AUDIT COMMITTEE RULES IN INDONESIA: DETERMINANTS OF COMPLIANCE AND THEIR ASSOCIATION WITH RESTATEMENTS

ARI KUNCARA WIDAGDO

THESIS SUBMITTED IN FULFILMENT
OF THE REQUIREMENTS
FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

FACULTY OF BUSINESS AND ACCOUNTANCY
UNIVERSITY OF MALAYA
KUALA LUMPUR

2014

UNIVERSITY OF MALAYA

ORIGINAL LITERARY WORK DECLARATION

Name of Candidate : Ari Kuncara Widagdo (I.C/Passport No: U 939346)

Registration/Matric No : CHA050019

Name of Degree : Doctor of Philosophy

Title of Project Paper/Research Report/Thesis ("this work"):

AUDIT COMMITTEE RULES IN INDONESIA: DETERMINANTS OF COMPLIANCE AND THEIR ASSOCIATION WITH RESTATEMENTS

Field of Study: Corporate Governance in Emerging Country

I do solemnly and sincerely declare that:

(1) I am the sole author/writer of this Work;
(2) This Work is original;
(3) Any use of any work in which copyright exists was done by the way of fair dealing and for permitted purposes and any excerpt or extract from, or reference to or reproduction of any copyright work has been disclosed expressly and sufficiently and the title of the Work and its authorship have been acknowledged in this Work;
(4) I do not have any actual knowledge nor do I ought reasonably to know that the making of this work constitutes an infringement of any copyright work;
(5) I hereby assign all and every rights in the copyright to this Work to the university of Malaya ("UM"), who henceforth shall be owner of the copyright in this Work and that any reproduction or use in any means whatsoever is prohibited without the written consent of UM having been first had and obtained;
(6) I am fully aware that if in the course of making this Work I have infringed any copyright whether intentionally or otherwise, I may be subject to legal action or any other action as may be determined by UM.

Candidate's Signature Date: 15th February 2014

Subscribed and solemnly declared before,

Witness's Signature Date: 16th February 2014

Name : Dr. S. Susela Devi
Designation: Professor

ABSTRACT

As a response to the 1997 Asian financial crisis, Indonesia intensively pursued corporate governance reforms. However, the reforms were found to be unsatisfactory; some factors, such as specific business characteristics, were considered as contributing to the ineffectiveness of the reforms. Therefore, Indonesia provides an interesting setting to examine the effectiveness of the implementation of the Anglo-American corporate governance model in an emerging economy context.

This study focuses on one Anglo-American corporate governance mechanism that has been actively promoted in Indonesia, namely, the audit committee. The objectives of the study are three-fold: (1) To examine the association between public listed companies with specific business characteristics (namely family control, politically connected independent commissioners, and foreign institutional investors) and their level of compliance with audit committee rules; (2) To examine whether the compliance, which also indicates the level of audit committee effectiveness, is associated with restatements of financial statements, and; (3) To examine the influence of family control on the association between audit committee effectiveness and restatements of financial statements.

This study is divided into two interrelated research stages: a study on the determinants of compliance of public listed companies with audit committee rules (Research Stage 1), and a study on the association between audit committee effectiveness and restatements (Research Stage 2). Research Stage 1 employs short balanced panel data that, in total, cover 828 company-year observations for the period 2006-2008. The method of analysis used is feasible generalised least squares (FGLS), as the presence of heteroskedasticity and autocorrelation are noted in the data. Meanwhile, Research Stage 2 utilises cross sectional data, namely, 158 restating companies for the period 2006-2012 matched with 158 control companies for the same period. The method of analysis is matched pair logistic regression.

The results of Research Stage 1 indicate that different types of family control have different effects on the level of compliance of public listed companies with audit committee rules. Family-controlled companies with family members on boards are less likely to comply with audit committee rules. In contrast, companies controlled through family shareholding but without family involvement in their daily business activities are more likely to comply with audit committee rules. Additionally, public listed companies with politically connected independent commissioners are less likely to comply with audit committee rules. As expected, public listed companies with large, genuine foreign institutional investors are more likely to comply with audit committee rules. Meanwhile, the results of Research Stage 2 reveal that audit committee effectiveness is not significantly associated with restatements of financial statements. This implies that the presence of an audit committee might be just cosmetic or symbolic. However, the use of restatements of financial statements as a proxy for financial reporting quality might contribute to the insignificance of audit committee effectiveness because this proxy might not be appropriate in the Indonesian environment.

ABSTRAK

Sebagai respons krisis kewangan Asia tahun 1997, Indonesia secara intensif melakukan pembaharuan urus tadbir korporat secara intensif. Walau bagaimanapun, pembaharuan telah didapati masih tidak memuaskan. Beberapa faktor, seperti ciri-ciri perniagaan tertentu, dianggap sebagai menyumbang kepada ketidakberkesanan pembaharuan. Oleh itu, Indonesia mempunyai persekitaran yang menarik untuk mengkaji keberkesanan pelaksanaan model tadbir urus korporat Anglo-Amerika di sebuah negara membangun.

Kajian ini menumpukan kepada satu mekanisma tadbir urus Anglo-American yang dipromosikan secara aktif di Indonesia, iaitu jawatankuasa audit. Objektif kajian ini adalah tiga peringkat: (1) untuk mengkaji perkaitan antara persekitaran perniagaan Indonesia dan pematuhan syarikat tersenarai awam dengan peraturan jawatankuasa audit, (2) untuk memeriksa sama ada tahap pematuhan, yang juga menunjukkan tahap keberkesanan jawatankuasa audit, dikaitkan dengan kualiti laporan kewangan, dan (3) untuk mengkaji pengaruh kawalan keluarga pada persatuan antara keberkesanan jawatankuasa audit dan kualiti laporan kewangan.

Kajian ini memberi tumpuan kepada satu mekanisme tadbir urus korporat Anglo-Amerika yang telah dinaikkan pangkat secara aktif di Indonesia, iaitu jawatankuasa audit. Objektif kajian ini adalah tiga kali ganda: (1) untuk memeriksa hubungan antara syarikat-syarikat tersenarai awam dengan ciri-ciri perniagaan tertentu (iaitu kawalan keluarga, politik yang berkaitan, pemilikan asing) dan tahap pematuhan syarikat-syarikat tersebut dengan peraturan jawatankuasa audit; (2) untuk mengkaji sama ada pematuhan, yang juga menunjukkan tahap keberkesanan jawatankuasa audit, dikaitkan dengan penyataan semula penyata kewangan, dan; (3) untuk mengkaji pengaruh kawalan keluarga pada hubungan antara keberkesanan jawatankuasa audit dan penyataan semula penyata kewangan.

Kajian ini terbahagi kepada dua peringkat penyelidikan saling berkaitan: satu kajian ke atas penentu pematuhan syarikat awam tersenarai dengan peraturan jawatankuasa audit (peringkat kajian 1), dan kajian mengenai hubungan antara keberkesanan jawatankuasa audit dan penyataan semula penyata kewangan (peringkat kajian 2). Peringkat kajian 1 menggunakan data panel pendek yang seimbang, secara total, meliputi 828 syarikat-syarikat tahun pemerhatian bagi tempoh 2006-2008. Kaedah kajian yang digunakan adalah kuasa dua umum terkecil (FGLS), kerana terdapatnya heteroskedasticity dan autokorelasi di dalam data. Sementara itu, peringkat kajian 2 menggunakan cross sectional data, iaitu 158 syarikat menyatakan semula penyata kewangan untuk tempoh 2006-2012 dipadankan dengan 158 syarikat kawalan dalam tempoh yang sama. Kaedah analisis menggunakan pasangan padanan regresi logistik (matched pair logistic regression).

Keputusan peringkat kajian 1 menunjukkan bahawa jenis kawalan keluarga yang berbeza mempunyai kesan yang berbeza pada tahap pematuhan syarikat tersenarai awam dengan peraturan jawatankuasa audit. Syarikat yang dikuasai keluarga dengan ahli keluarga di dewan pengarah kurang cenderung untuk mematuhi peraturan jawatankuasa audit. Sebaliknya, syarikat yang dikuasai melalui pegangan keluarga tetapi tanpa penglibatan keluarga dalam aktiviti perniagaan harian mereka lebih cenderung untuk mematuhi peraturan jawatankuasa audit. Selain itu, syarikat-syarikat

tersenarai awam dengan pesuruhjaya bebas berkaitan politik kurang cenderung untuk mematuhi peraturan jawatankuasa audit. Seperti yang dijangka, syarikat-syarikat tersenarai awam dengan pelabur institusi asing tulen besar lebih cenderung untuk mematuhi peraturan jawatankuasa audit. Sementara itu, keputusan peringkat kajian 2 menunjukkan bahawa keberkesanan jawatankuasa audit tidak memunyai perkaitan yang signifikan dengan penyataan semula penyata kewangan. Ini bermakna bahawa kehadiran jawatankuasa audit mungkin hanya kosmetik atau simbolik. Walau bagaimanapun, penggunaan penyataan semula penyata keuangan sebagai proksi kualiti laporan kewangan mungkin menyumbang kepada ketidaksetaraan kepada keberkesanan jawatankuasa audit kerana proksi ini mungkin tidak sesuai dalam persekitaran Indonesia.

ACKNOWLEDGMENTS

In the name of Allah (SWT), the most gracious and the most merciful, Lord of the universe. Peace and blessings be upon prophet Muhammad (SAW).

I wish to express my profound gratitude to my supervisor, Professor S. Susela Devi. This thesis would not have been possible without her expertise, encouragement, indefatigable patience, guidance and support through the research process.

My appreciation is also extended to the visiting professors during the doctoral colloquium at the Faculty of Business and Accountancy, University of Malaya, for their constructive criticism and excellent advice. I am also extremely grateful to participants of the international conferences that I followed for their input.

I would like to thank my late father, my mother, my dearest wife, and my children, who have sacrificed a great deal without giving up, for their support and prayers to see me succeed through this most challenging process.

I am also grateful to my employer, Sebelas Maret University, Surakarta, Indonesia, for giving me the chance to pursue the doctoral program and for the financial assistance provided.

Last but not least, I also would like to thank the Dean and the Academic Staff of the Faculty of Business and Accountancy, University of Malaya, for their assistance and services throughout my study at the university.

TABLE OF CONTENTS

CHAPTER 3: A REVIEW AND SYNTHESIS OF THE EXTANT LITERATURE

CHAPTER 6: RESULTS AND DISCUSSION

CHAPTER 7: CONCLUSION

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

ACRA	Accounting and Corporate Regulatory Authority
Bank Indonesia	Indonesian Central Bank
BAPEPAM	Badan Pengawas Pasar Modal (Capital Market Supervisory Agency)
BAPEPAM-LK	Badan Pengawas Pasar Modal dan Lembaga Keuangan (Capital Market and Non-Bank Supervisory Agency)
CLDI	Corporate Leadership Development Indonesia
COD	Certificate of Domicile
FCGI	Forum for Corporate Governance in Indonesia
FGRSDP	Financial Governance Reforms Sector Development Program
ICRIS	Integrated Companies Registry Information System
IDX	Indonesia Stock Exchange
IIAC	Indonesian Institute of Audit Committee
IICD	Indonesia Institute for Corporate Directorship
IICG	Indonesia Institute of Corporate Governance
IKAI	Ikatan Komite Audit Indonesia (Indonesian Institute of Audit Committee)
ISICOM	Indonesian Society of Independent Commissioner
ITO	Indonesia Tax Office
JSX	Jakarta Stock Exchange
KADIN	Kamar Dagang dan Industri Indonesia (Indonesian Chamber of Commerce and Industry)

LAPPI	Lembaga Advokasi Proteksi Investor (Institution for Advocacy, Proxy, and Investor Protection)
LKDI	Lembaga Komisaris dan Direktur Indonesia (Indonesian Institute for Commissioners and Directors)
MSOE	Ministry of State-Owned Enterprises
NCCG	National Committee for Corporate Governance
NCG	National Committee on Governance
PBI	Peraturan Bank Indonesia (Bank Indonesia Regulation)
ROSC	Reports of the Observance of Standards and Codes
SOE	State-Owned Enterprise
SOX	Sarbanes-Oxley Act
Tbk	Terbuka (go public)
UU	Undang-undang (Law)

CHAPTER 1

RESEARCH OVERVIEW

1.1 INTRODUCTION

This opening chapter provides a general overview of this study. It begins with a discussion of the study's research background in Section 1.2, highlighting the ineffectiveness of corporate governance reforms in Indonesia. The weak enforcement of corporate governance reforms in the country emphasizes the importance of the issue of compliance. In addition, the section also focuses on the key Indonesian business characteristics that might be perceived as obstacles to corporate governance reform in the country. This leads to a brief discussion of research gaps in the existing literature. Section 1.3 begins with an explanation of the reasons for selecting compliance with audit committee rules as the main research focus. This is followed by a discussion on the use of restatements as a proxy for financial reporting quality. The section ends with the presentation of the research problems. Section 1.4 presents the study's research objectives. In Section 1.5, five research questions are identified, based on the Indonesian business environment and gaps in the existing literature. Section 1.6 presents the study's research methodology and research process. This is followed by Section 1.7, which presents some important contributions of this study to the existing literature. The chapter ends with a description of the organisation of the contents of the remaining chapters.

1.2 RESEARCH BACKGROUND

International donors, such as the International Monetary Fund (IMF) and the World Bank, actively promote the Anglo-American corporate governance model to East Asian countries. The introduction of the Anglo-American model is part of their global agenda, which seeks the liberalisation of the financial markets in developing countries as stated in the Washington Consensus [1]. The Washington Consensus prescribes market deregulation, fiscal austerity and privatisation in developing countries (Robinson and Hadiz, 2004), while corporate governance reform is included as one of the policies in the augmented Washington Consensus (Rodrik, 2001). The goals of the corporate governance reforms are to ensure that emerging markets adhere to the principles of a neoliberal open market economy, and to protect the interests of institutional investors based on market-centric systems such as those in the US (Soederberg, 2003). The policies in the Washington Consensus are imposed on governments in developing countries across the world through loan agreements offered by the IMF and the World Bank (Hooper, 2002).

The East Asian financial crisis of 1997-98 provided a conduit for the IMF and the World Bank to promote the Anglo-American corporate governance agenda. Some characteristics of the Asian business environment, such as poor corporate governance, high concentrated ownership with control in the hands of families, and close relationships between government and business (cronyism), were blamed as being the root problems of the crisis (Singh and Zammit, 2006). In response to the crisis, the IMF advised affected countries to reform their corporate governance landscape. The IMF prescribed the Anglo-American model as a solution, as it is believed to have a superior ability to efficiently allocate resources and monitor corporate behaviour (Singh and Zammit, 2006; Sam, 2007). Corporate governance reform was one prerequisite for affected countries in East Asia to be able to access the assistance provided by the IMF and the World Bank. Consequently, several crisis-affected countries such as South Korea, Thailand and Indonesia commenced the structural reform of their corporate

[1] The Washington Consensus is a term referring to economic policies implemented in developing countries. The term was invented by John Williamson (Robinson and Hadiz, 2004).

governance systems with the assistance of the IMF, the World Bank, and other international donors, such as the Asian Development Bank (ADB). In short, the East Asian financial crisis of 1997-98 served as a means for the spread of the Anglo-American corporate governance model into Asian countries (Loftus and Purcell, 2008).

Indonesia, which was more severely impacted than other crisis-affected countries, implemented corporate governance reforms guided by the IMF. As stated in the Letter of Intent (IMF, 2000), the IMF mandated certain policy actions in corporate governance reform for Indonesia. These included the establishment of a national committee for corporate governance, the adoption of corporate governance reform strategies, amendments of company law, improvements in accountability and disclosure, and improvements to regulatory oversight and enforcement. As an integral part of the IMF-led multi-donor rescue package, the ADB also provided a loan to help restructure the banking sector and improve financial and public sector allocation of resources by strengthening governance, increasing disclosure and transparency of financial information, and reinforcing the financial sector's legal and regulatory framework (ADB, 2006).

There were concerns about the implementation of the Anglo-American corporate governance model in Indonesia. Scholars argued in academic literature that the corporate governance reforms in Indonesia were ineffective. For example, Patrick (2001) argued that Indonesia already had quite good prudential and other laws and regulations but lacked effective implementation. Similarly, Lindsey (2004) argued that Indonesian corporate governance reform lacked coordination and effective implementation. Dercon (2007) claimed that the efforts of Indonesia to promote good corporate governance by giving much attention to issues such as creating committees for corporate governance, publishing national and sector codes, amending and enacting numerous law or rules, seemed ineffective.

Further evidence of the ineffectiveness of corporate governance reform in Indonesia was noticeable from the low ranking of Indonesia in most surveys of corporate governance implementation in Asia conducted by international organizations. For example, surveys conducted by independent brokerage and investment group Credit Lyonnais Securities Asia (CLSA), in cooperation with the Asian Corporate Governance Association (ACGA), consistently placed Indonesia in the bottom rank. The criteria to evaluate the quality of corporate governance included corporate governance rules and practices, enforcement, the political and regulatory environment, accounting and auditing standards, as well as the overall corporate governance culture. These surveys were conducted on eleven countries in Asia, namely Hong Kong, Singapore, India, Taiwan, Japan, Korea, Malaysia, Thailand, China, Philippines, and Indonesia. Among the 11 countries surveyed, Indonesia has continuously occupied the bottom place since 2003. A slight improvement occurred in 2010 when the Indonesian corporate governance quality score increased by three points (CLSA, 2010) and Indonesia was placed ahead of the Philippines. However, the enforcement aspect remained the worst amongst all elements. This meant that Indonesia was quite good in terms of rules or standards, but lacked effective implementation. This finding is consistent with the view of some scholars regarding the ineffectiveness of corporate governance reform in Indonesia.

In addition to the IMF, the World Bank also concluded that corporate governance implementation in Indonesia lagged behind other countries in Asia and the South Pacific Region (World Bank, 2010). The World Bank and the IMF assessed the compliance of the Indonesian corporate governance framework against the OECD Principles of Corporate Governance under the Reports on Observance of Standards and Codes (ROSC) Financial Services Assessment Program (World Bank, 2010). Two assessments were done in Indonesia, in 2004 and in 2010. The results indicated that, in some respects, the Indonesian corporate governance framework was not substantially different from the OECD principles. In addition, Indonesia's score in 2010 improved from the ROSC carried out in 2004, and it closed with the regional pacesetters – particularly Malaysia, Thailand and India (World Bank, 2010). However, the adherence to corporate governance regulations remained a problem; this is consistent with the 2010 CLSA survey.

As discussed above, the corporate governance reform initiative in Indonesia is an example of the transplantation of the Anglo-American model. The Indonesian government has introduced a range of corporate governance reforms aimed at implementing the Anglo-American model, however the reforms have not produced satisfactory progress as there have been serious problems in their implementation. Therefore, this study examines the factors that influence the compliance of companies with corporate governance regulations in Indonesia, and whether the implementation of the corporate governance mechanism has produced desired results.

Scholars in finance and accounting argue that specific characteristics of the Indonesian business environment are not appropriate for the implementation of the Anglo-American corporate governance model. The Anglo-American corporate governance model is a market-based system with characteristics such as dispersed ownership, transparent disclosure, strong shareholder rights, highly liquid capital markets, active takeover markets and well-developed legal infrastructure (Khan, 1999). In contrast, the business system in Indonesia is relationship-based (guanxi), with commercial activities dominated by overseas Chinese and Chinese families (Daniel, 2003). The relationship-based system is associated with highly personal networks, cronyism, high concentrated family ownership and special relationships between the family business and political power (Daniel, 2003; Dieleman and Sachs, 2006). Politician-bureaucrats and families tend to block or subvert corporate governance reform as it might expose the special relationship between families (as owners of the domestic conglomerates) and the politician-bureaucrats (Rosser, 2005).

The effect of the specific Indonesian business environment (i.e., family control, collusion between politician-bureaucrats and owners of the domestic conglomerates, and with foreign investors) on compliance with corporate governance regulations has not been widely examined in prior studies. The main reason is that most of these prior corporate governance studies employed agency theory (DeZoort, Hermanson, Archambeault, and Reed, 2002; Turley and Zaman, 2004; Bédard and Gendron, 2010). The use of the agency theory as the main theory in corporate governance studies has resulted in such studies focussing solely on the agency problems between shareholders and management. Most prior studies examined some factors related to agency costs (e.g., agency cost of equity, agency cost of debt) and board characteristics (Piot, 2004). In fact, the agency problem in a developing country in Asia is different from that in a developed country as the agency problem in a developing country occurs between controlling shareholders and minority shareholders; it is a type 2 agency problem (Young, Peng, Ahlstrom, Bruton, and Jiang, 2008; Jaggi, Leung, and Gul, 2009; Chen, Li, and Shapiro, 2011). In addition, corporate governance practice, which consists of interrelated mechanisms, is also affected by various actors (Cohen, Krishnamoorthy, and Wright, 2004). As a result, the pertinent institutional factors in emerging economies (family control, foreign ownership and collusion between businesses and politicians) have been ignored in prior studies.

In recent literature, several scholars (e.g., Filatotchev, 2007; Aguilera, Filatotchev, Gospel, and Jackson, 2008; Ahrens, Filatotchev, and Thomsen, 2011) advocate that corporate governance research needs to employ an “open system” approach that enables an examination of the interdependence between the organisational environment and corporate governance practice. The use of this approach overcomes the inability of the agency theory to accurately compare and explain the diversity of the corporate governance arrangements across different institutional settings (Aguilera et al., 2008). In addition, other scholars (e.g., DeZoort et al., 2002; Cohen, Krishnamoorthy, and Wright, 2008; Bédard, and Gendron, 2010) argue the need for corporate governance studies to employ multiple theories, such as institutional theory, resource dependence theory and managerial hegemony. The use of multiple theories will provide a useful basis for reconciliation of the conflicting findings in the existing agency-based corporate governance studies (Cohen et al., 2008; Ahrens et al., 2011).

Drawing from the above discussion, it is clear that a research gap exists with respect to examining the impact of specific business characteristics (i.e., family control, foreign ownership, and collusion between businesses and politicians) on compliance with corporate governance regulations in Indonesia by using multiple theories and examining the interaction of corporate governance practices and specific business characteristics. The research questions and research objectives are presented in the next sections.

1.3 RESEARCH PROBLEM

The audit committee is among the Anglo-American corporate governance mechanisms introduced in Indonesia. The audit committee is a sub-committee of the board of directors, is comprised mainly or wholly of non-executive or independent directors, and has responsibility for the oversight of financial reporting and auditing activities (Spira, 1999; Collier and Zaman, 2005). The board of directors delegates these oversight duties to the audit committee.

The audit committee has been widely accepted in many countries as a common mechanism of corporate governance. The first concept of an audit committee was introduced by the New York Stock Exchange (NYSE) in 1940 as a response to the McKensson & Robbins scandal (Joshi and Wakil, 2004). In a further development, the Securities and Exchange Commission (SEC) urged listed companies to establish audit committees to protect investors (Collier, 1996). Some corporate governance reforms, such as the Blue Ribbon Committee (BRC, 1999) recommendations and Sarbanes-Oxley Act or SOX (2002), strengthened the roles and responsibilities of the audit committee in public-listed companies. At present, several professional and regulatory committees have recommended the adoption of audit committee structures and have advocated expanding audit committee roles (Turley and Zaman, 2004). However, the implementation of audit committees in Indonesia is relatively new, having only started in 2000. This clearly lags behind other countries such as Malaysia, which implemented such requirements as early as 1993 (Kuppusamy, Nazim, and Shanmugam, 2003).

To strengthen the implementation of the audit committee in Indonesia, the BAPEPAM-LK[2] issued two rules related to audit committees: guidelines for audit committee formation (BAPEPAM, 2004), and disclosure of audit committee membership and activities (BAPEPAM-LK, 2006). However, there is limited evidence concerning the extent of the compliance of public listed companies with these rules and the effectiveness of their audit committees. The audit committee is an Anglo American corporate governance mechanism, which has been widely adopted in Western countries such as the US and the UK. Indonesia, however, has specific business characteristics (i.e., family control, foreign ownership, and collusion between businesses and politicians) that are different from those of Western countries. As discussed in the above section, the specific business environment might serve as an obstacle to the implementation of the audit committee. Corporate governance mechanisms are not seen as being universally applicable, but they become effective in particular combinations of institutional and business settings (Jensen, 1993; Davis and Useem, 2002; Filatotchev, 2007). Each public listed company might have a different bundle of corporate governance mechanisms that is systematically dependent on institutional factors. In the adoption of the Anglo-American corporate governance model, public listed companies in Indonesia might consider the cost-benefit of the new mechanism and its interaction with the existing mechanism. Hence, it might be possible that the level of compliance of public listed companies with audit committees is varied. In addition, as stated by some scholars, the establishment of an audit committee might be perceived to be more for cosmetic purposes, in order to project a positive image rather than to actually monitor firm activity (Spira, 1998; Cohen et al., 2004; Haron, Jantan, and Pheng, 2005). Therefore, it is possible that the compliance of Indonesian public listed companies with audit committee rules in the early period of implementation (which is documented in

[2] BAPEPAM merged with the Directorate General of Financial Institutions into a single unit, namely, BAPEPAM-LK in 2005. The abbreviation BAPEPAM will be used in this study for events before 2005, whereas BAPEPAM-LK will be used for events from 2005 and onwards.

formal company documents such as annual reports) either does not reflect the real practice, or is just symbolic. Thus, public listed companies in Indonesia might establish audit committees solely to comply with BAPEPAM-LK rules.

In the extant literature, most prior studies on compliance with audit committee rules and its determinants have been undertaken by researchers in voluntary regimes such as the UK, Australia and New Zealand, whereas prior studies in mandatory regimes such as Indonesia are rare. In general, scholars in mandatory regimes such as the US are not interested in examining the determinants of compliance as law enforcement in the US is strong and results in a high level of compliance (see Carcello, Hermanson, and Neal, 2002; Pandit, Subrahmanyam, and Conway, 2005). As such, researchers in the US are concerned with examining voluntary audit committee attributes rather than mandatory requirements. Notwithstanding, a study concerning the determinants of compliance in a mandatory regime is important for emerging economies such as Indonesia where legal enforcement is weak, and where specific business characteristics may possibly influence compliance.

In the extant literature, there are also limited prior studies that simultaneously examine the factors affecting compliance and its association with accounting outcomes such as financial reporting quality. The study done by Braiotta and Zhou (2008) is the only one that is fairly similar to this study. The study simultaneously examines determinants of firms' compliance with the European Union's 8th Directive on Company Law, and the impact of compliance on financial reporting quality. The level of compliance is indicated by the changes in the number of audit committee members or the replacement of an audit committee member with another member to satisfy regulatory requirements. In other words, Braiotta and Zhou (2008) focus on whether a firm aligns the membership of its audit committee to meet the requirements. In addition, they examine determinants of compliance that are mostly based on agency theory, such as the proportion of independent directors, the financial expertise of audit committee members and leverage. In terms of the impact of compliance on financial reporting quality, they use earnings management as a proxy. The present study differs from Braiotta and Zhou (2008) in three aspects. First, the compliance level of companies in this study is indicated by an audit committee index that consists of several audit committee attributes, namely, membership, job duties, and disclosure. Second, this study focuses on determinants of compliance that have not been widely examined by prior studies and that are relevant to the Indonesian business environment. These include family control, foreign ownership, and collusion between businesses and politicians. Third, this study employs restatements as a proxy for financial reporting quality. Thus, this study extends Braiotta and Zhou (2008) to simultaneously examine the determinants of compliance with audit committee rules, and the effects of compliance on financial reporting quality.

This study selects restatement as a proxy for financial reporting quality. There are four key considerations underlying the selection of this proxy. First, only a limited number of studies in developing countries use restatements as a proxy for financial reporting quality (see Abdullah, Yusof, and Nor, 2010; Zhizhong, Juan, Yanzhi, and Wenli, 2011), whereas restatements are a popular proxy in the US. In fact, restatements occur not only in developed countries such as the US, but also in developing countries such as Indonesia and Malaysia. Second, compared to earnings management, restatements are a more valid proxy, as restatements are actual events that indicate a visible form of impaired financial reporting quality (Cao, Myers, and Omer, 2010; DeFond, 2010). In addition, restatements are categorised as demonstrating very low financial reporting quality, lower than the quality demonstrated by earnings management (Pomeroy and

Thornton, 2008). Third, most members of audit committees in Indonesia usually state that their duty is to review the financial statements issued by the company (see Table 6.1 in Chapter 6). However, in ASEAN countries, the role of the audit committee as stated in the annual report needs to be verified, as corporate governance information presented in the documents of public listed companies often does not reflect actual practice (Chuanrommanee and Swierczek, 2007). Hence, restatements provide a means to check whether audit committees have performed their roles as stated in the annual reports because restatements are actual events that indicate a visible form of impaired financial reporting quality.

1.4 RESEARCH OBJECTIVES

Based on the above discussion of the problem statement, the objectives of this study are as follows:

a. To examine the association between public listed companies with specific business characteristics (namely family control, politically connected independent commissioners, and foreign institutional investors) and the level of compliance of these companies with audit committee rules.
b. To examine whether the compliance, which also indicates the level of audit committee effectiveness, is associated with restatements of financial statements.
c. To examine the influence of family control on the association between audit committee effectiveness and restatements of financial statements.

1.5 RESEARCH QUESTIONS

This study addresses five research questions. The research questions were developed based on gaps in the extant literature, and on specific Indonesian business characteristics.

Different types of family control

Most Indonesian companies have high concentrated ownership with ultimate control in the hands of families that own business groups (Husnan, 2001; Achmad, Rusmin, Neilson, and Tower, 2009; Rusmin, Tower, Achmad, and Neilson, 2011). The families hold the control of companies by owning the majority percentage of outstanding shares. Besides using ownership, families retain control of companies through management: family members are often members of the board of directors, act as board commissioners, or both. The head of the board of commissioners often represents the controlling party of the company, or someone very close to the controlling shareholders (Husnan, 2001, Hanani, 2005).

The presence of family members on boards might serve as an effective mechanism to reduce agency costs (Jensen and Meckling, 1976; Fama and Jensen, 1983; Shleifer and Vishny, 1997; Anderson and Reeb, 2003). The combination of control and ownership in the hands of a family aligns the interests of shareholders and management, thus decreasing agency problems that arise as a result of conflict between the managers and shareholders (this is a type 1 agency cost). This is in line with the convergence-interest hypothesis proposed by Jensen and Meckling (1976). Consequently, family-controlled companies might be less concerned with the implementation of Anglo-American corporate governance mechanisms such as board independence and the audit committee, which are basically intended to solve the type 1 agency cost. It has been evidenced that family control weakens the effectiveness of Anglo-American corporate governance mechanisms (Chau and Leung, 2006; Jaggi and Leung, 2007; Rusmin et al., 2011).

Most family-controlled companies in Indonesia do not have a separation between ownership and control. However, some large business groups (conglomerates), such as the Salim group, separated ownership and control in many of their subsidiaries after the East Asian financial crisis of 1997-98 (Hanani, 2005). This business group hires professional executives who are non-family members, to be members of the board of directors, members of the board of commissioners, and to run their subsidiaries. The appointment of non-family executives might increase potential agency costs, as their appointment causes a separation of the owner from the management that is one driver of agency costs (Chua, Chrisman, and Sharma, 2003). Prior studies have examined whether the presence of family control and the absence of family ownership (e.g., Kabbach De Castro and Crespi Cladera, 2011) or different levels of family ownership (e.g., Chau and Leung, 2006) impact corporate governance. The effect of this type of family control on compliance with audit committee rules and other corporate governance regulations has not been covered by prior studies. Thus, this study proposes the following research question:

RQ1: Do family-controlled public listed companies with family members on the boards, and family-controlled public listed companies with professional management have a different effect on the compliance of the company with audit committee rules?

Collusion between businesses and the political elite

Another business characteristic that is common in Indonesia is collusion between big businesses (conglomerates) and the political elite (Husnan, 2001). The controlling shareholders maintain a special relationship with elite politicians in order to get some kind of protection or special treatment (Husnan, 2001). To maintain the special relationship, controlling family shareholders often give small portions of free shares to politicians or retired bureaucrats. Another method is by appointing such individuals to the board of directors or board of commissioners. These are known in the literature as politically connected directors (Chen, Fan, and Wong, 2006; Fan, Wong, and Zhang, 2007). In Indonesia, some public listed companies appoint politicians or current/retired bureaucrats as independent commissioners (Zaini, 2002). The presence of such politically connected independent commissioners, which is more pronounced in East Asian companies than in Western companies, is in line with the resource dependence theory (Young, Ahlstrom, Bruton, and Chan, 2001). The politically connected independent commissioner may be a means of providing the company with a special relationship with elite politicians in order to get some kind of protection or special treatment (Husnan, 2001).

The collusion between businesses and politician-bureaucrats tends to block or subvert corporate governance reform, as reform might expose the special relationship between families as owners of the domestic conglomerates, and the politician-bureaucrats (Rosser, 2005). Corporate governance reform may be threatening to some segments of business as it has the potential to expose the existence of collusion, corruption, and nepotism within family and politician-bureaucrat dominated companies. In addition, based on the agency theory, a politically connected independent commissioner might not perform his oversight duty effectively, since most often lack the prerequisite skills, experience, and education required to be an independent commissioner and chairman of the audit committee. Hence, this study proposes the following research question:

RQ2: Does the presence of politically connected independent commissioner on the board of a public listed company affect the company's compliance with audit committee rules?

Foreign institutional investors

Foreign institutional investors have been shown to play a role in improving corporate governance in emerging economies (Anderson, Jandik, and Makhija, 2001; Aguilera and Cuervo-Cazurra, 2004; Ananchotikul, 2006). The presence of foreign institutional investors might lead to changes in management and corporate governance practices within companies in emerging economies through the imposition of their own company policies, internal reporting systems and principles of information disclosure (OECD, 2002). International financial institutions (i.e., the World Bank, the IMF, and the ADB) and Western governments support governance reforms as part of their agenda for the liberalisation of emerging markets, and to protect the interests of Western institutional investors (Soederberg, 2003).

Subsequent to the East Asian financial crisis of 1997-98, family ownership is still dominant, although the number of shares owned by foreign investors is increasing. As evidence, foreign equity ownership of public listed companies on the IDX has steadily increased to more than 60 percent during the period 2004-2011 (BAPEPAM-LK, 2011). Caution needs to be exercised, however, in interpreting the increasing foreign ownership phenomenon because some of the foreign investors may actually be off-shore companies owned by Indonesians (World Bank, 2010).

Prior studies have examined the effect of foreign institutional investors on compliance with the corporate governance code (i.e., Ananchotikul, 2006; Bianchi, Ciavarella, Novembre, and Signoretti, 2010). However, all such prior studies use the percentage of common shares held by foreign investors as a measure of foreign institutional ownership. This may not be appropriate considering the specific Indonesian business environment where foreign institutional investors might actually be Indonesian offshore companies. Hence, the measurement must look at both the authenticity and the size of share ownership. Thus, this study proposes the following research question:

RQ3: Do foreign institutional investor attributes (i.e., ownership size and authenticity) affect a public listed company's compliance with audit committee rules?

Decoupling compliance from practice

In addition to the issue of compliance, another important issue of corporate governance in the Indonesian context is whether companies decouple compliance from practice. Many have observed that corporate governance in emerging economies often resembles the same in developed countries but in form only and not in substance (see Peng, 2004; Chuanrommanee and Swierczek, 2007; Sam, 2007). Hence, in this context, it is posited that Indonesian listed companies may exhibit a high level of compliance with audit committee rules solely to meet the requirements of the stock exchange, and that such a level of compliance presented in formal documents might not indicate actual practice. In other words, the presence of an audit committee is often only for cosmetic purposes (Cohen et al., 2004; Haron et al., 2005).

To detect whether the establishment of the audit committee is for cosmetic purposes or not, this study examines the association between the compliance of the public listed company with audit committee rules, and financial reporting quality. As noted by some scholars (e.g., Klein 2002a; Bedard, Chtourou, and Courteau 2004; Archambeault, DeZoort, and Hermanson, 2008), the role of the audit committee is to reduce agency costs by overseeing the financial reporting process. In other words, the audit committee can improve financial reporting quality by overseeing the financial reporting process (Bédard and Gendron, 2010). Thus, better financial reporting quality indicates higher audit committee effectiveness. Apart from that, strengthened financial reporting quality is considered by the regulators as a desired effect of the audit committee (Bédard and Gendron, 2010). Therefore, this study proposes the following research question:

RQ4: Does the level of compliance with audit committee rules by public listed companies result in an effective audit committee, as indicated by a negative association with restatements of financial statements?

Interaction of the audit committee

Several scholars (e.g., DeZoort et al., 2002; Turley and Zaman, 2004; Bédard, and Gendron, 2010) argue that studies on audit committees need to explore the interaction of the audit committee with other corporate governance mechanisms, as opposed to simply examining the effect of each individual characteristic. This is because the effectiveness of corporate governance is dependent on the effectiveness of a bundle of corporate governance mechanisms rather than the effectiveness of one mechanism (Ward, Brown, and Rodriguez, 2009). As a result, the operation of a single or multiple corporate governance mechanisms is not isolated or independent of others: the mechanisms are interrelated and substitute or complement each other as a related “bundle” of practices. In the context of the environments of emerging economies, research on audit committee effectiveness needs to examine the interaction of audit committee attributes and certain corporate governance characteristics such as family ownership (Bédard and Gendron, 2010), since this informal institution might play a greater role in shaping corporate governance than the formal Anglo-American mechanism (Young et al., 2008). Therefore, the following research question is proposed:

RQ5: Does family control affect the relationship between audit committee effectiveness and restatements of financial statements?

1.6 RESEARCH METHODOLOGY

This study consists of two interrelated research stages. Research Stage 1 is a study of the determinants of a public listed company's compliance with audit committee rules, while Research Stage 2 is a study of the association between audit committee effectiveness (measured by compliance with audit committee rules) and restatements (as a proxy for financial reporting quality). The dependent variable in Research Stage 1, the audit committee compliance index, serves as one independent variable in Research Stage 2.

This study is situated in the positivist paradigm (Chua, 1986). It starts with hypotheses development based on several underpinning theories (agency theory, a bundle of corporate governance theory, and institutional theory) for Research Stage 1. Meanwhile, hypotheses development in Research Stage 2 is based on and agency theory and a bundle of corporate governance theory. Archival research is well suited for this study as both stages of research explore the issue of association. The study uses archival data from annual reports, company announcements to the IDX, the Indonesian Capital Market Directory (ICMD) and other reliable sources. The study then employs the quantitative research approach to test the hypotheses. As each stage has different objectives, data types, and samples, the study employs a different method of data analysis in each stage. Research Stage 1 employs short balanced panel data that covers a total of 828 company-year observations for the period 2006-2008. The appropriate method of analysis for this type of data is panel data analysis. Meanwhile, Research Stage 2 utilises cross sectional data, namely, 158 restating companies for the period 2006-2012 matched with 158 control companies for the same period. The method of analysis in this stage is matched pair logistic regression, which has been widely used by prior studies on restatements. Furthermore, this study employs some sensitivity analyses in both stages to check the robustness of the results.

This study examines the endogeneity issue in investigating both the determinants of a public listed company's compliance with audit committee rules, and the effect of such compliance on financial reporting quality. As advocated by some scholars (e.g., Chenhall and Moers, 2007; Larcker and Rusticus, 2007; Van Lent, 2007; Wintoki, Linck, and Netter, 2007; Wintoki, Linck, and Netter, 2009; Carcello, Hermanson, and Ye, 2011a), research on corporate governance needs to give attention to the endogeneity issue. To date, only a few prior studies investigate endogeneity both in the study of compliance issues (see Rainsbury, Bradbury, and Cahan, 2008; Da Silveira, Leal, Carvalhal-da-Silva, and Barros, 2010) and the study of restatements (see Carcello, Neal, Palmrose, and Scholz, 2011b; Cohen, Hoitash, Krishnamoorty, and Wright, 2011; Lisic, Neal, and Zhang, 2011).

1.7 SIGNIFICANCE OF THE STUDY

This study makes several contributions to the extant corporate governance literature, namely:

1. The study employs multiple theories (i.e., bundle of corporate governance theory and institutional theory) to complement agency theory. This enables the study to examine unique variables, such as family control, politically connected independent commissioners, and the authenticity of large foreign institutional investors that have not been tested by prior studies. Furthermore, the use of multiple theories also enables the reconciliation of conflicting findings in prior studies in examining the interrelation among corporate governance mechanisms (Turley and Zaman, 2004; Aguilera et al., 2008; Cohen et al., 2008).

2. This study provides evidence that corporate governance mechanisms in the company are interrelated with each other and are affected by various actors, which is in line with the suggestions of some scholars (e.g., Turely and Zaman, 2004; Cohen et al., 2008; Aguilera, Desender, and Kabbach de Castro, 2011). Furthermore, the study provides evidence that informal institutional features, such as family control, foreign institutional investors and business-political relationships, play a greater role in shaping corporate governance in the company when law enforcement is weak.

3. The study provides evidence of the different effects of two types of family control on compliance: family-controlled companies with family members on the boards of directors, commissioners, or both, and family-controlled companies with professional management and no family members on the boards. In the extant literature, prior studies have either explored the effect of the presence of family control and absence of family ownership (e.g., Kabbach De Castro and Crespi Cladera, 2011), or have compared different levels of family ownership (e.g., Chau and Leung, 2006). The different effects of the two types of family control on corporate governance have not been examined by prior studies.

1.8 CHAPTER ORGANISATION

The remaining chapters are organised as follows:

Chapter 2: Corporate Governance Reforms in Indonesia

This chapter discusses corporate governance reforms in Indonesia, including audit committee reforms and the obstacles and progress of the reforms. The chapter begins with a general overview of corporate governance, including a definition, the mechanism, the model, the implementation approach of the code of corporate governance and the efforts and problems in the bringing the Anglo-American model to East Asian economies. The chapter then presents an overview of corporate governance reforms in Indonesia, covering Indonesian government initiatives ranging from the establishment of committees to the amendment of laws and regulations. The chapter ends with a presentation of both the obstacles to reform, and an update on the progress of implementation of the reforms.

Chapter 3: A Review and Synthesis of Extant Literature

The chapter provides thorough discussions on the prior studies related to compliance with audit committee rules and its determinants, and prior studies focusing on the association between audit committee attributes and financial reporting quality. The discussions are followed by the identification of several research gaps. Research questions are then proposed based on the Indonesian corporate governance reform experience.

Chapter 4: Research Framework and Hypotheses Development

This chapter commences with the identification of the theories underpinning the study, namely, a bundle of corporate governance theory, agency theory, institutional theory, and resource dependence theory. This is followed by a discussion of the need for a comprehensive audit committee index, and the selection of restatements as a proxy for financial reporting quality. The chapter highlights the study's research framework, which is divided into two stages: determinants of a public listed company's compliance with audit committee rules (Research Stage 1), and the effect of such compliance on restatements (Research Stage 2). The testable hypotheses for both research stages are developed in this chapter.

Chapter 5: Research Methodology

This chapter espouses the study's research paradigm and research method. In line with the research stage of the study, the presentation of the research method is also divided into two different sections, as each research stage employs different samples and methods of analysis. Therefore, discussion of the research method for each research stage includes details on sampling, method, variables measurements, source of data, and method of analysis.

Chapter 6: Results and Discussion

This chapter presents the study's results and discusses its findings. As there are two main issues in the study, the findings are presented in two main sections. The first presents the results of Research Stage 1, while the second presents the results of Research Stage 2. The presentation results of each research stage include descriptive statistics, multivariate statistics, and sensitivity analyses. As both research stages are interrelated, the presentation of the discussion of the results of both stages is placed in the same section.

Chapter 7: Conclusion

The start of the chapter presents a summary of the study, including its key findings. This is followed by a discussion of the implications of the study for knowledge, investors, and policy makers in Indonesia. The chapter also discusses the study's limitations, as well as suggestions for future research.

CHAPTER 2

CORPORATE GOVERNANCE REFORMS IN INDONESIA

2.1 INTRODUCTION

This chapter presents a discussion on corporate governance reforms in Indonesia. The chapter commences with an overview of corporate governance, including the definition of corporate governance, the corporate governance model, the approach to implementing corporate governance, and audit committees. Considering their relevance to this study, the issues and obstacles related to the implementation of the Anglo-American corporate governance model in East Asia are also discussed in the chapter. This is followed by a discussion of corporate governance reform in Indonesia that encompasses key initiatives undertaken by the Indonesian government. One of these includes the establishment of committees to oversee the amendments of laws and regulations. The next section discusses audit committee reforms and their comparison with international rules. The end of the chapter discusses the obstacles to the implementation of such reforms, along with the progress of corporate governance reform that provides the motivation for this study. The chapter ends with a conclusion.

2.2 CORPORATE GOVERNANCE OVERVIEW

The need for corporate governance arises from the existence of agency problems in modern companies, as well as incomplete contracts between principals (controlling shareholders) and management (Hart, 1995). Modern publicly traded companies are characterised by the separation of ownership and control. This separation leads to various manifestations of the agency problem in which parties in possession of control over a firm (i.e., CEOs), can extract private benefits of control at the expense of firm value accruing to shareholders (Li and Broshko, 2006). In other words, shareholders and managers have different interests and objectives: shareholders want to maximise the return on their investment, while managers with discretion in managing companies may be more interested in building empires. This is called the agency problem, and it occurs not only between shareholders and managers, but also between shareholders and creditors, and controlling and minority shareholders (Zhuang, 1999). Thus, corporate governance can be expected to reduce agency problems among shareholders, and between managers and shareholders by limiting private benefits and expropriation by controlling owners (Bruno and Claessens, 2010). However, the agency problem alone does not provide sufficient justification for corporate governance (Hart, 1995). The standard principle-agent model supposes that it is costly to write a complete contract. However, in practice, contracting costs may be large as many transaction costs need to be included (Hart, 1995). That is why the parties will not write comprehensive contracts. The existence of an incomplete contract requires a governance mechanism to deal with decision making for matters that have not been specified in the contract.

2.2.1 Definition of Corporate Governance

There is no consensus about the boundaries of the subject of corporate governance in the literature (Babic, 2003). Depending on one's view of the world, there are many definitions of corporate governance (Gillan, 2006), with different authors/institutions providing definitions based on their own perspective (Babic, 2003). Claessens (2006) separates corporate governance definitions into two categories. The first category includes definitions of corporate governance that are concerned with a set of behavioural patterns. It includes issues such as how the board of directors operates, the role of executive compensation in determining firm performance, the relationship between labour policies and firm performance, and the role of multiple shareholders. An example of this definition is provided by Pass (2006), who defines corporate governance as that which deals with the duties and responsibilities of a company's board of directors in managing the company and its relationships with the company's shareholders and stakeholders. Similarly, the OECD (2004) defines corporate governance as the way in which boards oversee the running of a company by its managers, and how board members are in turn accountable to shareholders and the company. This first category of definitions is appropriate for studies of single countries or firms within a country (Claessens, 2006). Meanwhile, the second category of corporate governance definitions is concerned with the regulatory framework, such as the rules under which firms operate, and the rules coming from sources such as the legal system, the judicial system, and financial and labour markets. For example, Weimer and Pape (1999) define corporate governance as a country-specific framework of legal, institutional and cultural factors shaping the patterns of influence that stakeholders exert on managerial decision making. Similarly, the Cadbury Committee (1992) defines corporate governance as a set of rules that define the relationship between shareholders, managers, creditors, the government, employees and other internal and external stakeholders in respect of their rights and responsibilities, or the system by which companies are directed and controlled. This second category of definitions is more appropriate for comparative studies.

