], and to reduce information asymmetry

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as well [4]. Reference [5] suggests, a sound corporate governance is needed to support a more transparent disclosure. Good Corporate Governance (GCG) supported by a strong regulation can avoid financial disclosure from any possible misstatements [6]. There are still limited numbers of research examining the association between corporate governance and IFR, especially in developing countries. Reference [3] found an association between IFR and governmental and institutional ownership. Reference [7] found a positive association between IFR timeliness and size, type of industry, liquidity, ownership structure, and size and composition of the board of commissioner. Reference [8] found empirical evidence that board composition and ownership structure influence IFR timeliness in Irish companies. Reference [3] showed that corporate governance mechanism influence disclosure transparencies measured by the level of Internet Financial Reporting Behaviour. Reference [9] found that board of commissioner independency, size of board of commissioner, and the number of shareholders influence IFR practice in Malaysian companies. Reference [10] found empirical evidence that the size of board of commissioner influences the extent of Internet Corporate Reporting (ICR) disclosure in Indonesian companies. This study tries to find empirical evidence whether ownership structure (managerial and blockholder ownership), independent commissioner, and audit committee characteristics (meeting frequencies and audit committee competencies) influence the level of Internet Financial Reporting especially in the context of Indonesian companies listed in Indonesian Stock Exchange. This study is important to conduct in the context of Indonesian companies as IFR is relatively a new media of disclosure utilized by Indonesian companies. Moreover, there is still very limited number of research in this field in Indonesia.

2. Literature review and hypothesis development

2.1. Agency theory, corporate governance mechanism, and internet financial reporting

Agency theory discuss about relationship between principal (owner/shareholders) and agent (management). Reference [11] states that agency relationship arises when one or more individual (principal) hire another individual (agent) to provide service. Agency theory states that a rational agent will act for their own interest, and not for their shareholders [6]. These managers' behavior occurs because they have more complete information about company than the owner (or it can be called as Asymmetric Information). The asymmetric information and self-serving behavior of manager enabling them to make decisions and policies those are less beneficial to company. These conditions lead to corporate governance which is lack of transparency disclosure about company's performance to principal [12]. Agency theory is closely related to corporate governance. Corporate governance mechanism aimed to ensure governance system within an organization. Reference [13] states that disclosure and transparency are important aspect in implementation of good corporate governance. Agency theory provides a framework that relates disclosure with corporate governance [14]. Corporate governance mechanism applied to control agency problems and ensure managers' behavior in line with the interest of shareholders. In the perspective of agency theory, there are two relationships between corporate disclosure policy i.e. complementary or substitution relationship [14]. Complementary relationship occurs when the adoption of corporate governance mechanism, strengthen internal controls and minimize the possibility for managers to withhold information for their own interest [14]. This leads to improved financial reporting quality and comprehensive disclosure. Therefore, if corporate governance is complementary, and then by strengthen of corporate governance mechanism, companies will tend also to make voluntary disclosure. On the other hand, substitution relationship arises when governance mechanism can reduce information asymmetry and opportunistic managers' behavior which is decreased monitoring and disclosure [14]. Thus companies prefer to raise one of the components because management considers the application of corporate governance is a "guarantee" for investors, and can reduce agency costs caused by

information asymmetry [15]. Internet Financial Reporting (IFR) is a media for company to disseminate their financial statements through internet, definitely in company's website. Some of the accounting literature states that the IFR is a form of voluntary disclosure practices as a media, not as information content [16]. Internet Financial Reporting (IFR) refers to the use of corporate websites in disseminates information about the company's financial performance [17]. Financial information provided by the company through the website i.e. financial statements; partial financial reports; and other financial information relates to summary data such as: stock quotes, analysis reports, operational management discussions, corporate news, and others company specific information [18]. Based of these definitions, it can be said that IFR provides many kind of information about the company, both financial and non-financial information, and can be used by users to make decisions.