2.2.2 Corporate Governance Models

Most corporate governance discussions focus on two dichotomous corporate governance models: the Anglo-American model, and the Continental European model (Khan, 1999; Aguilera and Jackson, 2003). The Anglo-American model is also known as the "shareholder" system, the market-outsider system, or stock-market capitalism, as it prioritises the equity market (Weimer and Pape, 1999). The model was developed with the belief that self-interest and decentralised markets can function in a selfregulated and balanced manner (Cernat, 2004). In other words, the Anglo-American model is shaped by the idea that the capital market is a market for corporate control (Koslowski, 2009). The Anglo-American model is found in countries such as the US and the UK, where ownership and debt are dispersed. Meanwhile, the Continental European model is also labelled as the relational-insider system, the stakeholder system, or the bank-led governance system (Khan, 1999; Aguilera and Jackson, 2003). The Continental European model is based on the participation of stakeholder groups in corporate governance through representation on advisory boards (Koslowski, 2009). This model prevails in Germany, Japan and some other countries. However, after the East Asian financial crisis of 1997-98, there is interest in other corporate governance models for East Asia, especially the family-based corporate governance model (Khan, 1999). This model recognises the existence of family-based firms that operate in a relationship-based system (Khan, 1999).

These three corporate governance models have different characteristics. As depicted in Table 2.1, Khan (1999) presents the differences among the three corporate governance models. This is an extension of Berglof's work (1997) that only presents the differences between the Anglo-American model and the German-Japanese model. The main characteristic of family-based governance is high concentrated ownership and control by the family. The dominant control by the family has implications for corporate funding sources and shareholder protection, as family-controlled companies tend to finance the company using internal resources. However, external sources of finance, such as banks, will be used if internal resources are insufficient. As a result, the equity market is often small and illiquid. In addition, shareholder protection is also not a major concern, and the market does not serve as a corporate control mechanism. In contrast, the Anglo-American model emphasises the protection of shareholder value, promotes a liquid equity market, and finds more dispersed ownership. The family-based governance model shares several similarities with the German-Japanese model. In both models, ownership is concentrated, shareholder protection is weak, and the equity market is relatively illiquid. The difference is that banks and large families are important in the German-Japanese governance model. The family-based governance model is also slightly similar to the Latin corporate governance model proposed by Weimer and Pape (1999). The Latin governance model, as practised by France and Italy, is a variant of the German model, with dominant holdings by the state, families, or industrial groups (Rama, 2007).

Table 2.1 Comparison of Corporate Governance Systems

	Type of corporate governance system		
	Equity Market Based System (EMS)	Bank-Led System (BLS)	Family-Based System (FBS)
Share of control-oriented finance	Low	High	High initially, but may vary as family groups get bank and equity financing from outside
Equity markets	Large, highly liquid	Not necessarily small, but less liquid than EMS	Small, less liquid
Share of all firms listed on exchanges	Large	Not necessarily small	Usually small
Ownership of debt and equity	Dispersed	Concentrated	Concentrated
Investor orientation	Portfolio-oriented	Control-oriented	Control-oriented for family groups
Shareholder rights	Strong	Weak	Weak for outsiders
Creditor rights	Strong	Strong for close creditors but applied according to a "contingent governance structure" (Aoki)	Strong for close creditors; Weak for arm's length creditors
Dominant agency conflict	Shareholders vs. Management	Banks vs. management; workers may be important stakeholders as in Aoki's model of the Japanese firm	Controlling vs. minority investors
Role of the board of directors	Important	Limited, but less so than in the case of FBS	Limited
Role of hostile takeovers	Potentially important	Quite limited	Almost absent
Role of insolvency/bankruptcy	Potentially important	Potentially important, but possible systemic crisis may postpone bankruptcies	Potentially important

Table 2.1 **(**continued)

	Type of corporate governance system		
	Equity Market Based System (EMS)	Bank-Led System (BLS)	Family-Based System (FBS)
Monitoring of non-financial enterprises (NFE)			Information asymmetry and agency costs rise with the growth of firms, making monitoring more costly
Self-monitoring			Initially, self-monitoring is effective because of non-separation of owner and management. Later stages present monitoring problems as agency costs rise due to separation of owner-managers and outside financiers

Source: Adapted from Khan (1999).

2.2.3 Approach to the Implementation of Corporate Governance Regulations

Having corporate governance rules in itself is insufficient: the rules must be implemented effectively. In general, there are three approaches to the implementation of corporate governance regulations: voluntary, mandatory, and comply and explain (Anand, 2005). The voluntary approach refers to the adoption of corporate governance practices or standards in the absence of a legal requirement to do so. In contrast, the mandatory approach – also known as the rules-based approach – requires listed companies to comply with stringent corporate governance legislation. This mandatory approach prescribes a certain set of sound corporate governance practices, and imposes penalties for non-compliance. It follows the "one size fits all" assumption and allows the state to establish minimum standards to which companies must adhere (Anand, 2005; Li and Broshko, 2006; Zadkovich, 2007). The "comply and explain" approach is considered partially mandatory (Anand, 2005). This approach is well known as a principles-based approach, and it allows companies the choice to comply with certain provisions. Companies are, however, required to state how they have applied the principles and to explain the reason(s) for non-compliance (Aguilera and Cuervo-Cazurra, 2009). In other words, this approach is characterised by a company's voluntary compliance with the code provisions, and mandatory disclosure as to whether it is complying with the code; if the company is not complying, it must explain why (Arcot and Bruno, 2007).

There are two underlying considerations under the "comply and explain" approach, namely, flexibility, and the role of the capital market in assessing the adequacy of a company's corporate governance practices (MacNeil and Li, 2006). Flexibility is based on the judgment that it is impossible to adopt "one size fits all" that requires all listed companies to adopt all provisions in the corporate governance code. The level of compliance with the corporate governance code varies depending on company characteristics such as size and ownership structure (Anand, 2005). Meanwhile, the role of the market in monitoring compliance assumes that the market has a mechanism to penalise non-compliance through a lowering of share prices, or that it can accept non-compliance (which may be justified considering the circumstances). The investors serve as judges of the effectiveness of a firm’s corporate governance policies (Li and Broshko, 2006). However, this underlying assumption places the onus on the investors (who are often uninformed and maintain small investment positions) to decide whether a firm’s corporate governance policies are sufficient (Li and Broshko, 2006).

Table 2.2 provides a snapshot of the implementation of the three approaches in several countries. The “comply and explain” approach seems to be the most popular in implementing corporate governance codes. Although, this approach was first adopted in the UK, it has been widely adopted by most Commonwealth countries. In contrast, the mandatory approach has been adopted by relatively few countries, such as Philippines, the US, and Vietnam. In the US, a well-known example of regulation – other than through a corporate governance code – is the SOX (2002), which was enacted to respond to some corporate failures. Both local and foreign companies must comply with the SOX (Aguilera and Cuervo-Cazurra, 2009). The philosophy of the SOX is that corporate governance needs stringent regulatory oversight rather than market or corporate self-regulation (MacNeil and Li, 2006). However, the mandatory approach of the SOX is criticised by some scholars, as compliance with it might be costly for small companies (Holmstrom and Kaplan, 2003; Zhang, 2007; Smith, 2007). Costs might arise for a company from monitoring and assessing its own practices, implementing new governance structures, producing disclosures and reports, and distributing disclosure information (Zadkovich, 2007). As a result, the number of small companies with high inside ownership going private has been higher in the post-SOX period compared to the pre-SOX period (Engel, Hayes, and Wang, 2007). Meanwhile, the number of countries adopting the voluntary approach is relatively high compared to those adopting the "comply and explain" approach. Indonesia is included in the group of countries that has adopted the voluntary approach for implementation of its code of corporate governance.

Table 2.2 Approach to Corporate Governance Code Implementation

Voluntary	Comply and Explain	Mandatory
Belgium	Australia	Philippines
Brazil	Austria	United States
China	Bangladesh	Vietnam
Denmark	Canada	
France	Finland	
Iceland	Germany	
India	Hong Kong	
Indonesia	Italy	
Lithuania	Malaysia	
Macedonia	Mauritius	
Mexico	Netherlands	
Peru	Pakistan	
Poland	Singapore	
Russia	Slovakia	
South Africa	Slovenia	
South Korea	Spain	
Switzerland	Sweden	
	Thailand	
	Turkey	
	United Kingdom	

Source: Anand (2005), OECD (2007).

2.2.4 Corporate Governance and the Audit Committee

The audit committee is one of the internal mechanisms of corporate governance. Conceptually, an audit committee is defined as a sub-committee of the main or supervisory board that is comprised mainly or wholly of non-executive or independent directors, with responsibility for the oversight of financial reporting and auditing activities (Spira, 1999; Collier and Zaman, 2005). The presence of an audit committee is associated with the oversight function of the board of directors. As suggested by agency theory, the board of directors has an oversight role that usually involves monitoring the CEO and other top executives, approving the corporation's strategy, and monitoring control systems (DeZoort et al., 2002). As these are complex responsibilities, the board of directors delegates its oversight duties to the audit committee.

The audit committee was born in the US. According to Joshi and Wakil (2004), the concept of an audit committee was first introduced by the New York Stock Exchange (NYSE) in 1940. As a response to the McKensson & Robbins scandal, the NYSE's board of governors suggested that external auditors be selected by a committee of external directors rather than by management. Thereafter, the SEC recommended that the boards of directors of public companies form auditing sub-committees of non-officer board members to ensure auditor independence (Fichtner, 2010). A series of corporate scandals in the late 1960s led to the SEC's renewed interest in the audit committee (Collier, 1996). In 1972, the SEC urged listed companies to establish audit committees to protect investors (Collier, 1996). The Commission set out formal regulations requiring listed companies to state the names of audit committee members, or to state that the board did not have an audit committee (Fichtner, 2010).

Over the next few years, there was a trend to improve the roles and responsibilities of the audit committees of public listed companies. Significant efforts widely discussed in the literature include the Blue Ribbon Committee (BRC) recommendations on Improving the Effectiveness of Corporate Audit Committees (1999), and the enactment of SOX (2002). The BRC was sponsored by the NYSE and the National Association of Securities Dealers (NASD) in the late 1990s with the aim of making recommendations for improving the effectiveness of audit committees (Carcello et al., 2002; Fichtner, 2010). These recommendations focused on strengthening the independence of the audit committee, improving audit committee effectiveness, and improving the mechanisms for discussion and accountability among the audit committee, outside auditors, and management (Joshi and Wakil, 2004; Fichtner, 2010). The recommendations were subsequently adopted as listing requirements by exchanges in the US, including the American Stock Exchange, the NYSE, and NASDAQ (Rowland, 2002). The trend of adopting the BRC's recommendations as listing requirements spread to exchanges outside the US, including the Hong Kong Stock Exchange, the Thailand Stock Exchange and the Jakarta Stock Exchange (Fichtner, 2010).

Further significant reform saw the enactment of the SOX in 2002 in response to a series of corporate scandals in the US involving Enron, WorldCom, Adelphia Communications, Qwest, and Global Crossing. These scandals led to public in the US questioning about audit committee roles and responsibilities in the oversight of a company's overall financial reporting process (Myers and Ziegefuss, 2006). As a result, the roles and responsibilities of the audit committee were intensified enormously with the enactment of the SOX. Among other things, the SOX required the auditor of a company to report directly to the audit committee concerning certain critical matters relating to the company's financial reporting process. The SOX also enhanced the audit committee's oversight responsibility, as compared to the BRC (1999). For example, the audit committee shall be directly responsible for the appointment, compensation, and oversight of the work of the external auditor (Section 301 of the SOX, 2002). The audit committee must pre-approve non-audit services, establish fraud reporting and whistle-blowing procedures, and has the authority to engage independent counsel and other advisors as may be deemed necessary to perform its oversight duties.

To date, the audit committee has been widely adopted by exchanges around the world. Table 2.3 presents a list of the 40 largest capital markets in the world that have adopted the audit committee as a mandatory requirement. The number of major capital markets requiring an audit committee increased significantly after the enactment of the SOX. As depicted in Table 2.3, there are only nine capital markets that do not have a mandatory requirement for an audit committee.

Table 2.3 Audit Committee Requirements of the 40 Largest Capital Markets

Capital markets with mandatory audit committee requirement (date of implementation)		Capital markets with no mandatory audit committee requirement
Canada (1975)	Portugal (2006)	Brazil
Nigeria (1990)	South Africa (2006)	Iran
Hong Kong (1999)	Russia (2007)	Ireland
Thailand (1999)	Finland (2008)	Italy
India (2000)	France (2008)	Japan
Indonesia (2000)	Netherlands (2008)	Norway
Korea (2000)	Romania (2008)	Saudi Arabia
Argentina (2001)	Sweden (2008)	Switzerland
Mexico (2001)	United Kingdom (2008)	Venezuela
United States (SOX, 2002)	Belgium (2009)	
Spain (2002)	China (2009)	
Turkey (2002)	Czech Republic (2009)	
Australia (2004)	Denmark (2009)	
Colombia (2005)	Germany (2009)	
Austria (2006)	Greece (2009)	
	Poland (2009)	

Source: Fichtner (2010)

2.2.5 Promoting Anglo-American Corporate Governance in East Asia

The IMF and the World Bank have actively promoted the Anglo-American corporate governance model as an appropriate corporate governance model for developing countries. The introduction of the Anglo-American model to East Asian countries by the IMF and the World Bank cannot be separated from their global agenda for financial market liberalisation in developing countries. This economic policy, well known as the Washington Consensus, prescribes market deregulation, fiscal austerity and privatisation in developing countries (Robinson and Hadiz, 2004). Economic policies in the original Washington Consensus included fiscal discipline, reorientation of public expenditures, tax reform, financial liberalisation, unified and competitive exchange rates, trade liberalisation, openness to direct foreign investment, privatisation, deregulation, and secure property rights. However, an expanded list of policies and corporate governance reforms are included in an augmented policy model (Rodrik, 2001). In the augmented model, policies were expanded to include other aspects such as legal/political reform, regulatory institutions, corruption, labour market flexibility, WTO agreements, financial codes and standards, "prudent" capital-account opening, non-intermediate exchange rate regimes, social safety nets, and poverty reduction. The Washington Consensus policies are imposed upon governments in developing countries across the world through loan agreements offered by the IMF and World Bank (Hooper, 2002).

The goals behind the standardisation of corporate governance are to ensure that emerging markets adhere to the principles of a neoliberal open market economy, and to protect the interests of institutional investors based on market-centric systems, such as those in the US (Soederberg, 2003). Since 1999, the IMF and the World Bank have conducted a joint project, namely, Reports of the Observance of Standards and Codes (ROSC). The standards and codes stipulated in the ROSC represent an "internationally agreed standard" that is benchmarked against practices in a certain country (Soederberg, 2003). In terms of corporate governance standards, the ROSC adopted the OECD principles of corporate governance that were drafted more in line with the Anglo-

American corporate governance model (Roberts, 2004; Krambia-Kapardis and Psaros, 2006).

The East Asian financial crisis of 1997-98 created an entry point for the IMF to promote Anglo-American corporate governance. Weak corporate governance in East Asia was blamed for contributing to the crisis. Some studies sponsored by the World Bank indicated that East Asian corporations were characterised by high leverage, concentrated ownership, a high level of ultimate control by a few families, and expropriation of minority shareholders (Sato, 2004). As a solution, the IMF proposed structural reforms of corporate governance in the affected countries. In the corporate governance reforms, the IMF prescribed the Anglo-American model, as this model was perceived to have a superior ability to allocate resources and monitor corporate behaviour (Singh and Zammit, 2006; Sam, 2007). The undertaking of corporate governance reforms by East Asian countries that were affected by the crisis (such as Indonesia) became one of the prerequisites to obtaining financial assistance from the IMF and the World Bank.

2.2.6 Problems in Implementing the Anglo-American Model in East Asia

The efforts of international donors to promote the Anglo-American corporate governance model in East Asia met some obstacles. Certain characteristics in East Asia, such as different legal systems (Iu and Batten, 2001; Rama, 2007;Yuka, 2010), the low level of stock market development (the IMF and the World Bank, cited in Singh and Zammit, 2006), different types of agency problems (Chen et al., 2011), high concentrated family ownership (Fan and Wong, 2002; Claessens and Fan, 2002), and cronyism (Fan and Wong, 2002; Claessens and Fan, 2002) were considered obstacles to implementing the Anglo-American corporate governance model. Informal institutions such as family control might play a greater role in shaping corporate governance than the formal Anglo-American mechanisms (Young et al., 2008). For example, the high concentration of ownership in the hands of families might result in ineffective internal corporate governance mechanisms (Claessens and Fan, 2002; Berglöf and Claessens, 2006), as firms controlled by families often appoint family members to corporate boards to take care of family interests (Jaggi and Leung, 2007). This dominance by insiders raises doubts as to whether independent directors can be truly independent and provide an adequate degree of monitoring of the majority shareholders (Cheung and Chan, 2004; Berglöf and Claessens, 2006). In addition, the family, as controlling shareholders, often maintains a connection to government officials to secure some kind of protection and special treatment (Husnan, 2001; Rosser, 2003). These officials often possess a lack of business experience or expertise in law, accounting, or finance. As a result, corporate governance in East Asia often resembles the outsider model (the Anglo-American model) in form but not in substance (Backman, 1999; Peng, 2004; Rosser, 2003; Sam, 2007; Yoshikawa and Rasheed, 2009), and corporate governance presented in company documents does not reflect actual practice (Chuanrommanee and Swierczek, 2007).

2.3 INDONESIAN CORPORATE GOVERNANCE REFORMS

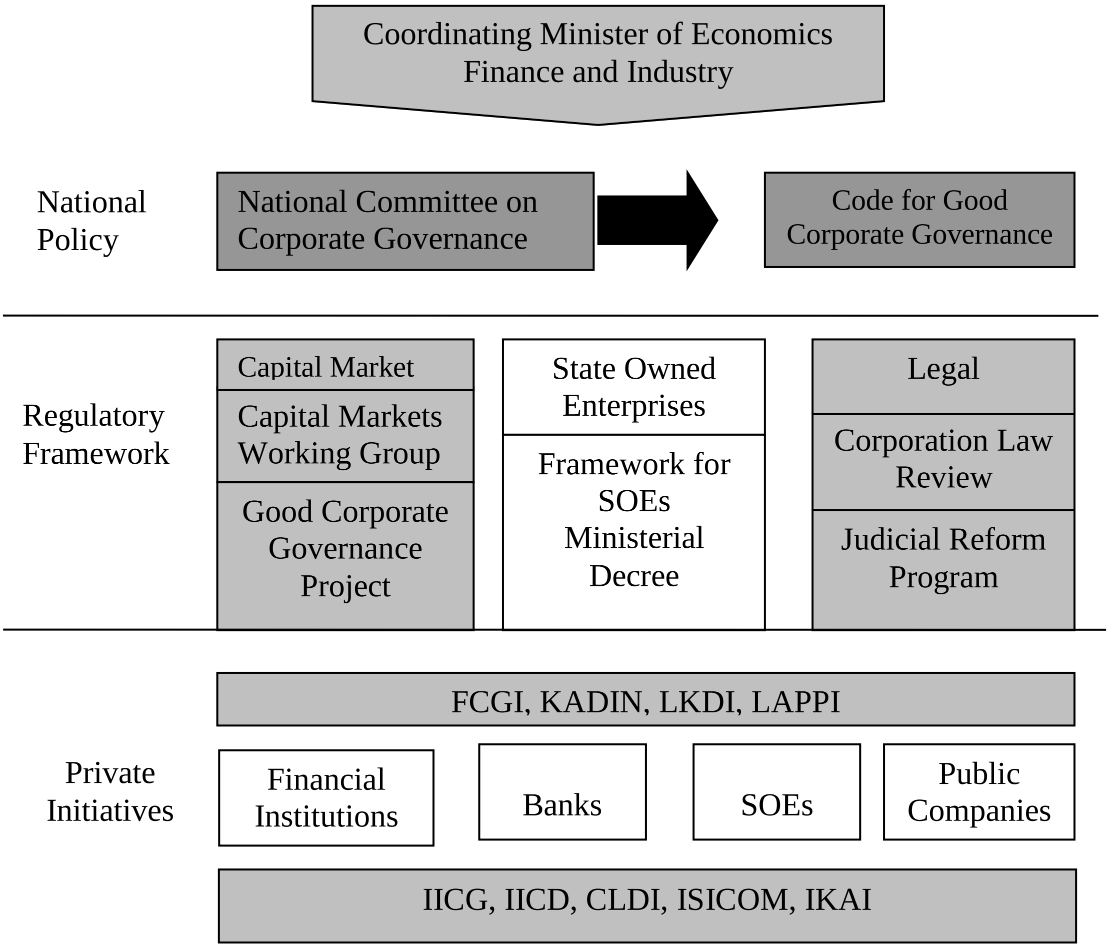
2.3.1 Corporate Governance Reform Agenda

As explained in Chapter 1, the implementation of corporate governance reforms in Indonesia was triggered by the East Asian financial crisis of 1997-98 (Husnan, 2001; Daniri, 2005). The weaknesses of corporate governance practices, such as highly concentrated ownership structures, ineffective supervision by the board of commissioners, inefficiency and lack of transparency on the procedures to acquire company control, over-reliance on external funding and inadequate supervision by creditors, were considered as contributors to the crisis (Daniri, 2005). In order to restore confidence in the economy, the Indonesian government agreed to receive financial assistance from the IMF, with corporate governance improvement included as one of the requirements in the IMF's Letter of Intent (Kurniawan and Indriantoro, 2000).

The IMF offered a multi-donor rescue package to help Indonesia overcome the financial crisis. The donors included the IMF itself and the World Bank/ADB. In its Letter of Intent (IMF, 2000), the IMF mandated that Indonesia initiate certain policy actions with respect to corporate governance reform. These included the establishment of a national committee for corporate governance, the adoption of corporate government reform strategies, the amendment of company law, the improvement of accountability and disclosure, and the improvement and enforcement of regulatory oversight. In 1998, the ADB also introduced the Financial Governance Reforms Sector Development Programme (FGRSDP) loan to Indonesia. This loan was an integral part of the IMF's multi-donor rescue package. The FGRSDP focused on helping to restructure the banking sector and to improve the financial and public sector allocation of resources by strengthening governance, increasing the disclosure and transparency of financial information, and reinforcing the financial sector's legal and regulatory framework (ADB, 2006).

The corporate governance reform agenda in Indonesia is presented in Figure 2.1. The agenda was comprised of three levels of activities consisting of national policy, regulatory framework, and private initiatives.

Figure 2.1 Agenda for the Implementation of Corporate Governance Reforms



Source: Daniri (2005)

2.3.1.1 National Policy

Following the IMF's guidance, the Indonesian government established the National Committee on Corporate Governance (NCCG) in 1999, which aimed to recommend a national framework for the implementation of good corporate governance and develop a national strategy for reforming corporate governance. The NCCG published the Indonesian corporate governance code (the Code for Good Corporate Governance) in 2000. In general, the Code adopted the OECD's principles of corporate governance (Kurniawan and Indriantoro, 2000; Daniel, 2003). The Code was revised in 2001 and 2006 to accommodate changes in the business environment, as well as the revised OECD principles of corporate governance issued in 2004. In 2006, the NCCG was replaced by the National Committee on Governance (NCG). Besides the national Code, the committee also produced corporate governance codes for specific industry sectors, including the code of corporate governance for banking (NCCG, 2004), and the code of corporate governance for insurance (NCG, 2006). The rationale for doing so was that each sector tended to have its own unique characteristics (NCG, 2006). In addition, the committee also produced guidance for the establishment of an effective audit committee (NCCG, 2002), and guidance for the establishment of the independent commissioners (NCG, 2004).

All corporate governance codes in Indonesia are voluntary and the Code itself is not incorporated into regulation. The NCCG argued that the intention of formulating a corporate governance code of principles was to provide more flexible and constructive methods of raising corporate governance standards; self-regulation in market development was deemed more appropriate (NCCG, 2001). Accordingly, an ethics-based approach was considered appropriate for the Indonesian environment. This approach is driven predominantly by the consciousness of business practitioners who operate their businesses not just with a short-term profit orientation but also to develop long-term relationships with their stakeholders (NCG, 2006). Consequently, the Code does not have any legal binding and serves only as a reference for companies and regulators in Indonesia (World Bank, 2010).

The voluntary approach adopted by the Indonesian corporate governance code was heavily criticised by World Bank (World Bank, 2010). The voluntary approach does not require companies to state in their annual reports why they comply or do not comply with certain corporate governance provisions (World Bank, 2010). This purely voluntary approach is contrasted with the approach adopted in other countries. In

Australia and the UK, for example, public listed companies that do not comply with certain provisions of the corporate governance code are required to provide sufficient and reasonable explanations for their non-compliance. In addition, the regulatory authorities in Indonesia, in developing the regulations, adopted certain key provisions of the corporate governance code and made them mandatory. The regulator then monitors the compliance of companies with the regulation but not with the specific provision of the code of corporate governance covered by the regulation. This approach has not resulted in high compliance with the mandated provisions of the corporate governance code (World Bank, 2010). According to a 2008 survey by the Indonesian Institute for Corporate Directorship (IICD), only 28 percent of public listed companies provided a comprehensive statement regarding governance policies, while 48 percent of public listed companies disclosed some aspects of governance policies, and 24 percent of public listed companies did not disclose anything related to governance (World Bank, 2010).

2.3.1.2 Regulatory Framework

The Indonesian government initiated intensive regulatory reforms by reviewing laws and regulations, as well as undertaking a judicial reform programme guided by the World Bank/ADB. To support corporate governance practices, the Indonesian government passed specific laws such as UU No. 23/1999 concerning the central bank, UU No. 4/1998 concerning bankruptcy, UU No. 19/2003 concerning state-owned enterprises and UU No. 25/2007 concerning investment. In addition, certain laws – including company law, company registry law and capital market law – were amended, (Daniri, 2005). Among the amended laws, the capital market law is the most relevant to this study and is discussed next.

The capital market in Indonesia is currently regulated by UU No. 8/1995 regarding capital market organisation. This law provides the legal basis for capital market development in Indonesia. Figure 2.2 presents the Indonesian capital market structure based on the law. The top position is held by the Ministry of Finance (MOF), which has the responsibility to determine general capital market policy. Below the MOF is the BAPEPAM, which is an administrative unit under the MOF and funded like other government units. The chairman of the BAPEPAM is appointed by the MOF. The position of the BAPEPAM has been criticised, as the agency is not financially independent and may be subject to government interference (Wells, 1999). In practice, the BAPEPAM-LK seems to be relatively independent from capital market players, but less independent from the MOF (World Bank, 2010). As stipulated in the law, the BAPEPAM has the responsibility to provide supervision, guidance, and regulation over the daily activities of the stock exchange. The stock exchange is not a fully independent organisation because it is strictly supervised by the BAPEPAM. For example, although the stock exchange has independent rule making authority, any rules it makes must be in line with the rules of the BAPEPAM. A rule proposed by the Indonesian Stock Exchange (IDX) must be submitted to the BAPEPAM for approval (BAPEPAM, 1996a). As a result, the IDX acts mostly as an implementer of BAPEPAM decisions rather than being a decision-maker and regulator in its own right (Wells, 1999). The audit committee rule, which is the focus of this study, is an example of the implementer role of the Exchange: audit committee rules issued by the BAPEPAM have been fully adopted by the IDX and have become a mandatory requirement for all companies listed on the IDX.

At the time of this writing, UU No. 8/1995 is in the process of being amended[3]. The main purpose of the amendment is to provide a more solid legal foundation for the Indonesian capital market in order to protect the interests of investors, and market participants in general. Revisions are also being made to promote the establishment of an Indonesian capital market that is efficient, fair, and orderly. Among the important points of the draft amendment is the requirement for public listed companies to appoint audit committees, independent commissioners, independent directors, and a corporate secretary. In addition, the draft amendment also provides additional authority for the BAPEPAM-LK to suppress the embezzlement of funds from investors (fraud) in the capital market.

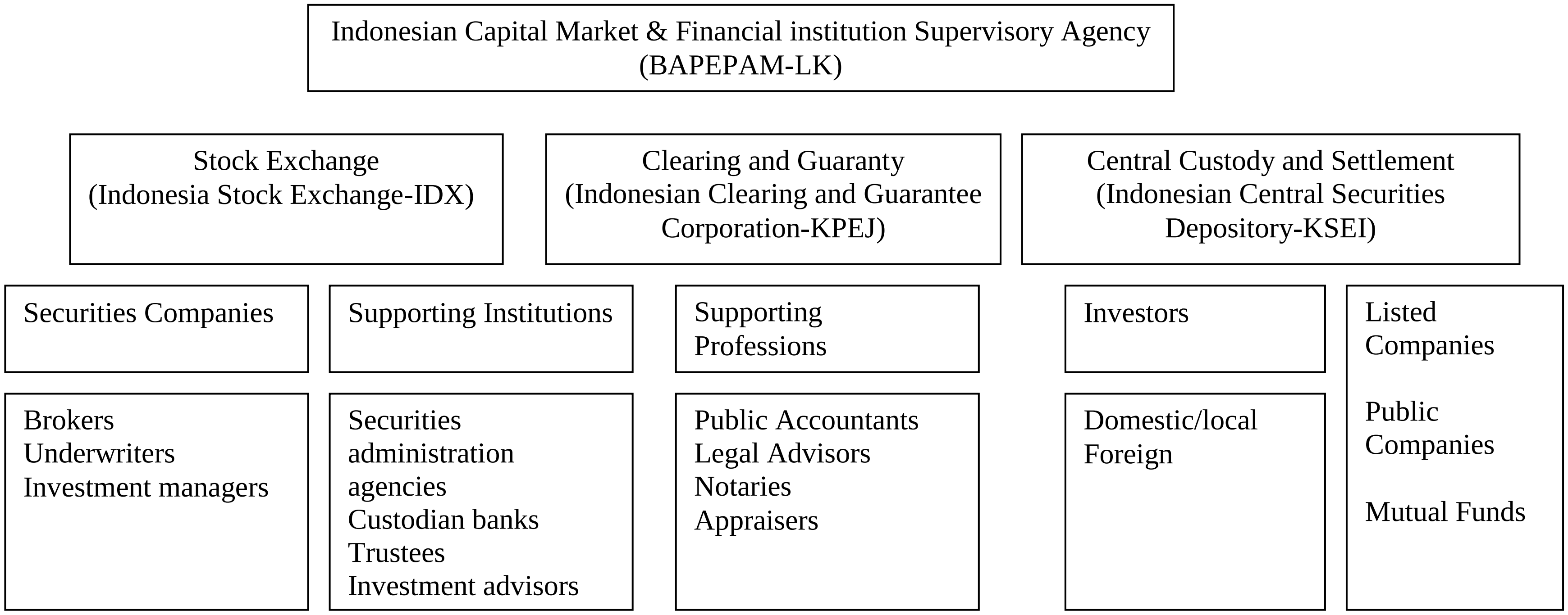
In terms of judicial reform programmes, some programmes have been implemented, including the Commercial Court in 1997, and the Capital Market Arbitration Agency in 2001. Indonesian regulators are continuing to review existing laws and regulations for conformity and synchronisation.

2.3.1.3 Private Initiatives

The implementation of corporate governance reform in Indonesia has also involved private initiatives. Some non-government organisations (NGOs) have assisted voluntarily in terms of providing education, training, ratings, research and advocacy. These NGOs include the Forum for Corporate Governance in Indonesia (FCGI), the Indonesian Institute for Corporate Directorship (IICD), the Indonesian Institute for Corporate Governance (IICG), the Corporate Leadership Development Institute (CLDI), the Indonesian Institute of Audit Committee (IKAI), and the Indonesian Society of Independent Commissioners (ISICOM).

[3] When this thesis was finalised in mid-2013, the process had not been completed.

Figure 2.2 Indonesian Capital Market Structure



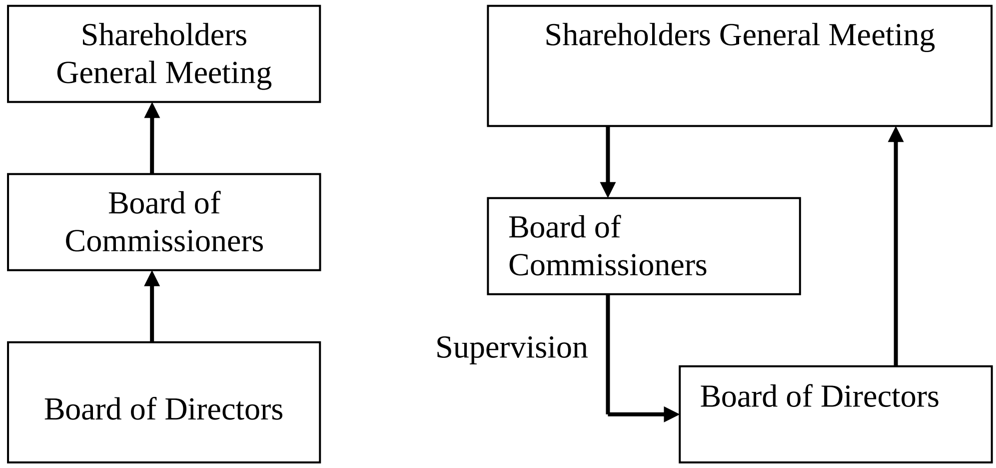
Source: IDX (2010b)

2.3.2 Independent Commissioner and Audit Committee Requirements

2.3.2.1 Independent Commissioners

As the Indonesian legal system is derived from the Dutch legal system, Indonesian company law has adopted a two-tier model with slight modifications. A company incorporated in Indonesia has two boards, consisting of a board of commissioners and a board of directors. The board of commissioners, as the representative of the shareholders, has the duty of supervisor and advisor to the board of directors, whereas the board of directors has an executive role. However, the Indonesian two-tier system differs slightly from the Dutch system. As can be seen in Figure 2.3, the board of directors and the board of commissioners are responsible to the annual general meeting of shareholders. Furthermore, the board of commissioners may suspend a director, but the decision must be confirmed by the annual general meeting of shareholders within 30 days (World Bank, 2010). The Indonesian model limits the oversight of directors by the board of commissioners and provides the opportunity for controlling shareholders to place their members on the board of directors. In contrast, the two-tier system adopted in other countries, such as the Netherlands, provides authority for the board of commissioners to select directors.

Figure 2.3 Two-Tier System: Indonesian versus Dutch



Dutch Two-Tier System

Indonesian Two-Tier System

Source: Forum for Corporate Governance in Indonesia (2001)

The need for independent commissioners in Indonesia was prompted by the IMF. In its Letter of Intent (LOI) dated 22 July 1999, the IMF requested public listed companies in Indonesia to appoint independent commissioners. As a follow up to the LOI, the BAPEPAM issued a circular letter (BAPEPAM, 2000) that recommended all public listed companies to establish independent commissioners and audit committees. Similarly, the Indonesian Code of Good Corporate Governance also recommended that each company establish independent commissioners and an audit committee. The mandatory era for independent commissioners was marked by the issuance of the decision letter of the board of directors of the Jakarta Stock Exchange (JSX)[4] No. Kep-315/BEJ/06-2000. This was amended later by the decision letter of the JSX No. Kep-339/BEJ/07-2001 concerning independent commissioners, audit committees, and corporate secretaries for public listed companies. This rule required that independent

[4] Jakarta Stock Exchange is the former name of the Indonesia Stock Exchange. On 1 December 2007, the Jakarta Stock Exchange merged with the Surabaya Stock Exchange and the new exchange was named the Indonesia Stock Exchange.

commissioners should comprise at least 30 percent of all members of the board of commissioners. Independent commissioners were further regulated by the BAPEPAM decree No. 29/PM/2004. The decree, which is a focus of this study, regulated independent commissioners and the audit committee as well. In this decree, an independent commissioner is defined as: (i) he/she comes from outside the issuers or listed companies; (ii) he/she does not have any direct or indirect ownership in the issuers or listed companies; (iii) he/she is not affiliated with the issuers or listed companies, commissioners, directors or majority shareholders of the issuers or listed companies; (iv) he/she does not own any business or conduct any activity that directly or indirectly relates to the business activity of the issuers or listed companies.

2.3.2.2 Audit Committee

At the national policy level, the requirement for an audit committee is stipulated in Indonesia's corporate governance code. One provision of the Code recommends that a company establish an audit committee. A detailed discussion on the audit committee is found in the guidelines for the establishment of an effective audit committee issued by the NCCG in 2002. These guidelines are applicable to all sectors, however, both the code and the guidelines are voluntary.

At the level of company sector regulation, the rules regarding the audit committee are governed by different government agencies, depending on the company type, as different company types have different regulators. For public listed companies, the audit committee is governed by the rules issued by the BAPEPAM-LK, which also governs the independent commissioners. For the banking sector, Bank Indonesia issues corporate governance regulations that cover audit committees for both listed and non-listed banks. Meanwhile, the Ministry of State Owned Enterprises (MSOE) issues rules concerning audit committees for state owned enterprises (SOEs). Unlike the Code, all these regulations are mandatory and use a rules-based approach that puts greater emphasis on regulatory enforcement than on voluntary compliance. Furthermore, the audit committee regulations of the BAPEPAM-LK and Bank Indonesia are applicable to all companies regardless of size (one size fits all), whereas the MSOE's regulations are applicable only to privatised SOEs, SOEs in the financial sector, and SOEs with a minimum asset size of one trillion rupiah.

a. Development of Audit Committee Rules: Public Listed Companies

The history of the audit committee for public listed companies in Indonesia began in 2000, when the IMF (2000) recommended that listed companies in Indonesia establish audit committees. In response to the recommendation, the BAPEPAM (2000) issued a circular letter that recommended that all public listed companies establish independent commissioners and audit committees. The audit committee was further regulated by the decision letter of the board of directors of JSX, No. Kep-315/BEJ/06-2000. This was amended later by the decision letter of JSX No. Kep-339/BEJ/07-2001, dated 20 July 2001 concerning independent commissioners, audit committees and corporate secretaries for public listed companies. The enactment of this rule marked the era of compulsory audit committees for public listed companies in Indonesia. The rule was included in paragraph C of Securities Listing Regulation No. I. A that outlined the general requirements for equity securities to be listed on the JSX. Public listed companies were required to fulfil these requirements by 31 December 2001 at the latest. Thus, implementation of the audit committee in Indonesia was initially voluntary and later mandatory, following the pattern of development in other countries.

In order to strengthen the regulation of audit committees of public listed companies, the BAPEPAM issued rules relating to the formation of audit committees as well as the mandatory disclosure of the membership and activities of audit committees in the annual report. In terms of audit committee formation, the BAPEPAM issued decree No. 41/PM/2003, which was amended later by decree No. 29/PM/2004, with respect to guidelines relating to the establishment and working implementation of audit committees. Meanwhile, in terms of the mandatory disclosures of the audit committee, the requirement was regulated by the BAPEPAM-LK decree No. 134/BL/2006, which was also known as Rule No. X.K.6. By enactment of these decrees, the BAPEPAM circular letter (2000) and JSX rule (2001) became ineffective. Consequently, the rules were adopted as general requirements for equity securities to be listed on the IDX. Furthermore, since formation of an audit committee became compulsory for each public listed company, this rule also gave BAPEPAM the right to impose sanctions for any violations of the rule. The BAPEPAM required public listed companies to comply with the decree no later than December 2004.

In some respects, the requirements of the BAPEPAM decree (2004) are quite similar to those of the JSX (2001). An example is the audit committee's membership structure. As depicted in Table 2.4, the membership requirements in both rules are similar in that all public listed companies must have an audit committee comprising at least three members, one of whom shall be an independent commissioner and concurrently the chairman of the audit committee, while the others shall be external independent parties at least one of whom shall have accounting and/or finance expertise. However, in terms of the job duties of the audit committee, there are some differences between the two rules. The main difference is that the BAPEPAM decree (2004) does not mention any duties of the audit committee relating to external auditors, whereas the JSX rules (2001) specify the relationship between the audit committee and the external auditor. Furthermore, the BAPEPAM decree (2004) does not define a specific timeframe regarding the reporting of the audit committee to the board of commissioners, and submission of the board of commissioners' recommendations to the board of directors and stock exchange.

Table 2.4 Comparison of BAPEPAM (2004) and JSX (2001)

Requirements		JSX (2001)	BAPEPAM (2004)
Membership	Consists of at least three members	✓	✓
	Members shall be external independent parties	✓	✓
	Chairman is an independent commissioner	✓	✓
	One member shall have educational background in accounting or finance	✓	✓
Job duties	Examining the financial information that will be released	✓	✓
	Reviewing company compliance with regulations and laws	✓	✓
	Reviewing work of the internal auditor	-	✓
	Reporting any risks facing company and risk management implementation	-	✓
	Scrutinizing and reporting of any complaints	-	✓
	To review the independence and objectivity of the public accountant	✓	-
	To review the adequacy of the audit conducted by the public accountant to ensure that all important risks have been considered	✓	-
	To review the effectiveness of the company's internal controls	✓	-
	To investigate any indication of a mistake in a resolution passed at a board of directors meeting, or an irregularity in implementing such a resolution. Such investigation can be conducted by the audit committee or any independent party appointed by the audit committee at the listed company's expense	✓	-

Source: Compiled by the author

In terms of audit committee disclosure in annual reports, the BAPEPAM-LK decree No. 134/BL/2006 (also known as Rule No. X.K.6) amended the previous BAPEPAM rule (BAPEPAM, 1996b) and required the reporting of corporate governance, including the audit committee, in annual reports. According to this new rule, as a minimum requirement for disclosure, the audit committee report should provide the following: (i) the name, position, and a short biography of audit committee members; (ii) the job description and responsibilities of the audit committee; (iii) the number of meetings held during the financial year and details of the attendance of each audit committee member; and (iv) a summary of the activities of the audit committee in the discharge of its duties for the listed company's financial year. The effective date of this rule was 7 December 2006, and public listed companies were obligated to comply with the rule by including the required information in their annual reports for the year-ended 31 December 2006.

b. Development of Audit Committee Rules: Banking Sector

There has been significant progress in the development of audit committee rules for the banking sector. The first audit committee requirement for the sector was introduced in 1995, when Bank Indonesia regulated that each bank should have an audit committee. This requirement was considered the first initiative in Indonesia as there was no previous requirement for audit committees in Indonesia (Kurniawan and Indriantoro, 2000). However, this audit committee requirement was considered ineffective in practice as many banks that had audit committees were liquidated or closed (Effendi, 2005). As a result, this regulation was revoked by Bank Indonesia in 1999 and replaced with the requirement stipulated in PBI No. 1/6/PBI/1999 to establish a compliance director. This decision was criticised because the function of the compliance director was different from that of an audit committee (Kurniawan and Indriantoro, 2000;

Effendi, 2005). In 2006, Bank Indonesia issued PBI No. 8/4/PBI/2006 (amended later by PBI No. 8/14/2006) in relation to the implementation of corporate governance for banks. This rule also incorporated audit committee formation for banks.

c. Development of Audit Committee Rules: State Owned Enterprises Sector

In line with developments in other sectors, the MSOE also required SOEs to establish audit committees under Ministerial Decree No. 103/MBU/2002. The decree specified the organisation of the committee, requirements of audit committee members, and the committee's functions.

Table 2.5 presents a comparison of audit committee rules between public listed companies, banks and SOEs. In some respects, there are many similarities among the rules. In terms of membership, all rules require a committee comprised of at least three members. Another similarity relates to audit committee functions: all rules require the audit committee to review financial information issued by the companies, and to review the work of the internal auditor. Apart from these aspects, the audit committee requirements between the company types are different. For example, SOEs and banks require audit committees to review the work of the external auditor, whereas the BAPEPAM is silent on this. Therefore, this study excludes banks and the SOEs from the sample as they have different audit committee requirements.

Table 2.5 Comparison of Audit Committee Rules in Indonesia

	Indonesia Stock Exchange (BAPEPAM, 2004)	Banks (PBI No 8/4/PBI/2006)	Stated Owned Companies (SK Kep-103/M-MBU/2002)
Membership	Consist of at least three members.	Consist of at least three members.	Consist of three members, at least one of whom is a commissioner.
	Members shall be external independent parties.	Majority of audit committee members to consist of independent commissioners and independent parties (at least 51%).	Members are not employees of the company (must be independent parties).
	Chairman is an independent commissioner.	Chairman is an independent commissioner.	Chairman is a commissioner.
	One member shall have an educational background in accounting or finance.	One member is an independent party with expertise in finance or accounting, while the others are independent parties with legal or banking expertise.	Members are experts.
	-	Audit committee members must possess good integrity, character, and mores.	-
Job duties	Examining the financial information.	Assess adequacy of financial reporting process including consistency between the financial reports and prevailing accounting standards.	Ensure that there have been satisfactory review procedures on all kinds of information published to shareholders.
	Reviewing company compliance with regulations.	-	-
	Reviewing internal auditor's work.	Monitoring and evaluation of the work of the internal and external auditors.	Review the work of the internal and external auditors and provide recommendations on improvement of internal controls and their implementation.
	Reporting of risks and risk management implementation.	-	-

Table 2.5 (continued)

	Indonesia Stock Exchange (BAPEPAM, 2004)	Banks (PBI No 8/4/PBI/2006)	Stated Owned Companies (SK Kep-103/M-MBU/2002)
Job duties	Scrutinizing and reporting of complaints.	-	-
	Audit committee has charter.	-	-
	-	Audit committee shall give a recommendation for the appointment of the public accountant and the public accountant's office to the board of commissioners, then the recommendation is submitted to the general meeting of shareholders.	-
	-	Monitor implementation of follow up actions by the board of directors on findings of the internal audit work unit, public accountant, and Bank Indonesia's supervision.	-
	-	-	Identify issues that require the attention of commissioners, and carry out other tasks given by the board of commissioners as long as they are still in the scope of duties and obligations of the board of commissioners.

Source: Compiled by the author

2.3.2.3 Comparison of Indonesian Audit Committee Rules with International Rules

Table 2.6 presents a general comparison of the BAPEPAM rules with those of Bursa Malaysia (formerly known as the Kuala Lumpur Stock Exchange, or KLSE), and two well-known audit committee recommendations, namely, the BRC (1999) and the SOX (2002). The selection of Bursa Malaysia is to provide a comparison with the audit committee rules of an exchange that is also located in an emerging economy. In comparison to the audit committee recommendations of the BRC and the SOX, the BAPEPAM rules have not included all important aspects of audit committee reforms called for in the recommendations. In general, only the audit committee membership requirements of the BAPEPAM rules (i.e., independence and its definition, minimum number of members) are quite similar to those of the BRC and the SOX. Other recommendations have not been included in the BAPEPAM rules. The striking difference is the absence of a mandatory audit committee function to deal with external auditors. In this respect, it seems that the BAPEPAM decrees are less stringent than the BRC and the SOX requirements. Meanwhile, Bursa Malaysia's rules are more comprehensive than those of the BAPEPAM. In terms of membership requirements and disclosure, the BAPEPAM rules and the Bursa Malaysia rules are not significantly different. However, in terms of functions, the Bursa Malaysia rules specify the audit committee's relationship with external auditors.

Table 2.6 General Comparison of BAPEPAM Decrees with International Rules

Sources	Audit Committee Recommendations	Bursa Malaysia rules	BAPEPAM rules
BRC 01 SOX section 301	Defines independence (for audit committee members).	Silent (not specifically mentioned)	Yes
BRC 02 SOX section 301	Companies should have an audit committee; all members should be independent.	Yes	Yes

Table 2.6 (continued)

Sources	Audit Committee Recommendations	Bursa Malaysia rules	BAPEPAM rules
BRC 03	Audit committee should be composed of at least three members who are financially literate; at least one member has accounting or related financial management expertise.	Yes	Yes
BRC 04	Audit committee should adopt a charter and reassess it annually.	Yes, but not required to reassess it annually.	Yes, but not required to reassess it annually.
BRC 05 SOX section 407	Proxy statements should disclose information about the audit committee.	Yes	Yes
BRC 06 SOX section 202	The outside audit engagement is the responsibility of the audit committee.	Silent	Silent
BRC 07	Audit committee must communicate with outside auditors about independence issues (consulting assignments, etc.).	Yes	Silent
BRC 08	External auditors should discuss the quality of the company's accounting policy with the audit committee.	Yes	Silent
BRC 09	A letter from the audit committee to be included in the company's annual reports to shareholders.	Yes	Silent
BRC 10	Auditors review quarterly reports before release.	Yes	Yes
SOX section 301	Audit committee must provide procedures to receive, retain, and treat complaints, and provide procedures to confidentially handle employee complaints (whistle-blower protection).	Silent	Receive complaints, but not required to set any procedure to handle them.
SOX section 201	Audit committee pre-approves non-audit services provided by the public accounting firm.	Silent	Silent
SOX section 301	Each audit committee shall have the authority to engage independent counsel or other advisors.	Silent	Silent
SOX section 301	Audit committee is properly funded.	Silent	Silent

Sources: Compiled by the author

2.3.3 Specific Features of the Indonesian Business Environment: Obstacles to Reform

As discussed in Section 2.2.6, the implementation of the Anglo-American corporate governance model in East Asia might not achieve the expected results. As seen above, Indonesia has actively reformed its regulations to support the Anglo-American corporate governance practice. The following section identifies certain key features in the Indonesian business environment that might serve as obstacles to the implementation of Anglo-American corporate governance.

2.3.3.1 High Concentration of Family Ownership

In Indonesia, the ownership of public listed companies is concentrated in the hands of families. This condition has not differed significantly between the pre- and post- East Asian financial crisis periods. In the pre-crisis period, the ownership of public listed companies was highly concentrated – particularly in the hands of a small number of families that owned groups of companies. Families retain control by keeping the majority percentage of outstanding shares. They enhance their control of companies through cross-shareholding and investing in shares among companies within the group. In addition, families prefer to finance expansion using debt instead of issuing stock in order to maintain their control (Husnan, 2001). In the post-crisis period, these conditions did not change much. As depicted in Table 2.7, concentrated ownership is still dominant in the post-crisis period (year 2000), and families remain as controlling shareholders of most public listed companies in Indonesia.

Table 2.7 Ownership of Public Listed Companies in Indonesia

Ownership Pattern [a]	Cut-off level 20%		Cut-off level 40%	
	1996	2000	1996	2000
Concentrated ownership				
Family/individual	78	58	70	49
Indonesian corporation	3	5	2	5
Foreign	8	13	9	13
State	5	14	5	16
Sub total	94	90	86	83
Widely held	2	4	13	17
Mixed				
Private [b] plus state	1	3	0	0
Private [b] plus foreign	3	3	1	0
Total	100	100	100	100

Source: Adapted from Sato (2004)
Notes: [a] = data for top 100 companies; [b] = private=family/individual

The high concentration of ownership in the hands of families tends to negatively affect implementation of the Anglo-American corporate governance model in Indonesia (Rusmin et al., 2011), and might render internal corporate governance mechanisms ineffective (Claessens and Fan, 2002; Berglöf and Claessens, 2006; Cheung and Chan, 2004). There is also less incentive to list the company on the stock exchange (Daniel, 2003). In addition, larger family-owned firms that collude with politicians resist the implementation of corporate governance measures in Indonesia (Rosser, 2003). Other challenges to the implementation of the Anglo-American corporate governance model in Indonesia are discussed next.

2.3.3.2 Low Number of Public Listed Companies on the Indonesia Stock Exchange

The number of public listed companies on the IDX is low. As can be seen in Table 2.8, the number of IDX-listed companies did not increase significantly during the 1998-2000 period. At the end of 2010, the number of public listed companies stood at 420. This number is much smaller than the number of listed companies in neighbouring ASEAN countries, such as Thailand (541) and Malaysia (956).

Table 2.8 Growth of Public Listed Companies on the IDX

Year	98	99	00	01	02	03	04	05	06	07	08	09	10
Newly listed	6	9	21	31	22	6	12	8	12	22	19	13	22
Total PLCs	288	277	287	316	331	333	331	336	344	383	396	398	420

Source: IDX (2004; 2010b)

The low growth in the number of public listed companies on the IDX might indicate the reluctance of family-owned companies in Indonesia to go public. In fact, stock exchanges serve as promoters of the spread of corporate governance among public listed companies (Christiansen and Koldertsova, 2009), as they might push implementation of corporate governance through regulations. Therefore, the low number of public listed companies might hinder the progress of corporate governance implementation among Indonesian companies.

2.3.3.3 Ineffectiveness of Boards of Directors

Ineffectiveness of boards of directors has been observed in Indonesia. The ineffectiveness has been considered to be related to the fact that family members are present on boards of directors, board of commissioners, or both. Large business groups (conglomerates) are frequently controlled by a single family with ownership concentrated in the hands of a founding patriarch and his sons, or by a subsidiary or investment holding company within the conglomerate (Brown, 2004). Family members, as controlling shareholders, dominate as members of the board of directors, board of commissioners, or both. The head of the board of commissioners often represents the controlling party of the company, or someone very close to the controlling shareholders (Husnan, 2001; Hanani, 2005). As evidenced by Tabalujan (2002), 59.8 percent of the 259 public listed companies on the JSX had two or more family members on their boards in 1997. The figure decreased slightly to 40.7 percent out of the 307 public listed companies in 2001. The presence of family on the boards may be due to the reluctance of families to trust people outside of their small circle of family and friends (Young et al., 2008). However, this dominance of families on boards raises doubts as to whether independent directors are truly independent and can provide adequate monitoring of the majority shareholders (Cheung and Chan, 2004; Berglöf and Claessens, 2006).

In addition to the presence of family members on the boards, the ineffectiveness of boards of directors is caused by the common phenomenon in Indonesia of collusion between the company and officials or the political elite (Husnan, 2001; Brown, 2004). The family, as controlling shareholders, maintains a special relationship with elite politicians in order to get some kind of protection or special treatment, such as access to outside capital and preservation of monopolistic strategies (Husnan, 2001). To maintain this special relationship, family controlling shareholders often give a small portion of shares for free to elite politicians and bureaucrats (Brown, 2004). Another method is placing the elite politicians or bureaucrats on their boards (Husnan, 2001; Rosser, 2003). In this study, these are referred to as politically connected directors/commissioners. However, the elite politician/bureaucrat most often lacks business experience or expertise in law, accounting, or finance and, thus, this collusion might provide resistance to the implementation of good corporate governance principles (Rosser, 2003).

2.3.3.4 The Presence of Foreign Institutional Investors Related to Indonesians

Although family ownership is still dominant after the East Asian financial crisis of 1997-98, the number of shares owned by foreign investors has increased. Increasing foreign ownership has been observed since the end of 1997. At that time, the Indonesian government removed the limit on foreign investment and foreign investors were allowed to buy up to 100 percent of the shares of listed companies (Husnan, 2001). Consequently, foreign investor interest in the IDX has increased year by year. It is not surprising that Sato (2004) found that foreign ownership rose from 8 percent to 13 percent at the 20 percent cut-off level between 1996 and 2000. The boom in foreign investor interest in the IDX began in 2002 and 2003 (Robinson and Hadiz, 2004). Table 2.9 presents the equity ownership composition of companies listed on the IDX from 2004 to 2011. Foreign ownership decreased steadily during the 2004-2011 period. It seems that recent Indonesian government policy to restrict foreign ownership in some industries may have led to the downward trend of foreign ownership. However, compared with domestic ownership, the percentage of foreign ownership is still much higher. This means that foreign investors are still the dominant players in the IDX, as foreign ownership accounts for approximately two-thirds of IDX market capitalisation (World Bank, 2010).

Table 2.9 Equity Ownership Percentages of Companies Listed on the IDX (December 2004-September 2011)

Year	Domestic (%)	Foreign (%)
2004	22.73	77.27
2005	26.95	73.05
2006	26.60	73.40
2007	33.65	66.35
2008	32.16	67.84
2009	32.76	67.24
2010	37.20	62.80
2011	39.38	60.62

Source: BAPEPAM-LK (2011)

Caution needs to be exercised in interpreting the increasing foreign ownership phenomenon because some of these foreign investors might, in actual fact, be offshore companies owned by Indonesians themselves (World Bank, 2010). Some of these foreign investors might be special purpose entities (SPEs) owned by Indonesians. The SPE, or so-called “paper company”, is usually established in a “tax haven” such as the Cayman Islands, British Virgin Islands, or some other country that has a tax treaty with Indonesia.

There are two possible reasons for the existence of SPEs owned by Indonesians. First, SPEs are used to conceal the identities of Indonesians as original debtors so they can purchase their loans from the loan asset sale program established after the East Asian financial crisis of 1997-98. The significant drop in the exchange rate of the rupiah during the crisis caused many banks owned by Indonesian conglomerates to experience huge bad loans. In response to this situation, the Indonesian government established the Indonesia Bank Restructuring Agency (IBRA) with two main functions: to lead the restructuring of the most illiquid and insolvent banks, and to manage the assets acquired (Kawai, 2000). In the first step, bad loans were transferred to the IBRA so that the troubled banks could continue performing their role in distributing loans to the public. In the next step, the IBRA sold unstructured and structured loans to the financial sector. Principally, original debtors were not allowed to repurchase the loans, however, many original debtors did so through third parties who were actually acting on their behalf. The original debtors often formed SPEs so that the ultimate owner was unknown due to the SPE’s pyramid structure (Chua, 2008). Many of the SPEs registered to bid for the loans and many of them won the bids (Karim and Rakhmat, 2005). For example, 40 percent of the shares of Indofood Tbk were acquired by First Pacific, a Hong Kong based investment arm of the Salim Group, which was the original debtor (Chua, 2008).

Second, the use of the SPE by Indonesian shareholders is to obtain a tax reduction by “treaty shopping”. Treaty shopping is defined as “the practice of some investors of 'borrowing' a tax treaty by forming an entity (usually a corporation) in a country having a favourable tax treaty with the country of source – that is, the country where the investment is to be made and the income in question is to be earned" (Rosenbloom, cited in Hji Panayi and Avi-Yonah, 2010). For example, in order to get a tax reduction for a dividend, Indonesians might establish an SPE in a country that has a tax treaty agreement with the Indonesian government. The SPE buys shares of Indonesian listed companies, or becomes a foreign investor in the Indonesian listed company. Indonesian income tax law adopts the source principle to levy income tax on non-resident taxpayers. Article 26 of the Income Tax Law (UU No. 36/2008) stipulates that dividends and interest (including premiums, discounts, and other remuneration in respect of debt claims), paid by a domestic corporate taxpayer to a resident, are subject to 20 percent tax on the gross amount received or earned by the non-resident taxpayer. However, the tax treaty might reduce the rate. As depicted in Table 2.10, most tax rates can be reduced to 10 or 15 percent. The dividend received by the SPE is subject to tax of 10 to 15 percent, which is lower than the normal domestic rate of 20 percent. In addition, the dividend might also be exempted from the tax if the SPE is established in a tax-haven country. Therefore, the SPE acts as a conduit that might not have any activity other than channelling income that would accrue to Indonesians.

To date, Indonesia has tax treaty agreements with 50 countries (KPMG, 2009). Some of these countries, such as Hong Kong, Malaysia (Labuan) and Singapore, are categorised as tax haven countries, (Zoromé, 2007). Mauritius was previously included in the list but was deleted at the beginning of 2005, as the Indonesian Tax Office (ITO) discovered several frauds such as treaty shopping.

Table 2.10 Withholding Tax Rates Under Indonesian Tax Treaties

Country	Dividends	Interest	Royalties
China	10	10	10
Japan	10/15	10	10
Luxembourg	10/15	10	10/12.5
Malaysia	15	15	15
Netherlands	10	10	10
Seychelles	10	10	10
United Kingdom	10/15	10	10/15

Source: Deloitte (2009)

One main requirement to get a tax rate based on a tax treaty is that the non-resident taxpayer must obtain a certificate of domicile (COD) from the tax authority in the country of residence. However, this requirement was not supported with a clear definition of the beneficial owner, and the format of the COD was not standardised. Consequently, the ITO accepts all certificates of domicile issued by the relevant authority of a treaty partner in the format generally used by the foreign tax authority. Furthermore, there is no specific deadline to submit the COD to the ITO. In practice, the taxpayer gives the COD to the ITO after the transaction is finalised (KPPMASATU, 2010). This weakness in the regulation was often misused by Indonesians to establish SPEs in other countries – particularly tax haven countries that had a tax treaty with Indonesia – using third parties acting on their behalf. Another method is to use a bank in those countries as a nominee. This is noted in the case of Bentoel International Tbk, which is owned by the Rajawali Group through its investment company (Bella Sapphire Ventures Ltd.) in Seychelles. See Appendix B for additional examples.

In Indonesia, the identities of the ultimate owners of the SPEs in tax haven countries are generally preserved and not disclosed in formal documents such as annual reports. The identity of the actual owner is not readily available and requires some effort to obtain, even if it is traced back to the home base of the SPE, as tax haven jurisdictions are characterised by a lack of transparency (OECD, 1999). In Indonesia, the requirement for disclosure of the ultimate shareholders is only regulated by Bank Indonesia (2003), which requires disclosure of the ultimate shareholders of institutional shareholders (including SPEs) in the annual reports of banks. Meanwhile, the BAPEPAM-LK rule requires disclosure of shareholders owning five percent or more of company shares. There is no requirement, however, to disclose the indirect/ultimate shareholders or control. As a result, most public listed companies just disclose direct shareholders (World Bank, 2010).

In environments where relationship-based business is dominant, foreign institutional investors might play a role in enhancing the effectiveness of formal corporate governance mechanisms (Anderson et al., 2001; Ananchotikul, 2006). Foreign institutional investors come from outside domestic social networks in which the institutional norms of behaviour are generated, thus they might be more resistant and more likely to push for transparency and shareholder protection (Peng, 2003). Therefore, foreign institutional investors serve as exogenous pressure to introduce corporate governance practices that are socially legitimate or widely perceived as appropriate and effective (Aguilera and Cuervo-Cazurra, 2004). However, the presence of foreign institutional investors related to Indonesian or Indonesian offshore companies might reduce the effectiveness of foreign institutional investors as agents that push for implementation of corporate governance. These types of foreign institutional investors are not independent from the public listed company or may even be related to the family as controlling shareholders. As a result, they are not resistant to common corporate governance practices in Indonesia, since the ultimate owners are Indonesian. Therefore, these types of foreign institutional investors might not bring better corporate governance practice from their home country to Indonesia.

2.4 PROGRESS OF CORPORATE GOVERNANCE REFORM

There were concerns about the implementation of the Anglo-American corporate governance model in Indonesia. Scholars argued in the academic literature that corporate governance reforms in Indonesia were ineffective. For example, Patrick (2001) argued that Indonesia already had quite good prudential and other laws and regulations but lacked effective implementation. Similarly, Lindsey (2004) argued that Indonesian corporate governance reform lacked coordination and effective implementation. Dercon (2007) claimed that the efforts of Indonesia to promote good corporate governance by giving much attention to issues such as creating committees for corporate governance, publishing national and sector codes, amending and enacting numerous law or rules, seemed ineffective. These claims were also supported by several empirical studies (e.g., Daniel, 2003; Utama, 2003). Daniel (2003) found that, based on a pilot programme for strengthening corporate governance conducted by the ADB and the Jakarta Stock Exchange, only 8 companies (3.12 percent) were found to have acceptable corporate governance standards. Likewise, Utama (2003) found that, in general, the disclosures of the 104 public listed companies in 1998 were weak – even the mandatory disclosures.

Further evidence of weak corporate governance in Indonesia is noticeable from the low ranking of Indonesia in most surveys of corporate governance implementation in Asia conducted by international organizations. Table 2.11 summarises the results of some international surveys of corporate governance conducted up until 2000. In all these surveys, Indonesia is placed at the lowest ranking among several Asian countries. The first survey, done by Booz-Allen and Hamilton in 1998 (Bisnis Indonesia, 11 September, 2003), showed that the corporate governance index for Indonesia was 2.88, which was the lowest in East Asia compared to Thailand (4.89), Malaysia (7.72), Singapore (8.93) and Japan (9.17). Another survey, done by Pricewaterhouse Coopers in 1999 in cooperation with the Singapore Stock Exchange (cited in Kurniawan and Indriantoro, 2000), used institutional investors in Singapore as respondents. This survey also placed Indonesia in the lowest ranking for perceived standards of transparency and disclosure, accountability to shareholders, board processes, auditing and compliance. The McKinsey and Company survey in 2000, done in collaboration with the Global Corporate Governance Forum, obtained the opinions of global investors from the United States, Asia, Europe and other countries with regard to premiums that investors were willing to pay for well-governed companies. In this survey, Indonesia was ranked the lowest among several Asian countries (Indonesia, Thailand, Malaysia, Korea, Taiwan and Japan) for corporate governance practice. Interestingly, the investors were willing to pay up to 27% more for shares of companies in Indonesia with good corporate governance, which was the highest, compared to other Asian countries.

Table 2.11 Corporate Governance Surveys in the 1990s

No.	Name of Survey	Ranking
1.	Booz-Allen and Hamilton (1998)	Lowest rank among East Asian countries that also included Malaysia, Thailand, Singapore and Japan.
2.	Pricewaterhouse Coopers in cooperation with the Singapore Stock exchange (1999)	Lowest ranking among countries in the Asia/Australia region.
3.	McKinsey and Company in cooperation with the Global Governance Forum (2000)	Lowest rank among Asian countries that also included Thailand, Malaysia, Korea, Taiwan and Japan.

Source: Compiled by the author

Similar results were also found in some recent corporate governance surveys conducted by the independent brokerage and investment group Credit Lyonnais Securities Asia (CLSA), in cooperation with the Asian Corporate Governance Association (ACGA).

These surveys assessed the quality of corporate governance practices in Asia Pacific markets. The criteria used to evaluate the quality of the corporate governance practices included corporate governance rules and practices, enforcement, the political and regulatory environment, accounting and auditing standards, as well as the overall corporate governance culture. As can be seen in Table 2.12, Indonesia has been continuously in last place, except for 2010 when Indonesia showed improvement and was ranked ahead of the Philippines. Further, Indonesia's corporate governance quality score increased by three points, possibly, indicating that corporate governance reform had started to make some progress.

Table 2.12 Corporate Governance Quality Score

	2010		2007		2006		2005		2004		2003	
Market	R	*S*	R	*S*	R	*S*	R	*S*	R	*S*	R	*S*
Hong Kong	2	*65*	1	*67*	1	*6.7*	1	*6.9*	1	*6.7*	1	*7.3*
Singapore	1	*67*	2	*65*	2	*6.5*	2	*7.0*	2	*7.5*	2	*7.7*
India	7	*49*	3	*56*	3	*5.6*	3	*6.1*	3	*6.2*	3	*6.6*
Taiwan	4	*55*	4	*54*	4	*5.4*	4	*5.2*	4	*5.5*	4	*5.8*
Japan	3	*57*	5	*52*	5	*5.2*	-	-		-		-
Korea	9	*45*	6	*49*	6	*4.9*	5	*5.0*	5	*5.8*	5	*5.5*
Malaysia	6	*52*	7	*49*	7	*4.9*	6	*5.6*	6	*6.0*	6	*5.5*
Thailand	4	*55*	8	*47*	8	*4.7*	7	*5.0*	7	*5.3*	7	*4.6*
China	7	*49*	9	*45*	9	*4.5*	8	*4.4*	8	*4.8*	8	*4.3*
Philippines	11	*37*	10	*41*	10	*4.1*	9	*4.6*	9	*5.0*	9	*3.7*
Indonesia	10	*40*	11	*37*	11	*3.7*	10	*3.7*	10	*4.0*	10	*3.2*

Source: Compiled by the author from Credit Lyonnais Securities Asia (2007 & 2010) and Daniri (2005). *Notes*: R= rank; S= corporate governance score quality in percentage.

With regard to the elements of corporate governance quality in the survey, the enforcement aspect was the worst amongst all elements. For example, the 2010 survey showed an enforcement score of 28 percent, the lowest, compared to other countries (see Table 2.13). However, the scores for corporate governance rules and practices and international generally accepted accounting principles (IGAAP), were relatively higher than the scores for other aspects. This means that, in terms of rules or standards, Indonesia is quite good, and that the problem might be a lack of implementation due to the absence of strong law enforcement.

Table 2.13 Market Categories Score (%) in 2010

Market	Total	CG rules & practices	Enforcement	Political & regulatory	IGAAP	CG culture
1.Singapore	67	65	60	69	88	53
2.Hong Kong	65	59	63	67	80	54
3. Japan	57	45	53	62	75	53
=4.Taiwan	55	50	47	56	78	46
=4.Thailand	55	56	42	54	73	49
6. Malaysia	52	49	38	60	80	32
=7. India	49	46	36	54	63	43
=7. China	49	47	36	56	75	30
9. Korea	45	43	28	44	78	33
10. Indonesia	40	39	28	33	67	32
11. Philippines	37	35	15	37	75	25

Source: Credit Lyonnais Securities Asia (2010)

In cooperation with the IMF, the World Bank also concluded that corporate governance implementation in Indonesia lagged behind other countries in Asia and the South Pacific Region (World Bank, 2010). The two organisations assessed the compliance of the Indonesian corporate governance framework against the OECD Principles of Corporate Governance under the Reports on Observance of Standards and Codes (ROSC) Financial Services Assessment Program (World Bank, 2010). Two assessments were done in Indonesia, in 2004 and 2010. The results indicated that, in some respects, the Indonesian corporate governance framework did not differ substantially from the OECD principles. In addition, Indonesia's score in 2010 had improved since the previous ROSC carried out in 2004, and had closed with regional pacesetters – particularly Malaysia, Thailand and India (World Bank, 2010). However, adherence to corporate governance regulations remained a problem, which was consistent with the 2010 CLSA survey.

2.5 CONCLUSION

The development of corporate governance reveals an increasing trend to converge with the Anglo-American model. However, the implementation of this model in Asian countries has been criticised as inappropriate as it is applied in a different institutional and business environment in Asia. It is noted that important business characteristics in the Asian context, such as high concentrated family ownership and collusion between businesses and bureaucrats, may obstruct the implementation of the Anglo-American model. The weak law enforcement regime provides a motivation to examine why the mandatory adoption of the audit committee (an Anglo-American corporate governance mechanism) in Indonesia might not achieve the expected goal. In this regard, the determinants of compliance with corporate governance regulations and the question of whether compliance affects accounting outcomes provide interesting insight into the influence of the institutional setting in “transplanting” systems in emerging economies.

In Chapter 3, the extant literature is divided into two main sections (determinants of compliance with audit committee rules, and the effect of audit committee effectiveness on financial report quality) and reviewed. The literature review covers prior studies in both developed countries and developing countries, particularly Indonesia. The review also identifies research gaps, and is followed by research questions.

CHAPTER 3

A REVIEW AND SYNTHESIS OF THE EXTANT LITERATURE

3.1 INTRODUCTION

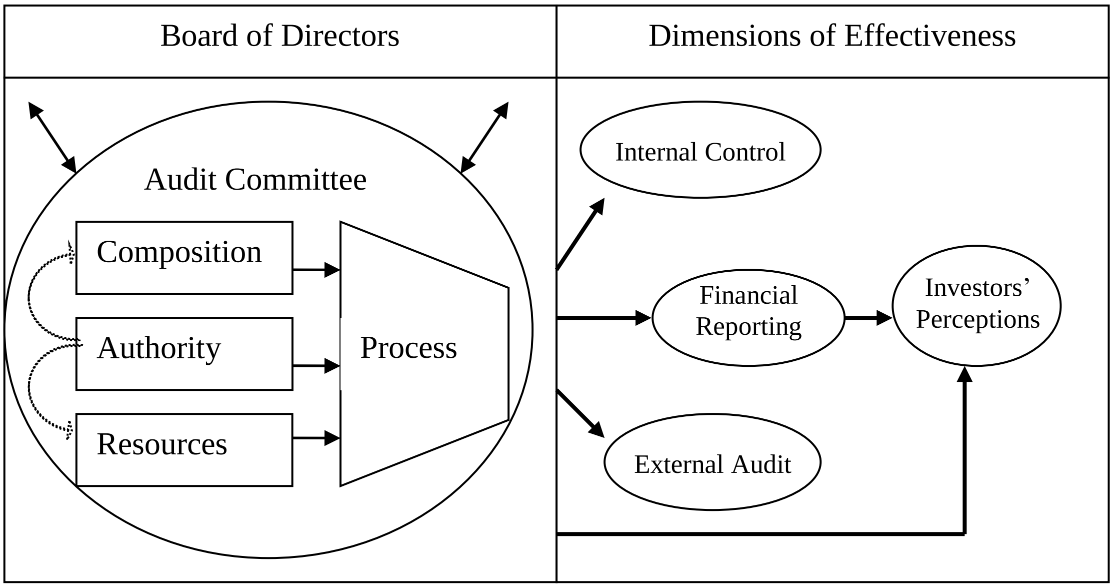
This chapter presents a review of extant literature related to the two main issues of the study: determinants of compliance with audit committee rules, and the effect of audit committee effectiveness on financial reporting quality. The literature review covers prior studies in both developed and developing countries and prior studies in Indonesia in particular. The organisation of the literature review follows the trend in audit committee research. During the phase when the establishment of audit committees was voluntary, researchers examined the determinants of audit committee formation. However, during the phase when audit committees were made mandatory, research shifted from a focus on the level of compliance with audit committee requirements to examine the possible association of audit committee characteristics and certain accounting consequences, such as financial reporting quality. Therefore, the first main section of this review (Section 3.3) discusses prior studies on audit committee compliance, and is divided into two sub-sections. Section 3.3.1 presents a review of prior studies concerning the level of compliance with audit committee rules, while Section 3.3.2 provides a review of prior studies concerning the determinants of compliance with audit committee rules. Meanwhile, the second main section of the literature review (Section 3.4) looks at prior studies on the association between audit committee characteristics and financial reporting quality. This second main section is also divided into two sub-sections: Section 3.4.1 presents prior studies in developed countries, while Section 3.4.2 presents prior studies in developing countries. The two main sections are followed by the identification of several research gaps (Section 3.5), a section highlighting the research questions (Section 3.6), and conclusions (Section 3.7).

3.2 THE COMPLIANCE WITH AUDIT COMMITTEE RULES AS THE FOCUS OF THE STUDY

Among the corporate governance regulations issued by the Indonesian government, this study focuses on audit committee rules. As explained in Section 2.3.2.2, audit committees in Indonesia are relatively new (since 2000). In line with international trends, the Indonesian government, through regulatory bodies in the capital market (i.e., the BAPEPAM-LK and the IDX), has introduced audit committee reform by issuing numerous regulations. Indonesia's adoption of the audit committee (one of the Anglo-American corporate governance mechanisms) was driven by international donors, namely the IMF and the World Bank. However, as discussed in Section 2.3.3, some unique business features in Indonesia might affect the country's implementation of Anglo-American corporate governance mechanisms. Thus, it is important to examine the level of compliance of public listed companies with audit committee rules, as well as the circumstances associated with their compliance. In addition, as noted by several researchers (e.g., Kalbers and Fogarty, 1998; DeZoort, 1997; Haroen et al., 2005), the adoption of the audit committee may be primarily symbolic and more rhetorical than substantive. The effectiveness of audit committees in Indonesian public listed companies raises doubts as to whether the establishment of a committee might be cosmetic, merely to respond to rules issued by the BAPEPAM or the IDX. This sets the motivation for this study to examine audit committee rules and their implementation in the Indonesian setting.

To detect whether the establishment of audit committees is for cosmetic purposes or not, this study examines the association between the compliance of public listed companies with audit committee rules (which indicates audit committee effectiveness) and financial reporting quality. There are several reasons why the study selects financial reporting quality. First, financial reporting quality is selected as, theoretically, the audit committee plays a key role in reducing agency costs by overseeing the financial reporting process (Klein 2002a; Bedard et al., 2004; Archambeault et al., 2008). As noted by Bédard and Gendron (2010), the audit committee can improve financial reporting quality, either indirectly or directly (see Figure 3.1). Direct improvement is accomplished by overseeing the financial reporting process, while indirect improvement is accomplished through the audit committee's oversight of internal control and external auditing. Second, regulators consider strengthened financial reporting quality a desired effect of the audit committee (Bédard and Gendron, 2010). In addition, several literature reviews or meta-analyses done by some scholars (e.g., DeZoort et al., 2002; Cohen et al., 2004; Turley and Zaman, 2004; Pomeroy and Thornton, 2008; He, Labelle, Piot, and Thornton, 2009; Bédard and Gendron, 2010; Carcello et al., 2011a), provide evidence of rapid interest in the association of the audit committee with the quality of financial reporting. Third, most of the audit committees in Indonesia state that their duty is to review financial statements issued by the public listed companies, meaning that they have an oversight responsibility with regard to the financial reporting process. Having set the motivation for the study, the rest of this chapter explicates the extant audit committee literature, and identifies the research gaps justifying this study.

Figure 3.1 Audit Committee and Dimensions of Effectiveness



Source: Bédard and Gendron (2010).

3.3 SYNTHESIS OF PRIOR STUDIES ON THE LEVEL OF COMPLIANCE WITH AUDIT COMMITTEE RULES AND ITS DETERMINANTS

The movement of countries toward the establishment of audit committees has attracted research on compliance issues. The details of such prior studies are summarised in Table A.1 and Table A.2 in Appendix A. Table A.1 presents prior studies that examined compliance with audit committee rules in mandatory regimes, while Table A.2 presents prior studies with respect to non-mandatory regimes. Mandatory regimes are countries, such as the US, that mandate audit committee formation. Non-mandatory regimes are countries that do not mandate the establishment of the audit committee, as well as countries such as France, Germany, the UK, Australia and New Zealand that employ the comply and explain approach to compliance with corporate governance codes.

3.3.1 Prior Studies on the Level of Compliance with Audit Committee Rules

Prior studies on the level of compliance with audit committee rules have been done mostly in regimes such as the US and other countries that have a mandatory requirement for audit committees. In the US, most of the prior studies were done in the period immediately after audit committee reforms such as the BRC (1999) and the SOX (2002). These include Carcello et al., 2002; Rezaee, Olibe, and Minmier, 2003; Carcello, Hollingsworth, and Neal, 2006; Pandit et al., 2005; Pandit, Subrahmanyam, and Conway, 2006; HassabElnaby, Said, and Wolfe, 2007; Lin, Kang, and Roline, 2009. These studies mostly examined the efficacy of the new requirements recommended by the BRC and the SOX. Some of these studies (e.g., Carcello et al., 2002; Carcello et al., 2006; Pandit et al., 2006) solely examined the level of compliance in the post-audit committee reform period. Meanwhile, other studies (e.g., Keinath and Walo, 2004; Pandit et al., 2005; Smith, 2006) compared the level of compliance in the pre-reform and post-reform periods. These prior studies mostly used descriptive statistics in their analysis. In general, the results indicated that the level of compliance of public listed companies in the US with new audit committee requirements was high. In other words, there was no variation across companies in their compliance with the mandatory audit committee requirement (see Carcello et al., 2002; Pandit et al., 2005). The mandatory requirement for the establishment of an audit committee by all types of public listed companies (one size fits all), supported by strong law enforcement, contributed to the high compliance.

As in the US, prior studies in developing countries with mandatory regimes, such as India, Indonesia and Malaysia, were also done to ascertain the level of compliance of public listed companies with the new audit committee requirements issued by the stock exchange. As discussed in Section 2.2.4, some stock exchanges around the world have adopted mandatory audit committee requirements. The audit committee requirements attracted some scholars in developing countries (e.g., Sori, Mohamad, and Hamid, 2001; Utama and Leonardo, 2004; Haron et al., 2005; Puri, Trehan, and Kakkar, 2010) to examine the compliance of public listed companies. For example, Sori et al. (2001) and Haron et al. (2005) examined the level of compliance of public listed companies in Malaysia with the Kuala Lumpur Stock Exchange rules on audit committees. In Indonesia, Utama and Leonardo (2004) examined the adherence of public listed companies in Indonesia to IDX rules. Meanwhile, other scholars (i.e., Al-Mudhaki and Joshi, 2004; Puri et al., 2010; Chatterjee, 2011) investigated the level of compliance of Indian public listed companies with audit committee requirements. In general, these studies found a high level of compliance among public listed companies with audit committee formation requirements, such as a minimum number of members, member and chairperson independence, and the financial expertise of members. The effectiveness of the audit committees, however, was seriously questioned (see Sori et al., 2001; Al-Mudhaki and Joshi, 2004; Utama and Leonardo, 2004; Sori, Deris, and Saad, 2005; Sori, Mohamad, Saad, 2007; Chatterjee, 2011). The findings suggested that audit committees in developing countries were perhaps just complying in form, and not in substance.

In non-mandatory regimes, prior studies on the level of compliance with audit committee rules are limited (e.g., Al–Twaijry, Brierley, and Gwilliam, 2002; Joshi and Wakil, 2004). Al–Twaijry et al. **(**2002) examined the level of compliance of public listed companies in Saudi Arabia with audit committee regulations recommended by the Saudi government. Likewise, Joshi and Wakil (2004) examined the level of compliance of public listed companies in Bahrain with the BRC recommendations. In both countries, most public listed companies formed audit committees as recommended by the regulator. Their compliance, however, seemed to be just to present a favourable appearance. This finding is consistent with that of other studies in developing countries. Meanwhile, other researchers in non-mandatory regimes, such as the UK, New Zealand

and Australia, were more interested in studying the determinants or incentives for audit committee formation rather than the compliance level. The absence of mandatory requirements for the establishment of audit committees in these countries provided an opportunity for researchers to focus on examining factors related to the formation of the audit committee by some companies.

3.3.2 Determinants of Compliance with Audit Committee Rules

Studies on the determinants of compliance with audit committee rules have been widely conducted by scholars in non-mandatory regimes rather than in mandatory regimes (e.g., Pincus, Rusbarsky, and Wong, 1989; Bradbury, 1990; Collier, 1993; Menon and Williams, 1994; Willekens, Bauwhede, and Gaeremynck, 2004; Chau and Leung, 2006; Rainsbury et al., 2008; Chen, Kilgore, and Radich, 2009; Sharma, Naiker, and Lee, 2009). Most of these studies examined the incentives that drove companies to voluntarily form audit committees. These prior studies largely relied on agency theory that argued that audit committees were formed to reduce agency costs (Turley and Zaman, 2004; Piot, 2004). Thus, these prior studies mostly employed factors related to agency costs (i.e., agency cost of equity, agency cost of debt), and board characteristics. The agency cost of equity included ownership percentage by directors (e.g., Pincus et al., 1989; Bradbury, 1990; Collier, 1993), block holders (e.g., Utama and Leonardo, 2006; Rainsbury et al., 2008), and the percentage of shares owned by insiders (e.g., Piot, 2004). Meanwhile, agency cost of debt included leverage represented by ratios such as the debt to asset ratio (e.g., Menon and Williams, 1994), long-term debt to size ratio (e.g., Pincus et al., 1989) and the total liabilities to size ratio (e.g., Bradbury, 1990). In terms of board characteristics, the most popular attribute was board independence (e.g., Pincus et al., 1989; Collier, 1993; Willekens et al., 2004; Rainsbury et al., 2008). As suggested by agency theory, a higher proportion of independent directors will be more effective in monitoring a board of directors. This was confirmed by corporate governance reforms, such as the SOX (2002), that sought to strengthen the role of the board of directors as representatives of the shareholders by increasing the independence of directors (Finegold, Benson, Hecht, 2007). In addition to the board characteristics mentioned, other board characteristics were used in prior studies. These included board size (e.g., Carson, 2002; Klein, 2002a; Piot, 2004; Willekens et al., 2004), director ownership (e.g., Pincus et al., 1989; Bradbury, 1990; Rainsbury et al., 2008), CEO dominance (e.g., Collier, 1993; Chen et al., 2009) and director financial expertise (e.g., Davidson III, Xie, and Xu, 2004; Baxter, 2010). It should be noted that the characteristic of politically connected directors/commissioners, which is a common feature in Indonesia, has not been examined in the extant literature.

Besides the determinants of audit committee formation, some studies in non-mandatory regimes have examined the determinants of other aspects of the audit committee, such as audit committee meeting frequency (Sharma et al., 2009; Greco, 2011) and audit committee alignment caused by the 8th European Directive (Braiotta and Zhou, 2008). These studies also employed factors very similar to those used in the study of the determinants of audit committee formation, such as board independence, board size, firm size and leverage.

In mandatory regimes, a few prior studies in both developed and developing countries have examined the determinants of compliance with audit committee rules (i.e., Klein, 2002b; Haron et al., 2005; Braiotta and Zhou, 2006). In the US, Klein (2002b) investigated the economic determinants of the independence of the audit committee as mandated by the NYSE and the NASDAQ listing requirements. Other studies in the US (i.e., Braiotta, 2004; Braiotta and Zhou, 2006) have examined the effects of audit committee reforms, such as the BRC and the SOX, on audit committee alignment. Meanwhile, other scholars in the US and Canada (i.e., Beasley and Salterio, 2001; Carcello et al., 2002) were more interested in examining the determinants of the voluntary aspects of the audit committee that exceed the minimum mandated requirements. For example, Carcello et al. (2002) investigated the voluntary disclosures of the audit committee in a mandatory setting in the US. While scholars in the US have not been interested in examining the determinants of audit committee compliance given that the compliance level of US public listed companies does not vary across companies (Carcello et al., 2002), such studies have been limited in developing countries, where law enforcement is weaker than in the US. For example, Haron et al. (2005) examined whether financial distress affected the compliance of listed companies with the audit committee rules of the Kuala Lumpur Stock Exchange.

A few prior studies on audit committee rule compliance used an index consisting of a set of audit committee requirements (e.g., Braiotta, 2004; Haron et al., 2005; Utama and Leonardo, 2006; Rainsbury et al., 2008; Baxter, 2010). Except for Haron et al. (2005) and Utama and Leonardo (2006), most of these studies developed indexes that only emphasised the membership aspect of audit committees. For example, Braiotta (2004) developed an audit committee index consisting of audit committee membership as a benchmark for examining the compliance of non-US registrants with audit committee requirements in the US. Similarly, Rainsbury et al. (2008) developed an audit committee index that consisted of audit committee best practice membership guidelines in New Zealand. The Rainsbury approach was then used by Baxter (2010) to measure the audit quality of public listed companies on the Australian Stock Exchange. Meanwhile, a more comprehensive index was used by Haron et al. (2005) and Utama and Leonardo (2006). Haron et al. (2005) used an audit committee index extracted from the audit committee rules of the Kuala Lumpur Stock Exchange. This index consisted of membership, job duties and disclosure. In another study, Utama and Leonardo (2006) developed two indexes (an audit membership index and job duties index) to examine the effectiveness of the audit committees of public listed companies on the Jakarta Stock Exchange. A detailed comparison of the use of audit committee indexes by researchers is shown in Table 3.1.

In terms of results, prior studies on the determinants of compliance with audit committee rules, both in mandatory regimes and non-mandatory regimes, have been inconclusive. For example, in the US, Braiotta and Zhou (2006) found that company size and leverage had a positive association with compliance with audit committee rules. In contrast, Klein (2002b) revealed that company size and leverage did not have any significant association with the independence of the audit committee. In non-mandatory regimes, Pincus et al. (1989) and Turpin and DeZoort (1997) found that company size had a positive significant association with audit committee formation. However, Bradbury (1990) and Menon and Williams (1994) found no significant association between company size and audit committee formation. In terms of the agency cost of debt, Collier (1993) and Adams (1997) found that leverage was associated with audit committee formation. In contrast, Pincus et al. (1989) and Turpin and DeZoort (1998) revealed no significant association. Regarding board characteristics, Rainsbury et al. (2008) and Baxter (2010) found that the proportion of independent directors on board of directors was associated with audit committee formation, whereas Piot (2004) did not find a significant association between the proportion of independent directors and audit committee formation in France. The inconsistent findings indicate that the dominance of the agency theory may have constrained the researchers to some extent from considering other factors, such as the institutional and organisational context in which the audit committees operated (Turley and Zaman, 2004).

The predominance of the Anglo-American agency theory may have led prior studies to ignore factors that are relevant in developing countries, such as family owners as controlling shareholders and politically connected directors. The agency problem in a developing country is different from that in a developed one. The agency problem in a developed country arises due to a conflict between the managers and shareholders (agency problem type 1), whereas the agency problem in a developing country is an agency problem type 2 and refers to the conflict between controlling shareholders and minority shareholders (Young et al., 2008; Jaggi et al., 2009; Chen et al., 2011). Consequently, the factors associated with the agency problem type 1 are different from those of the agency problem type 2. The agency problem type 2 has characteristics such as high concentrated ownership, weak legal protection of minority shareholders, an inactive market for corporate control, and ineffective boards of directors (Young et al., 2008).

3.4 SYNTHESIS OF PRIOR STUDIES ON AUDIT COMMITTEES AND FINANCIAL REPORTING QUALITY

A summary of prior studies that examined the association of audit committee attributes and financial reporting quality is shown in Table A.3 and Table A.4 in Appendix A. Table A.3 presents prior studies in developed countries, while Table A.4 presents prior studies in developing countries. These tables provide a broad picture of the research trend in both developed and developing countries, with an emphasis on audit committee attributes and some proxies of financial reporting quality used by prior studies. Therefore, these tables only present the audit committee attributes, the proxy of financial reporting quality, and the audit committee significant variable.

3.4.1 Prior Studies in Developed Countries

In developed countries, most prior studies on the association of audit committee attributes and financial reporting quality were completed by researchers during the mandatory period of audit committee formation, rather than during the voluntary period. In the period of voluntary audit committee formation, few studies explored the association between audit committee attributes and financial reporting quality. Except for Beasley (1996) and Dechow, Sloan, and Sweeney (1996), most of the prior studies in the voluntary era were done by researchers outside the US, in the UK, Australia, France, Spain and New Zealand (e.g., Koh, Laplante, and Tong, 2007; Osma and Noguer, 2007; Piot and Janin, 2007; Baxter and Cotter, 2009; Rainsbury, Bradbury, and Cahan, 2009; Song and Windram, 2009). Since the mandatory implementation of the audit committee occurred later in Europe, the UK, New Zealand and Australia than in the US, some recent publications by researchers in these countries still focus on the effect of the voluntary establishment of the audit committee on financial reporting quality. On the other hand, studies concerning the effect of voluntary audit committee formation on financial reporting quality were done by US researchers in the 1990s, when the audit committee was not yet mandatory there (see Table A.3 in Appendix A). Since the year 2000, and particularly after the issuance of the BRC recommendations, there has been a growing volume of studies on the association between audit committee characteristics recommended by audit committee reforms, and financial reporting quality in the US (e.g., Anderson, Deli, and Gillan, 2003; Xie, Davidson III, and DaDalt, 2003; Bédard et al., 2004; Li, Kao, and Bandyopadhyay, 2010; Dhaliwal, Naiker, and Navissi, 2010). These studies attempted to examine the efficacy of the recommendations of the audit committee reforms (i.e., BRC and SOX) on increasing audit committee effectiveness by using several proxies for financial reporting quality, such as earnings management, restatements and fraudulent financial statements. For example, Abbott, Park, and Parker (2000) examined whether two key audit committee attributes mandated by the BRC, namely, independence and activity, reduced the likelihood of fraudulent or aggressive financial statement actions. In a further study, Abbott, Parker, and Peter (2004) examined whether audit committee attributes recommended by the BRC, such as independence, size, financial expertise and the number of meetings, were associated with financial misstatements.

In line with strengthening the functions of audit committees, the number of attributes examined by prior studies has increased. In the voluntary period, the dominant audit committee attribute was the presence of an audit committee (e.g., Beasley, 1996; Dechow et al., 1996; Peasnell, Pope, and Young, 2005). After the audit committee was made mandatory and its role was strengthened, researchers examined additional audit committee attributes, such as financial expertise, frequency and number of meetings, and committee size. More recently, prior studies have also focused on audit committee industry expertise (i.e., Cohen, Hoitash, Krishnamoorty, and Wright, 2010; Cohen et al., 2011). They examined whether audit committee industry expertise improved audit committee effectiveness in overseeing financial reporting. In terms of findings, the results of prior studies are inconclusive. For example, some studies (e.g., Abbott et al., 2004; Archambeault et al., 2008) revealed that the proportion of independent directors on the audit committee was negatively and significantly associated with restatements. However, some studies (e.g., Lin, Li, and Yang, 2006; Romanus, Maher, and Fleming, 2008) did not find such significant findings. The inconclusive results found in this literature review are consistent with the findings of prior literature reviews (e.g., Turley and Zaman, 2004; Pomeroy and Thornton, 2008; Bédard and Gendron, 2010).

As noted by Turley and Zaman (2004), audit committee characteristics alone, which are drawn from the agency theory framework, are unlikely to improve financial reporting quality. Institutional and organisational contexts might influence the effectiveness of the audit committee since the committee does not operate in a vacuum. The researcher needs to consider the interaction of the audit committee and the company's other internal structures. In addition, they suggested that the personality of committee members, particularly the audit committee chair, is an important factor. In line with these suggestions, some recent studies have examined the interaction of the audit committee with other governance structures in the company, and have considered the personality of audit committee members as well. For example, Cohen et al. (2010) examined the association between audit committee member industry expertise and auditor expertise and restatements in the US. Subsequently, Cohen et al. (2011) investigated whether audit committee member industry expertise, combined with audit committee member financial expertise, contributed to a lower likelihood of restatements. Meanwhile, Dhaliwal et al. (2010) examined whether the interaction of the two different types of audit committee expertise (i.e., accounting and finance expertise) with some audit committee characteristics (e.g., independence, multiple directorships, tenure) was associated with earnings quality. In terms of CEO characteristics, Carcello et al. (2011b) investigated whether the chief executive officer's involvement in selecting board members reduced audit committee effectiveness. In another study, Lisic et al. (2011) investigated whether CEO power, which consists of a combination of several CEO attributes, moderated the association between audit committee financial expertise and restatements. In terms of the personality of audit committee members, some studies (e.g., Gul, Srinidhi, and Tsui, 2007; Sun, Liu, and Lan, 2011; Thiruvadi and Huang, 2011) examined the presence of female directors on audit committees.

Most of the prior studies employed single audit committee characteristics (e.g., the presence of an audit committee, independence, members with financial expertise). Although many aspects of audit committees were examined, prior studies examined these aspects separately. Only a few studies employed an audit committee index to measure the effectiveness of audit committees (e.g., Menon and Williams, 1994; Abbott et al., 2000; Rainsbury et al., 2009; Smaili and Labelle, 2009; Li et al., 2010; Sharma, Sharma, and Ananthanarayanan, 2011). Furthermore, the indexes of these studies focused merely on membership requirements. Menon and Williams (1994), who were followed by Abbott et al. (2000), used an index consisting of two elements: audit committee independence and the number of committee meetings. Similarly, other prior studies (e.g., Rainsbury et al., 2009; Smaili and Labelle, 2009; Li et al., 2010) developed an index consisting of two membership requirements, namely, audit committee member independence and the financial expertise of members.

The index of Rainsbury et al. (2009) is considerably similar to the index in their prior study on compliance of public listed companies with audit committee best practice membership guidelines (i.e., Rainsbury et al., 2008). Meanwhile, Sharma et al. (2011) used an index that consisted of three membership requirements: committee member independence, financial expertise of members and independent committee chairman. The details of each index are shown in Table 3.1.