2.2. *Managerial ownership and IFR*

Managerial ownership represents proportion of entities' shares owned by management of the entities. Managers, who are also the shareholders of the entities, are motivated to increase entities' values as well as to increase shareholders' wealth as it will also increase their own wealth. Therefore, managers tend to decrease their opportunistic behaviour. Governance mechanisms that have capabilities to decrease management's opportunistic behaviour and information asymmetry can reduce the level of monitoring and voluntary disclosure [14]. In other words, managerial ownership substitutes voluntary disclosure, including IFR. Although [19] as well as [3] did not find any association between managerial ownership and voluntary disclosure including IFR, [20] found empirical evidence that managerial ownership affects voluntary disclosure negatively. Therefore, the first hypothesis proposed is, *managerial ownership influence the level of IFR negatively.*

2.3. *Blockholder ownership and IFR*

Blockholder ownership represents the percentage of ordinary shares owned by substantial shareholders (5% or more). A high blockholder ownership shows a tight monitoring by outsiders to the management of the entities. This kind of monitoring will encourage managers to increase their performance and to manage the business more transparently. In turn, it will also decrease managers' opportunistic behaviour. Based on [14] concept, blockholder ownership substitutes voluntary disclosure, including IFR. Although [20] did not find any evidence that blockholder ownership influence voluntary disclosure, [3] found empirical evidence that blockholder ownership affects voluntary disclosure negatively. Therefore, the second hypothesis proposed is, *blockholder ownership influence the level of IFR negatively.*

2.4. *Independent commissioner and IFR*

Independent commissioners are commissioners that are not the management of the entities. Independent commissioners play important role in monitoring the accounting process, in increasing financial statements reliability [3], and also in ensuring the application of internal control system [21]. Moreover, independent commissioner can also reduce management's opportunities to hold certain information for their own favour. It means that in line with [14] concept, independent commissioner complements voluntary disclosure, including IFR. Although [10] did not find any evidence that independent commissioner influence IFR, [5] found empirical evidence that independent commissioner affects voluntary disclosure positively, while [3] and [9] found that independent commissioner affects IFR positively. Therefore, the third hypothesis proposed is, *independent commissioner influence the level of IFR positively.*

2.5. Audit committee meeting Frequency and IFR

Audit committee conducts meeting both with internal and external parties. The objectives of the meeting are to discuss about the financial statements preparation as well as the internal control and GCG application. The meeting frequencies conducted by audit committee positively related with the level of internal control and management control effectiveness and also with the level of GCG application. Based on [14] concept, audit committee meeting frequencies complement voluntary disclosure, including IFR. Although [9] did not find any evidence that audit committee meeting frequencies influence IFR, [3] found empirical evidence that audit committee meeting frequencies affect IFR positively. Therefore, the fourth hypothesis proposed is, *audit committee meeting frequencies influence the level of IFR positively.*

2.6. Audit committee competency and IFR

Audit committee supports the board of commissioner in monitoring financial statements preparation, internal control mechanism, and good corporate governance application. In order to function effectively, having financial literacy is a must for audit committee members. If the proportion of audit committee members having accounting and/or finance educational background is higher, the performance of the audit committee will also be higher. This in turn, will increase the quality of financial statements prepared [22], limit managers' opportunistic behavior [22], and increase voluntary disclosure. In line with [14] concept, audit committee competency complements voluntary disclosure, including IFR. Reference [3] found empirical evidence that audit committee competency affects IFR positively. Therefore, the fifth hypothesis proposed is, *audit committee competency influences the level of IFR positively.*

2.7. Explanatory factors

The agency theory states that big firms have higher agency costs than small firms [11]. In order to reduce this agency cost, big firms adopt a more extensive and comprehensive disclosure. Big firms also have a complete and sophisticated management information system, and it makes possible for these firms to generate comprehensive information and to use internet facility as a mean to share the information to the shareholders [16]. Entities with good financial performance tend to report their financial condition more completely and extensively compared to those with poor financial condition [16]. Entities' financial performance can be measured, for example, using profitability and liquidity ratios. Entities with high level of profitability and liquidity are considered to be in good condition, and tend to adopt a more detail disclosure to inform their activities voluntarily in the form of IFR [16]. Leverage represents entities' dependencies on debt. Entities with high rate of leverage need to share more extensive information to the stakeholders. They need to inform their capabilities to pay debts. They also need to share positive information so that creditors and shareholders are not only focus in this high leverage. Compared to paper-based financial reporting, more extensive information can be disclosed in the form of IFR [23].