In terms of a financial reporting quality proxy, studies in developed countries have used various proxies. The most popular proxy for financial reporting quality has been earnings management (see Xie et al., 2003; Bedard et al., 2004; Yang and Krishnan, 2005). The second most popular proxy has been restatements that have been examined by scholars in the US (e.g., Abbott et al., 2004; Baber, Kang, and Liang, 2005; Arthaud-

Day, Certo, and Dalton, 2006; Archambeault et al., 2008; Romanus et al., 2008; Marciukaityte, Szewczyk, and Varma, 2009). Besides these proxies, some scholars have used other proxies of financial reporting quality, such as fraudulent financial reporting (e.g., Beasley, Carcello, Hermanson, and Lapides, 2000; Farber, 2005; Owens-Jackson, Robinson, and Shelton, 2009), aggressive accounting choices (e.g., Rainsbury et al., 2009), perceived financial reporting quality (e.g., Felo, Krishnamurthy, and Solieeri, 2003), conservatism (e.g., Krishnan and Visvanathan, 2008) and earnings informativeness (e.g., Petra, 2007).

3.4.2 Prior Studies in Developing Countries

Like the developed countries, most prior studies on the association of audit committee attributes and financial reporting quality in developing countries were conducted in the mandatory period rather than in the voluntary period. As depicted in Table A.4, only a few prior studies on the association between audit committee attributes and financial reporting quality were conducted in the voluntary period (i.e., Chen, Elder, and Hsieh, 2007; Al-Abbas, 2009; Lo, Wong, and Firth, 2010; Zhizhong et al., 2011). These researchers come from developing countries where mandatory audit committee formation was recently introduced. These include Taiwan (2006), China (2009) and Saudi Arabia (2009). On the other hand, researchers in other developing countries (i.e., Hong Kong, Indonesia, Malaysia, and Thailand), where the implementation of mandatory audit committee formation occurred much earlier, focused on the efficacy of the attributes of the audit committee required by the regulator in increasing its effectiveness (see Table A.4).

In terms of audit committee attributes, prior studies in developing countries differed slightly from those in developed countries. As can be seen in Table A.4, the most prominent audit committee attribute in developing countries during the voluntary period was the presence of an audit committee; this is similar to prior studies in developed countries. However, several recent studies conducted in the mandatory period of the audit committee – particularly in Indonesia – still use the presence of the audit committee as the main variable of interest (e.g., Siallagan and Machfoedz, 2006; Siregar and Utama, 2008; Murhadi, 2010; Siagian and Tresnaningsih, 2011). Nevertheless, some prior studies in developing countries employed multiple attributes of audit committees. Some prior studies examined the audit committee attributes separately (e.g., Saleh, Iskandar, and Rahmat, 2007; Ismail, Iskandar, and Rahmat, 2008; Ibrahim, Raman, and Saidin, 2009; Lin, Hutchinson, and Percy, 2009; Wardhani and Joseph, 2010). In recent publications, some prior studies in developing countries employed an audit committee index that consisted of several audit committee attributes. For example, Akarak and Ussahawanitchakit (2010) employed an audit committee index that consisted of the job functions of audit committees in Thailand. In Indonesia, some prior studies (e.g., Utama and Leonardo, 2006; Hermawan, 2009; Ika and Ghazali, 2012; Sarumaha and Hermawan, 2013) employed audit committee indexes as proxies for audit committee effectiveness. Sarumaha and Hermawan (2013) employed an audit committee effectiveness index developed by Hermawan (2009). This recent development indicates that audit committee research in developing countries tends to follow the audit committee research trend in developed countries.

In terms of the interaction variable, a few recent prior studies in developing countries have examined the interaction of the audit committee with other corporate governance mechanisms. For example, Ismail et al. (2008) examined the association of audit committee attributes with external auditors in the Malaysian environment. In Indonesia, Jaswadi et al. (2012) examined the interaction between the audit committee and the board of directors, board of commissioners, and auditor. It can be concluded that the interaction between the audit committee and family ownership has not been examined by prior studies in developing countries.

The proxies for financial reporting quality used by prior studies in developing countries also differ slightly from those in developed countries. From the view of the type of financial reporting quality proxy used, there is no difference between studies in developing countries and developed countries. As depicted in Table A.4., the studies in developing countries employed proxies such as earnings management, restatements and conservatism for financial reporting quality. However, in terms of the popularity of proxies used, there is a slight difference: the most popular financial reporting quality proxy used in developing countries was earnings management, which is similar to prior studies in developed countries. The difference is in the second rank: although restatements were ranked as the second most popular proxy in studies in the developed countries, they were not widely used by prior studies in developing countries. This proxy was only used by two prior studies (i.e., Abdullah et al., 2010; Zhizhong et al., 2011), similar to the proxy of conservatism (i.e., Susiana and Herawaty, 2007; Wardhani, 2008). Meanwhile, other proxies were used in single studies. These included recipients of financial reporting awards (Ismail et al., 2008), accuracy of unaudited year-end quarterly accounts (Ibrahim et al., 2009), financial statement efficiency (Akarak and Ussahawanitchakit, 2010) and manipulation of transfer prices in related-party sales transactions (Lo et al., 2010).

Similar to the studies in developed countries, the results of prior studies on the association of audit committee attributes and financial reporting quality in developing countries were also inconclusive. For example, Jaggi and Leung (2007) revealed that the presence of audit committees was negatively and significantly associated with earnings management in Hong Kong, whereas Siregar and Utama (2008) found an insignificant association in Indonesia. In another conflicting finding, Saleh et al. (2007) found that the proportion of independent directors on audit committees was negatively and significantly associated with annual earnings management in Malaysia, whereas a study done by Rahman and Ali (2006) revealed insignificant findings.

Table 3.1 Audit Committee Indexes Used in Prior Studies

Element of index	Studies on compliance with audit committee rules					Studies on audit committee effectiveness and financial reporting quality									
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Membership															
Independent member	✓	✓	✓	✓	✓	✓	✓	✓	✓	-	✓	✓	✓	✓	-
Financial expertise of member	✓	✓	✓	✓	✓	-	-	✓	✓	-	✓	✓	✓	✓	✓
Chairman is an independent director	-	✓	-	-	-	-	-	-	-	-	-	✓	-	-	-
Consists of at least three members	-	✓	-	-	-	-	-	-	-	-	-	-	✓	✓	✓
Age of member															✓
Job Duties															
AC Charter	-	✓	-	-	-	-	-	-	-	-	-	-		✓	-
Review financial report	-	-	✓	-	-	-	-	-	-	✓	-	-		✓	✓
Review internal auditor work	-	-	✓	-	-	-	-	-	-	✓	-	-		✓	✓
Review compliance with regulations	-	-	✓	-	-	-	-	-	-	✓	-	-		✓	✓
Review risk management	-	-	-	-	-	-	-	-	-	✓	-	-		✓	-
Interaction with external auditor	-	-	✓	-	-	-	-	-	-	✓	-	-		✓	✓
Number of meetings	-	-	-	-	-	✓	✓	-	-	-	-	-	✓	✓	✓
Disclosure															
AC activities disclosure	-	✓	-	-	-	-	-	-	-	-	-	-		-	✓
AC meetings disclosure	-	✓	-	-	-	-	-	-	-	-	-	-		-	✓
Voluntary disclosure	-	-	-	-	-	-	-	-	-	-	-	-		✓	-

Source: Compiled by the author.

Notes: 1=Braiotta (2004); 2=Haroen et al. (2005); 3=Utama & Leonardo (2006); 4=Rainsbury et al. (2008); 5=Baxter (2010); 6=Menon & Williams (1994); 7=Abbott et al. (2000); 8=Rainsbury et al. (2009); 9= Smaili & Labelle (2009); 10=Akarak & Ussahawawanitchakit (2010); 11=Li et al. (2010); 12=Sharma et al. (2011); 13=Zaman et al. (2011); 14=Ika &Ghazali (2012); 15=Sarumaha and Hermawan (2013).

3.5 GAPS IN THE EXTANT LITERATURE

Based on the discussions in above sections, the following gaps in the extant literature have been identified.

3.5.1 Lack of Prior Studies on the Determinants of Compliance with Audit Committee Rules in Mandatory Regimes

As discussed in Section 3.3.2, most prior studies of the determinants of compliance with audit committee rules have been done by researchers in non-mandatory regimes, such as the UK, Australia and New Zealand, whereas prior studies in mandatory regimes, such as the US, are rare. It seems that scholars in mandatory regimes, such as the US, are not interested in examining the determinants of compliance as law enforcement has resulted in a high level of compliance. As evidenced, some scholars (i.e., Carcello et al., 2002; Pandit et al., 2005) revealed that the compliance of public listed companies with the mandatory audit committee requirement did not vary across companies in the US. As a result, researchers in the US have been more interested in examining voluntary audit committee attributes rather than mandatory requirements. Notwithstanding, studies on the determinants of compliance in mandatory regimes might be important for developing countries such as Indonesia, which is known to have good regulations, but where law enforcement is weak (Patrick, 2001; Lindsey, 2004; Dercon, 2007). Thus, the audit committee rules issued by the BAPEPAM do not guarantee a high level of compliance by public listed companies. Furthermore, the audit committee is an Anglo-American corporate governance mechanism that might not be appropriate for the Indonesian environment, as Indonesia has different characteristics than Anglo-American countries. These characteristics include high concentrated ownership in the hands of families, collusion between businesses and politicians and weak legal enforcement.

3.5.2 Lack of Longitudinal Studies on the Determinants of Compliance with Audit Committee Rules

From Table A.1 and Table A.2, studies using panel data for examining compliance with audit committee rules are limited. Most prior studies on audit committee compliance and its determinants employed cross sectional data. Even though some studies collected data for several periods, these studies used pooled regression in the data analysis (e.g., Willekens et al., 2004; Braiotta and Zhou, 2006). Meanwhile, as suggested by Turley and Zaman (2007), a longitudinal study, which focuses on the organisational and institutional context of audit committee operations, would enable examination of significant changes in the regulatory environment due to current structures and processes. In addition, panel data could be very useful for evaluating the impact of certain events or policies (Wooldridge, 2009).

3.5.3 Limited Comprehensive Studies on the Determinants of Compliance and Their Effect on Financial Reporting Quality

Studies that simultaneously examined the level of compliance with audit committee rules and its effect on financial reporting quality are limited. As depicted in Appendix A, most prior studies examined either the determinants of compliance, or the effect of compliance on financial reporting quality. Only Braiotta and Zhou (2008) simultaneously examined the determinants of compliance with audit committee rules, and the impact of compliance on financial reporting quality. In the first stage of their study, they examined the determinants of the compliance of European companies listed in the US with audit committee rules. In the second stage, they examined the impact of the compliance on financial reporting quality by using earnings management as a proxy. Meanwhile, this type of study is important in Indonesia. As discussed in Chapter 2, given Indonesia's weak legal enforcement, it would be interesting to know what factors are associated with the compliance of public listed companies with audit committee rules. In addition, as noted by several researchers (e.g., Kalbers and Fogarty, 1998; DeZoort, 1997; Haron et al., 2005), the adoption of an audit committee may be primarily symbolic and more rhetorical than substantive. The establishment of the audit committee in the early periods tended to show a passive cosmetic compliance (Spira, 1988). Thus, it is possible that the compliance of Indonesian public listed companies with audit committee rules in the earlier periods of implementation, as documented in formal company documents such as the annual reports, does not reflect real practice or is just symbolic. By simultaneously examining the determinants of compliance and the effect of the compliance on financial reporting quality, one is able to provide a more holistic picture of the implementation of audit committee rules in Indonesia.

3.5.4 The Dominance of the Agency Theory Ignores the Institutional Context

Most prior studies, with respect to both the determinants of compliance and the effect of the compliance on financial reporting, derived their variables based on the Anglo-American agency problem (agency problem type 1), such as agency cost of equity, agency cost of debt and board independence. Given that the agency problem in a developing country is different from that in a developed country, the application of the variables drawn from the Anglo-American corporate governance studies to studies in developing countries might not be appropriate (Young et al., 2008). As a result, other relevant institutional factors in developing countries, such as family owners as controlling shareholders, foreign ownership, and collusion between businesses and politicians have been ignored by most prior studies. These factors are explicated further next.

3.5.4.1 Family Owners as Controlling Shareholders

In the case of prior studies examining the association between audit committee attributes and financial reporting quality, studies related to compliance with audit committee rules are limited. Amongst the studies that examined compliance with corporate governance codes, very few examined the association of family control with the level of compliance. In terms of the determinants of compliance, Chau and Leung (2006) examined the effect of family ownership on audit committee formation in Hong Kong. They found that different levels of family ownership have different effects on audit committee formation. Meanwhile, Kabbach De Castro and Crespi Cladera (2011) revealed that firms with greater levels of family shareholding had lower compliance with the corporate governance code than firms with lower levels of family shareholding. In terms of the effect of family control on financial reporting quality, only a limited number of studies have explored the association between family ownership and some proxies of financial reporting quality, such as earnings management (e.g., Wang, 2006; Jaggi and Leung, 2007; Jaggi et al., 2009; Jiraporn and Dadalt, 2009), earnings manipulation sanctioned by SEC (e.g., Dechow et al., 1996) and restatements (e.g., Abbott et al., 2004; Agrawal and Chadha, 2005; Donoher, 2009).

There are three approaches to indicate the influence of family. The first approach uses the founder-CEO as a proxy for family control. Some scholars (e.g., Dechow et al., 1996; Abbott et al., 2004) argue that the CEO position held by the family founder might lead to less accountability to the board because the founder has large informational advantages about the company's control system. In addition, the founder might not appreciate the value of monitoring and may be unwilling to expend significant efforts on this function (Abbott et al., 2004). The second approach uses the presence of family members on boards as a proxy; this was originally used by Anderson and Reeb (2003).

This approach does not focus solely on the chairman of the board or the CEO and scholars usually look at the presence of one or more family members on the boards to determine whether or not family influence exists. In the third approach, Anderson and Reeb (2003) suggested an alternative measurement using the total percentage of shares owned by the family. This measurement approach has been used by some prior studies in earnings management (e.g., Wang, 2006; Jaggi and Leung, 2007; Jiraporn and Dadalt, 2009).

In terms of results, the examination of the effect of family control on financial reporting quality has yielded inconclusive results. For example, Dechow et al. (1996) found that the presence of the founder-CEO was positively associated with earnings manipulation sanctioned by the SEC. Similarly, Agrawal and Chadha (2005) and Donoher (2009) revealed that the founder-CEO was positively associated with restatements. In contrast, Abbott et al. (2004) found an insignificant association between the founder-CEO and restatements.

Therefore, it can be concluded that the effect of family control on compliance with audit committee rules, or even the corporate governance code, has not been widely examined by prior studies. Thus, there are no prior studies that examine the effect of different types of family control (i.e., family is the controlling shareholder with family member(s) on the board of directors versus family is the sole controlling shareholder with no family member(s) on the board). In addition, the inconclusive findings of previous studies concerning the association between family control and financial reporting quality provide an interesting subject for further study.

3.5.4.2. Foreign Institutional Investors

Foreign institutional investors are widely argued to be an alternative corporate governance mechanism in emerging countries (Andersen et al., 2001; Ananchotikul, 2006). The participation of foreign institutional investors might lead to changes in management and corporate governance as they impose their own company policies, internal reporting systems, and information disclosure principles on acquired firms in developing countries (OECD, 2002). Firms with foreign participation are seen as agents of transformation in diffusing specific assets, knowledge and culture, including governance practices, in developing countries (Chevalier, Prasetyantoko, and Rokhim, 2006). As foreign institutional investors come from outside the domestic social network from which the institutional norms of behaviour are generated, they are more likely to push for transparency and push governments in emerging economies to improve minority shareholder protection (Peng, 2003).

The association between foreign institutional investors and corporate governance in emerging economies has been attracting research attention since the late 1990s. This is in line with the wave of corporate governance reforms in emerging economies that provide a favourable environment for international investment (such as better minority shareholder protection). In general, prior studies on the role of foreign institutional investors with respect to corporate governance can be grouped according to two main research themes. The first theme covers studies that examined the determinants of decisions by foreign institutional investors to invest in emerging economies (e.g., Andersen et al., 2001; Chipalkatti, Le, and Rishi, 2007; Dam, Scholtens, and Sterken, 2007; Mangena and Tauringana, 2007; Chien, 2008; Bokpin and Isshaq, 2009; Leuz, Lins, and Warnock, 2010; Kim, Eppler-Kim, Kim, and Byun, 2010). The second theme includes studies that examined the impact of foreign institutional investor ownership on firm performance. (e.g., Sarkar and Sarkar, 2000; Douma, George, and Kabir, 2006; Bokpin and Isshaq, 2009; Omran, 2009; Gürbüz, Aybars, and Kutlu, 2010). Meanwhile, other studies attempted to examine the effect of foreign institutional investors on other issues, such as the monitoring role (i.e., Khanna and Palepu, 1999), capital structure choice (i.e., Chevalier et al., 2006; Gurunlu and Gursoy, 2010), corporate governance quality (i.e., Evana, Andriyanto, and Marbun, 2007), the relationship between auditor opinion and probability of default (i.e., Ting, Yen and Chiu, 2008), the relationship between investment in research & development and product diversification, and executive compensation (i.e., Yoshikawa, Rasheed, and Del Brio, 2010), and dividend policy (i.e., Jeon, Lee, and Moffett, 2010; Kim, Sul, and Kang, 2010). In terms of compliance studies, only two prior studies examined the association between foreign institutional ownership and compliance with corporate governance codes (i.e., Ananchotikul, 2006; Bianchi et al., 2010). Only one study, by Ananchotikul (2006), examined the role of foreign investors in emerging economies (i.e., Thailand), whereas Bianchi et al. (2010) examined the role of foreign institutional ownership on corporate governance practice in Italy. In terms of compliance with audit committee rules, no prior studies have examined the association between foreign institutional investors and compliance with audit committee rules.

In addition, the studies that examined the role of foreign institutional investors have shown inconclusive findings. Most prior studies revealed that foreign institutional investors had a positive impact on corporate governance in emerging countries. For example, Khanna and Palepu (1999) found that foreign institutional investors were better than domestic institutional investors in the monitoring function in India. Likewise, Chevalier et al. (2006) found that Indonesian firms controlled by foreign investors were essentially more prudent in their financing policies than firms controlled by domestic investors. In contrast, Ananchotikul (2006) revealed that foreign institutional investors (not industrial joint ventures) had a significant effect on corporate governance improvement, whereas foreign industrial owners (joint venture firms) with large shareholdings had a negative significant effect on corporate governance practice. In another study, Evana et al. (2007) found that there was no significant association between foreign ownership and the quality of corporate governance in Indonesia's public listed companies.

In terms of measuring the foreign institutional investor variable, all prior studies used the percentage of common shares held by foreign investors, which might not be appropriate for the Indonesian environment. As noted by some researchers (i.e., Claessens, Djankov, Lang, 2000; Fan and Wong, 2002), East Asian firms, including those in Indonesia, are generally associated with a complicated pyramidal and cross-holding ownership structure. Thus, it is possible that Indonesians might be the ultimate owners of foreign institutional investors (see Section 2.3.3). The aforementioned method of defining foreign ownership might have been responsible for the conflicting findings of prior studies in Indonesia. Clearly, it is vital to trace the ultimate ownership of foreign investors to ensure that only genuine foreign investors are included.

3.5.4.3 Politically Connected Independent Directors/Commissioners

Prior studies on the determinants of compliance with audit committee rules by public listed companies did not examine politically connected directors/commissioners as a variable of interest. Most prior studies on the determinants of compliance employed board characteristics such as board independence, CEO dominance (i.e., CEO duality) and board member financial expertise, based on agency theory. Therefore, the presence of politically connected directors/commissioners, which is not based on agency theory, received little attention in prior studies. A company's selection of a politician as an independent director/commissioner might be intended to facilitate access to external networks, which is in line with the resource dependence theory. However, the independent director/commissioner has an oversight duty and his role has been strengthened. Thus, it would be interesting to know what role (if any) this type of independent director/commissioner plays in enhancing compliance with audit committee rules.

3.5.5 Few Prior Studies Used an Audit Committee Index

A few prior studies on both the determinants of compliance of public listed companies with audit committee rules, and the association between audit committee attributes and financial reporting quality, employed an index consisting of several audit committee attributes. In fact, an index was widely used by prior studies on compliance with corporate governance codes (e.g., Khanchel, 2007; Ananchotikul et al., 2008; Shaukat, 2008), and prior studies concerning the association of the corporate governance code and accounting outputs such as firm value (e.g., Kouwenberg, 2006; Garay and González, 2008; Henry, 2010), stock performance (e.g., Alves and Mendes 2004; Berthelot, Morris, and Morrill, 2010), and financial performance (e.g., Gürbüz et al., 2010; Price, Roman, and Rountree, 2011). However, only a few prior studies on compliance with both audit committee rules, and the association of audit committee attributes with financial reporting quality, employed an index. Most prior studies tended to focus on a single audit committee attribute. In instances where studies investigated more than one audit committee attribute, two prior studies (at most) examined such attributes in separate models and not collectively. Except for the audit committee indexes developed by Ika and Ghazali (2012) and Sarumaha and Hermawan (2013), other indexes were not comprehensive because they only covered either audit committee membership or audit committee duties (see Table 3.1).

As suggested by Carcello et al. (2011a), research on corporate governance needs to include a richer set of corporate governance characteristics, as there are many governance characteristics that may affect the phenomenon being studied; omitting some of these characteristics might lead to a spurious conclusion. Meanwhile, audit committee reforms under the BRC and SOX have strengthened the role of the audit committee by adding requirements related not only to membership, but also to other aspects, such as duties and functions, disclosure and financing arrangements. In addition, some scholars (i.e., DeZoort et al., 2002; Bédard, and Gendron, 2010) argue that the effectiveness of the audit committee depends on other elements as well, such as membership composition, authority, resources and process/diligence. That is why a comprehensive audit committee index needs to be developed for the study of audit committee effectiveness.

3.5.6 Lack of Examination of the Interaction between Audit Committee Attributes and Other Corporate Governance Mechanisms

As discussed in Section 3.4, a limited number of studies have examined the interaction between audit committee attributes and other corporate governance mechanisms. As suggested by some scholars (e.g., DeZoort et al., 2002; Turley and Zaman, 2004; Bédard, and Gendron, 2010), audit committee studies need to explore the interaction of audit committees with other corporate governance mechanisms, as opposed to simply examining the direct effect of each individual characteristic. However, as of late, more studies (i.e., Cohen et al., 2010; Dhaliwal et al., 2010; Carcello et al., 2011b; Lisic et al., 2011) have begun exploring the effect of such interaction. Incidentally, these studies were conducted by researchers in the US; research on audit committee effectiveness outside the US institutional setting, is needed to examine the interaction of audit committee attributes and other corporate governance characteristics (such as family ownership) in developing countries, (Bédard and Gendron, 2010).

3.5.7 Lack of Studies on Restatements in Developing Countries

Only a few studies concerning audit committee attributes and financial reporting quality in developing countries have employed restatements as a proxy for financial reporting quality (i.e., Abdullah et al., 2010; Zhizhong et al., 2011). Most prior studies in developing countries preferred to use earnings management, rather than other proxies such as restatements, as a proxy for financial reporting quality. Compared to the earnings management proxy, however, restatements have advantages. For example, DeFond (2010) criticized the use of abnormal accruals in earnings management studies, arguing that the accuracy of the prediction of the model is questionable. Restatements do not suffer from validity concerns since they are actual events.

In this study, the above mentioned research gaps are addressed holistically, taking into consideration the institutional context of an emerging economy with its unique political economy. The related research questions are developed in the next section.

3.6 RESEARCH QUESTIONS

In order to contribute significantly to the improvement of Indonesian corporate governance practice, as well as extend the literature, the research questions have been formulated by matching the Indonesian business environment with the research gaps identified in Section 3.5. As discussed in the above sections, the implementation of corporate governance reforms in Indonesia has progressed rather slowly, and has been ineffective. Moreover, the corporate governance mechanisms in developing countries such as Indonesia often resemble the mechanisms in developed countries in form but not in substance. Important institutional factors, such as family control, board of commissioner characteristics and foreign ownership, might influence the implementation of the reforms. Therefore, this study investigates compliance with corporate governance rules, and examines whether companies decouple the adoption of corporate governance rules and practices. This is an important issue in the context of Indonesia and most emerging economies. Meanwhile, several gaps have been identified in the extant literature, including: the dominance of agency theory and rising doubts as to its applicability in a different institutional setting, the absence of studies on determinants of compliance in a mandatory regime, the absence of a comprehensive study that simultaneously examines the determinants of compliance and the impact of such compliance on financial reporting quality, and the absence of a comprehensive measure of audit committee attributes in prior studies. Hence, based on the Indonesian business environment and the gaps in the extant literature, this study proposes five research questions which are depicted in Table 3.2.

Table 3.2 Research Questions

Indonesian Business Environment	Literature Gaps	Research Questions
• High family ownership. • Firms controlled by families often place family members on the board of directors, board of commissioners, or both. • Some family-controlled companies employ professional management.	• Dominance of agency theory in prior studies ignores institutional factors in developing countries.	Do family-controlled public listed companies with family members on the boards, and family-controlled public listed companies with professional management have a different effect on the compliance of the company with audit committee rules?
• High family ownership • The collusion between family-controlled companies and bureaucrats/officials by giving the latter board positions.	• Dominance of agency theory in prior studies ignores institutional factors in developing countries.	Does the presence of politically connected independent commissioner on the board of a public listed company affect the company's compliance with audit committee rules?

Table 3.2 (continued)

Indonesian Business Environment	Literature Gaps	Research Questions
• Foreign investors are significant players in the IDX. • The presence of foreign institutional investors related to Indonesians.	• Dominance of agency theory in prior studies ignores institutional factors in developing countries.	Do foreign institutional investor attributes (i.e., ownership size and authenticity) affect a public listed company's compliance with audit committee rules?
• The corporate governance mechanisms in developing countries are often embraced just in form and not in substance (for cosmetic purposes).	• Few prior studies simultaneously examine the determinants of compliance and their effect on financial reporting quality. • Few prior studies employed a comprehensive measure of audit committee attributes. • The results of prior studies concerning audit committee attributes and financial reporting quality were inconclusive.	Does the level of compliance with audit committee rules by public listed companies result in an effective audit committee, as indicated by a negative association with restatements of financial statements?
• Family control might serve as an alternative corporate governance mechanism.	• Prior studies on audit committee attributes and financial reporting quality were inconclusive. • Due to the dominance of agency theory, there is a lack of prior studies examining the association between the audit committee and institutional factors.	Does family control affect the relationship between audit committee effectiveness and restatements of financial statements?

As indicated in Table 3.2, answers to the research questions are intended to fill the literature gaps. These gaps include the dominance of agency theory that ignores relevant institutional factors in a developing country, limited examination of the interaction between the audit committee and other corporate governance mechanisms, and limited examination in a comprehensive study that simultaneously looks at the determinants of the compliance of public listed companies with audit committee rules, and the effect of compliance on financial reporting quality. In addition, this study also attempts to fill the remaining literature gaps that will be discussed further in Chapter 4.

3.7 CONCLUSION

The development of corporate governance in Indonesia reveals a trend toward increased implementation of the Anglo-American model. However, the implementation of the Anglo-American model in Asian countries has been criticised because the institutional and business environment of Asian countries is different from the one that produced the model. It has been noted that important business characteristics in the Indonesia context, such as high family ownership levels and collusion between businesses and bureaucrats, may obstruct the implementation of the Anglo-American model. These business characteristics, along with a weak law enforcement regime, provide a motivation to examine why the mandatory adoption of the audit committee in Indonesia might not achieve its expected goal. In this regard, the determinants of compliance with corporate governance regulations provide an interesting insight because of the influence of the institutional setting in "transplanting" the Anglo-American model to emerging economies.

This study intends to fill all the gaps in the extant literature; this is discussed further in the next chapter. The use of panel data and comprehensive audit committee indexes is discussed in Chapter 5. The reasons for the use of restatements as a proxy for financial reporting quality are discussed in Chapter 4 and Chapter 6. The effects of the interaction between audit committee attributes and other corporate governance mechanisms are discussed in Chapter 4. Meanwhile, Chapter 6 presents endogeneity issues.

CHAPTER 4

RESEARCH FRAMEWORK AND HYPOTHESES DEVELOPMENT

4.1 INTRODUCTION

This chapter presents the underlying theories for this research, the development of a comprehensive audit committee index, justifications for the use of restatements as a proxy for financial reporting quality, the study's research framework, and the development of testable hypotheses. The chapter is organised as follows. Section 4.2 discusses the underlying theories encompassing the bundle of corporate governance theory, agency theory, institutional theory, and resource dependence theory. Section 4.3 provides the justification for developing a comprehensive audit committee index. Section 4.4 offers arguments for the selection of restatements as a proxy for financial reporting quality. Section 4.5 presents the development of testable hypotheses. As the study is categorised into two stages of research, namely, determinants of compliance of public listed companies with audit committee rules (Research Stage 1), and the effect of such compliance on restatements (Research Stage 2), the presentation of the development of testable hypotheses is presented in two sections. The research framework for both research stages is discussed in Section 4.6. Section 4.7 provides a conclusion to the chapter.

4.2 UNDERLYING THEORIES OF THE STUDY

As discussed in Chapter 2, most corporate governance studies have used a single theory, namely the agency theory, which is inadequate to depict corporate governance in all national contexts. It was posited in Chapter 3 that the results of prior studies on both the determinants of the compliance of public listed companies with audit committee rules, and the effect of such compliance on financial reporting quality, were inconclusive due to the predominant use of agency theory. Some scholars (e.g., Cohen et al., 2008; Ahrens et al., 2011) have suggested that studies on corporate governance need to consider the use of alternative theories to provide a basis for reconciling conflicting findings in the existing agency-based studies. Chapter 3 also highlighted that the nature of agency conflict in developing countries is different from the nature of agency conflict in developed countries. Hence, corporate governance research in developing countries needs to consider elements such as the institutional factors that impact organisational action (Young et al., 2008). The agency theory also ignores the "social aspect" of networking, which is important outside the developed Western countries (McCarthy & Puffer, 2008). Therefore, several theories are employed in this study to complement agency theory. The following sections discuss the various theories used in this study, namely, bundle of corporate governance theory, agency theory, institutional theory and resource dependence theory.

4.2.1 Bundle of Corporate Governance Theory

The concept of the bundle of corporate governance theory assumes that the effectiveness of corporate governance is dependent on the effectiveness of a bundle of corporate governance mechanisms, rather than on the effectiveness of one mechanism (Ward et al., 2009). The concept was first advocated by Rediker and Seth (1995). In their study, the researchers concluded that a firm has a variety of corporate governance mechanisms to align the interests of shareholders and managers, and that a firm has flexibility in designing efficient combinations of corporate governance mechanisms. Furthermore, they argued that the level of a particular mechanism might be influenced by the levels of other mechanisms that simultaneously operate in the firm. This implies that corporate governance mechanisms are not seen as being universal applications, but that they become effective in a particular combination (Jensen, 1993; David and Useem, 2002; Filatotchev, 2007). In other words, single or multiple corporate governance mechanisms do not operate in isolation or independently of each other, but are interrelated and substitute or complement each other as related "bundles" of practices. In short, the corporate governance bundle concept provides an explanation as to why corporate governance mechanisms vary among firms (Aguilera et al., 2011).

Based on the assumption of a corporate governance bundle, it is possible that certain corporate governance mechanisms might substitute for or complement each other (Ward et al., 2009). Complementarities refer to the corporate governance mechanisms in the corporate governance bundle that are aligned with one another to achieve effective corporate governance (Filatotchev, 2007). In other words, the presence or addition of one mechanism might strengthen another mechanism and lead to more effective governance (Aguilera et al., 2011). For example, the effectiveness of an independent director should be complemented by high shareholder involvement and strong legal protection for investors (Filatotchev, 2007). Meanwhile, one corporate governance mechanism acts as a substitute if the mechanism is replaced by another mechanism, while the overall functionality of the corporate governance system remains constant (Aguilera et al., 2011). For example, in the German and Japanese corporate governance systems, banks might serve as an effective monitoring mechanism that substitute for active market control (Aoki, 1994). In emerging markets, large non-management shareholders can act as a partial substitute for missing institutional governance mechanisms (Claessens and Fan, 2002).

This study draws upon the bundle of corporate governance concept to establish a conceptual base to develop hypotheses for both the determinants of compliance with audit committee rules, and the effect of such compliance on financial reporting quality.

The audit committee is not an isolated corporate governance mechanism within a company, therefore this study assumes that compliance of public listed companies with audit committee rules, and its effect on financial reporting quality is affected by other existing formal and informal corporate governance mechanisms. These might include, among others, independent commissioner characteristics, size of the board of commissioners, foreign ownership, family control and audit quality.

4.2.2 Agency Theory

Agency theory is based on the notion that the separation between agents (management) and principals (shareholders or owners) will lead to some conflicts between the two since they are both assumed to act in their own self-interest (Jensen and Meckling, 1976). Management actions may not always be in the best interests of shareholders, and may create agency problems such as excess spending, suboptimal investment decisions and information asymmetry – especially when a very opportunistic person is involved in the process. In other words, the agents (management) will not manage the company as diligently as the owners. In the literature, an agency problem that arises because of the divergence of interests between owners (principals) and management (agents) is known as an agency problem type 1. The agency problem type 1 is common in developed countries such as the US and UK because ownership and control are often separated and legal mechanisms protect the owners' interests. The institutional context in developed countries leads itself to relatively efficient enforcement of arm's-length agency contracts (Peng, 2003).

In addition to divergent interests, agency problems arise when the principal-agent relationship is characterised by informational asymmetries and bounded rationality (Chua et al., 2003). Information asymmetry refers to the condition where the manager has better information than the owner. Bounded rationality refers to behaviour that is intentionally rational, but limitedly so. The owner has limitations in foreseeing all future possibilities and in processing information, including identifying optimal actions. In such conditions, owners require protection (Fama and Jensen, 1983), and adequate monitoring mechanisms need to be established to protect shareholders from management conflicts of interest. The costs of all activities and operating systems designed to align the interests of managers with the interests of owners are called agency costs (Jensen and Meckling, 1976).

In addition to agency problem type 1, there is also another type of agency problem known as agency problem type 2. Researchers are increasingly realizing that there is no single agency model that can adequately accommodate the conditions in all nations (Young et al., 2008). The institutional context in developing countries is different from that in developed countries, and includes high concentrated ownership and poor protection of minority shareholders. These conditions, combined with an absence of effective external governance mechanisms, leads to a conflict known as agency problem type 2 between controlling shareholders and minority shareholders (Young et al., 2008; Jaggi et al., 2009; Chen et al., 2011). In other words, the agency problem type 2 is an extension of agency theory that is applied to other types of relationships, such as the relationship between controlling shareholders and minority shareholders. An example of agency problem type 2 is expropriation, which refers to the transfer of value from minority shareholders to majority shareholders (Shleifer and Vishny, 1997). The expropriation may include interrelated transactions, not paying out dividends, or transferring profits to other companies controlled by the majority shareholders. Claessens et al. (1999) have evidenced the expropriation of minority shareholders in East Asia, including Indonesia.

Corporate governance mechanisms, such as the board of directors and the audit committee, are assumed to reduce agency costs (Cohen et al., 2008). The effectiveness of the board of directors as an internal corporate governance mechanism is enhanced by the inclusion of outside directors (Fama and Jensen, 1983). Thus, the primary attribute of the board of directors is the independence of its members (Beasley 1996; Dechow et al., 1996; Cohen et al., 2008). In carrying out its oversight duties, the board of directors delegates its duties to the audit committee (DeZoort et al., 2002).

4.2.3 Institutional Theory

Institutional theory posits that an organisation is part of a comprehensive set of organisational dynamics, including the institutional environments and the ceremonial structures that play a role within these dynamics (Meyer and Rowan, 1977). Accordingly, institutions are considered to be the “rules of the game”, while the organisations are the “players” (North, 1991); both are influenced by the institutional environment in which they function (Doh and Guay, 2006). Environmental pressures create organizational isomorphism with the aim of seeking legitimacy within the environment (Salvato, 1999). The isomorphism causes the institutions to become similar over time, as the organisation adapts to become more similar to those around it (DiMaggio and Powell, 1983). The isomorphism is created through coercive, mimetic and normative mechanisms. Coercive isomorphism refers to the consequences of external regulatory-type pressures for organisational convergence. The normative pressure stems from professionalization and socialisation. Meanwhile, mimetic isomorphism refers to the tendency of social actors to imitate others that are viewed as successful and legitimate (Cohen et al., 2008).

Institutional theory is one of the theories recommended by some scholars as a complement to agency theory (Cohen et al., 2008). Agency theory, which focuses on the principal-agent problem, is considered to present a partial view of the world and ignores the complexity of organisations (Eisenhardt, 1989). The complexity of organizations and its effect on variations of corporate governance structures could be explained by institutional theory (Filatotchev, 2007). In addition, institutional theory suggests that some governance activities and structures may be primarily driven by a desire to foster legitimacy (Beasley, Carcello, Hermanson, and Neal, 2009). As a result, corporate governance structures, such as boards of directors and audit committees, may emphasise ceremonial and symbolic roles (Cohen et al., 2008). Therefore, this view might be relevant in the context of developing countries such as Indonesia, as corporate governance in developing countries often resembles the outsider model (the Anglo-American model) in form, but not in substance.

In the extant literature, audit committee studies that employed institutional theory are limited. For example, Fogarty and Kalbers (1998) revealed that agency theory variables do not have a strong relationship with audit committee effectiveness. They suggested that audit committees might exist for ceremonial purposes. Gendron, Bédard, and Gosselin (2004) found that audit committee meetings serve both a symbolic and substantive purpose. In a later study, Beasley et al. (2009) revealed that some audit committees play a substantive role in financial reporting oversight, whereas others merely play a ceremonial role. They found that neither agency theory nor institutional theory fully explains the result.

4.2.4 Resource Dependence Theory

Resource dependence theory holds the view that the key success of organisations is contingent on their ability to acquire and control resources (Pfeffer and Salancik, 1978). Organisations are, however, embedded in an environment comprised of other organisations, and they depend on those other organisations for the many resources that they need. In other words, organisations do not control all resources they need, and such resources are found in outside organizations (Salvato, 1999). The acquisition of resources by organisations is critical for their survival and is carried out through interaction with the subjects that control those resources (Pfeffer and Salancik, 1978). Hence, this theory focuses on the strategic actions taken by organisations to manage resource dependence in their environment (Salvato, 1999). Organisations are motivated to undertake such actions to minimise their loss of power due to a reliance on others for resources (Van der Zahn, Singh, and Singh, 2008).

In the corporate governance context, resource dependence theory holds the view that various elements of corporate governance can act as critical resources for a firm (Udayasankar, 2008). For example, the board of directors is the corporate governance element that can provide resources for a firm (Pfeffer and Salancik, 1978). Based on this theory, the board of directors acts as a means to access and manage scarce resources (Pfeffer, 1973), and to obtain legitimacy, such as contracts and financing (Young et al., 2001). Thus, good corporate governance is achieved when board members are appointed for their expertise in helping a firm cope with environmental uncertainty (Cohen et al., 2008).

From the resource dependence perspective, the primary role of the board of directors is less that of monitoring, and more inclined to being a provider of resources, including industry expertise, knowledge in facilitating corporate strategies, and enhancing access to external networks (Cohen et al., 2008). Based on this theory, the expertise of board members is more important than their independence in achieving good corporate governance (Cohen et al., 2008). Thus, the valuable attributes of board members include industry expertise, expertise in helping to set corporate strategy, and providing access to external networks. For example, an independent director with financial expertise is likely to have a better ability to review financial reports than a fully independent director with no industry expertise. From this theoretical perspective, the role of the board is more relevant to Asian firms than their Western counterparts due to the predominantly relationship-based business environment in Asia (Young et al., 2001). It is generally accepted that personal contact is more important in Asia, due to the absence of strong contract law enforcement regimes and efficient markets.

With regard to the audit committee, the resource dependence theory suggests that the role of the audit committee is to provide a source of advice and counsel to the board of directors, which is important in bringing valued resources to the firm (Daily, Dalton, and Canella, 2003). In addition, this theory recognizes that audit committee members provide resources, in terms of their expertise and knowledge that may improve the effectiveness of the audit committee. For example, the industry expertise of audit committee members might improve audit committee effectiveness, since the members have sufficient knowledge to assess business activities and the risk to the company to enable them to determine whether the company’s accounting methods properly reflect the economic substance of transactions, and whether estimates are realistic (Cohen et al., 2008). Another example is audit committee size: the theory views a larger audit committee as being more effective since it has more resources to address issues faced by the company (Rahmat, Iskandar, and Saleh, 2009). However, Cohen et al. (2008) contended that, from the resource dependence perspective, the audit committee’s oversight of financial reporting is less effective, and is replaced by the external auditor who plays a key role in ensuring sound financial reporting.

The use of the above multiple theories enables this study to consider determinants of the compliance of public listed companies with audit committee rules that are not derived solely from agency theory. As discussed in Chapter 3, the predominance of the Anglo-American agency theory may have led prior studies to ignore factors relevant in developing countries. In addition, multiple theories are useful in examining the interrelationship among various actors (both internal and external) and corporate governance mechanisms (Cohen et al., 2008). Multiple theories might also be used to explain the conflicting findings of prior studies. Therefore, this study attempts to focus on certain relevant factors in developing countries, namely, family control, foreign institutional investors and politically connected independent commissioners. In addition, this study also addresses the issue of interaction among corporate governance mechanisms in both its examination of compliance, and the effect of compliance on financial reporting quality.

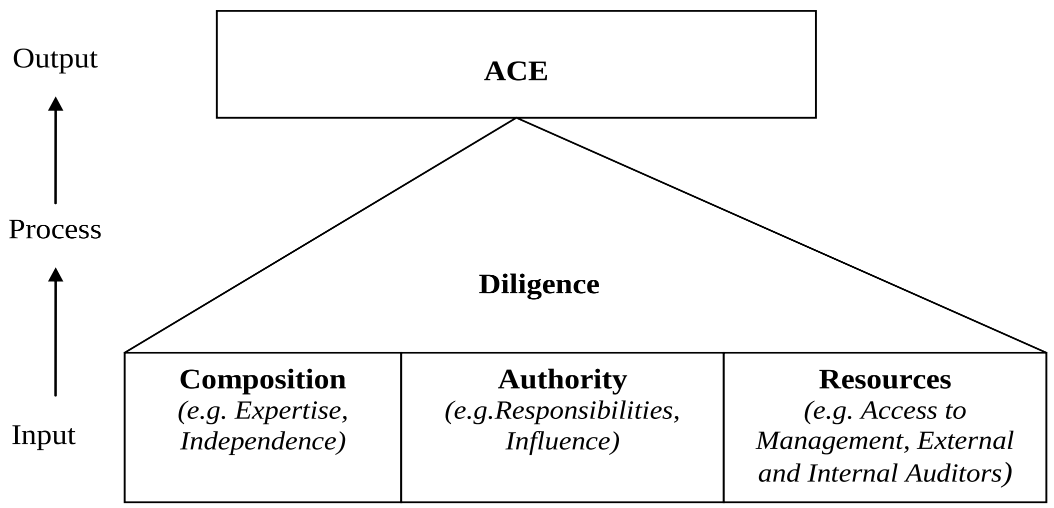
4.3 AUDIT COMMITTEE INDEX

As identified in Section 3.5.5, a few prior studies have employed a comprehensive audit committee index in both audit committee compliance studies, and studies on the association between audit committee attributes and financial reporting quality. Most prior studies on audit committee effectiveness focused exclusively on individual audit committee members and their characteristics (i.e., financial expertise and independence). DeZoort et al. (2002) suggested that a more plausible measurement of audit committee attributes should include additional aspects, such as qualified members equipped with the authority and resources to protect stakeholder interests through diligent oversight mechanisms. They defined an effective audit committee as follows:

> *An effective audit committee has qualified members with the authority and resources to protect stakeholder interests by ensuring reliable financial reporting, internal controls, and risk management through diligent oversight efforts.* (p. 41)

The above definition asserts that the ultimate goal of the audit committee is to protect shareholder interests, and that it can achieve this goal through the use of qualified members with adequate authority and resources to provide diligent oversight. According to DeZoort et al. (2002), there are four dimensions that determine audit committee effectiveness: composition, authority, resources, and diligence. They argued that composition, authority, and resources are the diligence process inputs that would result in an effective audit committee. Figure 4.1 depicts the audit committee effectiveness framework proposed by DeZoort et al. (2002).

Figure 4.1 Audit Committee Effectiveness (ACE) Framework



Source: DeZoort et al. (2002)

From the illustration, composition covers expertise, independence, integrity, and objectivity. The most common variable for composition in prior studies was member independence, followed by financial expertise and the experience of audit committee members. Authority is derived from the full board of directors, and legal and listing requirements. Prior studies have mostly examined audit committee authority mandated by regulations such as the SOX (2002). Resources include an adequate number of members, and access to management, and internal and external auditors. According to DeZoort et al. (2002), prior studies involving the resources component of audit committee effectiveness focused on audit committee size and support from the external and internal audit function. Diligence refers to incentive, motivation, and perseverance. In prior studies of the audit committee, the number of audit committee meetings became a popular proxy for diligence. As noted by DeZoort et al. (2002), diligence is extremely difficult to observe directly and, therefore, more innovative methods of observation are needed. For example, some prior studies used voluntary disclosure as a proxy for diligence (e.g., Turpin and DeZoort, 1998; Carcello et al., 2002).

The audit committee effectiveness framework proposed by DeZoort et al. (2002) was extended by Bédard and Gendron (2010). As depicted in Figure 3.1 in Chapter 3, Bédard and Gendron (2010) similarly proposed an audit committee effectiveness framework comprising four dimensions, namely, composition, authority, resources, and process. They replaced the dimension of “diligence” proposed by DeZoort et al. (2002) with the dimension of “process”. Process consists of meetings, agendas, questioning, relationships, power, and leadership. Basically, both diligence and process refer to the same thing, which is the effort or act needed to achieve audit committee effectiveness. Based on their review of prior studies, Bédard and Gendron (2010) found that the number of audit committee meetings was only one of the visible dimensions of process examined by prior studies. This finding is consistent with that of DeZoort et al. (2002), which found that the number of meetings was a common proxy for diligence. The non-public nature of the audit committee process and the predominance of archival data in prior studies caused difficulties in examining the other dimensions of process in prior studies (Bédard and Gendron, 2010).

Based on the above discussion, it can be concluded that the measurement of audit committee effectiveness needs to consider certain dimensions such as composition, authority, resources and diligence/process. In addition, these dimensions are interrelated. Therefore, this study intends to employ a comprehensive audit committee index consisting of several dimensions that are in line with the audit committee effectiveness frameworks proposed by DeZoort et al. (2002), and Bédard and Gendron (2010). The audit committee index will serve as a measurement of the level of compliance of public listed companies with audit committee rules (Research Stage 1). In Research Stage 2, the audit committee index, which is the dependent variable in the first research stage, serves as a measurement of audit committee effectiveness.

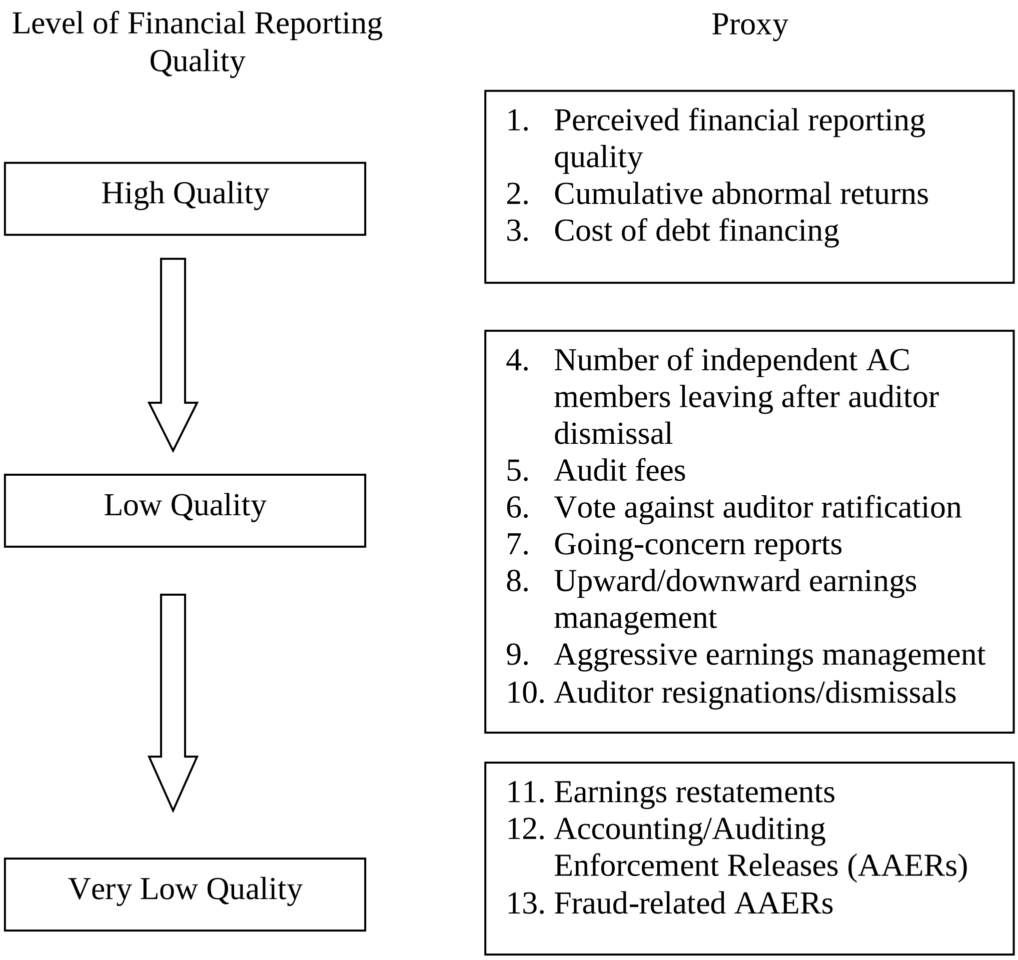
4.4 RESTATEMENTS AS A PROXY FOR FINANCIAL REPORTING QUALITY

In this study, restatements are selected as a proxy for financial reporting quality. There are four key considerations underlying the selection of this proxy. First, as discussed in Section 3.5.7, a limited number of prior studies in developing countries have used restatements as a proxy for financial reporting quality (e.g., Abdullah et al., 2010; Zhizhong et al., 2011), whereas restatements are the second most popular proxy in the US. In fact, restatements occur not only in developed countries such as the US, but also in developing countries such as Indonesia. As evidence, the percentage of listed companies in the US that announced annual financial restatements from 2002 to 2005 ranged from 3.7 percent to 6.8 percent (see GAO, 2006), while restatements decreased in 2007 (see Cheffers, Whalen, and Usvyatsky, 2010; Roybark, 2010). Meanwhile, in Indonesia, the percentage of public listed companies that announced annual restatements from 2006 to 2012 ranged from 1 percent to 3 percent, while the percentage that announced interim restatements ranged from 1 percent to 7 percent.

Second, compared to earnings management, restatements are a more valid proxy as they are actual events that indicate a visible form of impaired financial reporting quality (Cao et al., 2010; DeFond, 2010). The use of earnings management as a proxy for financial reporting quality has also been widely criticised (e.g., Hribar and Collins, 2002; DeFond, 2010). Hribar and Collins (2002) argued that the measurement of accruals based on the balance sheet is potentially contaminated by measurement errors in accrual estimates, particularly if the partitioning variable used to indicate the presence of earnings management is correlated with the occurrence of mergers and acquisitions or discontinued operations. In addition, they also argued that estimation errors in balance sheet accruals can confound returns regressions where discretionary and non-discretionary accruals are used as explanatory variables. Meanwhile, Defond (2010) argued that the accrual model, such as the Jones model or its modified version, suffers from an inherent limitation as the accuracy prediction of the model cannot be validated. This means that it is impossible to provide assurance as to whether the estimates of discretionary accruals are the results of management’s opportunistic accounting choices, or just an artefact of the model.

Third, most members of audit committees usually state that their duty is to review the financial statements issued by the company (Carcello et al., 2002). In ASEAN countries, however, the role of the audit committee as stated in the annual reports needs to be verified, as corporate governance information presented in the documents of public listed companies often does not reflect actual practice (Chuanrommanee and Swierczek, 2007). Since restatements are actual events that indicate a visible form of impaired financial reporting quality (Cao et al., 2010; DeFond, 2010), they provide a means to check whether or not audit committees perform their roles as stated in company annual reports. Fourth, restatements are categorised as indicating very low financial reporting quality – quality that is lower than earnings management (Pomeroy and Thornton, 2008). This means that the presence of restatements indicates lower financial reporting quality as compared to the presence of earnings management (see Figure 4.2).

Figure 4.2 Tentative Ranking of Financial Reporting Quality Proxies



Source: Adapted from Pomeroy and Thornton (2008)

4.5 HYPOTHESES DEVELOPMENT

This study attempts to fill one gap identified in Chapter 3, namely, the absence of a longitudinal study that simultaneously examines the determinants of the compliance of public listed companies with audit committee rules, and the effect of such compliance on financial reporting quality. Thus, the present research is separated into two stages: the determinants of the compliance of public listed companies with audit committee rules (Research Stage 1), and the effect of such compliance on financial reporting quality using restatements as a proxy (Research Stage 2). Research Stage 1 focuses on exploring the determinants of the compliance. Compliance, which is the dependent variable in Research Stage 1, is then examined in Research Stage 2 in order to determine its association with financial reporting quality. Therefore, a discussion concerning the development of testable hypotheses for both stages of research is also presented in two different sections (i.e., Section 4.5.1 and Section 4.5.2).

4.5.1 Research Stage 1: Determinants of the Compliance of Public Listed Companies with Audit Committee Rules

4.5.1.1 Family Control

As discussed earlier, Asian company ownership is concentrated in the hands of families (Claessens et al., 2002; Fan and Wong, 2002). Typically, families use several methods to gain effective control in firms (Carney, 2005). In some cases, families may require a majority of voting shares in order to get effective control. In other cases, control of the company can be attained even with a low level of ownership through the establishment of pyramids and cross-holdings. In another context, families might use dual-class shares rather than majority stock ownership[5].

[5] A pyramid occurs when the largest ultimate shareholder owns one corporation through another which he does not totally own. Cross-holdings occur when one firm has some shares in another firm in the chain of control. Dual-class shares are found in firms that have outstanding shares with different voting rights (Claessens et al., 2000).

The ownership structure could also act as a means to solve this divergence-of-interest problem and to mitigate agency costs. One distinctive feature of family governance is the unification of control and ownership by the family, also known as owner management. In affected firms, board members are often family members, close friends and close business associates (Young et al., 2001). As discussed in Chapter 2, it is common in the Indonesian environment to see family members on the board of directors, board of commissioners, or both. More often than not, the head of the board of commissioners represents the controlling party of the company, or someone very close to the controlling shareholders (Husnan, 2001, Hanani, 2005). As family ownership increases, the conflicts between managers and shareholders are likely to be reduced. This is called the convergence-of-interest hypothesis, or the alignment effect (Jensen and Meckling, 1976). However, the presence of family ownership or insider ownership also has costs associated with it that might offset the gains of convergence-of-interest. When family members on boards hold a substantial fraction of the firm's shares, they have sufficient voting power or influence to pursue their personal agendas (non-value maximising) without jeopardising their employment and remuneration. This is called the entrenchment hypothesis (Fama and Jensen, 1983). In addition, families in Asia often enhance their control of companies through the use of pyramids, cross listings, and deviations from "one share, one vote" rules that give them control rights significantly in excess of their cash flow rights (Claessens et al., 1999). As a result, family policies might result in the expropriation of the minority shareholders.

Based on alignment theory, the presence of family members on boards might serve as an alternative mechanism to reduce agency costs (Jensen and Meckling, 1976; Fama and Jensen, 1983; Shleifer and Vishny, 1997; Khan, 1999; Anderson and Reeb, 2003; Wang, 2006). The presence of family members on boards means that combined control and ownership rests with the family, thus aligning the interests of shareholders and management. Under this condition, the family has the incentive, power and knowledge to run the business. As the family is actively engaged in the daily activities of the company, there will be less information asymmetry, fewer conflicts, and fewer issues related to hierarchical organisation structures (Niemi, 2005). As a result, the occurrence of agency problem type 1, which occurs between the owner and management, decreases.

The alignment effect might cause Anglo-American corporate governance to be less effective, as Anglo-American corporate governance mechanisms such as board independence and audit committees are intended to solve agency problems between owners and managements, or agency problem type 1 (Chen et al., 2011). However, as discussed above, combined family ownership and control reduces agency problems. In addition, the controlling family generally tends to maintain personal control rather than rely on formalised procedures to monitor the company (Daily and Dollinger, 1992). Consequently, family-controlled companies tend to be less concerned with Anglo-American corporate governance. Moreover, families generally resist and are often reluctant to embrace radical changes (Chizema, 2011). Hence, family-controlled firms might not welcome the introduction of Anglo-American corporate governance structures, such as the audit committee, separation of the chairman and CEO and other mechanisms that are interpreted as an indication of loss of control (Storey, 1994; Maug, 1996).

As the interests of the owner and management converge, the assumption that family firms have low or no agency costs depends on the factor of altruism (Chua et al., 2003; Chrisman, Chua, and Litz, 2004; Chrisman, Chua, and Sharma, 2005). The concept of altruism is drawn from the stewardship theory in the context of family firms, and can be defined as unselfish concern and devotion to others without expected return (Corbetta and Salvato, 2004). Altruism is a distinctive characteristic of family firms that is not generally found in other enterprises (Dyer, 2003). Van den Berghe and Carchon (2003) contend that altruism in family firms has four benefits. First, altruism creates a self-reinforcing system of incentives that encourages family members to be thoughtful and selfless to one another. Second, altruism gives rise to a sense of collective ownership among family members employed in the firm. Third, altruism reduces information asymmetry among family members. Finally, altruism encourages family members to create a unique loyalty and commitment to the firm that is longer than that found in many non-family managed firms. In short, altruistic behaviour through family ties might create a sense of togetherness and reciprocity that permeates throughout the firm, leading to reduced agency costs (Karra, Tracey, and Phillips, 2006).

Hence, altruism might make family firms reluctant to adopt formal corporate governance; even if family firms adopt formal governance mechanisms, parental altruism can reduce their effectiveness (Schulze, Lubatkin, Dino, and Bucholtz, 2001). The founder’s ability to discipline the family agent might be compromised because of the potential ramifications of such actions on familial relationships (Schulze et al., 2001; Lubatkin, Ling, and Schulze, 2007). As family welfare is a common goal, the founder might avoid actions that suppress one family member’s utility at the expense of another family member’s utility that harms the family’s total welfare (Schulze et al., 2001).

Based on entrenchment theory, family firms are less efficient because concentrated ownership creates incentives for controlling shareholders to expropriate wealth from other shareholders (Fama and Jensen, 1983). One form of expropriation involves placing less qualified family members, cronies, or close friends on boards. As evident in Indonesia, family usually dominates boards as members of the board of directors, board of commissioners, or both (Husnan, 2001). The head of the board of commissioners often represents the controlling party of the company or someone very close to the controlling shareholders (Hanani, 2005). Under this condition, family firms might have inferior corporate governance because of ineffective monitoring of the board. Ineffective board monitoring might result in a less effective audit committee. In the context of this study, a less effective audit committee is indicated by the low compliance of family firms with audit committee rules. In short, family firms tend to implement weak corporate governance in order to provide a chance for entrenchment.

Based the above explanation, this study proposes the following testable hypothesis:

H_1 *Family-controlled companies with family members represented on the boards are less likely to comply with audit committee rules.*

Even if most family-controlled companies do not have a separation between ownership and control as hypothesized above, it is possible for family-controlled firms to hire professional executives, who are non-family members, to run their businesses. In Indonesia, some large business groups (conglomerates), such as the Salim group, separated the ownership and control of many of their subsidiaries after the East Asian financial crisis of 1997-98 (Hanani, 2005). The Salim group is a multinational enterprise that has large subsidiaries in various sectors both in Indonesia and internationally. Many of its subsidiaries are listed on stock exchanges, whereas the holding company remains private to retain flexibility (Dielemen and Sachs, 2006). Family member are present on the boards of large Indonesian businesses (the traditional cash cow), such as Indofood and Indocement, while other Indonesian businesses and international businesses are entrusted to professional management (Dielemen and Sachs, 2006).

There are several plausible explanations as to why family firms employ non-family professional executives. First, the increasing size of firms requires more executives with higher levels of professionalism, external knowledge and expertise (Daily and Dollinger, 1992; Klein and Bell, 2007). When family business increases family business owners might not have a successor, or the family successor may not be as talented as a non-family professional executive (Chua et al., 2003;Lin and Hu, 2007). Second, the non-family professional executive is needed by family business owners to prepare a family member of the next generation as a potential future family manager (Poza, Alfred, and Maheshwari, 1997; Le Breton-Miller, Miller, and Steier, 2004). Third, the non-family professional executive is needed by family business owners to serve as a mediator in case of family conflicts (Dyer, 1989).

The appointment of non-family executives may then increase potential agency costs (Chua et al., 2003). As discussed in Section 4.2.2, agency costs arise when the principal-agent relationship is characterised by divergent interests, informational asymmetry and bounding rationality. In terms of divergent interests, the appointment of non-family executives results in a separation of owner and management, which is one driver of agency costs. The appointment of non-family executives, followed by the delegation of more authority to them, will result in the family firm increasingly resembling a non-family firm (Chua et al., 2003). The personal goals of non-family professional executives might differ strongly from those of family owners, as family owners usually have a stronger long-term orientation than non-family professional executives (Block, 2011). A non-family executive might tend to use this autonomy in order to serve his/her own interests and goals that might not align with those of the family (Bhattacharya and Ravikumar, 2004). Besides the potential divergence of interests, the presence of more non-family executives in the family business might increase information asymmetry (Chua et al., 2003). Chua et al. (2003) argued that larger numbers of non-family executives might also have a stronger impact on bounded rationality, as family owners have to monitor more people and more transactions in which family owners are not directly involved. In addition, the presence of non-family executives might also reduce altruistic behaviour in family firms. The absence of the family bond as a basis for reciprocal altruism will increase the incentive for non-family executives to act opportunistically (Chua et al., 2003).

This study assumes that formal corporate governance mechanisms such as independent commissioners and audit committees in family-controlled companies are more effective when there is no family member present on the board of directors, board of commissioners, or both. There are three possible reasons for the reliance on formal mechanisms. First, as family members are absent from the day-to-day activities of the firm and serve as passive shareholders, the family would tend to insist on utilising formal mechanisms to protect its investment. Second, professional managers themselves are likely to rely on formal mechanisms to provide them with feedback on their performance. Finally, corporate governance mechanisms, such as board independence and monitoring, might serve as a solution to family rivalry, especially in cases where the founder is not actively managing the firm (Bertrand, Johnson, Samphantharak, and Schoar, 2008).

In the extant literature, the effect of this type of family control on corporate governance compliance has not been widely studied. Prior studies tended to compare the effects of the presence and absence of family ownership (e.g., Kabbach De Castro and Crespi Cladera, 2011), or compare different levels of family ownership (e.g., Chau and Leung, 2006). In the Indonesian environment, a prior study similar to the present study, was done by Utama and Leonardo (2006). Using audit committee effectiveness as the dependent variable, they found that the control of majority shareholders through ownership is not significantly associated with audit committee effectiveness. Further, they found that a higher representation of majority shareholders on the board of commissioners, and the appointment of the CEO and the chair of the board of commissioners by majority shareholders had a negative impact on audit committee effectiveness. These findings imply that, in Indonesia, the presence of family members on boards has a stronger negative influence on audit committee effectiveness than family control through ownership.

Based on the above explanation, this study proposes the following testable hypothesis:

H_2 *Family-controlled companies with non-family members represented on the boards are more likely to comply with audit committee rules.*

4.5.1.2 Politically Connected Independent Commissioners

Indonesia's two-tier system results in companies having two independent boards: a board of commissioners and a board of directors. The existence and function of the independent commissioner on the board of commissioners are similar to those of the non-executive members of the board of directors under the one tier system.

According to Johnson, Daily, and Ellstrand (1996), the functions of the board of directors include resource dependence, service and control. As depicted in Table 4.1., there is a difference between the functions of the board of directors in East Asian and Western countries. The roles, such as service, monitoring and control are more pronounced in Western companies, whereas resource dependence is more pronounced in East Asia companies. Several factors contribute to the difference. First, the economic system in East Asia, which is a relationship-based system, differs from the market-based system in Western countries (Rajan and Zingales, 1998). The relationship-based system, which is characterized by cronyism and low levels of transparency, works well in jurisdictions with weak corporate governance mechanisms, and where contracts are poorly enforced (Gul, 2006). In such a system, business opportunities arise as a result of personal ties with other business families and political powers. Therefore, business in the relationship-based model is associated with highly personal networks, special favours for both parties, and opaque transactions within and between companies, groups of individuals, and institutions (Dieleman and Sachs, 2006). This is in contrast to the market-based system in which logic independent of personalities prevails. The business model in the market-based system is therefore associated with competition based on the choice of superior business strategies, on the rational allocation of resources and on adherence to certain internationally accepted rules (Rajan and Zingales 1998). Second, the legal environment in East Asia is less developed, thus, informal contacts are more effective in conducting business (Young et al., 2001). Third, most companies in East Asia have a high concentration of ownership in the hands of families. Family control enables families to run companies and maintain tight control over information, leading to a lack of transparency (Young et al., 2001).

Table 4.1 Board Functions

Board Function	Description	Implementation
Resource dependence	Board members assist in providing access to critical firm resources that can include capital, competitive information, and reputation/legitimacy.	Although this role is important in Western literature, it is emphasized relatively less than the other functions. However, this role is more pronounced in East Asian companies.
Service	Board members often serve as a sounding board for the CEO and offer valuable counselling and advice services.	This function is less pronounced in East Asian boards as the management of businesses in East Asia is primarily family-based.
Monitoring and control	Board members serve as active monitors of shareholder interests.	This function is less pronounced in East Asian companies than in Western companies.

Source: Adapted from Young et al. (2001)

Consistent with Young et al. (2001), the function of the board of directors in Indonesia seems to emphasize the resource dependence role. It can be seen in Indonesia that some of the independent commissioners who also sit on the audit committees, are former or current bureaucrats (government officials), or retired army personnel (Husnan, 2001; Zaini, 2002). The presence of this type of independent commissioner is in line with the resource dependence theory. The presence of this politically connected independent commissioner might be intended to provide the company with a special relationship with elite politicians in order to get some kind of protection or special treatment, such as access to outside capital and the preservation of monopolistic strategies (Husnan, 2001).

This study assumes that the presence of politically connected independent commissioners might have a negative association with the compliance of public listed companies with audit committee rules. There are some reasons underlying this position. First, the politically connected commissioners might provide benefits to the company due to their knowledge of and experience with government procedures, their insights into government actions, their ability to enlist government support of the firm's interests at the expense of competitors, or due to their ability to forestall government action inimical to the firm (Agrawal and Knoeber, 2001). In the context of public policy, it is possible that the company might receive selective enforcement (Pittman, 1977) and that the IDX or the BAPEPAM-LK might be reluctant to enforce the implementation of audit committee rules against public listed companies with a politically connected independent commissioner. Second, most politically connected independent commissioners often lack the competency to perform an oversight duty. For example, Chen et al. (2006) found that most directors affiliated with various layers of government agencies in China did not possess business experience or expertise in law, accounting, or finance. In addition, they might not have had any prior work experience in finance or accounting, an educational background in accounting, or both. In another study, Young et al. (2001) found that some outside directors in Hong Kong and Taiwan were appointed to boards strictly to provide legitimacy, and that they often lacked the ability to provide advice and counsel management. Similarly, Zaini (2002) argued that politically connected independent commissioners in Indonesia lacked the skill, experience, and education required to be independent commissioners and audit committee members. Consequently, politically connected independent commissioners might not effectively perform the monitoring function. Third, Rosser (2003) argued that politicians/bureaucrats in Indonesia tend to block corporate governance reform, as they have an interest in maintaining the old system that enables them to hide the nature of their relationship with leading business groups, as well as to exploit SOEs.

Based on the above argument, this study proposes the following testable hypothesis:

H_3 *Public listed companies with a politically connected independent commissioner are less likely to comply with audit committee rules.*

4.5.1.3 Foreign Institutional Investors

In environments where relationship-based business is dominant, foreign institutional investors might play a role in enhancing the effectiveness of formal corporate governance mechanisms (Anderson et al., 2001; Ananchotikul, 2006). Foreign institutional investors might lead to changes in management and corporate governance by imposing their own company policies, internal reporting systems and principles of information disclosure on acquired firms in developing countries (OECD, 2002). Firms with foreign participation act as agents of transformation by diffusing specific assets, knowledge and culture (including governance practices), in developing countries (Chevalier et al., 2006).

The role of foreign institutional investors in improving corporate governance practice in developing countries is in line with the institutional theory. In this context, foreign institutional investors serve as exogenous pressure to introduce corporate governance practices that are socially legitimate or widely perceived as appropriate and effective (Aguilera and Cuervo-Cazurra, 2004). The pressures from foreign institutional investors cause mimetic isomorphism among companies (Yoshikawa and Rasheed, 2009). In the context of the audit committee, this study assumes that foreign institutional investors consider audit committees to be effective Anglo-American corporate governance mechanisms in the oversight of financial reporting quality and auditing activities. As such, the audit committee has been widely adopted by exchanges around the world. Thus, foreign institutional investors might push public listed companies to comply with audit committee rules.

Since foreign institutional investors come from outside the domestic social networks that generate the institutional norms of behaviour, they might be more resistant to common Indonesian corporate governance practices and more likely to push for transparency and shareholder protection (Peng, 2003). While family ownership is high and provides an opportunity for expropriation, foreign institutional investors might play an effective monitoring role to avoid the possibility of the expropriation of the wealth of minority shareholders. As evidence, Lam, Sami, and Zhou (2012) revealed that foreign ownership prevents tunnelling activities that use dividends as a proxy. In short, foreign institutional investors might prevent or mitigate the presence of the agency problem type 2.

The current study recognises that not all types of foreign institutional investors affect corporate governance. Even though foreign institutional investors are significant players in the IDX, some of these investors might be owned by or have a special relationship with Indonesians. Therefore, in exploring the role of foreign institutional investors, one needs to be cognizant as to whether their investment is genuine. In addition, the size of the investment also matters.

This study pays particular attention to the genuineness of the foreign institutional investors when examining the effect of foreign institutional investors on corporate governance in Indonesia. As described in Section 2.3.3 in Chapter 2, most of the foreign investors might be Indonesian offshore companies that are established in tax heaven countries with the intention of hiding the identity of the beneficial owner, and for the purpose of tax avoidance. It is therefore important to trace the ultimate shareholders of foreign institutional investors, as the genuineness of foreign institutional investors becomes an important attribute that must be considered when examining their role in enhancing corporate governance in Indonesia. The genuineness of foreign institutional investors also implies that they are bodies independent from the company. As noted by

Chen, Harford, and Li (2007), an independent institutional investor is active in monitoring. Monitoring would not make sense for foreign institutional investors owned by Indonesians – particularly by families as controlling shareholders – as this type of foreign institutional investor is not independent from the company. In addition, such companies are not resistant to common Indonesian corporate governance practices, since the ultimate owners are Indonesian. As such, this type of foreign institutional investor might not bring better corporate governance practices from its country of origin to Indonesia.

Besides the genuineness of the foreign institutional investor, another attribute that must be considered is the amount of shares owned by the investor. Typically, foreign investors with a large ownership stake have significant power to influence company policy and, thus, the incentive for monitoring (Chen et al., 2007). Empirical studies provide evidence of the role of large foreign shareholding on corporate governance in developing countries. For example, Chevalier et al. (2006) found that a high level of foreign ownership is likely to be positively related to better corporate governance practices. Similarly, Douma et al. (2006) found that foreign investors with a large ownership stake and long term involvement have a positive effect on financial performance. In contrast, Ananchotikul (2006) found that large foreign ownership stakes would not stimulate improvement in corporate governance.

Based on the above argument, this study proposes the following testable hypothesis:

H_4 *Public listed companies with a large genuine foreign institutional investor are more likely to comply with audit committee rules.*

4.5.1.4 Control Variables

a. Proportion of Independent Commissioners

Based on agency theory, independent directors serve as a reliable mechanism to diffuse agency conflicts between managers and owners (Fama and Jensen, 1983). Independent directors are representatives of minority shareholders with respect to monitoring companies, and boards of directors with a higher proportion of independent directors will be more effective in monitoring the company. Independent directors serving on boards champion the implementation of sound corporate governance practices (Teen, 2007). Recent corporate governance reforms, such as the SOX, seek to strengthen the role of the board of directors as representatives of shareholders (Finegold, et al., 2007). At present, the BAPEPAM (2004) requires at least 30 percent of the members of the board of commissioners (the body representing the interests of shareholders in Indonesian public listed companies) to be independent from the company. Furthermore, the chair of the audit committee is required to be an independent commissioner.

As discussed in Chapter 3, prior studies that examined the association of the proportion of independent directors and compliance with audit committee rules produced mixed results. For instance, in the compliance literature, the proportion of independent directors was associated with audit committee formation (Pincus et al., 1989; Willekens et al., 2004; Chau and Leung, 2006; Chen et al., 2009; Baxter, 2010). In other studies, the proportion of independent directors was associated with reliance on the audit committee (Menon and Williams, 1994), audit committee independence (Klein, 2002b) and audit committee best practices (Rainsbury et al., 2008). On the other hand, some prior studies indicated the opposite result. For example, Piot (2004) reported that the presence of an audit committee was not associated with the proportion of independent directors. Similarly, Webb (2008) reported that the percentage of outside directors was not associated with compliance with SOX, section 404. The predominance of agency theory as the main theory in prior studies might have caused the conflicting findings. Based on agency theory, the primary attributes of board directors is independence of its members (Beasley 1996; Dechow et al., 1996; Cohen et al., 2008). In fact, some institutional factors that are not represented in simple agency theory might influence the effectiveness of independent directors.

As discussed in Section 2.3.2.1, Indonesian company law has adopted a two-tier board model consisting of a board of commissioners and a board of directors. The board of commissioners has the duty of supervisor and advisor to the board of directors, while the board of directors has an executive role. BAPEPAM (2004) requires at least 30 percent of the members of the board of commissioners to be independent from the company and from the majority shareholders. These independent commissioners are similar to the independent directors in the one-tier model (Siregar and Utama, 2008). Thus, in the context of this study, the study assumes that the proportion of independent commissioners is associated with a public listed company's compliance with audit committee rules because the audit committee is a sub-committee headed by an independent commissioner. As the independent commissioner strongly influences the effectiveness of the audit committee, the study expects a positive association between the proportion of independent commissioners and the compliance of public listed companies with audit committee rules.

b. Independent Commissioners with Financial Expertise

Agency theory suggests that the presence of directors with financial expertise will increase the effectiveness of the audit committee. Financial expertise is needed to anticipate the increasingly complex accounting and auditing issues facing the audit committee. Moreover, the audit committee is effective when its members understand the various financial and operational issues faced by the company's management (BRC, 1999). The first requirement for directors to possess financial expertise was proposed by the BRC (1999). In a subsequent reform, SOX (2002) further regulated the financial expertise component for the audit committee by requiring the disclosure of the audit committee's financial experts (the SOX section 407).

Recent studies provide empirical evidence that the presence of independent directors with financial expertise on audit committees improves the effectiveness of the committees. Audit committees with more financial experts are associated with outputs such as lower cost of debt (Anderson, Mansi, and Reeb, 2004), less earnings management (Krishnan and Visvanathan, 2009; Jaggi and Leung, 2007; Bedard et al., 2004), fewer restatements (Abbott et al., 2004), lower internal control weaknesses (Zhang, Zhou, and Zhou, 2007), high quality of earnings (Qin, 2007) and improved governance (DeFond, Hann, and Hu, 2005). Therefore, the current study expects a positive association between independent commissioners with financial expertise and the compliance of public listed companies with audit committee rules.

c. Board of Commissioners Size

There are two competing views in the literature on board size and its effectiveness. Some scholars (i.e., Jensen, 1993; Lipton and Lorsch, 1992) advocated that larger boards may be less effective than smaller boards due to coordination problems in larger boards, and problems such as free riding. In contrast, some scholars argued that some firms require larger boards for effective monitoring (Yermack, 1996). A larger board also provides firms with greater expertise and access to resources, which is in line with resource dependence theory (Ning, Davidson III, and Wang, 2010). A larger board might contain directors with diverse industry experience and education that will allow it to provide high quality advice to management (Zahra and Pearce, 1989). Furthermore, larger boards might indicate that the complexity of governance issues requires delegates to serve on committees to improve board responsiveness and oversight (Rainsbury et al., 2008).

Prior study results mostly indicate that board size is significantly associated with the audit committee. For example, Beasley and Salterio (2001) revealed that larger boards were associated with the voluntary improvement of audit committee composition. Klein (2002b) found that audit committee independence increased with board size. In New Zealand, Carson (2002) found that board size was associated with audit committee formation. Subsequently, Webb (2008) found that the board size of companies that complied with the SOX was larger than that of non-compliant companies. Furthermore, Rainsbury et al. (2008) found that board size was positively related to audit committee best practices in New Zealand. The results of prior studies imply that larger boards might indicate that the complexity of governance issues requires an audit committee in order to improve board responsiveness and oversight.

Following the results of prior studies in countries using a one-tier board model, a larger board of commissioners with more members with specific experience and expertise is expected to increase advisory and monitoring quality in the Indonesian context. Therefore, this study also expects a positive association between board of commissioners size and the compliance of public listed companies with audit committee rules.

d. Company Size

In the extant literature, some scholars argued that large firms tend to have better corporate governance practices due to high agency costs, the economic scale of adoption and public scrutiny. Large firms may have more severe agency problems, because it is harder to monitor them, or because of the agency cost of free cash flows[6] (Khancel, 2007). Thus, agency costs need to be compensated for with stricter governance mechanisms (Ariff, Ibrahim, and Othman, 2001; Khanchel, 2007). One of the benefits from economies of scale is that large firms tend to be "early adopters" of corporate governance mechanisms (Pincus et al., 1989), as there is a fixed cost for large firms in implementing corporate governance mechanisms (Guriev, Lazareva, Rachinsky, and Tsouhlo, 2003). Moreover, larger companies are subject to more public and regulatory scrutiny than small firms, which leads to stronger corporate governance (Kale, Ciceksever, and Ryan, 2006).

However, prior studies that used this variable provided mixed results. In terms of voluntary audit committee formation, some prior studies reported a positive association between firm size and audit committee formation (e.g., Pincus et al., 1989; Adams, 1997; Turpin and DeZoort, 1998; Joshi and Wakil, 2004). In contrast, Bradbury (1990), Collier (1993), Menon and Williams (1994), among others, did not find any significant association. In other studies, company size was associated with voluntary audit committee disclosure (Carcello et al., 2002), compliance with SOX section 404 (Webb, 2008), and compliance with audit committee rules (Braiotta and Zhou, 2006). However, in Indonesia, prior studies indicate that company size was not related to the compliance of public listed companies with JSX board governance regulations (Nuryanah, 2004), and to efficient earnings management (Siregar and Utama, 2008). Like the proportion of

[6] Free cash flow is defined as cash flow in excess of that required to fund all projects that have a positive NPV when discounted at the relevant cost of capital (Jensen, 1986).

independent commissioners, it seems that the different institutional and organizational contexts of each prior study might have resulted in the conflicting findings of those studies.

Regardless of the inconclusive findings of prior studies, this study expects firm size to be positively associated with the compliance of public listed companies with audit committee rules. The current study assumes that larger firms have higher agency costs that must be compensated for by the adoption of corporate governance mechanisms such as the audit committee. Moreover, large companies also receive more scrutiny from the public, and this demands a high level of compliance with regulations.

e. Audit Quality

The high concentration of family ownership in Asian corporations raises the risk of expropriation of minority rights (Claessens and Fan, 2002). Theory suggests that firms may voluntarily employ monitoring and bonding mechanisms to mitigate the concern of outside investors about being expropriated (Jensen and Meckling, 1976). In addition, the use of monitoring or bonding mechanisms might assure outside investors of the credibility of the accounting information (Fan and Wong, 2005). The external auditor is one of the monitoring or bonding mechanisms that is often employed by companies in emerging markets. An external auditor might serve as a monitoring device to alleviate type 2 agency costs (resulting from conflict between the controlling shareholder and minority shareholders) that are difficult to mitigate using conventional corporate governance mechanisms such as boards of directors and takeovers (Fan and Wong, 2005). In this context, the external auditor plays a key role in independently ensuring sound financial reporting that is in line with the resource dependence theory (Cohen et al., 2008). As evidence, Fan and Wong (2005) revealed that the external auditor (i.e., one of the study period's Big 5 auditors) played a corporate governance role in Asia. They found that firms with high agency conflicts, indicated by their high concentration of control and a large separation of control and ownership, were likely to employ one of the Big 5 auditors. In addition, they found significant association between the audited company's ownership structure and choice of auditor only among small and high-risk audited companies where the threat of expropriation by ultimate owners was high.

With regard to the audit committee, the external auditor might influence the effectiveness of the audit committee, and an effective audit committee might demand a high quality audit. The external auditor might encourage companies to form an effective audit committee because it is important for the audit firm to protect itself from allegations of inadequate auditing associated with business failure or fraud. The present Big 4 audit firms, a proxy for high quality audits, mostly recommend the establishment of audit committees, and might prefer to work for companies with audit committees to ensure easier communication between their auditors and the company (Joshi and Wakil, 2004). From the side of the audit committee, independent and active audit committee members might demand a high level of audit quality (Abbott and Parker, 2000), as boards of directors assign audit committees to oversee the financial reporting process. The low quality of financial statements could damage the reputation of the audit committee and raise the risk of potential litigation (Zaman, Hudaib, and Haniffa, 2011). Being associated with the performance of high quality audits, the Big 4 audit firms are more likely to detect financial statement errors or fraud and provide a higher level of assurance to the audit committee than non-Big 4 firms. As a result, a high quality audit might protect the audit committee from non-monetary and reputational losses due to lawsuits or stock exchange sanctions (Abbott and Parker, 2000).

Prior studies on the association of audit quality and some aspects of the audit committee revealed inconsistent findings. In terms of voluntary audit committee formation, some prior studies in developed countries (e.g., Pincus et al., 1989; Collier and Gregory, 1999; Carson, 2002; Willekens et al., 2004) found a strong association. Surprisingly, other studies in developed countries (Bradbury, 1990; Collier, 1993; Menon and Williams, 1994) provided contrary results. In more recent study, Rainsbury et al. (2008) indicated that the Big 5 auditors were not significantly associated with company compliance with the New Zealand Securities Commission guidelines. Meanwhile, in a developing country environment, Joshi and Wakil (2004) revealed that companies in Bahrain that had established audit committees were audited by Big 4 audit firms. Further, Fan and Wong (2005) found a positive relationship between agency problems and the choice of Big 5 auditors in East Asia. It seems that prior studies in developing country provide a consistent result because firms in developing countries tend to have a higher incidence of agency problems and a greater demand for high quality financial statements. A high quality audit might reduce the incidence of agency problems and provide better quality financial statements. Thus, this study expects that the Big 4 firms are positively associated with the compliance of public listed companies with audit committee rules.

f. Financial Loss

The current study posits that financial loss is negatively associated with the demands of the audit committee. Shareholders of firms with a negative income might demand less scrutiny of the financial-reporting system because financial information is less value-relevant for firms with losses (Klein, 2002b). In addition, financial distress may cause firms to invest less in the maintenance of proper internal control (Krishnan, 2005). As evidence, Klein (2002b) revealed that audit committee independence decreased when firms reported consecutive losses. Therefore, the current study expects a negative association between financial loss and the compliance of public listed companies with audit committee rules

g. Leverage

With use of debt of financing, agency costs potentially arise because of a conflict of interest between shareholders and debt holders (Jensen and Meckling, 1976). To mitigate agency costs, a debt covenant is written and the firm is required to provide audited financial statements and a certificate confirming compliance with the contract. Violating the debt contract is costly for the firm. In this situation, managers of the firm have a greater incentive to make accounting policy choices that manipulate their financial statements to avoid the cost of violating debt covenants (Baxter, 2010). Therefore, the directors have a responsibility to ensure the integrity of the financial statements provided to debt holders, and to monitor compliance with the debt covenant provisions (Rainsbury et al., 2008). On the other hand, debt holders also need to increase monitoring because of the conflicting interests of managers and debt holders (Jensen and Meckling, 1976). The conflicts are especially severe in firms with large free cash flows, where more cash is available than profitable investment opportunities. Monitoring might reduce the agency costs of free cash flows that are available for spending at the discretion of managers. Accordingly, the need for monitoring by both parties is addressed by establishing a monitoring mechanism such as the audit committee. As evidence, Adams (1997) and Braiotta and Zhou (2006) revealed that leverage is positively and significantly associated with compliance with audit committee effectiveness. However, some prior studies on audit committee compliance revealed that leverage is negatively associated with audit committee effectiveness (i.e., Rainsbury et al., 2008; Baxter, 2010). There are some possible reasons for this finding.

First, leverage can discipline managers and reduce agency costs (Mustapha and Ahmad, 2011). Second, debt holders might directly monitor a firm without using an audit committee. In this situation, leverage might act as a monitoring mechanism in substitution for an audit committee (Rainsbury et al., 2008).

The current study expects a negative association between leverage and the compliance of public listed companies with audit committee rules. Public listed companies in Indonesia are dominated by families as controlling shareholders. As families tend to finance their companies using internal resources and bank financing, and the bank is usually in the same business group as the family controlled companies (Husnan, 2001), leverage might not require an audit committee to mitigate the agency cost of debt. This study assumes that the families themselves, who are also creditors, have a dominant role in monitoring. Therefore, leverage is considered as a substitute for an audit committee.

4.5.2 Research Stage 2: Audit Committee Effectiveness and Restatements

4.5.2.1 Audit Committee Effectiveness

Based on agency theory, one of the solutions for the agency problem is to apply good corporate governance practices, one of which is the establishment of an audit committee (Cohen et al., 2008). As a committee under the board of directors, the audit committee exists to protect the interests of shareholders through its oversight responsibility in the areas of financial reporting, internal control, and external auditing activity (BRC, 1999; SOX, 2002; BAPEPAM, 2004). The audit committee is an independent committee in the company, since it acts for the board of directors which has the knowledge and expertise to ensure the integrity and reliability of financial reporting (Joshi and Wakil, 2004). The audit committee may serve to reduce asymmetric information risk by reviewing the quality of financial information for existing and prospective investors. Therefore, the study argues that the audit committee is negatively associated with restatements.

In the extant literature, prior studies often investigated the association of audit committee attributes with certain proxies of financial reporting quality in order to identify the role of the audit committee in mitigating agency costs. The audit committee attributes included the presence of an audit committee, independent members, members with financial expertise, size, numbers of meetings and the existence of an audit charter (see Bédard and Gendron, 2010 for a complete review). As discussed in Section 3.5.5, most prior studies examined the attributes separately, while a few prior studies employed an audit committee index. However, a richer set of corporate governance characteristics is needed in research on corporate governance as there are many governance characteristics that may affect the phenomenon being studied, and omitting some of these characteristics can lead to spurious conclusions (Carcello et al., 2011a). Furthermore, some scholars (e.g., DeZoort et al., 2002; Bédard, and Gendron, 2010) have argued that the effectiveness of the audit committee must consist of some attributes, such as membership composition, authority, resources and process/diligence.

In contrast to most prior studies, this study employs an audit committee compliance index as a proxy for audit committee effectiveness. As noted by Haron et al. (2005), the audit committee is effective if it fulfils all requirements stipulated in the rules and regulations. The first step towards achieving effectiveness should therefore be full compliance with the prevailing rules and regulations. The audit committee rules in Indonesia consist of a set of mandatory requirements (i.e., membership, job duties and disclosure) that are in line with international trends (see Section 2.3.2.3 in Chapter 2).

Following Haron et al. (2005), the current study assumes that a high level of compliance with audit committee rules indicates a high level of audit committee effectiveness. That is why this study employs an audit committee compliance index, consisting of certain audit committee attributes, as a proxy for audit committee effectiveness. This study argues that the use of a compliance index as a proxy for audit committee effectiveness is in line with the idea of some scholars who have suggested using a comprehensive index to measure audit committee effectiveness (e.g., DeZoort et al., 2002; Bédard, and Gendron, 2010). In addition, since the audit committee compliance index is measured based on formal documents such as annual reports, it enables the study to detect whether compliance is just symbolic or truly indicative of the substantive implementation of the audit committee. The way to do this is to examine the relationship between audit committee effectiveness and restatements.

Based on the above explanation, this study proposes the following testable hypothesis:

H_5 *There is a negative association between audit committee effectiveness and financial restatements.*

4.5.2.2 Interaction between Audit Committee Effectiveness and Family Control

As discussed in Section 3.5.6, some scholars (e.g., DeZoort et al., 2002; Turley and Zaman, 2004; Bédard and Gendron, 2010) argued that studies on the audit committee need to explore the interaction of the audit committee with other corporate governance mechanisms, as opposed to simply examining the effect of each individual characteristic. This idea is consistent with the bundle of corporate governance theory. As discussed in Section 4.2.1, the concept of the bundle of corporate governance assumes that the effectiveness of corporate governance is dependent on the effectiveness of a bundle of corporate governance mechanisms, and not just one (Ward et al., 2009). This means that single or multiple corporate governance mechanisms do not operate in isolation from or independent of each other, but are interrelated and substitute or complement each other as a related "bundle" of practices. In terms of the interaction of the audit committee with other mechanisms, Bédard and Gendron (2010) argued that research on audit committee effectiveness outside the US, such as in developing countries, needs to examine the interaction of audit committee attributes and certain corporate governance characteristics, such as family ownership. Therefore, the hypothesis in this section attempts to examine the effect of the interaction of family control and the audit committee on restatements.

As discussed in Section 4.5.1.1, family control might reduce the effectiveness of the audit committee. This can be explained using two competing views: the alignment effect (the convergence-interest hypothesis), and the entrenchment effect. The alignment effect argues that combined control and ownership in the hands of the family might reduce type 1 agency costs (Jensen and Meckling, 1976; Fama and Jensen, 1983; Shleifer and Vishny, 1997; Anderson and Reeb, 2003). The self-monitoring of the family serves as an affective corporate governance mechanism because the controlling family has an interest in the long-term viability of the firm's reputation (Wang, 2006). With regard to Anglo-American corporate governance, the family might also interpret the implementation of an Anglo-American corporate governance mechanism (such as an audit committee) as reducing its authority (Storey, 1994; Maug, 1996). As a result, the effectiveness of family control as an informal corporate governance mechanism might reduce the need for formal corporate governance mechanisms such as a board of directors and an audit committee.

According to the entrenchment effect, family firms are less efficient because concentrated ownership creates incentives for the controlling shareholders to expropriate wealth from other shareholders (Fama and Jensen, 1983). In other words, the family has an incentive to implement weak corporate governance in order to allow for expropriation. For example, a family often places family members on boards, causing ineffective monitoring of the board and audit committee. As evidence, Jaggi and Leung (2007) found that the effectiveness of the audit committee was significantly reduced when family members were present on corporate boards.

Most prior studies examined only the effect of family control on restatements (e.g., Dechow et al., 1996; Abbott et al., 2004; Agrawal and Chadha, 2005; Donoher, 2009; Leone and Liu, 2010; Lisic et al., 2011). These studies employed the presence of the founder as CEO or board chair as a proxy for family control. They argued that that the presence of the founder as CEO or board chair reduces the effectiveness of the board's monitoring function, including that of the audit committee. However, the results of these prior studies were inconclusive. For example, some prior studies found that the founder as CEO or board chair was positively and significantly associated with restatements (i.e., Dechow et al., 1996; Agrawal and Chadha, 2005; Donoher, 2009). On the other hand, Abbott et al. (2004) and Lisic et al. (2011) did not find any significant association. The conflicting findings of prior studies provide a strong reason for the current study to examine the interaction of family control with other corporate governance mechanisms, namely, the audit committee.

In the extant literature, only the previous study by Lisic et al. (2011) comes close to this study, as it developed a CEO power index that used the CEO founder as one of its elements. The study found that the negative association between an audit committee's financial expertise and restatements was moderated by CEO power. Meanwhile, outside the restatements research stream, Jaggi and Leung (2007) found that the effectiveness of audit committees in constraining earnings management was significantly reduced when family members were present on corporate boards. This recent finding provides a convincing argument to examine family control and its interaction with formal corporate governance mechanisms such as the audit committee.

Based on the above explanation, this study proposes the following testable alternative hypothesis:

H_6 *The negative association of audit committee effectiveness and financial restatements is reduced when the company is controlled by family and the family members are present on the boards.*

4.5.2.3 Control Variables

a. Proportion of Independent Commissioners

Similar to the discussion regarding this variable in Research Stage 1, this study assumes that independent directors enhance the effectiveness of the board's monitoring function as suggested by agency theory. Thus, the study expects a negative association between the proportion of independent commissioners and financial restatements.

b. Board of Commissioners Size

As stated in Research Stage 1, there are two competing views on board size and effectiveness. Larger boards may be less effective than smaller boards due to coordination problems, free riding, and other problems (Jensen, 1993; Lipton and Lorsch, 1992). In contrast, some scholars have argued that some firms require larger boards for effective monitoring (Yermack, 1996; Adams and Mehran, 2002). Larger boards also provide firms with greater expertise and access to resources, which is line with resource dependence theory (Ning et al., 2010).

In the extant literature, most prior studies on the association between board size and restatements or fraud predicted a positive association. The results, however, were inconclusive: while Abbott et al. (2004) found a positive significant association between board size and restatements, other prior studies revealed an insignificant association between the two (e.g., Farber, 2005; Baber et al., 2005; Carcello et al., 2011b).