3. Research methods

3.1. Population and sample

Populations of this research are all 420 companies listed in The Indonesian Stock Exchange in the period of 2010. Sample of this research is determined using purposive sampling method, based on 6 criteria as follows: (1) the companies are not bank, credit agencies other than bank, securities, insurance, and holding and other investment companies; (2) the companies have websites to share financial and nonfinancial

information, not only to advertise their products; (3) the website is not under construction; (4) the companies do not report equity deficiency; (5) the financial statements are denominated in rupiah; and (6) the companies have all data needed in this research. There are 95 companies fulfil these criteria.

3.2. Research data

The data of this research are categorized as secondary data. Corporate governance mechanism data and financial ratios data are gained from annual report of sample companies for the year 2010 and downloaded from www.idx.co.id. Financial and nonfinancial data to measure the level of IFR are taken from companies' website.

3.3. Variables

Dependent variable of this research is the level of voluntary disclosure in the form of IFR. This variable is measured using Internet Disclosure Index (IDI) developed by [24]. This index consists of 50 items to measure the content (40 items) and the presentation (10 items) of companies' website. In more detail, 40 items of website content consist of accounting and financial information (15 items), corporate governance information (9 items), corporate social responsibility (CSR) and Human Resources Information (8 items), contact detail to Investor Relation (IR) and related information (8 items), while 10 items of website presentation consist of material processable formats (3 items) and technological advantages and user support (7 items). Each item disclosed will be scored 1. Finally, the total score is divided by 50 to get the IDI. Independent variables used in this research are managerial ownership, blockholder ownership, independent commissioners, audit committee meeting frequencies, and audit committee competency. Managerial ownership is the percentage of the number of shares owned by managers, affiliated commissioners, and directors to the total number of outstanding shares. Blockholder ownership is the proportion of shares owned by substantial shareholders (5% or more). Independent commissioner is determined as the percentage of independent commissioners to the total number of board of commissioner members. Audit committee meeting frequencies are the number of meeting frequencies held by the audit committee, both with internal and external parties, in one year. Audit committee competency is the proportion of audit committee members having finance and/or accounting educational background to the total number of audit committee members. Moreover, this research uses 4 control variables, i.e. companies' size measured by natural logarithm of companies' total assets, profitability measured by ROA, liquidity measured by current ratio, and leverage measured by debt to equity ratio.

3.4. Methods of data analysis

The data in this research are analysed using multiple regression analysis. The regression equation is as follows:

$$IDI = \alpha + \beta_1 MOWN + \beta_2 BOWN + \beta_3 IC + \beta_4 MF + \beta_5 AC + \beta_6 SIZE + \beta_7 Profit + \beta_8 Liquid + \beta_9 Lev + \varepsilon_1 \quad (1)$$

which is IDI is the level of IFR, MOWN is managerial ownership, BOWN is blockholder ownership, IC is independent commissioner, MF is audit committee meeting frequencies, AC is audit committee competency, SIZE is companies' size, Profit is profitability (ROA), Liquid is liquidity (current ratio), and Lev is leverage (debt to equity ratio). Before conducting data analysis using the multiple regression analysis, data are exercised in order to comprehend whether they serve the classic assumptions or not. The classic assumptions

in this study include normality, tested using Kolmogorov-Smirnov Test, multicollinearity, tested using Tolerance Value and Variance Inflation Factor, and heteroskedasticity, and tested using Glejser Test. Autocorrelation test is not needed in this research as the data used are cross sectional data.

4. Results of data analysis and discussion

4.1. Descriptive Statistics

The result of descriptive statistics tests of IFR is illustrated in Table 1.

Table 1. Descriptive statistics of IFR

	N	Minimum	Maximum	Mean	Std. Deviation
Content	95	0.02	0.60	0.24	0.16
Presentation	95	0.00	0.18	0.08	0.04
IDI	95	0.04	0.78	0.32	0.19

Content represents variations of information disclosed by companies in their websites, while presentation represents information presentation and internet technology sophistication used in the companies' websites. In general, types of information disclosed and information presentation in the companies' websites are still very limited, only 24% and 8%, respectively. This result also implies that Indonesian companies are still focus on the types of information disclosed in their websites and has not fully utilized internet technology to support companies' disclosure. Overall, the level of voluntary disclosure disclosed by Indonesian companies in the form of IFR is still low, approximately 32%. Table 2 shows the result of descriptive statistics test of independent and control variables.

Table 2. Descriptive statistics of independent and control variables

	N	Minimum	Maximum	Mean	Std. Deviation
MOWN	95	0.00	0.70	0.03	0.11
BOWN	95	0.05	0.99	0.67	0.21
IC	95	0.20	1.00	0.42	0.14
MF	95	1.00	44.00	9.91	9.50
AC	95	0.20	1.00	0.73	0.26
SIZE	95	25.33	32.36	28.56	1.49
Profit	95	-0.38	0.51	0.08	0.10
Liquid	95	.010	42.59	2.46	4.44
Lev	95	0.01	2.40	0.43	0.44

From Table 2, it can be concluded that most of Indonesian companies' shareholders are blockholders and it seems that managers tend to be minority shareholders. These facts are shown by the percentage of blockholder ownership and managerial ownership that are 67% and 3%, respectively. In line with the valid rule, 42% of the board of commissioner members are independent commissioners. However, there is a

company that only has 20% independent commissioners in the composition of its board of commissioner. There is a large variation in the audit committee meeting frequencies, from once a year up to 44 times a year. In general, audit committee conducted 10 meetings in the year 2010. Moreover, most of audit committee members have financial literacy. Although the rule requires only one of audit committee members has finance and/or accounting educational background, on average, 73% of audit committee members have finance and/or accounting educational background.

4.2. Results of normality and classic assumption test

The result of normality test of residuals using Kolmogorov-Smirnov Test is shown in Table 3 As the value of Kolmogorov-Smirnov Z is 0.559 with significance level of more than 5%, it can be summarized that the data come from normally distributed population. Meanwhile, the results of multicollinearity test utilising Tolerance Value and Variance Inflation Factor as well as heteroskedasticity test using Glejser Test are demonstrated in Table 4. Based on the test results, it is clearly seen that all research variables have Tolerance Value of more than 0.1 and Variance Inflation Factor of less than 10, demonstrating that there is no indication of multicollinearity. Further, the values of Glejser statistics have significance level of more than 5%, indicating that there is no heteroskedasticity problem.

Table 3. Normality test

	Unstandardized Residual
K-S Z	0.559
Sig. (2-tailed)	0.913

Table 4. Multicollinearity and heteroskedasticity tests

Variables	Tolerance	VIF	Glejser (sign.)
MOWN	0.771	1.298	0.396
BOWN	0.707	1.414	0.707
IC	0.908	1.102	0.461
MF	0.874	1.144	0.466
AC	0.910	1.099	0.964
SIZE	0.755	1324	0.790
Profit	0.824	1.214	0.067
Liquid	0.923	1.084	0.999
Lev	0.840	1.190	0.847

4.3. Results of hypothesis tests

The results of hypothesis tests are exhibited in Table 5. Based on Table 5, it can be seen that among independent variables used in this study, only audit committee meeting frequencies variable that is statistically significant at the level of 1%. Looking at the positive coefficient of this variable, it can be concluded that audit committee meeting frequencies affect the level of IFR positively. Therefore, only one of five proposed hypothesis, hypothesis 4, is supported, while hypothesis 1, 2, 3, and 5 are rejected. This study succeeds in finding evidence that audit committee meeting frequencies affect the level of IFR positively.

However, this study could not find any evidence that managerial ownership, blockholder ownership, independent commissioners, and audit committee competency influence the level of IFR.

Table 5. Hypothesis tests

Variables	Regression Coefficients	t-values
MOWN	-0.003	-0.018
BOWN	-0.078	-0.946
IC	-0.036	-0.330
MF	0.006	3.458*
AC	0.018	0.307
SIZE	0.069	6.178*
Profit	0.108	0.696
Liquid	-0.002	-0.552
Lev	0.019	0.546
Adjusted R Square	= 0.448	
F Statistics	= 9.482*	