In line with prior studies, the current study posits that smaller boards are more effective in monitoring the quality of financial reporting. In a smaller board, each member will have more responsibility for the quality of the financial statements and the board can discuss them more extensively. In contrast, the responsibility for monitoring financial reporting in larger boards is likely to become diffused, and detailed discussions on financial reporting quality would not be feasible (Vafeas, 2000). Thus, this study predicts a positive association between board of commissioners size and financial restatements.

c. Leverage

Some scholars (e.g., Richardson, Tuna, and Wu, 2002; Johnson, Khurana, and Reynolds, 2002; Romanus et al., 2008) have argued that firms with higher levels of outstanding debt have a greater incentive for issuing restatements. This argument can be explained using the debt-covenant hypothesis. The debt-covenant hypothesis predicts that firms are likely to choose accounting methods that decrease the likelihood of debt covenant violations (Watts and Zimmerman, 1986; DeFond and Jiambalvo, 1994), as covenant violations are costly to the firm (Chava and Roberts, 2008). The high cost of covenant violations will provide a strong incentive for managers to make income increasing accounting choices (Dichev and Skinner, 2002). As a result, firms that are close to violating their debt covenants have an incentive to manage their earnings. Some prior studies (e.g., DeFond and Jiambalvo, 1994; Sweeney, 1994; Dichev and Skinner, 2002) revealed a positive association between leverage or debt defaults and earnings management activities. In addition, highly leveraged firms also have a greater incentive to misreport because of the desire to obtain financing at a lower cost (Dechow et al., 1996; Amoah, 2012). Therefore, this study posits a positive association between leverage and restatements.

d. Profitability

Firms with better performance will have fewer incentives to manage earnings, and vice versa (Romanus et al., 2008). The main motive for a change in accounting methods and earnings manipulation is to mask poor financial performance (Callen, Livnat, and Segal, 2006). As evidence, some prior studies revealed that restating companies tended to be less profitable and had higher leverage than non-restating companies (Kinney and McDaniel 1989; DeFond and Jiambalvo 1991). Thus, this study posits a negative association between profitability and restatements.

e. Listing Age

Listing age refers to the length of time that a firm's common stock has been publicly traded (Abbott et al., 2004; Carcello and Nagy, 2004a; 2004b). It is assumed that older firms are less likely to restate their financial results than younger firms, since an older firm has a lengthy history as a listed company, and the quality of its disclosures tends to be higher than those of younger firms. There are some possible explanations for the argument. First, older firms have more experience and a learning process that reduces the possibility of restatements (Alyousef and Almutairi, 2010). Second, firms are likely to face greater pressure when newly listed on the stock exchange (Carcello and Nagy, 2004b). In the US, newly listed firms also encounter difficulty with the SEC's enforced reporting requirements, and may not have established commensurate financial reporting controls (Beasley, 1996). Third, newly listed firms face pressure to boost their earnings and this might cause managers to issue restatements (Abbott et al., 2004; Carcello et al., 2011b). Therefore, the current study expects a negative association between listing age and financial restatements.

Table 4.2 presents a summary of the hypotheses developed for both Research Stage 1 and Research Stage 2, and includes the theories underlying their development.

Table 4.2 Summary of Hypothesis Statements

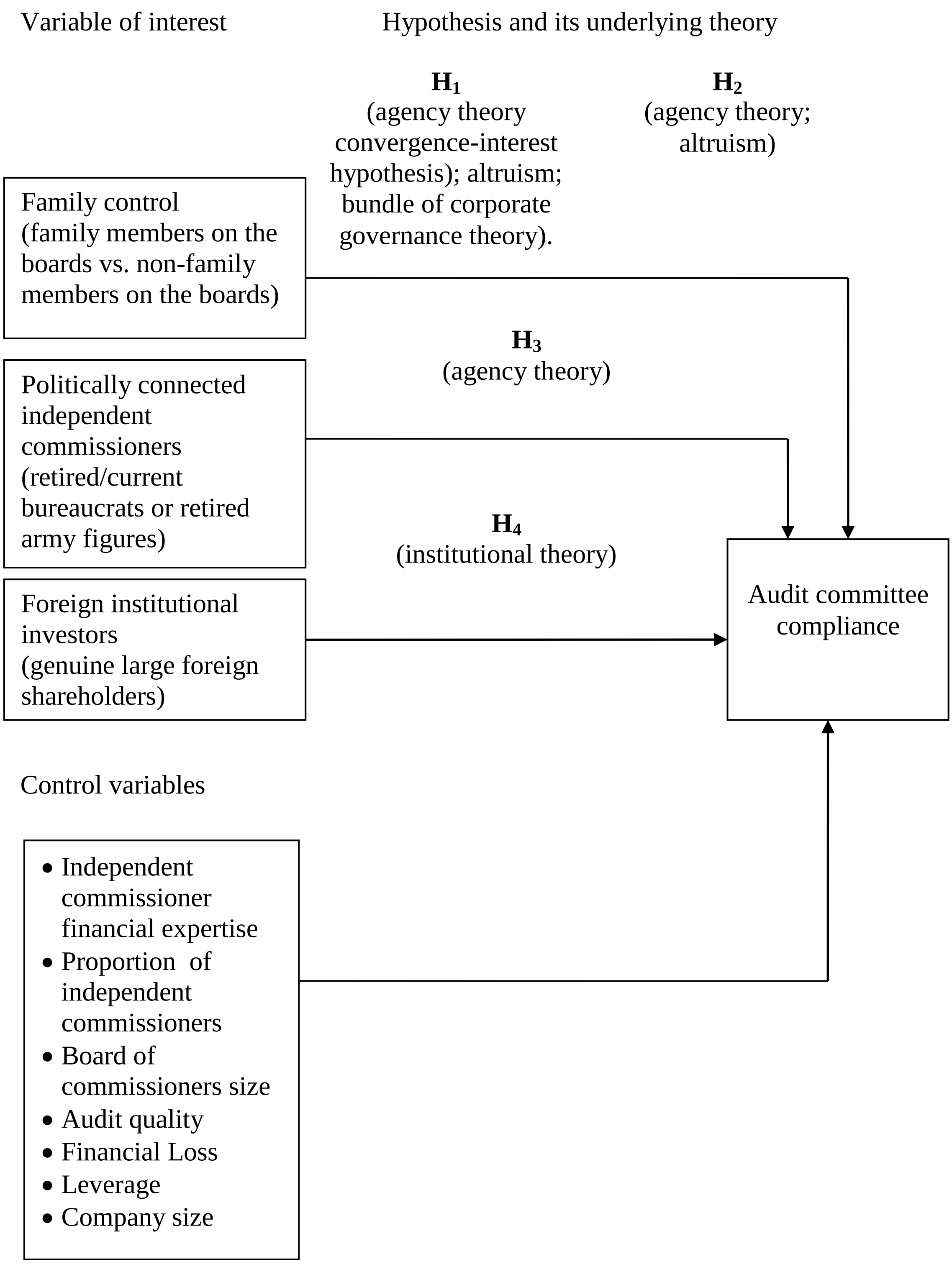
Hypothesis	Underlying theory	Statement of hypothesis
Research Stage 1: Determinants of the compliance of public listed companies with audit committee rules		
H_1	Agency theory; altruism; bundle of corporate governance theory.	*Family-controlled companies with family members represented on the boards are less likely to comply with audit committee rules*
H_2	Agency theory; Altruism	*Family-controlled companies with non-family members represented on the boards are more likely to comply with audit committee rules.*
H_3	Agency theory	*Public listed companies with a politically connected independent commissioner are less likely to comply with audit committee rules.*
H_4	Institutional theory	*Public listed companies with a large genuine foreign institutional investor are more likely to comply with audit committee rules.*
Research Stage 2: Audit Committee Effectiveness and Financial Reporting Quality		
H_5	Agency theory	*There is a negative association between audit committee effectiveness and financial restatements.*
H_6	Agency theory; bundle of corporate governance theory	*The negative association of audit committee effectiveness and financial restatements is reduced when a company is controlled by family and the family members are present on the boards.*

4.6 RESEARCH FRAMEWORK

Even though Research Stage 1 and Research Stage 2 are interrelated, the research framework for each is presented separately. Figure 4.3 presents a diagrammatic representation of the research framework for Research Stage 1, while Figure 4.4 presents the diagrammatic representation of the research framework for Research Stage 2. There are two reasons for the separation. First, the several independent variables employed in the first stage are different from those employed in the second. For example, the independent variables of interest in Research Stage 1 are politically connected independent commissioners, family control and foreign institutional investors. Meanwhile, only family control is included as an independent variable of interest in Research Stage 2. Similarly, the control variables in Research Stage 1 differ slightly from those in Research Stage 2. For example, some control variables present in Research Stage 1 (audit quality, leverage, loss and company size), are not present in Research Stage 2. In contrast, listing age and return on assets, which are included as control variables in Research Stage 2, are not present in Research Stage 1. Second, each of the study's research stages uses a different type of data and method of analysis. In Research Stage 1, the data is short balanced panel data covering the period 2006-2008. The use of this data is to fill the gap of a lack of prior studies that employed panel data on the compliance of public listed companies with audit committee rules, as panel data is useful for policy analysis (Wooldridge, 2009). Consequently, the method of analysis for panel data includes statistical analysis such as fixed effects or random effects. For Research Stage 2 on the other hand, data is cross sectional, even though the period covers 2006-2009. The method of analysis uses matched pair logistic analysis, which has been widely used in studies on restatements. In short, the separate presentation is intended to facilitate an ease of understanding.

Figure 4.3 shows all the independent variables investigated by the study. The dependent variable is the compliance of public listed companies with audit committee rules, while the independent variables are politically connected independent directors, family control and foreign institutional investors. The use of these independent variables is to fill in the literature gap, namely, that the dominance of the agency theory ignores the institutional context. As discussed in in Section 3.5.4, most prior studies on the determinants of compliance with audit committee rules derived their variables based on the Anglo-American agency problem (agency problem type 1), whereas the agency problem in a developing country is different from that in a developed country. As a result, some relevant institutional factors in developing countries, such as family owners as controlling shareholders, foreign ownership, and collusion between businesses and politicians have been ignored by most prior studies. Other variables that have been widely used in prior studies (i.e., proportion of independent commissioners, financial expertise of independent commissioners, size of the board of commissioners, loss, leverage, audit quality and company size are placed as control variables.

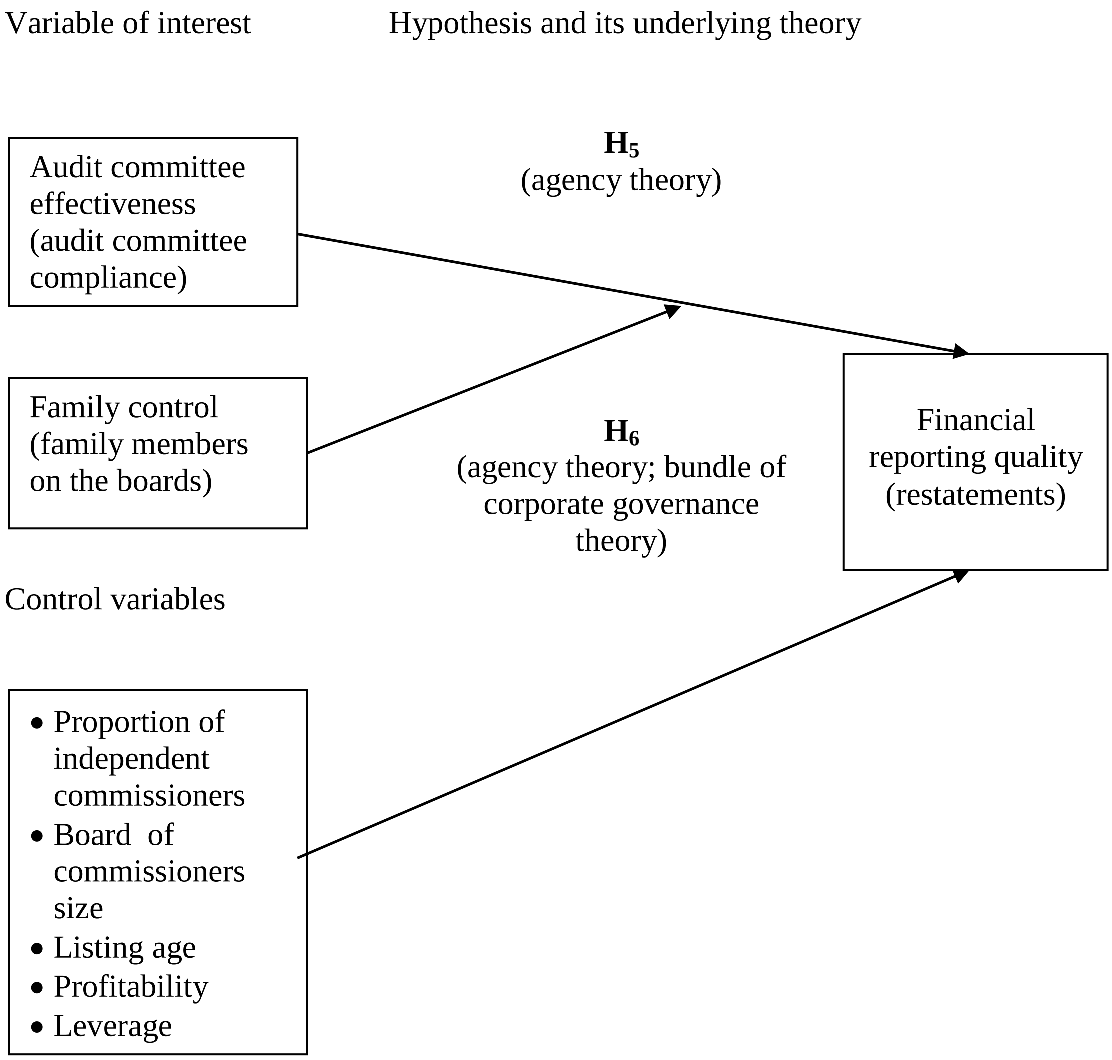
Figure 4.3 Research Framework of the Study on the Determinants of Compliance of Public Listed Companies with Audit Committee Rules (Research Stage 1)



As can be seen in Figure 4.4, the dependent variable in Research Stage 2 is restatements, while the independent variables are family control and the compliance of public listed companies with audit committee rules that served as the dependent variable in Research Stage 1. The study assumes that the level of audit committee compliance also measures audit committee effectiveness. As noted by Haron et al. (2005), the audit committee is effective if it fulfils all the requirements stipulated in the rules and regulations; the first step towards effectiveness should therefore be full compliance with the prevailing rules and regulations. Meanwhile, the control variables are the proportion of independent commissioners, size of the board of commissioners, leverage, profitability and listing age. As this study has to consider the adequacy of the ratio of cases to variables that meet the requirements for logistic analysis, the control variables in Research Stage 2 are few, anticipating the limited number of restatements during the period of observation. It is noted that prior studies using restatements in developing countries often obtained a limited number of samples (e.g., Abdullah et al., 2010; Alyousef and Almutairi, 2010).

In Research Stage 2, the study also examines the interaction between audit committee effectiveness and family control. This is intended to fill the literature gap of a lack of empirical investigations on the interaction of the audit committee and other corporate governance mechanisms. Audit committees alone are unlikely to improve financial reporting quality, and they evidently interact with other corporate governance mechanisms (DeZoort et al., 2002; Turley and Zaman, 2004; Bédard, and Gendron, 2010).

Figure 4.4 Research Framework of the Study on Audit Committee Effectiveness and Financial Reporting Quality (Research Stage 2)



4.7 CONCLUSION

This chapter presented the underlying theories behind the study, articulated the need for the use of an audit committee index and justified using restatements as a proxy for financial reporting quality. It also discussed the development of hypotheses derived from the underlying theories, and linked them to the research framework. Next, Chapter 5 presents the research method adopted in each research stage. The discussion of research methods includes the research approach, sample, measurement of variables, data sources and method of analysis.

CHAPTER 5

RESEARCH METHODOLOGY

5.1 INTRODUCTION

The purpose of this chapter is to explain the research methodology adopted for this study. The research paradigm employed in the study is presented in section 5.2. The discussion on the research methodology is divided into Section 5.3 and Section 5.4. Section 5.3 covers the study on the determinants of compliance of public listed companies with audit committee rules (Research Stage 1), while Section 5.4 deals with the study on the association of audit committee effectiveness and restatements (Research Stage 2). For each research stage, issues related to sample selection, variables measurement, data sources and method of analysis are discussed. The chapter concludes with Section 5.5.

5.2 RESEARCH METHODOLOGY

According to Chua (1986), there are three accounting research paradigms: positivist, interpretive and critical theory. Each of the paradigms (shown in Table 5.1) has a different ontology, epistemology and methodology. Positivism is a belief system that emerged from practices in the natural sciences. It assumes that subjects of research can be investigated objectively, and their veracity can be established with a reasonable degree of certainty (Brand, 2009). Its ontology assumes that reality is static and fixed, while its epistemology assumes that knowledge is objective. The positivist methodology involves testing the hypotheses, which is called hypothetico-deductivism. Hypotheses, which are claimed as general principles, are tested empirically by observation with statistical analysis (a quantitative method) to arrive at a generalization (Hooper, 2006). The interpretive paradigm, on the other hand, could be categorised as non-positivist as it has views that are opposite to those of positivism. Ontologically, interpretivism views reality as subjective and changing, while its epistemological stand is that knowledge is subjective. In terms of methodology, this paradigm focuses on understanding particular situations by using qualitative methods to capture various interpretations of a phenomenon. Finally, the critical theory paradigm refers to a form of research that does not contend with the status quo (Brand, 2009). The difference between the interpretive and critical theory paradigms is that the interpretive paradigm involves research merely to understand, whereas the critical theory paradigm involves research that challenges (Crotty, 1998). However, the critical theory paradigm does not provide a particular method for research, only a process for evaluating and considering knowledge (Hooper, 2006). In other words, the critical theory paradigm does not favour empiricism over qualitative methods, or vice versa; research in this paradigm may use both quantitative and qualitative methods.

Table 5.1 Summary of Research Approach

Item	Positivist	Interpretive	Critical Theory
Ontology (what is the nature of reality?)	Reality is static and fixed. The world is ordered according to an overarching objective truth.	Reality is subjective and changing. There is no one ultimate truth.	Reality may be objective, but truth is continually contested by competing groups.
Epistemology (what is the nature of knowledge?)	• Objective, generalisable theory can be developed to accurately describe the world. • Knowledge can be neutral or value-free.	• Knowledge is subjective. There are multiple, diverse interpretations of reality. • There is no one ultimate or ‘correct’ way of knowing.	• Knowledge is co-constructed between individuals and groups. • Knowledge is mediated by power relations and therefore continuously under revision.

Table 5.1 (continued)

Item	Positivist	Interpretive	Critical
Methodology (what is the nature of the approach to research?)	• The aim is to discover what exists through prediction and control. • Theory is established deductively. • Uses scientific methods to develop abstract laws, to describe and to predict patterns. • Looks for causality and fundamental laws.	• Focus on understanding. • Uses inductive reasoning. • Meaning is constructed in the researcher-participant interaction in the natural environment. • Gathers diverse interpretations (e.g., grounded theory, ethnography).	• Focus on emancipation. • Research is used to envision how things could change for the better. • Seeks representation of diverse and under-represented views. • Characterised by continual redefinition of problems and cooperative interaction (e.g., action research).
Methods (what techniques can be used to gather this information?)	Tends to use quantitative methods, often including statistical testing of hypotheses (e.g. randomised controlled trials, questionnaires).	Tends to use qualitative methods to capture various interpretations of a phenomenon (e.g. naturalistic observation, interviews, use of narrative).	• May use both quantitative and qualitative methods, usually in a participatory way. • Often uses iterative research design (e.g., case studies, focus groups, participant observation).

Source: Adapted from Bunniss and Kelly (2010)

Among the three paradigms, positivism is the most dominant in accounting literature (Chua, 1986; Bisman, 2010). Positivist research also dominates the types of papers published in top tier US journals (Oler, Oler, and Skousen, 2010). Positivist research in accounting assumes that the accounting world is knowable and characterised by constant relationships, thus, accounting theory must have the ability to predict and to explain (Hooper, 2006). Positivist research starts with hypotheses, which are deduced from accounting theory. This is followed by data analysis to determine whether the data support the hypotheses. Corporate governance studies have traditionally adopted agency theory the as the dominant theory that focuses exclusively on resolving conflicts of interest (agency problems) between corporate management and shareholders. Meanwhile, agency theory itself is derived from positivist theory and is considered the most influential accounting research approach in explaining and predicting (Hooper, 2006). Typically, positivist researchers identify situations in which conflict between owners and management is present, and then describe the governance mechanisms that overcome the agency problems (Eisenhardt, 1989). Positivism was a dominant paradigm in prior studies on audit committees, which were marked by the wide adoption of agency theory followed by data analysis using quantitative methods (see Beasley et al., 2009).

In line with mainstream corporate governance studies, this study is similarly situated in the positivist paradigm. As discussed in Chapter 2, the purpose of the presence of an audit committee is to reduce the agency problem, which is in line with agency theory. Thus, as discussed in Chapter 3, this study starts to develop hypotheses based on agency theory. Other theories, such as the bundle of corporate governance theory and institutional theory, are used as complementary theories. To test the hypotheses, the study employs the quantitative research approach. Quantitative research is the systematic scientific examination of quantitative phenomena and their properties and links. The aim of quantitative research is to create and utilise mathematical models, theories and hypotheses pertaining to natural phenomena (Cavana, Delahaye, and

Sekaran, 2001). To capture data, this study uses the content analysis approach using secondary data such as the annual reports of companies and other documentary evidence. Content analysis is a method of analysing documents that allows the researcher to test theoretical issues to enhance understanding of the data. Therefore, data was hand-collected via content analysis involving reading and finding information from annual reports, announcements of public listed companies to stock exchanges and other relevant resources.

Archival research is well suited for this study, as both stages of research explore the issue of association. Research Stage 1 attempts to examine the association between specific Indonesian business characteristics (family control, foreign institutional investors, politically connected independent commissioners) and a corporate governance mechanism (the audit committee). Meanwhile, Research Stage 2 examines the association between a corporate governance mechanism (the audit committee) and financial reporting quality (restatements). As suggested by Carcello et al. (2011a), archival research is appropriate for analysing the association between corporate governance and outcomes. Furthermore, using an index that collects data from corporate archives in order to assess the compliance of companies with corporate governance rules was widely used by prior studies on corporate governance compliance.

5.3 RESEARCH DESIGN FOR RESEARCH STAGE 1: DETERMINANTS OF COMPLIANCE OF PUBLIC LISTED COMPANIES WITH AUDIT COMMITTEE RULES

5.3.1 Sample Selection

This study uses panel data covering the 2006 to 2008 period. The starting year of 2006 was chosen because the BAPEPAM-LK rule No. X.K.6 concerning the mandatory disclosure of information related to audit committees took effect in that year. Thus, the mandatory disclosure requirement enables an examination of actual audit committee practices. There were a total of 1129 company-year observations during the 2006-2008 period, however this initial sample was reduced due to the reasons shown in Table 5.2, and detailed next.

First, banks and state owned enterprises were removed from the sample as they are subject to different corporate governance requirements (discussed in Chapter 2). In addition, these sectors have become targets for corporate governance reforms; Bank Indonesia strictly monitors the implementation of corporate governance reforms in the banking sector, while the Ministry of State Enterprises diligently supervises the implementation of such reforms at state owned enterprises. The tight monitoring done by these government agencies might serve as a monitoring mechanism substitute (Demsetz and Lehn, 1985). As noted by Beasley and Salterio (2001), a regulatory agency might require firms to enhance the effectiveness of their boards and audit committees to enhance the ability of regulators to monitor firms on behalf of the state. As evidence, Nuryanah (2004) reports that the banking sector's level of compliance with the IDX's rule-related corporate governance requirements is higher than that of other sectors.

Second, new public listed companies – those which were listed starting in 2007 and 2008 – were removed from the sample, as the study used a balanced panel that required each company to have the same number of observations (Gujarati and Porter, 2009). In the case of companies newly listed in either 2007 or 2008, their data would be incomplete as three years of observations were not available.

Third, cross-listed companies – public companies listed not only on the IDX but also on other exchanges – were also removed from the sample. When a country's legal enforcement is weak, companies have an incentive to develop functional alternatives to assure that minority shareholder interests are protected (Cai, 2007). One alternative is for the company to voluntary "bond" itself. It is widely accepted in literature that cross-listing is considered as a voluntary bonding mechanism to enhance corporate governance practice. Some prior studies revealed that cross listing increases investor confidence and monitoring that might reduce agency costs (Saliva, 2003), increases disclosure (e.g., Huafang and Jianguo, 2007; Tsamenyi, Enninful-Adu, and Onumah, 2007) and increases corporate governance ratings (e.g., Woejcik, Clark, Bauer, 2005). The elimination of cross-listed companies enables this study to focus on domestic factors, since a cross-listed company might have more incentive than a company only listed on the IDX to improve the effectiveness of its audit committee. During the 2006-2008 period, 8 public listed companies providing 24 firm-year observations were cross-listed.

Fourth, public listed companies that were merged or delisted during the 2006-2008 period were removed from the sample because this caused unbalanced panel data. Fifth, public listed companies with incomplete annual reports during the 2006-2008 period were also removed from the sample because the absence of annual reports of certain listed companies in the period caused unbalanced panel data. These selection procedures resulted in a final sample of 828 firm-year observations. A list of the public listed companies included in the sample is shown in Table B.1 (Appendix B).

Table 5.2 Sampling Selection Procedure

Sample selection	Number
Total number of firm-year observations of IDX-listed companies from 2006 to 2008	1129
Less:	
Firm-year observations of listed banks during the 2006-2008 period	(69)
Firm-year observations of listed state owned enterprises during the 2006-2008 period	(27)
Firm-year observations of companies listed after 2006	(41)
Firm-year observations of cross-listed companies during the 2006-2008 period	(24)
Firm-year observations of delisted and merged companies during the 2006-2008 period	(9)
Firm-year observations of companies with incomplete annual reports during the 2006-2008 period	(131)
Final sample of firm-year observations of listed companies during the 2006-2008 period	828

5.3.2 Variables Measurement and Data Sources

5.3.2.1 Audit Committee Compliance Index

This study examines the compliance of public listed companies on the IDX with audit committee rules. To measure compliance, an index called the audit committee compliance index total (ACCIT) was developed for the study. As discussed in Chapter 3, the use of self-developed compliance indexes in prior studies on compliance with audit committee rules was rare; it was more common in prior studies on compliance with corporate governance codes (e.g., Khanchel, 2007; Ananchotikul et al., 2008; Shaukat, 2008).

The audit committee compliance index total (ACCIT) consists of audit committee requirements extracted from two recent BAPEPAM rules, namely, BAPEPAM (2004) regarding membership requirements and job duties, and BAPEPAM-LK (2006) regarding audit committee disclosure. This implies that the ACCIT could be divided into two sub-indexes: an audit committee compliance index (ACCI2004) based on BAPEPAM (2004), and an audit committee compliance index (ACCI2006) based on BAPEPAM-LK (2006). As presented in Table 5.3, BAPEPAM (2004) consists of 10 requirements, while BAPEPAM-LK (2006) consists of 3 requirements. Thus, a total of 13 requirements have been extracted from the two rules. To measure the level of compliance, this study utilised a binary scoring system: if a company complied with a particular requirement, it got a score of 1, otherwise it scored 0. The level of compliance of a particular company was obtained from the sum of the scores of all the requirements.

Data for measuring the ACCIT was collected from two sources: the annual reports of the public listed companies in the sample, and announcements made by the public listed companies to the IDX. The annual reports were used to collect audit committee data related to membership and job duties (ACCI2004). Data was sourced from the corporate governance section of the reports, and from other parts of the reports where information related to the audit committee was located. However, important information was sometimes not found in the reports due to low levels of disclosure. To overcome this lack of information, audit committee information was sourced from the announcements of public listed companies to the IDX. Since public listed companies in Indonesia are required to report any changes regarding their audit committee to the IDX, announcements of such changes should appear in the IDX's online interactive database. If the required information was not found in either the annual reports or the announcements to the IDX, the study assumed that the company did not comply with the requirement and the company was given a score of 0. For compliance with audit committee disclosure in annual reports (ACCI2006), information was sourced solely from the annual reports of the public listed companies in the sample. If there was no audit committee disclosure in the annual report as required by BAPEPAM-LK (2006), it was assumed that the company did not comply and the company got a score of 0.

In developing the ACCIT, the equal weight approach was used. This meant that each sub index (ACCI2004 and ACCI2006) had equal weight. The equal weight approach was chosen as it is transparent and relatively objective (Florou and Galarniotis, 2007). As noted by Van den Berghe and Levrau (2003), assigning different weightings to different governance dimensions would appear to be based on subjective judgment. In addition, the underpinning theory concerning which variables or dimensions are most important in evaluating governance quality is relatively weak (Florou and Galarniotis, 2007; Black, Jang, and Kim, 2006). The equal weight approach was also used by some prior corporate governance studies (e.g., Alves and Mendes, 2004; Drobetz, Schillhofer, and Zimmerman, 2004; Mangena and Pike, 2005; Florou and Galarniotis, 2007; Abdul Wahab, How, and Verhoeven, 2007). Given the use of the equal weight approach, the formula to compute total compliance (ACCIT) is as follows:

$$ACCIT = \frac{(ACCI2004 + ACCI2006)}{2}$$

where $ACCI2004 = \frac{1}{10} \sum_{j=1}^{10} X_j$ and $ACCI2006 = \frac{1}{3} \sum_{j=1}^{3} Y_j$

X = requirement of BAPEPAM (2004)

Y = requirement of BAPEPAM-LK (2006)

Using this formula, the maximum ACCIT score for each public listed company is 1, and the minimum score is 0. ACCIT scores for each company in the sample are depicted in Table B.1 (Appendix B).

Table 5.3 Weights and Data Sources of Components of the Audit Committee Compliance Index Total (ACCIT)

No.	Requirements	Rules	Data source	Weight
	Structure, membership and independence			
1	Comprises at least three members		AR; CAI	
2	Comprises at least one independent commissioner and other members shall be external, independent parties.		AR; CAI	
3	Chairman is an independent commissioner.		AR; CAI	
4	One member shall have an educational background in accounting or finance.	BAPEPAM (2004)	AR; CAI	
	Job duties			
5	Establish an audit committee charter.		AR; CAI	
6	Examining the financial information.		AR; CAI	
7	Reviewing the compliance of the company with regulations.		AR; CAI	50 %
8	Reviewing the internal auditor's work.		AR; CAI	
9	Reporting of risks and risk management implementation.		AR; CAI	
10	Scrutinizing and reporting of complaints.		AR; CAI	
	Disclosure			
11	Name, position and brief profile of audit committee members.		AR	
12	Frequency of meetings and attendance of each member.	BAPEPAM-LK (2006)	AR	50%
13	Brief report of audit committee activities.		AR	

Notes: AR=annual report; CAI=company announcements to the IDX

5.3.2.2 Genuine Large Foreign Institutional Investors

In measuring this variable, this study focused on the top foreign institutional investors. This study categorized the foreign institutional investors as large if they had ownership of at least 20 percent. The use of a 20 percent cut-off level was consistent with prior studies (e.g., Sato, 2004; Chevalier et al., 2006; Tribo, Berrone, and Surroca, 2007; Achmad et al., 2009).

After defining the large foreign institutional shareholders, it was necessary to identify whether they were genuine. Identification of their authenticity was the most difficult part of the study's data collection process, as well as its most time consuming. As explained in Chapter 2, the foreign institutional investors of public listed companies often intentionally keep secret their ultimate owners, mainly for taxation purposes. Except for banks, there are no regulations in Indonesia requiring the disclosure of a company's ultimate shareholders (World Bank, 2010). The use of databases, such as Bloomberg, to trace the ultimate shareholder was not useful since Bloomberg categorised the suspected foreign institutional investors as "internal transaction" and, as such, no further information was available. Therefore, an innovative approach was required to trace the ultimate owners of the suspected foreign institutional investors.

In the investigation of the authenticity of foreign institutional investors, large foreign institutional investors formed in tax haven countries, or countries with treaty agreements with Indonesia, were classified as "Indonesian offshore companies" or suspect foreign institutional investors. After this, the investigation followed the steps presented in Table 5.4. Four steps for tracing the ultimate owners of suspect foreign institutional investors are detailed in the table. In the first step, the investigation sought information from the public listed company's formal documents, such as its annual reports and announcements to the IDX. In the second step, the investigation sought to obtain information from reliable business magazines or newspapers. In the third step, information was collected from the business profile purchased from a regulatory agency in the foreign institutional investor's registered home country. In the fourth step, the investigation was required to make a judgement based on certain criteria, since the first three steps did not provide any information.

Table 5.4 Steps in Tracing the Ultimate Owners of Suspect Foreign Institutional Investors

Step	Explanation
Step 1	The study examines the public listed company's annual report and tries to find information related to the suspect foreign institutional investor. If there is no information in the report, the study attempts to find the information from the listed company's announcements to the IDX. To provide more information, company announcements filed since the period before the suspect foreign institutional shareholder became a shareholder in the company are examined. This is mostly from the year 2000 onward, since most companies started their debt restructuring during that time. Company announcements include announcements about any significant activities in the company, short prospectuses for certain corporate actions and monthly reports of share ownership prepared by the share registrar. Sometimes the minutes of annual general meetings of shareholders can be found in the IDX database, however not all public listed companies disclose their minutes. Minutes of AGMs may be helpful in finding information related to foreign institutional investors, as the minutes may report the name of the representative of the suspect foreign institutional investor that attended the meeting. With regard to the short prospectuses issued for certain corporate actions, sometimes the ultimate owner of foreign institutional investors can be found in the document. If no information can be collected from any of these sources, the study then moves to Step 2.
Step 2	The study collects relevant information on the suspect foreign institutional investors from reliable business magazines/newspapers, both local and foreign. The business magazines include Tempo, Investor Daily, Viva and Forbes, and the newspapers are Kontan, Neraca and Bisnis Indonesia. Information is also collected from equity analyses prepared by market research analysts. If there is no available information from these sources, the study moves to Step 3 for Singaporean and Hong Kong foreign institutional investors, or to Step 4 for other foreign institutional investors.
Step 3	This step is for suspect foreign institutional investors established in Singapore and Hong Kong. In these countries, a business profile of the registered company can be purchased from the company regulator. For Singaporean institutional investors, a business profile can be obtained from the Accounting and Corporate Regulatory Authority (ACRA). For Hong Kong institutional investors, a business profile can be bought from the Integrated Companies Registry Information System (ICRIS). Sometimes, the ultimate owner of the suspect foreign institutional investor still cannot be found, as the company uses the name of a company located in a tax haven country as a shareholder. In this case, the study moves to the last step in the procedure, Step 4.

Table 5.4 (continued)

Step	Explanation
Step 4	This step uses a judgment to define whether the ultimate owner of a suspect foreign institutional investor is Indonesian, since no relevant information was found in Steps 1 to 3. The judgment is based on the following criteria: a. The foreign institutional investor is established in a tax haven country, or a country that has a tax treaty agreement with Indonesia. The establishment of the foreign firm occurs only a few days/months before the firm became a shareholder of the listed company in Indonesia. This indicates that the establishment of the firm might be just for investment in Indonesia and for treaty shopping, as discussed in Chapter 2. In addition, sometimes the foreign investor has no relevant experience in the field of business of the Indonesian listed company. b. Even though the suspect foreign institutional investors has had a significant stake in the Indonesian listed company for a long period of time (such as more than 1 year), the management of the acquired listed company (board of directors and board of commissioners) remains completely unchanged. This is very unusual for a takeover, and indicates that the suspect foreign institutional investor might have a close relationship with the Indonesian controlling shareholders. c. Sometimes the entry of the suspect foreign institutional investor causes a change in management, however, the newly appointed director or commissioner is Indonesian. This provides an indication that the suspect foreign institutional investor might be owned by Indonesians.

Source: Developed by the author

Based on the above steps, this study managed to identify several foreign institutional shareholders that were owned by Indonesians. The complete list of the Indonesian offshore companies is shown in Table C.1 (Appendix C). The list includes Indonesian offshore companies in the form of special purpose interests, and also well-known banks that usually act as custodian banks on behalf of the Indonesian shareholders. The special purpose interests are formed in tax haven countries, while the banks, which act as nominees, usually operate in Singapore. Table 5.5 presents the location of the Indonesian offshore companies – excluding the banks, which act as custodians or nominees. As can be seen, Singapore and the British Virgin Islands are the most favourite jurisdictions for Indonesian offshore companies. It seems that the advantages of forming Indonesian offshore companies in Singapore include the close proximity of Indonesia to Singapore, and the tax treaty agreement between the two countries. As a result, Indonesian offshore companies registered in Singapore enjoy lower tax rates on income earned from operations in Indonesia. Meanwhile, the British Virgin Islands offers some tax benefits, such as no dividend and interest tax, no royalty tax and no personal income tax (Deloitte, 2011). As discussed in Chapter 2, Indonesian offshore companies arguably do not enhance the corporate governance practices of listed companies in Indonesia. Therefore, public listed companies which had foreign institutional investors with large stakes (20 percent and above), and that were genuine (not Indonesian offshore companies or banks acting as custodians on behalf of Indonesians), were scored 1, otherwise 0.

Table 5.5 List of Jurisdictions of Indonesian Offshore Companies

No.	Jurisdiction	No. of Observations	Percentage
1	Singapore	16	29
2	British Virgin Islands	16	29
3	Hong Kong	7	13
4	Mahe, Seychelles	4	7
5	Labuan, Malaysia	3	5
6	Cayman Islands	2	4
7	Mauritius	2	4
8	Samoa	2	4
9	Cook Islands	1	2
10	Charlestown, Nevis	1	2
11	Jersey, Channel Islands	1	2
12	Marshall Islands	1	2
	Total	56	100

Source: Compiled by the author

5.3.2.3 Other Independent Variables of Interest

Besides the authenticity of large foreign institutional investors, other independent variables examined in this study included family-controlled company with family members on the boards (FMLBOCD), family-controlled company with professional management (PROFBOCD) and politically connected independent commissioners (POLIC). All were measured using nominal scale.

For the family-controlled company with family members on the boards (FMLBOCD) variable, the public listed company was scored 1 if one or more family members sat on the board of directors, the board of commissioners, or both; it scored 0, otherwise. It is common in East Asia, including Indonesia, for controlling shareholders to control the company through pyramid structures and cross-holdings among firms (Claessens et al., 2000). In pyramid structures, it is possible that the controlling shareholder controls the firm through a small stake (Bebchuk, Kraakman, Trianties, 2000). In this study, a family might control a company, with a small stake, through a pyramid structure. Therefore, the study did not determine a certain cut-off level of family ownership: as long as the family had ownership and it placed a family member on one or more of the boards, the combination of control and ownership was considered to be in the hands of the family. This measurement was consistent with prior studies (e.g., Anderson and Reeb, 2004; Wang, 2006; Jaggi and Leung, 2007; Jiraporn and Dadalt, 2009). The study simply relied on the annual report, IPO prospectus, monthly report of share ownership prepared by the share registrar, and other secondary resources such as Conglomeration Indonesia (1997) and Top Companies and Big Groups in Indonesia (1995), to identify the ownership percentage of families and family members who sat on the boards. If there was a change in ownership after the IPO, the study collected information from the short prospectuses and the announcements of public listed companies to the IDX.

In terms of the family-controlled company with professional management (PROFBOCD) variable, the public listed company was scored 1 if the company was controlled by a family holding ownership of 20 percent or more of the company and with no family members on the board; it scored 0, otherwise. The use of 20 percent as a cut-off point was to ensure that the family was actually the controlling shareholder with a large enough stake in the company. Like the FMLBOCD variable, data sources for the measurement of this variable consisted of the annual report (biographies of directors and commissioners, company ownership structure), the IPO and short prospectuses, the monthly report of share ownership prepared by the share registrar, and the announcements of the public listed company to the IDX.

With regard to the politically connected independent commissioners (POLIC) variable, the pubic listed company was scored 1 if one or more of the independent commissioners were retired army officers or current or retired bureaucrats; it scored 0, otherwise. Bureaucrat refers to a person who is currently, or was formerly, an officer of a central government, local government or government agency. The data source for measuring this variable was the annual report of the company and, in particular, the profiles of the members of the board of commissioners. In addition to the names of the commissioners, the profile typically contained information on their age, gender, education, professional background, and employment history.

5.3.2.4 Control Variables

The financial expertise of independent commissioners (ICED) was measured using nominal scale. A listed company was scored 1 if the independent commissioner appointed as the audit committee chair had an educational background in accounting or was a CPA holder; it was scored 0, otherwise. This definition was consistent with the

BAPEPAM (2004), which required at least one member of the audit committee to have an educational background in accounting or finance. Obviously, this definition is narrower than the BRC (1999) and the SOX (2002), but it was adopted due to the lack of comprehensive disclosures on the backgrounds of commissioners in company annual reports. The measurement approach is similar to Bradbury et al. (2009). The information was collected from the biographies of commissioners contained in the annual reports of the listed companies.

The proportion of independent commissioners (BOC) variable was measured by comparing the number of independent commissioners to the total number of commissioners on the board of commissioners, and calculating the percentage. The BAPEPAM rule (2004) defines an independent commissioner as a person who comes from outside the firm and is free from any business relationship with it. Board of commissioners size (BCS) variable was measured by counting the total number of commissioners on the board of commissioners. Company size (SIZE) was measured using the natural log of total assets. For audit quality (AUD), a company was scored 1 if it had been audited by one of the Big Four firms; it was scored 0, otherwise. To operate in Indonesia, foreign accounting firms, such as the Big Four, are obligated to partner with local public accounting firms. Financial loss (LOSS) was measured using nominal scale, and the listed company was scored 1 if there was negative income in the year of observation; it was scored 0, otherwise. Leverage (LEV) was measured as the ratio of total liabilities to total assets and was used to control for the liquidity of the firm. The data sources for these variables included the annual reports of public listed companies and the Indonesia Capital Market Directory (ICMD). A complete list of variables measured in the study is shown in Table 5.6.

Table 5.6 Summary of the Variables Measured in Research Stage 1

Main Variables	Measurement and Scoring
GLFGR	1 if the top foreign institutional investor was genuine and large (ownership is at least 20 percent), 0 if otherwise.
FMLBOCD	1 if at least one family member is a board member, 0 if otherwise.
PROFBOCD	1 if the firm was controlled by family (ownership is at least 20 percent) and was managed by a professional, 0 if otherwise.
POLIC	1 if one or more independent commissioners was a retired army officer or current or retired bureaucrat, 0 if otherwise.
Control Variables	
ICED	1 if an independent commissioner, as audit committee chair, had educational background in accounting or was a CPA holder, 0 if otherwise.
BOC	Number of independent commissioners divided by the total number of members on the board of commissioners.
Control Variables	
BCS	Number of members on the board of commissioners.
AUD	1 if the listed company was audited by a Big 4 auditor, 0 if otherwise.
LOSS	1 if the listed company had a negative net income in the year of obersvation, 0 if otherwise.
LEV	Debt ratio = total debt to total assets.
SIZE	Natural log of total assets at year-end.

5.3.3 Research Models

Based on the research framework and the hypotheses constructed in Chapter 4, multiple regression models were developed for testing the hypotheses. Two multiple regression models were developed to examine the relationship between the independent variables and compliance with audit committee rules. The data analysis used panel data analysis and the Stata version 11.1 software application. The specifications of the models are as follows:

Model 1

$$ACCIT_{it} = \beta_{0it} + \beta_1 FMLBOCD_{it} + \beta_2 GLFRG\mathit{it} + \beta_3 POLIC_{it} + \beta_4 ICED_{it} + \beta_5 BOC_{it} + \beta_6 BCS_{it} + \beta_7 AUD_{it} + B_8 LOSS_{it} + \beta_9 LEV_{it} + \beta_{10} SIZE_{it} + \varepsilon_{it}$$

Model 2

$$ACCIT_{it} = \beta_{0it} + \beta_1 PROFBOCD_{it} + \beta_2 GLFRG\mathit{it} + \beta_3 POLIC_{it} + \beta_4 ICED_{it} + \beta_5 BOC_{it} + \beta_6 BCS_{it} + \beta_7 AUD_{it} + B_8 LOSS_{it} + \beta_9 LEV_{it} + \beta_{10} SIZE_{it} + \varepsilon_{it}$$

Where:

FMLBOCD = family-controlled company with family members on the boards

PROFBOCD = family-controlled company with professional management

GLFRG = genuine large foreign institutional investor

POLIC = politically connected independent commissioners

ICED = independent commissioner with financial expertise

BOC = proportion of independent commissioners

BCS = board of commissioners size

AUD = audit quality

LOSS = financial loss

LEV = leverage

SIZE = company size

ε = error term

The two models use similar variables to some extent, however Model 2 is different from Model 1 in that the variable of FMLBOCD in Model 1 is replaced by the variable PROFBOCD in Model 2. Model 1 was intended to test hypothesis $H_{1,}$ while Model 2 was used to test hypothesis H_2.

5.3.4 Method of Analysis

5.3.4.1 Assumption of the Classical Linear Regression Model

In using a classical linear regression model (CLRM), several assumptions known as the Gauss-Markov assumptions need to be fulfilled. The assumptions tested in this study were: (1) the number of observations in the sample must be greater than the number of regressors, and (2) the regressor values have sufficient variability (no multicollinearity), homoscedasticity or constant variance of u_i (no heteroskedasticity) and no autocorrelation between the disturbances. The assumptions are suitable for cross-sectional analysis with random sampling, time-series and panel data as well (Wooldridge, 2009). It is also possible to use the pooled ordinary least squares (OLS) regression model, the fixed effects model and the random effects model for panel data, as those models are fundamentally based on the OLS in terms of estimation (Park, 2009). The statistical properties of the OLS itself are based on the assumptions of the CLRM (Gujarati and Porter, 2009).

a. Multicollinearity

Multicollinearity is related to the two assumptions of the classical linear regression model, namely, the number of observations in the sample must be greater than the number of regressors, and the regressor values have sufficient variability. Multicollinearity refers to the presence of "perfect" or exact linear relationships among some or all explanatory variables of the regression model (Gujarati and Porter, 2009). It means that there is more than one exact linear relationship. If a single linear relationship is present, this is called collinearity. The presence of multicollinearity affects the accuracy of the regression coefficient and standard errors in the regression. For example, if high multicollinearity is present, an estimation of the regression coefficient could be determined, but standard errors tend to be large. Meanwhile, perfect multicollinearity causes the regression coefficient to be indeterminate, and the standard error also cannot be defined (Gujarati and Porter, 2009).

In this study, multicollinearity is detected using two methods, namely, Pearson‘s correlation and the value of the variance inflation factor (VIF). According to Pallant (2001), the multicollinearity problem exists if the correlation coefficient between two regressors exceeds 0.70. Meanwhile, if the variance inflation factor (VIF) exceeds 10, it can be said that the variable is highly collinear (Ghozali, 2006; Gujarati and Porter, 2009). Some measures can be taken to remedy the multicollinearity problem. These include combining cross-sectional and time-series data, dropping collinear variables, transforming variables, adding new data and using other statistical techniques such as factor analysis of principal components (Gujarati and Porter, 2009).

b. Heteroskedasticity

The classical linear regression model also assumes that the disturbance (u) in the regression function is equal in variance. This is the homoscedasticity assumption. It means that the variation around the regression line (the line of the average relationship between Y and X) is the same across the X values (Gujarati and Porter, 2009). Symbolically, it can be written as follows.

$$\mathrm{Var}\ (u_i^2) = \sigma^2$$

where u is the error term or disturbance, σ^2 is the error variance or disturbance variance, and var stands for variance. Thus, heteroskedasticity occurs when the variance of an unobservable error (u), which is conditional on independent variables, is not constant. Symbolically, it can be written as follows.

$$\mathrm{Var}\ (u_i^2) = \sigma_i^2$$

The heteroskedasticity problem is more common in cross-sectional data than in time-series data. While heteroskedasticity is present, the usual OLS estimators remain linear, unbiased and asymptotically normally distributed (in a large sample). However, the estimates of the parameters obtained by the OLS technique are not best linear unbiased estimators (BLUE) or not efficient (Gujarati and Porter, 2009). As the OLS standard errors are based directly on the variance, they are biased (not valid) for constructing confidence interval and t-statistics (Wooldridge, 2009). As a result, this causes invalid hypothesis testing.

The existence of heteroskedasticity for panel data can be detected using the likelihood ratio (LR) test. The test compares the model with both heteroskedasticity and homoscedasticity. The null hypothesis is homoscedasticity or constant variance. If the probability value (prob.) is lower than 0.05, the null hypothesis is rejected and heteroskedasticity is present (Wiggins and Poi, 2001; Baum, 2010). Using Stata, the likelihood ratio (LR) test can be performed with the command lrtest.

There are two approaches to remedy heteroskedasticity. One is used when the σ_i^2 is known and the other is used when σ_i^2 is unknown (Gujarati and Porter, 2009). Under the condition where σ_i^2 is known, the approach uses generalised least squares (GLS) estimators – known as weighted least squares (WLS) estimators – for correcting heteroskedasticity. In the GLS method, the original variables are transformed in such a way that the transformed variables meet the assumptions of the classical regression model (Wooldridge, 2009). In practice, error variance (σ_i^2) is rarely known (Cameron and Trivedi, 2009; Gujarati and Porter, 2009; Wooldridge, 2009).

Where error variance (σ_i^2) is unknown, there are two possible methods for overcoming heteroskedasticity. The first method is the heteroskedasticity-robust standard errors method, also known as the Huber-White standard errors method, the Eicker-White or the Eicker-Huber-White standard errors method (Wooldridge, 2002). This method does not change the estimation procedure: the coefficient estimators are the same as those of the OLS, but their standard errors are different. The heteroskedasticity-robust standard errors method is valid for large samples because, with small sample sizes, the robust *t* statistics can have a distribution which is close to the *t* distribution produced by usual OLS standard errors (Wooldridge, 2009). In Stata, the heteroskedasticity-robust standard errors test can be performed using the vce (robust) command. The second procedure to remedy heteroskedasticity uses the feasible generalised least squares (FGLS) procedure. Like the WLS estimators, this procedure changes the estimation procedure, which provides different estimates than the OLS. The estimation procedure in the FGLS starts with estimation of the model using OLS and then uses the OLS estimated residuals to construct an estimate of the error variance specification. In the next step, weighted least squares is applied. The FGLS could also be used to remedy heteroskedasticity, and autocorrelation as well (Greene, 2002; Wooldridge, 2009; Stata Press, 2009). In Stata, the FGLS procedure can be performed using the xtgls command, and applying the additional command (h) if heteroskedasticity is present.

c. Autocorrelation

According to Gujarati and Porter (2009), autocorrelation refers to "correlation between two time series". A classical linear regression model assumes that the disturbance appearing in the regression function is not influenced by the existence of disturbance in any other observation. Symbolically, it can be written as follows.

$$\text{cov}\,(u_i, u_j \mid X_i, X_j) = 0 \quad \text{for } i \neq j$$

where u is the error term (disturbance), i and j are two different observations, and cov means covariance. The presence of autocorrelation can be written,

$$\text{cov}\,(u_i, u_j \mid X_i, X_j) \neq 0 \quad \text{for } i \neq j$$

Autocorrelation is more common in time-series data than cross-section data. In time-series data, autocorrelation is present when error terms at one date can be correlated with the error terms in the previous periods. Like heteroskedasticity, the presence of autocorrelation might cause the usual OLS estimators to remain unbiased, consistent, and asymptotically normally distributed, but no longer efficient. As a result, standard errors and t-statistics are not valid (Gujarati and Porter, 2009; Wooldridge, 2009). In this study, the test for detecting serial correlation in the panel data used Wooldridge's test (2002) because this method requires few assumptions and is easy to implement (Drukker, 2003). The null hypothesis (H_0) tested in this technique is that there is no serial correlation (autocorrelation) in the model. If the probability value is significant (p <0.05), the null hypothesis is rejected or autocorrelation is present (Drukker, 2003). In Stata, Wooldridge's test can be performed using the xtserial command.

Like heteroskedasticity, the existence of autocorrelation can be resolved by using the FGLS method of estimation, and the OLS with corrected standard errors (which is known as heteroskedasticity and autocorrelation consistent standard errors, or HAC). Both FGLS and HAC can be used to overcome heteroskedasticity and autocorrelation. The FGLS and HAC produce efficient estimators for a large sample. However, compared to FGLS, the HAC still uses OLS estimation but it corrects standard errors for autocorrelation using a procedure developed by Newey and West (Gujarati and Porter, 2009) that uses OLS estimation with robust standard errors. This study employs FGLS to solve the autocorrelation problem. In Stata, FGLS can be performed using the xtgls command, with the additional command corr (ar1) if there is an autocorrelation in the model. Basically, the xtgls command can overcome autocorrelation across and within companies over time (Cameron and Trivendi, 2009; Stata Press, 2009).

5.3.4.2 Panel Data

The analysis of the determinants of compliance with audit committee rules involved an estimation procedure based on a panel data model. Panel data (or longitudinal data) refers to the observation of N unit cases along two (or more) time periods. In other words, panel data has both cross-sectional and time-series dimensions (Wooldridge, 2009). According to Cameron and Trivedi (2005), panel data has several advantages:

1. Panel data provides an increased precision of estimation because of the increased number of observations.

2. Panel data takes into account unobserved heterogeneity that might be correlated with the regressors. Such unobserved heterogeneity might lead to omitted variable bias.
3. Panel data provides the possibility of learning more about the dynamics of individual behaviour.

In addition, panel data is useful for evaluating the impact of a certain event or policy (Wooldridge, 2009). Therefore, the study on compliance with audit committee rules employed panel data. There are three panel data models: the pooled ordinary least squares (OLS) model, the fixed effects model and the random effects model.

a. Pooled Ordinary Least Squares Model

The pooled regression model combines or pools cross-sectional and time-series data into one "grand" regression without making a distinction between cross-sectional and time-series data (Gujarati and Porter, 2009). As a consequence of pooling together all observations, this model ignores the heterogeneity or uniqueness that might exist among observations. In this model, the model's parameters (the intercept and slope coefficient) are assumed to be equal (constant) across companies and stable over time. The heterogeneity of each subject is subsumed in disturbance term u_{it} (Gujarati and Porter, 2009). In practice, the assumption might be difficult to maintain, as unobservable heterogeneity (which is constant over time but varied among subjects), might exist in panel data. It is possible that α_i (unobserved or heterogeneity) is correlated with one or more of the regressors that could induce autocorrelation. That condition violates the classical linear regression model assumption, namely, that there is no correlation between the regressors and the disturbance or error term. In Stata, the pooled OLS regression is executed using the command regress.

b. Fixed Effects Model and Random Effects Model

The effects of unobserved heterogeneity can either be assumed as fixed parameters, (referred to as the fixed effects model), or random variables (referred to as the random effects model). In short, the differences between the fixed effects model and the random effects model can be seen in Table 5.7.

Table 5.7 Differences between the Fixed Effects Model and the Random Effects Model

Items	Fixed Effects	Random Effects
Intercepts	Varying across groups and/or times	Constant
Error variances	Constant	Varying across groups and/or times
Slopes	Constant	Constant
Estimation	LSDV, within effect method	GLS, FGLS

Source: Park (2009)

The fixed effects model assumes the same slopes and constant variance across entities or subjects, but the intercept may differ across individuals. This model argues that the error term is assumed to have a mean of zero, conditional on past, current and future values of the regressors or strong exogeneity (Cameron and Trivedi, 2005). In the model, an unobserved fixed effect, which is a time invariant characteristic of an individual or group, could be correlated with any regressors. The fixed effects can eliminate the time invariant unobserved effect. There are two methods in the fixed effects model, namely, the least-squares dummy variable (LSDV) and the within effect estimation method. In the LSDV method, the dummy variable technique is used to vary the intercept among subjects (Gujarati and Porter, 2009). This model is known as the one-way fixed effects model because it allows the intercept to differ between subjects. An extension of this model is also possible by allowing a time effect. This could be done by creating time dummies. In econometrics, such a model is known as a two-way fixed effects model that takes account of individual and time effects. Meanwhile, the within effect estimation method uses differencing sample observations around their sample mean to eliminate unobserved heterogeneity. The first step of this method is computing "demeaned" or mean-corrected values (Gujarati and Porter, 2009). The mean-corrected value of each subject could be computed by subtracting its mean value from the sample of mean values. The next step involves pooling all the mean-corrected values and running OLS regression. In Stata, the command for the fixed effects model is xtreg.

The random effects model, which is known as the error correction model (ECM), refers to a model with a constant intercept and slopes, and an error variance that is varied across subjects or times. This model assumes that α_i (unobserved effects) are uncorrelated with regressors (Wooldridge, 2009). In other words, α_i (unobserved effects) are comprised of random variables that are distributed independently of the regressors (Cameron and Trivedi, 2005). Subjects have a common mean value for intercept, whereas differences among subjects are reflected by the variance of error terms (Park, 2009). Thus, the differences between the fixed effects and the random effects models are based on whether the α_i (unobserved effects) are linked to the explanatory variables (regressors). If α_i (unobserved effects) are correlated to independent variables, it is appropriate to use the fixed effects model. On the other hand, when α_i (unobserved effects) are uncorrelated to independent variables, the random effects model is appropriate. The estimation method in the random effects model is generalised least squares (GLS) when the variance structure is known, and feasible generalised least squares (FGLS) when the variance is unknown (Park, 2009). In Stata, the random effects model is executed by the command xtreg.

5.3.4.3 Model Selection

This study estimated both regression models (Model 1 and Model 2) using the pooled OLS regression model, the fixed effects model and the random effects model. Several statistical tests, as explained below, were then performed to determine the appropriate model. Along with the test of model selection, tests for occurrences of multicollinearity, heteroskedasticity and autocorrelation were also performed.

Following is a description of several tests that must be performed to select the appropriate analysis model.

a. The Likelihood-Ratio Test

The Likelihood-Ratio (LR) test is used to decide which of the models – the OLS model (pooled regression), or the fixed effects model – is more appropriate for use in data analysis. This test compares the log-likelihood ratio (LR) between the two models, namely, the pooled regression (or "restricted") model, and the fixed effects (or "unrestricted") model. The LR value will follow the distribution of the chi-square ($\chi2$). If the chi-square value is significant (p <0.05), the restricted model is rejected, and the unrestricted model is more appropriate model for data analysis, and vice versa (Gujarati and Porter, 2009; Wooldridge, 2009). In Stata, the LR test can be performed using the command lrtest.

b. The Lagrange Multiplier Test

The Lagrange Multiplier (LM) test is used to examine both the OLS (pooled regression) model and the random effects model, and determine which of the two is more appropriate to use in data analysis. Similar to the LR test, this test compares the chi-square ($\chi2$) value of the two models. If the test value of the chi-square is significant (p <0.05), the pooled regression model is rejected, and the random effects model is more appropriate for data analysis, and vice versa (Gujarati and Porter, 2009; Wooldridge, 2001). In Stata, the LM test can be performed with the command xttest0.

c. Hausman Test

The Hausman test is used to determine which of the models, the fixed effects model or the random effects model, is more appropriate for data analysis. The underlying idea of the Hausman test is to compare the fixed versus random effects under the null hypothesis that α_i (unobserved effects) are uncorrelated with the other regressors in the model. Thus, this test compares two sets of estimators, one of which is consistent under both the null and the alternative (i.e., the fixed effects model), and another (i.e., the random effects model) which is consistent only under the null hypothesis (Greene, 2002). The Hausman test value will follow the chi-square ($\chi 2$) distribution. If the test value of the chi-square is significant (p <0.05), the null hypothesis is rejected – meaning that α_i (unobserved effects) are correlated, so the fixed effects model is preferred. In Stata, the Hausman test can be performed with the command hausman.

5.4 RESEARCH DESIGN FOR RESEARCH STAGE 2: AUDIT COMMITTEE EFFECTIVENESS AND RESTATEMENTS

5.4.1 Sample Selection

The sample for this study consisted of firms that revised their annual or interim financial statements during the 2006-2012 period. The year 2006 was selected because audit committee disclosure in company annual reports was compulsory from 2006 onward.

In terms of financial statement types, this study used both interim and annual restatements. In some prior studies (e.g., Abbott et al., 2004; Archambeault et al., 2008), interim restatements were removed from the sample based on the argument that it would be difficult to examine the relationship of audit committee effectiveness with interim reports when the external auditor was not involved in the reporting process. On the other hand, some prior studies (e.g., Kinney, Palmrose, and Scholz, 2004; Myers, Myers, Palmrose, and Scholz 2005) employed both interim and annual restatements. They argued that restatements in both types of financial statements were equally important to investors and regulators. As evidence, Palmrose, Richardson, and Scholz (2004) found that the market reaction to restatement announcements was no different for annual or quarterly misstatements. In line with this view, the current study considered that the interim and annual restatements were equally important in examining audit committee effectiveness. As stated in the BAPEPAM rule No. IX.I.5 regarding audit committee membership and job duties, the audit committee of a public listed company in Indonesia shall examine financial information issued by the company including, but not limited to, examining financial statements and financial projections. This requires the audit committee to examine both annual and interim financial statements.

To find restating firms, this study searched the IDX interactive online database by typing keywords, such as “revise”, “restate” and “correct”. The search involved the period from 01 January 2007 to 30 June 2013, inclusive. Table 5.8 details the IDX database search results based on a search of the initial sample of 658 firms with restatements.

Table 5.8 Sample Detail

Description		Number
Firms revising statements in the period 2006-2013, as identified from the IDX database		658
Less:		
(-) Annual report revisions		(77)
(-) Multiple restatements		(21)
(-) Bank sector		(60)
(-) State-owned enterprise (SOE)		(19)
(-) Unknown reason		(65)
(-) Restatement not within the GAO's definition of restatement		
• Problems in sending files		(124)
• Wording correction		(86)
• Additional disclosure in the notes of the financial statements		(27)
• Accounting policy change		(7)
• Mathematical correction		(2)
Final restatements sample		158
Interim financial statements	98	
Annual financial statements	60	
Control firms		158
Total number of firms		316

Source: Compiled by the author

As shown in the table, some restating firms were eliminated from the sample for various reasons. Some restating companies with annual report revisions were removed as the revisions were not the focus of the study[7]. In addition, firms that had multiple restatements were identified. Following prior studies (e.g., Srinivasan, 2005; Arthaud-Day et al., 2006; Amoah and Tang, 2010), only the first restatements were included if a firm had the same type of financial statement restatements more than once in one year. This elimination was intended to avoid data redundancy, as the logistic regression that would be used in the data analysis required that a single case could only be represented once and must be in one group (Leech, Barret, and Morgan, 2008). Thus, data redundancy would violate the assumption. As with the study on the determinants of compliance with audit committee rules, banks and state owned enterprises were also

[7] The type of revision in the report was not related to financial statements.

removed from the sample of restating companies, as these sectors had different corporate governance requirements.

The current study also excluded restatement announcements where the reasons for the restatements were unknown. It was important to know the reasons for the restatements because these were used to determine their materiality. The study followed GAO (2006) to classify material misstatements of financial information (see Table 5.9). As can be seen in Table 5.8., the number of unknown reasons for restatements was relatively high and occurred because the restating firms did not provide any information regarding them. The IDX requires restating firms to announce the restatement of their financial statements by filing form E012 for annual financial statements, and form E015 for interim financial statements. Unfortunately, these forms do not require the disclosure of the reason behind the restatement. As a result, not all restating firms disclosed the reasons behind their restatements. Some restating firms did not voluntarily disclose reasons because they may have been afraid that the restatements would damage their reputation. It should be noted that the category of unknown reasons includes some restating companies that were excluded from the sample due to missing data (caused by delisting) for the relevant time period.

Once the reasons for restatements were identified, the study excluded sample firms with restatement reasons that did not meet GAO (2006) criteria. GAO (2006) criteria have been used by some prior studies in both the US (e.g., Flanagan, Muse, and O'Shaughnessy, 2008; Burks, 2010; Chang, Wei, Wu, and Teng, 2010) and developing countries (e.g., Siregar and Bachtiar, 2005; Abdullah et al., 2010). As the GAO (2006) includes only announced restatements made to correct mistakes in the application of accounting standards, the current study excluded restatements due to normal business activities, non-accounting errors, and restatements for presentation purposes. The study also excluded restatements due to stock splits in affiliated firms, changes in accounting policy, additional disclosures contained in the notes to the financial statements, wording corrections, mathematical corrections, and problems in sending files. Amongst the reasons for excluding restating companies from the sample, problems in sending files resulted in the highest number of exclusions. “Problems in sending files” refers to problems incurred by restating companies in sending their financial statements to the IDX through its IDXnet network system. The use of the network to send the statements is an IDX requirement but problems with the network often result in the receipt of incomplete or even duplicate files. After all exclusions, the final sample included 158 restating firms with 60 annual restatements and 98 interim restatements. The sample detail for each year can be found in Table B.3 in Appendix B.

Table 5.9 Restatement Category Descriptions

No.	Category Description	Category Description
1.	Acquisition and merger	Restatements of acquisitions or mergers that were improperly accounted for or not accounted for at all. These include instances in which the wrong accounting method was used, or losses or gains related to the acquisition were understated or overstated. This does not include in-process research and development, or restatements for mergers, acquisitions, and discontinued operations when appropriate accounting methods were employed.
2.	Cost or expense	Restatements due to improper cost accounting. This category includes instances of improperly recognizing costs or expenses, improperly capitalizing expenditures, or any other number of mistakes or improprieties that led to misreported costs. It also includes restatements due to improper treatment of tax liabilities, income tax reserves, and other tax-related items.
3.	In-process research and development	Restatements resulting from instances in which improper accounting methodologies were used to value in-process research and development at the time of an acquisition.

Table 5.9 (continued)

No.	Category Description	Category Description
4.	Reclassification	Restatements due to improperly classified accounting items. These include restatements due to improprieties such as debt payments being classified as investments.
5.	Related-party transaction	Restatements due to inadequate disclosure or improper accounting of revenues, expenses, debts, or assets involving transactions or relationships with related parties. This category includes those involving special purpose entities.
6.	Restructuring, assets, or inventory	Restatements due to asset impairment, errors relating to the accounting treatment of investments, timing of asset write-downs, goodwill, restructuring activity and inventory valuation, and inventory quantity issues.
7.	Revenue recognition	Restatements due to improper revenue accounting. This category includes instances in which revenue was improperly recognized, questionable revenues were recognized, or any other number of mistakes or improprieties that led to misreported revenue.
8.	Securities-related	Restatements due to improper accounting for derivatives, warrants, stock options and other convertible securities.
9.	Other	Any restatement not covered by the listed categories. Cases in this category include restatements due to inadequate loan-loss reserves, delinquent loans, loan write-offs, or improper accounting for bad loans and restatements due to fraud, or accounting irregularities that were left unspecified.

Source: GAO (2006).

The incidence of restatements identified in this study is considered smaller than that of prior studies in the US (see Section 6.3.1.1 in Chapter 6 for a detailed discussion). The number of restatements, however, is not much different from, or is even higher than, the number in some prior studies in other developing countries. For example, Rasyid (2012) used a sample of 11 restating firms in a study in Indonesia. Abdullah et al. (2010) studied restatements in Malaysia with a sample of 31 restating firms for the period 2002-2005. In Kuwait, Alyousef and Almutairi (2010) studied restatements with a sample of 46 restating firms. Similarly, Chang et al. (2010) employed 31 restating firms for a study in Taiwan.

Consistent with prior studies (e.g., Abbott et al., 2004; Romanus et al., 2008; Amoah and Tang, 2010), the next step in the study involved the matching of restating firms with non-restating firms that were used as control firms. The primary advantage of using logistic regression with matched data is to control some variables other than the matched variables (Kleinbaum, 1994). The current study used one control for each case to create one to one matching. The criteria for the inclusion of firms in the control group included: the firms had no restatements, they had a similar financial year, they were listed only on the IDX (they were not cross listed), and they were classified in the same IDX industry sector and were closest to the restating firms in terms of year-end asset size. To obtain a list of control firms, the study generated a list of all listed firms and their asset sizes. Firms were categorized based on the two digit IDX industry sector code and on the year period. Then, one firm with the closest total asset size and complete data for the period of interest was chosen. If no control firms in the two digit industry sector met the size criteria, the restating firm was matched with a control firm in a one-digit industry sector. The procedure resulted in a total of 316 firms, consisting of 158 restating firms matched with 158 non-restating firms as a control group. The list of name of each restating company and its control company can be found in Table B.2.2 and Table B.2.3 in Appendix B.

5.4.2 Variables Measurement and Data Sources

5.4.2.1 Audit Committee Effectiveness

This study assumes that the audit committee is effective if it fulfils all requirements stipulated in the rules and regulations. The first step towards effectiveness should be full compliance with the prevailing rules and regulations (Haron et al., 2005). Thus, high compliance with audit committee rules also indicates high effectiveness of the audit committee. That is why the audit committee compliance index total (ACCIT) used as a dependent variable in Research Stage 1 serves as a measurement of audit committee effectiveness in Research Stage 2.

The use of the ACCIT as a measurement of audit committee effectiveness causes this study to differ from most prior studies on audit committee effectiveness and financial reporting quality. As discussed in Chapter 3, most prior studies used a proxy for audit committee effectiveness that was comprised of a single audit committee characteristic, such as the presence of an audit committee, audit committee independence, audit committee size, number of audit committee meetings and audit committee expertise. If several audit committee aspects were used in prior studies, each aspect was examined in a separate analysis.

In this study of restatements, the ACCIT score (which was obtained from the determinants of the study in Research Stage 1) was centred to avoid multicollinearity (see Aiken and West, 1991). As discussed in Chapter 3, hypothesis H_6 required testing the interaction between the audit committee compliance index total (ACCIT) and family-controlled company with family members on the boards (FMLBOCD). This interaction of independent variables might have created multicollinearity if the ACCIT had not been centred. Thus, centring was done by subtracting the audit committee compliance index total (ACCIT) score from its mean value.

Compared to the audit committee index used in prior studies, the ACCIT is considered more comprehensive, as the index consists of several elements, such as membership, job duties and disclosure. Even though the elements of the index consisted merely of mandatory requirements extracted from BAPEPAM rules, the index seems to be a combination of several elements that have been used by prior studies (see Table 5.10). Only two elements of the index (job duty of the audit committee to scrutinise complaints, and the disclosure of audit committee members' profiles) have not been used in the indexes of prior studies.

This study assumes that all elements of the index match with all the dimensions of audit committee effectiveness proposed by DeZoort et al. (2002) and Bédard and Gendron (2010). As discussed in Chapter 3, both DeZoort et al. (2002) and Bédard and Gendron (2010) argued that audit committee effectiveness should consist of four interrelated dimensions: composition, resources, authority and diligence or process. In addition, according to scholars, these dimensions are interrelated (see Figure 3.1 in Chapter 3). As depicted in Table 5.10, elements of the index represent the four dimensions. Membership requirements related to independence and expertise are a proxy for the composition dimension, and have been widely used by some prior studies. Meanwhile, the requirement for a minimum number of audit committee members is a proxy for the resources dimension. Authority dimension is represented by the job duties of the audit committee, as extracted from the BAPEPAM rule (2004). For the diligence or process dimension, the index uses mandatory disclosure rather than voluntary disclosure. DeZoort et al. (2002) suggested that voluntary disclosure could be used as an alternative proxy, as some prior studies in the US (i.e., Turpin and DeZoort, 1998; Carcello et al., 2002) have used this proxy. It seems that voluntary disclosure is preferred, since mandatory disclosure in the US has limited the variability of disclosure rates across companies (see Carcello et al., 2002). However, unlike the US, the level of compliance with mandatory disclosure requirements in Indonesia varies across companies due to the weak legal enforcement regime. As evidenced by Utama (2003), the disclosure level of public listed companies in Indonesia, even for mandatory disclosure, is generally low.

Therefore, mandatory disclosure is considered viable as a proxy for the diligence/process dimension.

5.4.2.2 Alternative Measurement of Audit Committee Effectiveness

Based on the discussion in Chapter 2, the BAPEPAM-LK rules are less stringent compared to those of other audit committee reforms, such as the BRC (1999) and the SOX (2002). As a result, the use of the BAPEPAM-LK rules requirements as an element of the measurement of audit committee effectiveness might not represent audit committee best practices. Unlike the BRC recommendations, for example, the BAPEPAM rule (2004) does not require audit committees to communicate with external auditors. Yet, according DeZoort et al. (2002), support from the external auditor is part of the resources component of audit committee effectiveness. Thus, to examine the robustness of the results of the use of the audit committee compliance index as a proxy for audit committee effectiveness, the study employed another index to measure audit committee effectiveness. In the extant literature from Indonesia, two prior studies, Ika and Ghazali (2012) and Sarumaha and Hermawan (2013), used a comprehensive index to measure audit committee effectiveness. Both studies employed an audit committee effectiveness index that consisted of mandatory and voluntary requirements. However, the current study chose to use Ika and Ghazali’s index because their paper has already been published in an international journal (i.e., Managerial Auditing Journal), whereas the paper of Sarumaha and Hermawan (2013) has not. Ika and Ghazali (2012) employed an audit committee effectiveness index (ACEFEC) to examine the association between the audit committee and the timeliness of financial reporting. The study evidenced that audit committee effectiveness was negatively and significantly associated with financial reporting time lead. This finding implies that audit committee effectiveness is a significant factor influencing the timeliness of reporting in Indonesia.

As depicted in Table 5.10, the main differences between the audit committee compliance index total (ACCIT) and the audit committee effectiveness index (ACEFEC) are the elements in each. As previously discussed, the ACCIT consists of 13 mandatory audit committee requirements extracted from the BAPEPAM regulations. On the other hand, the ACEFEC consists of both mandatory and voluntary audit committee characteristics. The ACEFEC's voluntary elements are related to the authority and diligence/process dimensions of audit committee effectiveness. In terms of the authority dimension, the audit committee shall review external auditing activity. Meanwhile, the diligence/process dimension includes the requirement to hold a minimum of four audit committee meetings per year, and the voluntary disclosure of the audit committee report. These voluntary audit committee characteristics are used in the audit committee effectiveness index developed by Sarumaha and Hermawan (2013), which also examined audit committee effectiveness in Indonesia. In short, this study assumes that the ACEFEC can be used to validate the results of the analysis using the ACCIT.

Like the ACCIT score, the ACEFEC score was centred to avoid multicollinearity (Aiken and West, 1991). The centring was done by subtracting the ACEFEF score from its mean value.

Table 5.10 Elements of Audit Committee Effectiveness Indexes

Requirements	Dimension	ACCIT	ACEFEC	Citations to prior studies
Audit committee membership				
1. Audit committee shall consist of at least three members.	Resources	✓	✓	Haron et al. (2005);Yang and Krishnan (2005), Lin et al. (2006); Pucheta-Martinez and Fuentes (2007); Sarumaha and Hermawan (2013)
2. Comprises at least one independent commissioner and other members shall be external independent parties.	Composition	✓	✓	Menon and Williams (1994); Abott et al. (2000, 2004); Braiotta (2004); Bédard et al. (2004); Haron et al. (2005); Utama and Leonardo (2006); Rainsbury et al. (2008); Rainsbury et al. (2009); Baxter (2010).
3. Chairman is an independent commissioner.	Composition	✓	-	Haron et al. (2005).
4. One member shall have an educational background in accounting or finance.	Composition	✓	✓	Braiotta (2004); Haron et al. (2005); Utama and Leonardo[a] (2006); Rainsbury et al. (2008); Rainsbury et al. (2009); Baxter (2010); Sarumaha and Hermawan (2013)
Audit Committee duties				
5. Listed company shall adopt audit committee charter.	Authority	✓	✓	Haron et al. (2005).
6. Audit committee shall examine the financial information that will be issued by the company, such as financial statements, projections and other financial information.	Authority	✓	✓	Utama and Leonardo (2006); Akarak and Ussahawanitchakit (2010); Sarumaha and Hermawan (2013).

Table 5.10 (continued)

Requirements	Dimension	ACCIT	ACEFEC	Citations to prior studies
7. Audit committee shall examine the company's compliance with regulations.	Authority	✓	✓	Utama and Leonardo (2006); Akarak and Ussahawanitchakit (2010); Sarumaha and Hermawan (2013).
8. Audit committee shall examine the effectiveness of the company's internal controls.	Authority	✓	✓	Utama and Leonardo (2006); Akarak and Ussahawanitchakit (2010); Sarumaha and Hermawan (2013)
9. Audit committee shall scrutinize and report to the commissioner all complaints related to the company.	Authority	✓	-	None
10. Audit committee shall review external auditing activity.		-	✓	Bedard et al. (2004); Sarumaha and Hermawan (2013)
Audit committee disclosure				
11. Name, position, and brief profile of each audit committee member.	Diligence/ process	✓	-	None
12. Frequency of meetings and attendance of each member.	Diligence/ process	✓	-	Haron et al. (2005); Sarumaha and Hermawan (2013)
13. Audit committee shall hold a meeting at least four times in a year.	Diligence/ process	-	✓	Abbott et al. (2004); Sarumaha and Hermawan (2013)
14. Brief report of audit committee activities.	Diligence/ process	✓	-	Haron et al. (2005)
15. Audit committee shall report voluntary disclosures.	Diligence/ process	-	✓	Sarumaha and Hermawan (2013)

Source: Compiled by the author *Notes:* ACCIT=audit committee compliance index total; ACEFEC=audit committee effectiveness index.

5.4.2.3 Other Variables

The dependent variable was restatements measured using nominal scale. This dependent variable was recorded as 1 if a firm restated its financial statements during the 2006-2009 period, and 0 otherwise. The measurement of other variables, which were used in Research Stage 1, followed a similar method. The family-controlled company with family members on the boards (FMLBOCD) variable was measured by the binary method, which recorded 1 if at least one family member sat on the board of directors, board of commissioners, or both, and 0 otherwise. The proportion of independent commissioners (BOC) was measured by dividing the total number of independent commissioners by the total number of members on the board of commissioners (Abbott et al., 2004; Uzun, Szewczyk, and Varma, 2004; Beasley, 1996). Board of commissioners size (BCS) was measured by counting the number of members on the board of commissioners (Abbott et al., 2004; Farber, 2005; Baber et al., 2005; Carcello et al., 2011b). Leverage (LEV) was measured using a company's debt ratio (total debt to total assets) in the year of the restatement (Romanus et al. 2008). Meanwhile, listing age (AGE) was derived from the number of years that the firm had been listed on the stock exchange (Abbott et al., 2004; Carcello and Nagy, 2004a; 2004b). Profitability was measured using return on assets (ROA) in the year of the restatement (Romanus et al., 2008; Lisic et al., 2011; Zhizhong et al., 2011). Data for these variables were collected from annual reports and the Indonesian Capital Market Directory (ICMD).

Table 5.11 Summary of Variables Measurement for Research Stage 2

Variables	Acronym	Measurements
Dependent Variable		
Restatements	RSTMT	Dichotomous, with 1 if the firm restated its financial statements during the 2006-2009 period and 0 otherwise.
Independent Variables		
Audit committee compliance index total	ACCIT_c	Sum of the total score of compliance with mandatory audit committee requirements (centred).
Audit committee effectiveness index	ACEFEC_c	Sum of the total score of mandatory and voluntary characteristics of audit committee (centred).
Family-controlled company with family members on the boards	FMLBOCD	1 if at least one family member was a board member, 0 if otherwise.
Control Variables		
Proportion of independent commissioners	BOC	Number of independent commissioners divided by the total number of members on the board of commissioners.
Size of board of commissioners	BCS	Number of members on the board of commissioners.
Listing age	AGE	Number of years that the firm has been listed on the IDX.
Profitability	ROA	Return on assets: total return to total assets in the year of restatement.
Leverage	LEV	Debt ratio = total debt to total assets in the year of restatement.

Source: Compiled by the author

5.4.3 Method of Analysis

Consistent with most prior studies on restatements (e.g., Abbot et al., 2004; Agrawal and Chadha, 2005; Lin et al., 2006; Archembault et al., 2008), this study used logistic regression to test the hypotheses. According to Leech et al. (2008), logistic regression is an appropriate method of analysis to predict an outcome from a set of predictor variables where the outcome (the dependent variable) is dichotomous (i.e., restating firms are given a value of 1 and non-restating firms are given a value of 0). Logistic regression allows the prediction of discrete variables by a mix of continuous and discrete predictors. In this study, the logistic analysis was done using the Statistical Program for Social Science (SPSS) software, version 17.

To test the hypotheses, the study used hierarchy logistic regression that enabled examination of the main effects and interaction effects in separate models. In using this method, independent variables were entered into the model based on a particular sequence. In the first model or first block, all main variables, including control variables, were entered into the logistic model. The first block analysed partial models that consisted of main independent variables without the interaction variable. The partial model is written as follows:

$$\text{RSTMT} = \beta_0 + \beta_1\text{ACCIT\_c} + \beta_2\text{FMLBOCD} + \beta_3\text{BOC} + \beta_4\text{BCS} + \beta_5\text{AGE} + \beta_6\text{ROA} + \beta_7\text{LEV} + e_{\text{i}}$$

where: RSTMT = restatements; ACCIT_c = audit committee compliance index total (centred); FMLBOCD = family-controlled company with family members on the boards; AGE = listing age; BOC = proportion of independent commissioners; BCS = board of commissioners size; ROA = return on assets; LEV = leverage.

In the second block, the full model consisting of all independent variables in the first block and interaction variables (i.e., interaction between audit committee compliance index total (ACCIT_c) and family-controlled company with family members on the boards (FMLBOCD)) were entered into the logistic model. The full model is written as follows:

$$\text{RSTMT} = \beta_0 + \beta_1\text{ACCIT\_c} + \beta_2\text{FMLBOCD} + \beta_3\text{ACCIT} * \text{FMLBOCD} + \beta_4\text{BOC} + \beta_5\text{BCS} + \beta_6\text{AGE} + \beta_7\text{ROA} + \beta_8\text{LEV} + e_{\text{i}}$$

where: RSTMT = restatements; ACCIT_c = audit committee compliance index total (centred); FMLBOCD = family-controlled company with family members on the boards; AGE = listing age; BOC = proportion of independent commissioners; BCS = board of commissioners size; ROA = return on assets; LEV = leverage.

The same procedure of analysis was used for the use of the audit committee effectiveness index (ACEFEC) as a measure of audit committee effectiveness. The variable of ACCIT_c in the model was replaced by ACEFEC_c.

Logistic regression is a popular method as it has very few assumptions (Leech et al., 2008). Unlike OLS regression, logistic regression does not strictly require an assumption of multivariate normality and equal variance-covariance across groups (Hair, Black, Babin, Anderson, and Tatham, 2006). However, there are two conditions that should be fulfilled before running logistic regression (Leech et al., 2008). First, the dependent or outcome variable needs to be dichotomous, and a single case can only be represented once and must be in one group or the other. Second, logistic regression requires large samples in order to predict accurately. In terms of the adequacy of the sample size, there is no uniformity in the literature (Peng, Lee, and Ingersoll, 2002). For example, both Tabachnick and Fidel (2007) and Peng et al. (2002) recommend a minimum ratio of 10 to 1. Meanwhile, Leech et al. (2008) set a higher ratio of 20 to 1. To anticipate the low number of incidents of restatements, this study argues that it is preferable to use a ratio of 10 to 1 (Tabachnick and Fidel, 2007; Peng et al., 2002).

Similar to other forms of regression, multicollinearity (i.e., high correlations among the predictors) is also a potential problem that may mislead the results of logistic regression. Therefore, the existence of multicollinearity must be assessed first before running the logistic regression. Since Tolerance and VIF scores are not available through the logistic regression command in SPSS, these values can be obtained from the linear regression command (Leech et al., 2008).

According to Peng et al. (2002), there are three key items that should be addressed adequately in presenting the logistic regression results: (1) the logistic model evaluation; (2) the statistical tests of individual predictors; and (3) goodness of fit statistics. The evaluation of the logistic model is assessed through the significance value of the chi-square (χ^2) test, which is analogous to the F test in the OLS regression. In SPSS output, this test can be seen on the table labelled omnibus tests of model coefficients. If the significance value of the chi-square (χ^2) is below 5%, it indicates that the overall model is significant when a number of independent variables are entered simultaneously, meaning that at least one predictor is significantly related to the outcome. As this study uses hierarchy logistic regression, an assessment is needed to determine whether adding the interaction variable in the full model improves the model significantly. This assessment can be done by computing the difference in the log-likelihood (times -2) (Tabachnick and Fidel, 2007). The formula is as follows:

$$\Delta \text{ -2 Log likelihood} = (\text{-2 log-likelihood for smaller model}) - (\text{-2 log-likelihood for bigger model})$$

The Δ -2 Log likelihood is compared to the value of χ^2 in the table based on its degree of freedom (df). Meanwhile, the statistical significance of individual regression coefficients is tested using the Wald chi-square statistic. The significant result of the Wald chi-square statistic indicates that an independent variable is reliably associated with outcomes. Like the OLS regression, the direction of the relationship can be seen from the sign of the original coefficient (Hair et al., 2006). A positive coefficient means increasing probability, whereas a negative value means decreasing predicted probability.

Goodness of fit statistics are used to determine the fit of a logistic model to actual outcomes (Peng et al., 2002). In assessing of the goodness of fit statistics, there are three methods that can be employed: the Hosmer-Lemeshow (H-L) test, Cox and Snell R^2 and

Nagelkerke R^2 and classification accuracy. The Hosmer-Lemeshow goodness of fit statistic measures the correspondence between the actual and predicted values of the dependent variable. In this case, a better fit of the model is indicated by a smaller difference in the observed and predicted classification that is notified by the non-significance of the chi-square (χ^2). In other words, if the chi-square (χ^2) of the H-L test is above 5 percent, a logistic regression model fits to the data. The Cox and Snell R^2 and Nagelkerke R^2 are used to assess the variance of the dependent variable that can be predicted from the combination of the entered independent variables. These are similar to R^2 in the OLS regression, and a higher value indicates a greater fit of the model. However, Cox and Snell R^2 is limited as it cannot reach the maximum value of 1, so Nagelkerke R^2 proposes a modification that has a range of 0 to 1 (Hair et al., 2006). Meanwhile, classification accuracy provides a correct prediction of a set of independent variables towards overall cases, which is also called the concordant pair. As stated earlier, logistic regression is able to determine the correct prediction of a set of independent variables towards each category of the dependent variable. Thus, this classification accuracy represents the level of predictive accuracy achieved by logistic regression.

5.5 CONCLUSION

This chapter explains the research methods employed in the two research stages. It explains the research paradigm in which the study is located, and its justification for using the quantitative approach. Issues related to sample selection, variables measurement, data sources and the method of analysis of each research stage have been explicated. The next chapter presents the results of the data analysis and the associated interpretations.

CHAPTER 6

RESULTS AND DISCUSSION

6.1 INTRODUCTION

This chapter presents the results and discussion of the study findings. As there are two main issues in this study, the findings are presented in two main sections. The first main section, Section 6.2, presents the results from Research Stage 1. Section 6.2.1 discusses the results of the data analysis relating to the level of compliance of public listed companies. This is followed by a discussion of the preliminary analysis comprising the descriptive statistics, a test of normality and a test of multicollinearity in Section 6.2.2. In Section 6.2.3, the results of the hypotheses testing using panel data analysis are presented, together with several sensitivity analyses. In the second main section, Section 6.3 presents the results from Research Stage 2. Section 6.3.1 presents the preliminary analysis, which consists of descriptive statistics and a multicollinearity test. The logistic regression results depicting the hypotheses testing are presented in Section 6.3.2. Several sensitivity analyses are presented in Section 6.3.2.1. As both stages of the study are interrelated, a discussion of the results from both is provided in Section 6.4. The chapter concludes with Section 6.5.

6.2 RESULTS OF RESEARCH STAGE 1: DETERMINANTS OF COMPLIANCE OF PUBLIC LISTED COMPANIES WITH AUDIT COMMITTEE RULES

6.2.1 Level of Compliance

Table 6.1 shows the compliance of Indonesia's public listed companies with each audit committee requirement for the 2006 to 2008 period. As envisaged, none of the requirements were fully complied with (100 percent) by all public listed companies during the period under observation. Compliance with membership rules achieved the highest level compared to compliance with other audit committee rules. Compliance with membership rules remained high throughout the three years under observation,. This finding is consistent with Utama and Leonardo (2004), which also found high compliance with membership rules. This may be due to monitoring by the IDX and the BAPEPAM that puts emphasis on whether the audit committees of public listed companies conform to the membership requirements, as opposed to whether the audit committees carry out their functions. In the early stages of the mandatory implementation of the audit committee regulations, the IDX reportedly distributed a circular to each public listed company to inquire whether the company had adjusted its audit committee to comply with the new regulations. Most public listed companies replied that the establishment of their audit committee, including the audit committee charter, met the new BAPEPAM regulations. However, the IDX did not do any further investigation to ascertain whether the audit committee had been carrying out its functions as mandated by the regulations (see IDX annual report 2004). Another factor that may have contributed to the high rate of compliance with the membership rules is the similarity between the membership requirements stipulated in the BAPEPAM (2004), and the prior requirement (i.e., JSX, 2001). As discussed in Chapter 2, the membership requirements in both regulations included: the audit committee must have at least three members, the independent commissioner shall be the head of the audit committee, and an independent member and at least one other member must have knowledge in accounting and/or finance.

The fact that the membership aspect had the highest level of compliance compared to the other aspects might present an early indication that the presence of the audit committee was for symbolic purposes. Public listed companies tended just to indicate that their audit committees met the membership requirements, rather than showing that the committees did their assigned job. This finding is in line with institutional theory. As noted by Cohen et al. (2008), an implication of institutional theory is that the audit committee might emphasise a ceremonial role. Audit committee members tend to become similar to others within the same industry and are selected based on their credentials without considering their ability to effectively monitor management. As a result, the audit committee is adopted primarily to enhance external legitimacy but is not necessarily coupled with actual monitoring functions (Cohen et al., 2008; Beasley et al., 2009; Carcello et al., 2011a). The detailed compliance score of each public listed company can be seen in Table B.1 in Appendix B.

In terms of improvement in compliance, annual improvement rates varied among the different aspects of compliance. Using 2006 as a base year, the annual improvement rate for compliance with audit committee membership rules was relatively low, around 0 to 3 percent. This might be because the level of compliance with membership rules in 2006 was already relatively high, thus, improvement in subsequent years was low. Meanwhile, in terms of compliance with job duties and disclosure requirements, the annual improvement rates were relatively high: between 9 and 88 percent. However, as the level of compliance in 2006 was mostly low, the large increase in the percentage of compliance in subsequent years still did not bring compliance up to a satisfactory level. For example, the requirement for disclosure of the frequency of meetings and the attendance record of each member improved by 88 percent in 2008. However, the level of compliance in 2006 was just 17 percent, thus the improvement of 88 percent in 2008 only produced a compliance level of 32 percent, which is unsatisfactory.

Further analysis of the membership requirements found that audit committee membership ranged from 0 to 6 members, with the average being 3 members.

Regarding job duties, audit committee duties seemed focused mostly on examining company financial reports. This finding is consistent with the US study by Carcello et al., 2002. On the other hand, the audit committee's duty of scrutinising and reporting complaints had the lowest level of compliance compared to other committee requirements. In fact, the BAPEPAM (2004) rule for this aspect is less stringent than the SOX (2002) rule because the BAPEPAM (2004) rule does not require listed companies to establish any procedures to handle complaints. Another element of audit committee job duties that had a low compliance level was the requirement for an audit committee charter. During the 2006-2008 period, the level of compliance with this requirement ranged from 17 to 24 percent.

In terms of mandatory disclosure requirements, compliance with the disclosure of the frequency of meetings and the attendance record of each member was low. Based on the review of company annual reports, most public listed companies tended to report that their audit committee held several meetings but they did not disclose specific details regarding frequency. This might indicate the symbolic nature of the audit committee; public listed companies might be reluctant to report the frequency of meetings as meeting frequency is often associated with audit committee diligence (DeZoort et al., 2002; Bédard and Gendron, 2010). Based on the data provided by the 439 listed companies in the sample that disclosed the number of audit committee meetings, the average number of meetings held in a year was 7, with the number of meetings per company ranging from 0 to 48. The average number of meetings was higher than the BRC recommendation (1999) of at least four audit committee meetings per year, and higher than the numbers found by prior studies (i.e., Carcello et al., 2002; Haron et al., 2005). The study by Carcello et al. (2002) revealed 3.54 meetings per year, while Haron et al. (2005) reported that Malaysian companies held an average of 4.8 audit committee meetings per year. Regardless of the high number of meetings, it seems that compliance with disclosure requirements was relatively low compared to other audit committee requirements. A possible explanation is that the disclosure rule (BAPEPAM-LK, 2006) is more recent than the rules related to the establishment of audit committees (BAPEPAM, 2004), which consisted of membership and job duty requirements. Therefore, the low level of compliance with the disclosure requirement indicates that listed companies are making less effort to comply with recent rules.

Table 6.1 Level of Compliance of Public Listed Companies with Audit Committee Rules

Requirements	Level of compliance (%)				
	2006	2007	Δ	2008	Δ
Structure, membership, and independence					
1. Comprises at least three members.	96	98	2	97	1
2. Comprises at least one independent commissioner and other members shall be external independent parties.	86	88	2	86	0
3. Chairman is an independent commissioner.	96	98	2	98	2
4. One member shall have an educational background in accounting or finance.	92	95	3	95	3
Job duties					
5. Establish an audit committee charter.	17	20	18	24	41
6. Examining the financial information.	81	89	10	90	11
7. Reviewing the company's compliance with regulations.	57	62	9	68	19
8. Reviewing the internal auditor's work.	62	71	15	75	21
9. Reporting of risks and risk management implementation.	25	36	44	40	60
10. Scrutinizing and reporting complaints.	8	10	25	11	38

Table 6.1 (continued)

Requirements	Level of compliance (%)				
	2006	2007	Δ	2008	Δ
Disclosure					
11. Name, position and brief profile of each audit committee member.	42	54	29	60	43
12. Frequency of meetings and attendance of each member.	17	29	71	32	88
13. Brief report on audit committee activities.	58	67	16	71	22

Source: Compiled by the author

Table 6.2 presents the level of compliance by sector. As can be seen, the mean of the compliance level across sectors ranges from 0.508 to 0.632, while the mean of all samples is 0.567. The basic industry and chemicals sector had the highest compliance score (0.632), followed by the mining sector (0.628). Meanwhile, all other sectors had a mean compliance score of less than 0.600. For example, the finance (non-bank) sector, the agriculture and plantation sector, and the trade, service, and investment sector had moderate mean scores of 0.553, 0.552 and 0.547, respectively. The consumer goods industry sector had the lowest mean compliance score of 0.508. Overall, the relatively similar mean scores across sectors may indicate the capacity of the study to eliminate particular factors – such as cross-listings, banks, and state-owned enterprises – contributing to significant differences in compliance levels across industry sectors.

Table 6.2 Compliance Level by Industry Sector

Sector	No. Obs.	Min	Max	Mean	Std. dev.
Agriculture and plantation	30	0	0.90	0.552	0.222
Mining	27	0.25	0.95	0.628	0.278
Basic industry and chemicals	123	0.00	1.00	0.632	0.198
Miscellaneous industry	105	0.10	1.00	0.590	0.235
Consumer goods industry	84	0.00	1.00	0.508	0.231
Property, real estate and building construction	90	0.20	1.00	0.572	0.204
Infrastructure, utilities and transportation	54	0.00	0.95	0.545	0.254
Finance	114	0.00	1.00	0.553	0.223
Trade, service, investment	201	0.00	0.95	0.547	0.247
All	828	0.00	1.00	0.567	0.232

Source: Compiled by the author

6.2.2 Preliminary Analysis

6.2.2.1 Descriptive Statistics

This section reports the descriptive statistics of all variables examined in this stage of research. It also reports on the existence of any violations of the assumptions underlying the statistical techniques used in the data analysis. The descriptive statistics include the mean, median, maximum and minimum values, standard deviation, skewness and kurtosis. Unlike the mean, which can be affected by a few extremely high or low values, the median is a measure of central tendency and is not sensitive to outlying values. Standard deviation is essentially a weighted average of the deviations from the expected values. Skewness and kurtosis provide information concerning the distribution of the scores (Pallant, 2001). As different data types need different analysis, the descriptive statistics are presented for both categorical and continuous data. The descriptive statistics analysis was done using SPSS version 17.0.