* Significant at the level of 1%

4.4. Discussions

This study could not find any evidence that managerial ownership influence the level of IFR negatively. This result is consistent with [19] and [3] but inconsistent with [20]. A very limited percentage of managerial ownership in Indonesian companies (only 3%) cannot eliminate the conflict of interest between managers and owners. Managers' personal interests are still not in line with owners' interests, so that managers' opportunistic behaviour cannot be reduced. Therefore, because of the very low percentage, managerial ownership in Indonesian companies cannot influence voluntary disclosure policies, including IFR policies. This study also could not find any evidence that blockholder ownership influences the level of IFR negatively. This result is consistent with [20]. However, this result is inconsistent with [3]. This finding suggests that blockholder has not been able to optimize its function as a monitoring system. Besides, this study did not differentiate between individual blockholder and institutional blockholder. These two groups of blockholder have their own different characteristics that may affect their policies on voluntary disclosure, including IFR. This research could not find any evidence that independent commissioners influence the level of IFR positively. This result is consistent with [10]. However, this result is inconsistent with [5], [3], [9], [20], and [25]. This finding suggests that although the proportion of independent commissioners is higher than the requirement, it seems that independent commissioners have not functioned properly. This can be caused by the selection procedures. In Indonesia, it seems that board of commissioners are established just as a formality, to obey the rules. The members are not independent and do not have sufficient competencies needed [26]. It is a common phenomenon in Indonesia that government officers or ex-government officers are elected as board of commissioner members as they can help the companies to get an access to the governmental institutions more easily [27]. It tends to be common that integrity, competency, and independency are not too important to be considered in selecting board of commissioner members. This study succeeded in finding evidence that audit committee meeting frequencies influence the level of IFR positively. This result is consistent with [3] but inconsistent with [9]. Audit committee conducts meeting with internal parties, such as board of directors, as well as with external parties, such as external auditors. The main

objective of the meeting is to create a kind of coordination in monitoring financial statements preparation and in enhancing internal control and good corporate governance application. The more frequent the meeting, the higher the coordination, and the more effective the monitoring system conducted by audit committee. It means, audit committee meeting frequencies can increase internal control and decrease managements' opportunities to hold information for their own favour. Further, this can increase information disclosure, including voluntary disclosure in the form of IFR, comprehensively. This research could not find any evidence that audit committee competency influences the level of IFR positively. This result is inconsistent with [3]. Audit committee is not only responsible for monitoring financial statements preparation, but also responsible for monitoring internal control and good corporate governance application. With this wide range of responsibilities, finance and/or accounting competencies alone is not enough for audit committee to be able to function properly. It is also a must for audit committee as a team to have competencies and experiences in the field of law, stock market, and other related business practices [28]. This study also found that from four control variables, only size tends to affect the level of IFR. This study could not find any evidence that profitability, liquidity, and leverage affect the level of IFR. These findings suggest that companies' financial performance numbers are not factors considered in deciding the variation and the extent of voluntary disclosures, including in deciding the level of IFR. However, this research found evidence that company size influences the level of IFR positively. Big firms have to afford high agency cost, and this kind of cost can be reduced by adopting a comprehensive disclosure policy, such as in the form of IFR. Besides, big firms have sufficient funds to develop sophisticated management information system that enables them to provide better and more comprehensive information to the stakeholders, including utilizing internet technology as a mean to disseminate financial and nonfinancial information in companies' websites [10].

5. Closing remarks

The objective of this study is to find empirical evidence whether corporate governance mechanism affects the level of Internet Financial Reporting (IFR). IFR is a media used by companies to share financial and nonfinancial information to their stakeholders. This study succeeded in finding evidence that audit committee meeting frequencies influence the level of IFR positively. However, this study did not find any evidence that managerial ownership, blockholder ownership, independent commissioners, and audit committee competency influence the level of IFR. This study has limitation in the research period used, which is only one year, the year of 2010, so that the result represents condition only in that period. However, one period is selected based on important consideration, i.e. the fact that companies' websites are always changing. Besides, the result shows that the determination coefficient is only 44.8%, meaning that there are other factors influence the level of IFR not yet covered in this research. Finally, institutional blockholder ownership in this study was not separately examined from individual blockholder ownership. Based on those limitations, subsequent research may use the more recent period to examine the influence of corporate governance mechanism to the level of IFR, and also to understand the development of IFR practices from period to period, especially in the context of Indonesian companies. Moreover, future research can consider using other variable, such as executive compensation, multi division business structures, and market control. It is also important for next research to analyse institutional blockholder ownership separately from individual blockholder ownership to find any possible different results.

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