Table 6.3 presents the descriptive statistics of categorical data consisting of: family-controlled company with family members on the boards (FMLBOCD), family-controlled company with professional management (PROFBOCD), genuine large foreign institutional investor (GLFRG), politically connected independent commissioner (POLIC), independent commissioner with financial expertise (ICED), audit quality (AUD) and financial loss (LOSS). As can be seen, 68 percent of companies in the sample were in the category of family-controlled company with family members on the boards (FMLBOCD). In more detail, companies with family members on the board of directors comprised 9 percent, companies with family members on the board of commissioners comprised 24 percent, and companies with family members on both boards comprised 35 percent. This finding is in line with the Sato (2004) study, which reported an insignificant difference in family control of companies before and after the East Asian financial crisis of 1997-98. In terms of family-controlled companies with professional management, the data indicated that only 14 percent of the family-controlled companies were managed by professionals, whilst the rest were managed by the family itself. In terms of foreign institutional investors, only 23 percent of companies in the sample were considered to be genuine large foreign institutional investors (GLFRG). This means that the majority of the foreign institutional investors might not be large, might be owned by Indonesians, or might be both. In terms of politically connected independent commissioners (POLIC), only 21 percent of public listed companies had this type of commissioner. Similarly, only 25 percent of public listed companies in the sample had an audit committee chair who was a CPA holder, or who possessed an educational background in accounting. In terms of audit quality (AUD), most of the sample companies (62 percent) were audited by non-Big 4 audit firms. Meanwhile, a vast majority of companies in the sample (79 percent) did not have negative income (LOSS) in the year of observation.

Table 6.3 Descriptive Statistics of Categorical Variables

Variable	Proportion (in percentage)		Skewness	Kurtosis
	Dummy = 1	Dummy =0		
FMLBOCD	68	32	-0.785	-1.387
PROFBOCD	14	86	2.107	2.445
GLFRG	23	77	1.257	-0.421
POLIC	21	79	1.417	0.007
ICED	25	75	1.187	-0.593
AUD	38	62	0.488	-1.766
LOSS	21	79	1.408	-0.018

Notes: FMLBOCD=family-controlled company with family members on the boards; PROFBOCD=family-controlled company with professional management; GLFRG= genuine large foreign institutional investor; POLIC=politically connected independent commissioner; ICED=independent commissioner with financial expertise; AUD=audit quality; LOSS=financial loss.

The descriptive statistics for the continuous variables are presented in Table 6.4. The continuous variables in this study include audit committee compliance index total (ACCIT), proportion of independent commissioners (BOC), board of commissioners size (BCS), leverage (LEV) and company size (SIZE). The descriptive statistics presented in Table 6.4 include values for mean, median, minimum, maximum, standard deviation, skewness and kurtosis. For the audit committee compliance index total (ACCIT), the mean, median, and standard deviation were 0.567, 0.567 and 0.232, respectively. However, the mean value was only 0.567, indicating a low level of compliance of public listed companies with audit committee rules. This finding is consistent with prior Indonesian studies (i.e., Utama and Leonardo, 2004). In terms of the proportion of independent commissioners (BOC), the mean, median, and standard deviation values were 0.41, 0.33 and 0.132, respectively. As the maximum value of this variable is 1, it seems that almost half of the board of commissioners (i.e., 41%) consisted of independent commissioners. This exceeds the minimum mandatory requirement of the BAPEPAM (2004), which requires at least one third of commissioners to be independent. In terms of the size of the board of commissioners

(BCS), the mean of the samples was 4.09 while board size ranged from 1 to 12 members. With respect to leverage (measured as total debts divided by total assets), the mean, median, and standard deviation values were 0.55, 0.53 and 0.37, respectively. The maximum value of 3.8 – much higher than the mean value – indicates that some public listed companies might have high leverage, which is likely to occur since most public listed companies are controlled by families that prefer to expand the company by borrowing from banks rather than issuing shares. Meanwhile, the mean of company size was 13.512, which is quite similar to its median of 13.409.

Table 6.4 Descriptive Statistics of the Continuous Variables

Variable	Mean	Median	Min.	Max.	Std. dev.	Skewness	Kurtosis
ACCIT	0.567	0.567	0	1	0.232	-0.236	0.767
BOC	0.405	0.330	0.16	1	0.132	1.856	4.623
BCS	4.09	3.00	1	12	1.807	1.485	2.262
LEV	0.554	0.530	0.004	3.800	0.365	3.223	18.981*
SIZE	13.512	13.409	6.34	18.21	1.713	-0.040	0.436

* kurtosis value exceeded critical value recommended

Notes: ACCIT=audit committee compliance index total; BOC=proportion of independent commissioners; BCS=board of commissioners size; LEV=leverage; SIZE= company size.

6.2.2.2 Assessing Normality

Normality distribution of data is a requirement and the most fundamental assumption in using parametric tests in data analysis (Hair et al., 2006). Normal distribution is used to describe a symmetrical, bell shaped curve, which has the greatest frequency of scores in the middle, with smaller frequencies towards the extremes (Gravetter and Walnau, 2000 cited by Pallant, 2001). A large variation from the normal distribution would cause statistical tests to be invalid because normality is required for F and t statistics (Hair et al., 2006). Therefore, screening continuous variables for normality is an important step in multivariate analysis (Tabachnick and Fidell, 2007).

Hair et al. (2006) argued that multivariate analysis requires that the assumptions underlying the statistical techniques be tested twice: for a univariate analysis and for a multivariate model. In terms of normality, if a variable is multivariate normal, it is also univariate normal. In contrast, if two or more variables are univariate normal, they are not necessarily multivariate normal variables. Therefore, this study employed both univariate and multivariate analyses for normality.

In terms of univariate analysis, this study utilised skewness and kurtosis for the normality distribution tests. Skewness is a measure of the asymmetry of a distribution. The normal distribution is symmetric and has a skewness value of zero. Positive skewness values indicate positive skew (scores clustered to the left at the low value), whereas negative skewness values indicate a clustering of scores at the high end (on the right-hand side of a graph). Meanwhile, kurtosis measures "the peakedness or flatness" of the distribution. Positive kurtosis values indicate that the observations are more clustered and have longer tails than those in the normal distribution, whereas negative kurtosis values indicate that the observations are less clustered and have shorter tails. If the distribution is perfectly normal, the skewness and kurtosis values will be 0, but this is an uncommon occurrence in the social sciences (Pallant, 2001). According Gujarati and Porter (2009), the normality assumption plays a critical role when dealing with small sample sizes (e.g., less than 100 observations), while a normal distribution assumption might be relaxed for large sample sizes. Therefore, as suggested by Kline (1998) and Hoyle (1995), the data is normal if the skewness value is less than 3, and the kurtosis value is less than 10.

Tables 6.3 and 6.4 present the skewness and kurtosis values for each variable. Particular attention should be paid to the values for the continuous variables. As can been seen, except for leverage, all the independent variables have kurtosis and skewness values that are below the recommended value for normality. The skewness and kurtosis values for leverage are 3.223 and 18.981, respectively, which are higher than the recommended value for normality. It was necessary to do a transformation of the leverage values in order to meet the normality assumption. As leverage had positive skewness, the transformation procedure used the square root method. The result of the transformation is presented in Table 6.5.

Table 6.5 Transformation of the Leverage Variable

Variable	Skewness	Kurtosis
LEV	3.223	18.981
SqrtLEV	0.572	3.860

Notes: LEV=leverage; SqrtLEV=square root leverage

The leverage (LEV) variable was transformed using the square root method and the new variable was named as SqrtLEV. As depicted in Table 6.5, the SqrtLEV variable has skewness and kurtosis values that are below the recommended values.

As suggested by Hair et al. (2006), univariate normal variables are not a guarantee of multivariate normal variables. Thus, this study assumed that an examination of the multivariate normality of variables was also needed. This study employed the Kolmogorov-Smirnov (K-S) test for multivariate normality (Hair et al., 2006). The K-S test is a normality test of residuals of a linear regression model. The results of the K-S test are presented in Table 6.6.

Table 6.6 Kolmogorov-Smirnov Test

		Unstandardized Residual
N		828
Normal Parameters[a,b]	Mean	0.0000000
	Std. Deviation	0.20827566
Most Extreme Differences	Absolute	0.042
	Positive	0.035
	Negative	-0.042
Kolmogorov-Smirnov Z		1.202
Asymp. Sig. (2-tailed)		0.111

Notes: a. test distribution is normal; b. calculated from data

The null hypothesis for the K-S test states that the actual distribution is equal to the expected distribution. As can be seen in Table 6.6, the probability associated with the test of normality (0.111) is greater than the level of significance (i.e., 0.05). Thus, the study fails to reject the null hypothesis and concludes that the residuals are normally distributed. In conclusion, both the univariate and multivariate analysis for normality produced consistent findings.

6.2.2.3 Test for Multicollinearity

The test for multicollinearity among independent variables was conducted using a bivariate correlation analysis and a variance inflation factor (VIF) analysis. The bivariate correlation analysis was done using the Pearson product-moment. The results of the bivariate correlation analysis are presented in Table 6.7, while the results of the variance inflation factor (VIF) analysis are presented in Table 6.8.

As can be seen in Table 6.7, all variables have a correlation value below 0.80, which is the cut-off value for the presence of multicollinearity. Among all correlations, the correlation between family-controlled company with family members on the boards

(FMLBOCD) and family-controlled company with professional management (PROFBOCD) had the highest significant correlation value of -0.528. The high correlation can be understood as the two variables measure a similar issue, which is the presence of family control of boards. However, the value of this correlation is still lower than the cut-off value of 0.80 so there is no need to drop one of the variables from the analysis. In short, the results of the correlation analysis suggest that the problem of multicollinearity is minimal.

Some interesting significant correlations were found in the correlation matrix. As expected, the audit committee compliance index total (ACCIT), as the main dependent variable, correlates with almost all independent variables. The exception is the correlation with family-controlled company with professional management (PROFBOCD), where the correlation is positive but not significant. It seems that the presence of professional management in a family-controlled company cannot fully promote compliance with audit committee rules, as the family's influence in the company remains dominant. In terms of the correlation among independent variables, the proportion of independent commissioners (BOC) is negatively and significantly correlated with family-controlled company with family members on the boards (FMLBOCD), whereas the correlation of this variable with family-controlled company with professional management (PROFBOCD) is positive and significant. This suggests that public listed companies have a higher proportion of independent commissioners when there are no family members on the boards.

Another interesting finding is that the genuine large foreign institutional investor (GLFRG) variable has a negative and significant correlation with the family-controlled company with family members on the boards (FMLBOCD) and the family-controlled company with professional management (PROFBOCD) variables. This means that foreign institutional investors are less likely to invest in family-controlled companies. Similarly, audit quality (AUD) also has a negative and significant correlation with family-controlled company with family members on the boards (FMLBOCD) and family-controlled company with professional management (PROFBOCD). This implies that family-controlled companies are less likely to hire any of the Big 4 audit firms. On the other hand, audit quality (AUD) has a positive and significant correlation with the genuine large foreign institutional investor (GLFRG), independent commissioner with financial expertise (ICED) and size of board of commissioners (BCS) variables. This means that public listed companies with foreign institutional investor ownership, with independent commissioners that possess accounting education or that are CPA holders, and with large boards of commissioners are likely to be audited by the Big 4 audit firms.

The independent commissioner with financial expertise (ICED) variable has a positive and significant correlation with the family-controlled company with family members on the boards (FMLBOCD) variable. However, this variable has a negative and significant correlation with the family-controlled company with the professional management (PROFBOCD) and politically connected independent commissioner (POLIC) variables. It seems that companies with family members on their boards try to enhance the image of their audit committees by appointing independent commissioners that are CPA holders, or that have an accounting background. In addition, the presence of politically connected independent commissioners in public listed companies might be reduced by having independent commissioners with an accounting education or that are CPA holders on the board of commissioners.

Board of commissioners size (BCS) has a positive and significant correlation with the genuine large foreign institutional investor (GLFRG), independent commissioner with financial expertise (ICED) and politically connected independent commissioner (POLIC) variables. However, board of commissioners size (BCS) has a negative and significant correlation with the proportion of independent commissioners (BOC). This means that public listed companies tend to expand the size of the board of commissioners to accommodate the presence of foreign institutional investors, politically connected independent commissioners and independent commissioners with an accounting education background, or that are CPA holders.

The last interesting finding is that company size (SIZE) has a positive and significant correlation with several other variables, such as genuine large foreign institutional investor (GLFRG), politically connected independent commissioner (POLIC), board of commissioners size (BCS) and audit quality (AUD). This means that foreign institutional investors tend to invest in large public listed companies. Large public listed companies also tend to have large boards of commissioners and politically connected independent commissioners. Furthermore, large public listed companies are likely to hire the Big 4 audit firms. On the other hand, company size (SIZE) is negatively and significantly correlated with financial loss (LOSS), implying that large public listed companies are less likely to have financial losses (negative income).

Table 6.7 Correlation Analysis

	ACCIT	FMLBOCD	PROFBOCD	GLFRG	POLIC	ICED	BOC	BCS	AUD	LOSS	SqrtLEV	SIZE
ACCIT	1											
FMLBOCD	-0.081*	1										
PROFBOCD	0.021	-0.528**	1									
GLFRG	0.142**	-0.332**	-0.113**	1								
POLIC	-0.050	-0.042	0.041	-0.014	1							
ICED	0.140**	0.081*	-0.085*	-0.030	-0.206**	1						
BOC	0.116**	-0.097**	0.127**	0.019	0.038	0.066	1					
BCS	0.276**	-0.039	-0.010	0.143**	0.094**	0.186**	-0.122**	1				
AUD	0.284**	-0.086*	-0.124**	0.328**	0.056	0.130**	-0.032	0.268**	1			
LOSS	-0.129**	-0.033	0.004	0.019	0.035	-0.083*	0.010	-0.098**	-0.110**	1		
SqrtLEV	-0.074*	-0.054	0.073*	0.037	0.066	0.001	-0.081*	0.000	0.045	0.229**	1	
SIZE	0.331**	-0.050	0.038	0.107**	0.133**	0.060	0.015	0.513**	0.383**	-0.151**	0.050	1

Notes: *, ** indicates significance at the 0.05 and 0.01 levels (2-tailed); FMLBOCD=family-controlled company with family members on the boards; PROFBOCD=family-controlled company with professional management; GLFRG=genuine large foreign institutional investor; POLIC=politically connected independent commissioner; ICED=independent commissioner with financial expertise; BOC=proportion of independent commissioners; BCS=board of commissioners size; AUD=audit quality; LOSS=financial loss; SqrtLEV=leverage (transformed); SIZE=firm size.

In terms of VIF, as depicted in Table 6.8, presentation of the VIF value for each variable is divided based on the study models. Ghozali (2006) suggested that high collinearity is present if a VIF value is greater than 10. Since the VIF values for the regression models shown are all much lower than 10, it can be concluded that multicollinearity is not present in this study.

Table 6.8 Variance Inflation Factor

Variable	Model 1	Model 2
FMLBOCD	1.147	
PROFBOCD		1.065
GLFRG	1.275	1.160
POLIC	1.090	1.089
Control variable		
ICED	1.144	1.147
BOC	1.064	1.074
BCS	1.480	1.481
AUD	1.339	1.353
LOSS	1.101	1.101
LEV	1.083	1.091
SIZE	1.551	1.557

Notes: FMLBOCD=family-controlled company with family members on the boards; PROFBOCD=family-controlled company with professional management; GLFRG=genuine large foreign institutional investor; POLIC=politically connected independent commissioner; ICED=independent commissioner with financial expertise; BOC=proportion of independent commissioners; BCS=board of commissioners size; AUD=audit quality; LOSS=financial loss; LEV=leverage; SIZE=firm size

6.2.3 Panel Data Analysis

As explained in Chapter 5, the study data consisted of short balanced panel data for the 2006-2008 period. Chapter 5 also explained that three possible models can be used in the estimation of panel data, namely: the pooled ordinary least squares (OLS) model, the fixed effects model and the random effects model. Several tests must be performed to determine the appropriate model to use. In addition, several tests also must be performed to check for violations of the assumptions of the classical linear regression model.

This section presents the results of the panel data analysis, which was conducted in two steps. In the first step, the panel data was analysed using all three models (pooled OLS, the fixed effects model, and the random effects model). In the second step, the appropriate estimation model was selected. Once the appropriate model was selected, the classical linear regression model assumptions were then tested. The tests were intended to check whether heteroskedasticity and autocorrelation problems were present. For other classical linear regression assumptions (i.e., the normality and no multicollinearity assumptions), the results of the tests were identified in the preliminary analysis previously described in Section 6.2.2.2 and 6.2.2.3.

The results of the estimations using the pooled OLS model, the fixed effects model and the random effects model for both models are shown in Table D.1 and Table D.2 in Appendix D. After estimating the models, tests to select the most appropriate model were performed. The results are presented in Table 6.9. As can be seen, the Likelihood-Ratio (LR) tests provide evidence that the fixed effects model is more appropriate than the pooled OLS regression model for both models. The next test, the Lagrange Multiplier (LM) test, also indicated that the random effects model was more appropriate than the pooled OLS regression model. Both results are in line with the short balanced panel data characteristics. Hence, the pooled OLS model was determined to be not appropriate. In the next step, the study used the Hausman test to select between the fixed effects model and the random effects model. Test results indicated that the fixed effects model was more appropriate than the random effects model. Although this was the case, the study still needed to check for the presence of heteroskedasticity and autocorrelation problems.

Along with the model selection test, the study further examined the classical linear regression model assumptions needed for the panel data. As depicted in Table 6.10, the results indicated that both models contained autocorrelation and heteroskedasticity problems. As a solution, the study used the feasible generalised least squares (FGLS) method (Greene, 2002; Wooldridge, 2009; Stata Press, 2009), and the fixed effects model was replaced by the FGLS.

Table 6.9 Model Selection Tests

Test		Model 1	Model 2	Decision
Likelihood-Ratio (LR)	LR chi2(275) Prob > chi2	1333.19 0.0000	1307.56 0.0000	Fixed effects model is more appropriate than the pooled OLS model
Lagrange Multiplier (LM)	chi2(1) Prob > chi2	377.54 0.0000	375.54 0.0000	Random effects model is more appropriate than the pooled OLS model
Hausman	chi2(10) Prob>chi2	31.23 0.0005	19.48 0.0345	Fixed effects model is more appropriate than the random effects model

Table 6.10 Classical Linear Regression Model Assumption Tests

Test		Model 1	Model 2	Decision
Wooldridge test (Auto correlation)	F(1, 275) Prob > F	275.725 0.0000	244.975 0.0000	Autocorrelation is present
Likelihood-Ratio test (Heteroskedasticity)	LR chi2(275) Prob > chi2	739.56 0.0000	559.64 0.0000	Heteroskedasticity is present

Table 6.11 presents the estimation results using the FGLS method for both models. In Model 1, most coefficients of the independent variables meet the expectations. The family-controlled company with family members on the boards (FMLBOCD) and

politically connected independent commissioner (POLIC) variables are negatively and significantly associated with the audit committee compliance index total (ACCIT) variable. These findings support hypotheses H_1 and H_3. Meanwhile, as expected, genuine large foreign institutional investor (GLFRG) is positively and significantly associated with audit committee compliance index total (ACCIT). This finding supports H_4 that genuine large foreign institutional investors are more likely to comply with audit committee rules.

Model 2 was developed to test hypothesis H_2 by replacing the family-controlled company with family members on the boards (FMLBOCD) variable with the family-controlled company with professional management (PROFBOCD) variable. The replacement was needed in order to determine the different effects of the two variables on the audit committee compliance index total (ACCIT). As expected, the result indicated that family-controlled company with professional management (PROFBOCD) shows a positive and significant association with the audit committee compliance index total (ACCIT). This is in contrast to the family-controlled company with family members on the boards (FMLBOCD) variable, which is negatively and significantly associated with the audit committee compliance index total (ACCIT). The positive and significant association of the family-controlled company with professional management (PROFBOCD) variable with the audit committee compliance index total (ACCIT) supports hypothesis H_2.

In terms of the control variables, all control variables except for financial loss (LOSS) showed a significant association with the audit committee compliance index total (ACCIT) in both models. While the sign of the coefficient of financial loss (LOSS) was negative, as expected, the variable does not have a significant association.

Table 6.11 Results of Feasible Generalised Least Squares (FGLS) Method of the Main Models

Variable	Exp. Sign	Model 1	Model 2
FMLBOCD	-	-0.040***	-
		(0.000)	
PROFBOCD	+	-	0.029**
			(0.021)
GLFRG	+	0.021**	0.038***
		(0.026)	(0.000)
POLIC	-	-0.023***	-0.021***
		(0.002)	(0.003)
Control Variable			
ICED	+	0.031***	0.025***
		(0.000)	(0.000)
BOC	+	0.086***	0.077***
		(0.000)	(0.000)
BCS	+	0.014***	0.014***
		(0.000)	(0.000)
AUD	+	0.065***	0.067***
		(0.000)	(0.000)
LOSS	-	-0.006	-0.007
		(0.269)	(0.173)
Sqrt LEV	-	-0.055***	-0.054***
		(0.000)	(0.000)
SIZE	+	0.034***	0.034***
		(0.000)	(0.000)
Constant		0.054*	0.027
		(0.069)	(0.326)
Wald chi2(10)		1275.14	1284.73
Prob > chi2		0.000	0.000
Observation		828	828

Notes: p-value in parentheses; *, **, *** indicates significance at the 0.10, 0.05 and 0.01 levels, respectively; FMLBOCD=family-controlled company with family members on the boards; PROFBOCD=family-controlled company with professional management; GLFRG=genuine large foreign institutional investor; POLIC=politically connected independent commissioner; ICED=independent commissioner with financial expertise; BOC=proportion of independent commissioners; BCS=board of commissioners size; AUD=audit quality; LOSS=financial loss; LEV=leverage; SIZE=firm size.

Sensitivity analyses were performed during the study to check the robustness of the results of the main models. The details of the sensitivity analyses are presented in the next section.

6.2.3.1 Sensitivity Analysis

To check the robustness of the results, several sensitivity analyses were performed. These analyses involved the use of an alternative measurement of foreign institutional investors, adding a year dummy, and addressing endogeneity concerns. This section details each analysis.

a. Use of an Alternative Measurement of Foreign Institutional Investors

One of the features that distinguish this study from other prior studies is the measurement of the foreign institutional investor variable, which considers the aspect of the authenticity of foreign institutional investors. Given the Indonesian environment, it is important to measure the authenticity aspect because many foreign institutional investors are actually Indonesian offshore companies (World Bank, 2010). As presented in an earlier section, the genuine large foreign institutional investor (GLFRG) variable has a positive and significant association with the audit committee compliance index total (ACCIT), which supports hypothesis $H_{4.}$ For the sensitivity analysis, the study used a different measurement of foreign institutional investors that ignored the authenticity aspect. The measurement of foreign institutional investors was made by pooling the total percentage of shares held by foreign institutional investors (FRGOWN). Even though this measurement has been widely used by prior studies (e.g., Sarkar and Sarkar, 2000; Colpana, Yoshikawab, Hikinoc, and Miyoshi, 2007; Chien, 2008), its use might produce a different result in the Indonesian environment because some of the shares might actually be owned by Indonesian offshore companies. Thus, compared to the genuine large foreign institutional investor (GLFRG) variable, the total percentage of shares held by foreign institutional investors (FRGOWN) variable was expected to provide a different result, namely, a less significant association of foreign institutional investors with the audit committee compliance index total (ACCIT). Following is the equation for Model 3, in which the genuine large foreign institutional investor (GLFRG) variable is replaced by the total percentage of shares held by foreign institutional investors (FRGOWN) variable:

Model 3

$$ACCIT_{it} = \beta_{0it} + \beta_1 FMLBOCD_{it} + \beta_2 FRGOWN_{it} + \beta_3 POLIC_{it} + \beta_4 ICED_{it} + \beta_5 BOC_{it} + \beta_6\, BCS_{it} + \beta_7 AUD_{it} + B_8 LOSS_{it} + \beta_9 LEV_{it} + \beta_{10} SIZE_{it} + \varepsilon_{it}$$

The procedures for analysing the panel data for Model 3 were similar to those used with the other models (i.e., Model 1 and Model 2). The regression estimations based on three models (pooled OLS, fixed effects, random effects) were computed, and this was followed by a selection model test and classical linear regression model assumption test. The results of the pooled OLS model, the fixed effects model and the random effects model are presented in Table D.3 in Appendix D. Like Model 1 and Model 2, the appropriate method for use with Model 3 was the feasible generalised least squares (FGLS), due to the presence of heteroskedasticity and autocorrelation. As presented in Table 6.12, the fixed effects model was selected as the most appropriate method; classical linear regression tests did, however, indicate the presence of heteroskedasticity and autocorrelation (see Table 6.13).

Table 6.12 Model Selection Test

Test		Model 3	Decision
Likelihood-Ratio (LR)	LR chi2(275) Prob > chi2	1333.68 0.000	Fixed effects model is more appropriate than the pooled OLS model
Lagrange Multiplier (LM)	chi2(1) Prob > chi2	376.45 0.0000	Random effects model is more appropriate than the pooled OLS model
Hausman	chi2(10) Prob>chi2	32.30 0.0004	Fixed effects model is more appropriate than the random effects model

Table 6.13 Classical Linear Regression Model Assumption Tests

Test		Model 3	Decision
Wooldridge test	F(1, 275)	274.083	Autocorrelation is present
(auto correlation)	Prob > F	0.0000	
Likelihood-Ratio test	LR	710.95	Heteroskedasticity is present
(heteroskedasticity)	chi2(275)		
	Prob > chi2	0.0000	

Table 6.14 presents the results of the FGLS analysis of Model 3. In general, the findings were consistent with those of Model 1, in which the family-controlled company with family members on the boards (FMLBOCD) variable and the politically connected independent commissioner (POLIC) variable were negatively and significantly associated with the audit committee compliance index total (ACCIT). This supports hypotheses H_1 and $H_{3.}$ As expected, the replacement of the genuine large foreign institutional investor (GLFRG) variable with the total percentage of shares held by foreign institutional investors (FRGOWN) variable provided the opposite result. In Model 1, the genuine large foreign institutional investor (GLFRG) variable had a positive and significant association with the audit committee compliance index total (ACCIT). In contrast, the total percentage of shares held by foreign institutional investors (FRGOWN) variable in Model 3 is not significant; even the coefficient sign is a negative. In sum, this finding provides evidence of the inappropriateness of measuring foreign institutional investor ownership solely on the basis of the total percentage of shares owned without identifying the authenticity of the investors.

Table 6.14 Results of the Feasible Generalised Least Squares (FGLS) Method Using an Alternative Proxy for Foreign Institutional Investors

Variable	Exp. Sign	Model 3
FMLBOCD	-	-0.051***
		(0.000)
FRGOWN	+	-0.000
		(0.412)
POLIC	-	-0.025***
		(0.001)
Control Variable		
ICED	+	0.029***
		(0.000)
BOC	+	0.077***
		(0.000)
BCS	+	0.014***
		(0.000)
AUD	+	0.069 ***
		(0.000)
LOSS	-	-0.006
		(0.258)
Sqrt	-	-0.055***
LEV		(0.000)
SIZE	+	0.033***
		(0.000)
Constant		0.077***
		(0.010)
Wald chi2(10)		972.42
Prob > chi2		0.000
Observation		828

Notes: p-value in parentheses; *, **, *** indicates significance at the 0.10, 0.05 and 0.01 levels, respectively; FMLBOCD=family-controlled company with family members on the boards; FRGOWN=total percentage of shares held by foreign institutional investors; POLIC=politically connected independent commissioner; ICED=independent commissioner with financial expertise; BOC=proportion of independent commissioners; BCS=board of commissioners size; AUD=audit quality; LOSS=financial loss; LEV=leverage; SIZE=firm size.

b. Adding a Year Dummy

To check the robustness of the results, the regression was re-estimated by adding year dummies as independent variables. A year dummy is used to accommodate unobserved heterogeneity that varies across time rather than across subjects such as technological changes and changes in government regulations and/or tax policies (Gujarati and Porter, 2009). The time effect might affect the subjects in the same way, but it may be different at different points in time. To avoid the dummy-variable trap (perfect collinearity), the number of years in the time dummy series should be smaller than the total time series. As the period of the study is only three years (2006-2008), the year dummy considers only two (2007 and 2008), while year 2006 serves as a base or reference.

The steps for analysing data with the year dummy were similar to those used in analysing data without the year dummy. In the first step, all models were estimated using the pooled OLS, fixed effects and random effects models (see Table D.1, D.2, and D.3 in Appendix D for detailed results). In the second step, the model selection and classical linear regression model assumption tests were conducted. As depicted in Table 6.15, the final appropriate model was the random effects model. This model differed from the analysis without year dummy that found the fixed effects model to be the most appropriate model. However, similar to the models without a year dummy, a check of the data revealed autocorrelation and heteroskedasticity problems (see Table 6.16). As a solution, the feasible generalised least squares (FGLS) method was employed, similar to the method of analysis used for models without a year dummy.

Table 6.15 Model Selection Tests

Test		Model 1	Model 2	Model 3	Decision
Likelihood - Ratio (LR)	LR chi2(275)	1444.03	1440.79	1426.00	Fixed effects model is more appropriate than the pooled OLS model
	Prob > chi2	0.0000	0.0000	0.0000	
Lagrange Multiplier (LM)	chi2(1)	434.75	434.49	433.45	Random effects model is more appropriate than the pooled OLS model
	Prob > chi2	0.0000	0.0000	0.0000	
Hausman	chi2(10)	16.85	15.75	9.96	Random effects model is more appropriate than the fixed effects model
	Prob>chi2	0.1554	0.2028	0.6199	

Table 6.16 Classical Linear Regression Model Assumption Tests

Test		Model 1	Model 2	Model 3	Decision
Wooldridge test (autocorrelation)	F(1, 275)	175.553	177.659	160.271	Autocorrelation is present
	Prob > F	0.0000	0.0000	0.0000	
Likelihood-Ratio test (heteroskedasticity	LR chi2(275)	1546.68	679.02	1938.22	Heteroskedasti-city is present
	Prob > chi2	0.0000	0.0000	0.0000	

Table 6.17 presents the FGLS regression test results with a year dummy. It must be noted that Model 4, Model 5, and Model 6 are extensions of the earlier models that added a year dummy as an additional independent variable. The results were considered robust, as all variables had similar findings to those obtained from the analysis without a year dummy (see Table 6.11). However, there were slight differences related to the significance level of the variables of concern. For example, the genuine large foreign institutional investor (GLFRG) variable in Model 1 (without a year dummy) shows a 5 percent significance level, while the strength of the association increases in Model 4 (with a year dummy), with a 1 percent significance level. In contrast, the significance level of the family-controlled company with professional management (PROFBOCD) variable increases from 5 percent (in Model 2 without a year dummy) to 10 percent (in Model 5 with a year dummy), indicating a weaker association. Similarly, the politically connected independent commissioner (POLIC) variable also has a weaker association in the analysis with a year dummy, than in the analysis without a year dummy: the level of significance increased from 5 percent to 10 percent. Meanwhile, the total percentage of shares held by foreign institutional investors (FRGOWN) variable has a negative and insignificant association, which is consistent with the results of the analysis that did not use a year dummy. The year dummies of 2007 and 2008 are positively and significantly associated with the audit committee compliance index total (ACCIT) in all models (i.e.,

Model 4, Model 5, and Model 6). This indicates that a longer period of implementation of audit committee rules might lead to better compliance with the rules. Meanwhile, all control variables presented findings similar to those found in the analysis of models that did not contain a year dummy.

Table 6.17 Results of the Feasible Generalised Least Squares (FGLS) Method with a Year Dummy

Variable	Exp. Sign	Model 4	Model 5	Model 6
FMLBOCD	-	-0.036*** (0.005)	-	-0.050*** (0.000)
PROFBOCD	+	-	0.032* (0.094)	-
FRGOWN	+	-	-	-0.000 (0.408)
GLFRG	+	0.034*** (0.009)	0.050*** (0.000)	-
POLIC	-	-0.021** (0.050)	-0.020* (0.065)	-0.022** (0.036)
Control Variable				
ICED	+	0.036*** (0.000)	0.036*** (0.000)	0.036*** (0.000)
BOC	+	0.069** (0.031)	0.074** (0.020)	0.072** (0.027)
BCS	+	0.011*** (0.000)	0.011*** (0.000)	0.013*** (0.000)
AUD	+	0.063*** (0.000)	0.065*** (0.000)	0.070*** (0.000)
LOSS	-	-0.002 (0.789)	-0.002 (0.795)	-0.003 (0.693)
Sqrt LEV	-	-0.037** (0.039)	-0.037** (0.040)	-0.042** (0.025)
SIZE	+	0.027*** (0.000)	0.027*** (0.000)	0.027*** (0.000)
Year Dummy				
2007	+	0.045*** (0.000)	0.045*** (0.000)	0.045*** (0.000)
2008	+	0.059*** (0.000)	0.060*** (0.000)	0.060*** (0.000)
Constant		0.1134*** (0.006)	0.082** (0.041)	0.128*** (0.002)
Wald chi2(12)		533.35	544.16	521.33
Prob > chi2		0.000	0.0000	0.000
Observation		828	828	828

Notes: p-value in parentheses; *, **, *** indicates significance at the 0.10, 0.05 and 0.01 levels, respectively; FMLBOCD=family-controlled company with family members on the boards; PROFBOCD=family-controlled company with professional management; FRGOWN=total percentage of shares held by foreign institutional investors; GLFRG=genuine large foreign institutional investor; POLIC=politically connected independent commissioner; ICED=independent commissioner with financial expertise; BOC=proportion of independent commissioners; BCS=board of commissioners size; AUD=audit quality; LOSS=financial loss; LEV=leverage; SIZE=firm size.

c. Endogeneity

One of the assumptions of the classical linear regression model is that the error term (u) has an expected value of zero (0) given any values of independent variables (Wooldridge, 2009). Symbolically, it can be written as follows:

$$E(u|x_1, x_2, \ldots x_k) = 0$$

If this assumption holds true, it means that the regressors are exogenous. Violation of the assumption is called endogeneity, in which the error term (u) has a correlation with the regressors. The presence of endogeneity causes the OLS estimation to be biased and inefficient (Schultz, Tan, and Walsh, 2010). According to Wintoki et al. (2009), there are three sources of potential endogeneity in corporate governance: dynamic endogeneity, simultaneity and unobserved heterogeneity. Dynamic endogeneity means that the current value of the variable is influenced by its value in the preceding period. Simultaneity is present when two or more variables are jointly determined. Unobserved heterogeneity indicates that a relationship between two or more variables is affected by an unobservable factor.

Some researchers in accounting have discussed the importance of paying attention to the endogeneity issue. For example, Larker and Rusticus (2007) discussed endogeneity in accounting research, while Van Lent (2007), and Chenhall and Moers (2007) discussed endogeneity in quantitative management accounting research. In corporate governance studies, Wintoki et al. (2007) proposed the need to give attention to the dynamic relationship among a firm's characteristics that might create dynamic endogeneity. This dynamic endogeneity has been demonstrated by some prior studies of the relationship between corporate governance and performance (see Wintoki et al., 2007; 2009; Schultz et al., 2010). In studies on compliance with corporate governance codes, a few prior studies were concerned with endogeneity. For example, Rainsbury et al. (2008) examined endogeneity because of simultaneity. The study assumed that audit committee structure and board structure were jointly determined, and the study used a two-stage approach as a solution. However, the results indicated that the presence of simultaneity could not be proved. In another study, Da Silveira et al. (2010) examined endogeneity in a study on the determinants of Brazilian corporate governance quality using a generalised method of moments system (GMM-system), which was developed by Arellano and Bover (1995). The study examined endogeneity because of simultaneity and dynamic endogeneity. An important finding was that corporate governance practice in a prior period significantly affects current corporate governance practice, thus dynamic endogeneity was proved.

Following Da Silveira et al. (2010), the potential endogeneity problem in this study was tested using the GMM-system (Arellano and Bover, 1995). In particular, this study focused on examining potential dynamic endogeneity, as it was assumed that the level of compliance with audit committee rules in the preceding period would affect the level of compliance in the current period. The GMM-system was selected for the analysis of endogeneity because it is robust enough to deal with all forms of endogeneity: dynamic endogeneity, simultaneity, and unobservable heterogeneity (Schultz et al., 2010). Three other reasons for the use of the GMM-system are explicated as follows:

1. All the models in this study have an unknown heteroskedasticity problem, and the GMM estimator is efficient when unknown heteroskedasticity is present (Baum, Schaffer, and Stillman, 2003).

2. In this study, reliable exogenous external instruments were not available due to an absence of prior studies. Under such conditions, it might be better to assume that all variables are endogenous (Franses, 2005). The GMM-system is suitable to deal with endogeneity in panel data as it uses the lags of the potential endogenous regressors as their own instrumental variables (Da Silveira et al., 2010).

3. The Arellano-Bond GMM estimator is designed for panel data that has short periods (small T) and large observations (large N) (Mileva, 2007).

In the GMM-system analysis, all models had the lag of the audit committee compliance index total ($ACCIT_{t-1}$) added as regressors. All regressors were assumed endogenous and instrumented using their lags. The lagged variable was assumed to be a predetermined variable as its value was not determined in the current time period and was not correlated with an error term (Gujarati and Porter, 2009). Rainsbury et al. (2008) and Da Silveira et al. (2010) also used lagged variables as instrumental variables. This study used one lag period for dynamic completeness, as the study only covered three periods in total. In Stata, the command for the Arellano-Bond GMM-system is xtabond2.

The GMM panel model produces more consistent parameter estimates than those of the OLS when regressors are endogenous, or when endogeneity is present. In contrast, when the regressors are exogenous, the OLS model will produce parameter estimates that are more efficient than the GMM panel model (Schultz et al., 2010). Therefore, before using the GMM model, it is necessary to test and to confirm the need for GMM as an additional analysis of the OLS regression. The test is called the Durbin-Wu-Hausman (DWH) test for endogeneity. Principally, the DWH test is not an endogeneity or exogeneity of regressors test, but is perhaps best interpreted as a test of the consequence of employing different estimation methods on the same equation (Baum et al., 2003). The test statistic of the DWH test follows a chi-squared distribution with *K* degrees of freedom, where *K* is the number of regressors tested for endogeneity. For this study, the number of regressors for all the models was 10. The null hypothesis of the DWH test was that regressors are exogenous. In Stata, the command for this test is ivendog. As depicted in Table 6.18, the results of the DWH test for all models indicated that the null hypothesis could not be rejected, as the *p-value* was higher than 0.05. This means that the regressors in each model are exogenous. These insignificant findings imply that, in all models, the OLS regression model will provide more consistent parameter estimates than those of the GMM-system model. Therefore, the study assumed that the OLS model would be more appropriate than the GMM-system model because it would produce parameter estimates that are more efficient than those of the GMM-system. The results of the GMM-system analysis for all models can be found in Table D.1, D.2, and D.3 in Appendix D.

Table 6.18 The Durbin-Wu-Hausman Test for the Endogeneity of Regressors

	Model 1	Model 2	Model 3
Durbin-Wu-Hausman test statistic	12.63279	13.90436	17.73957
p-value	0.24493	0.17740	0.05952
Degree of freedom	10	10	10

The steps involved in the analysis of the OLS regression with lagged dependent variables were similar to the steps involved with other analyses. All models with lagged dependent variables were estimated by the pooled OLS, fixed effects and random effects models. Model selection tests and classical linear regression model assumption tests were then done. As can be seen in Table 6.20, while the fixed effects model was selected for all models, the classical linear regression assumption test indicated the presence of heteroskedasticity and autocorrelation. As with the other analyses previously discussed, feasible generalised least squares (FGLS) was used to remedy those problems.

Table 6.19 Model Selection Tests

Test		Model 1	Model 2	Model 3	Decision
Likelihood -Ratio (LR)	LR chi2(275)	996.19	992.79	997.73	Fixed effects model is more appropriate than the pooled
	Prob > chi2	0.000	0.000	0.000	OLS model
Lagrange Multiplier (LM)	chi2(1)	1.23	1.20	1.20	Pooled OLS model is more appropriate than the random
	Prob > chi2	0.1336	0.1363	0.1365	effects model.
Hausman	chi2(11)	247.38	246.64	248.05	Fixed effects model
	Prob>chi2	0.000	0.000	0.000	is more appropriate than the random effects model.

Table 6.20 Classical Linear Regression Model Assumption Tests

Test		Model 1	Model 2	Model 3	Decision
Wooldridge test	F(1, 275)	275.725	244.975	274.083	Autocorrelation
(autocorrelation)	Prob > F	0.000	0.000	0.000	is present
Likelihood-Ratio test	LR chi2(275)	6396.38	7518.96	6236.94	Heteroskedasti-city is present
(heteroskedasticity)	Prob > chi2	0.000	0.000	0.000	

The results of the analysis using the lag dependent variable are presented in Table 6.21. Model 7, Model 8, and Model 9 are extensions of the original models and were derived by adding the lagged dependent variable as an explanatory variable. As a consequence of the use of the lagged dependent variable in one period, the number of observations reduced from 828 to 552.

Table 6.21 Results of the Feasible Generalised Least Squares (FGLS) Method with the Lagged Dependent Variable

Variable	Exp. Sign	Model 7	Model 8	Model 9
$ACCIT_{(t-1)}$	+	0.629***	0.853***	0.637***
		(0.000)	(0.000)	(0.000)
FMLBOCD	-	-0.010***	-	-0.015***
		(0.000)		(0.000)
PROFBOCD	+	-	-0.005	-
			(0.551)	
FRGOWN	+	-	-	0.000
				(0.760)
GLFRG	+	0.023***	0.014***	-
		(0.000)	(0.000)	
POLIC	-	-0.033***	-0.018***	-0.025***
		(0.000)	(0.000)	(0.000)
Control Variable				
ICED	+	0.039***	0.044***	0.037***
		(0.000)	(0.000)	(0.000)
BOC	+	0.053***	0.025***	0.045***
		(0.000)	(0.006)	(0.000)
BCS	+	0.000	-0.006***	0.000
		(0.552)	(0.000)	(0.990)
AUD	+	0.023***	0.010**	0.022***
		(0.000)	(0.011)	(0.000)
LOSS	-	-0.040***	-0.025***	-0.040***
		(0.000)	(0.000)	(0.000)
Sqrt	-	-0.011**	0.014*	-0.015***
LEV		(0.021)	(0.081)	(0.007)
SIZE	+	0.012***	0.007***	0.014***
		(0.000)	(0.000)	(0.000)
Constant		0.085***	0.034***	0.071***
		(0.000)	(0.007)	(0.000)
Wald chi2(11)		1.36e+07	244711.01	34963.70
Prob > chi2		0.000	0.000	0.000
Observation		552	552	552

Notes: p-value in parentheses; *, **, *** indicates significance at the 0.10, 0.05 and 0.01 levels, respectively; FMLBOCD=family-controlled company with family members on the boards; PROFBOCD=family-controlled company with professional management; FRGOWN=total percentage of shares held by foreign institutional investors; GLFRG=genuine large foreign institutional investor; POLIC=politically connected independent commissioner; ICED=independent commissioner with financial expertise; BOC=proportion of independent commissioners; BCS=board of commissioners size; AUD=audit quality; LOSS=financial loss; LEV=leverage; SIZE=firm size.

As expected, the lag of the audit committee compliance index total ($ACCIT_{(t-1)}$) had a positive and significant association with the audit committee compliance index total

(ACCIT). This means that the level of audit committee compliance in the preceding period positively affects audit committee compliance in the current period. Except for family-controlled company with professional management (PROFBOCD), all other variables of concern, such as family-controlled company with family members on the boards (FMLBOCD), total percentage of shares held by foreign institutional investors (FRGOWN), genuine large foreign institutional investor (GLFRG) and politically connected independent commissioner (POLIC) provided consistent findings. Family-controlled company with family members on the boards (FMLBOCD) showed a negative and significant association with the audit committee compliance index total (ACCIT) in Model 7 and Model 9. Similarly, the politically connected independent commissioner (POLIC) variable also had a negative and significant association with the audit committee compliance index total (ACCIT) variable in Model 7, Model 8, and Model 9. Meanwhile, the results of the analysis of the total percentage of shares held by foreign institutional investors (FRGOWN) variable are in contrast to those obtained from the analysis of the genuine large foreign institutional investor (GLFRG) variable; this is consistent with the results of the earlier analyses conducted. However, the analysis of the family-controlled company with professional management (PROFBOCD) variable provided a conflicting result: as can be seen in Model 8, this variable has a negative coefficient and insignificant association. Obviously, this result is contrary to the results of the earlier analyses (see Model 2 and Model 5). The presence of the lagged dependent variable, which reduced the sample to 552, may have caused different results for the family-controlled company with professional management (PROFBOCD) variable. In respect of the control variables, most results were consistent.

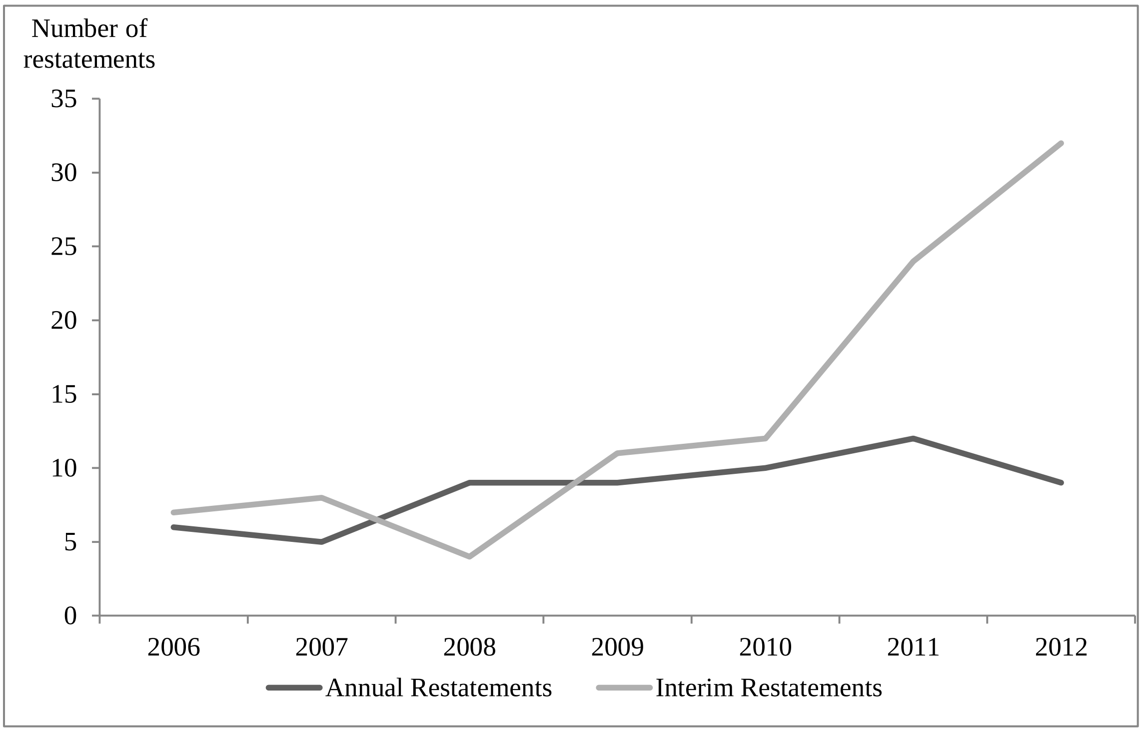
6.3 RESULTS OF RESEARCH STAGE 2: AUDIT COMMITTEE EFFECTIVENESS AND FINANCIAL REPORTING QUALITY

6.3.1 Preliminary Analysis

6.3.1.1 Descriptive Statistics

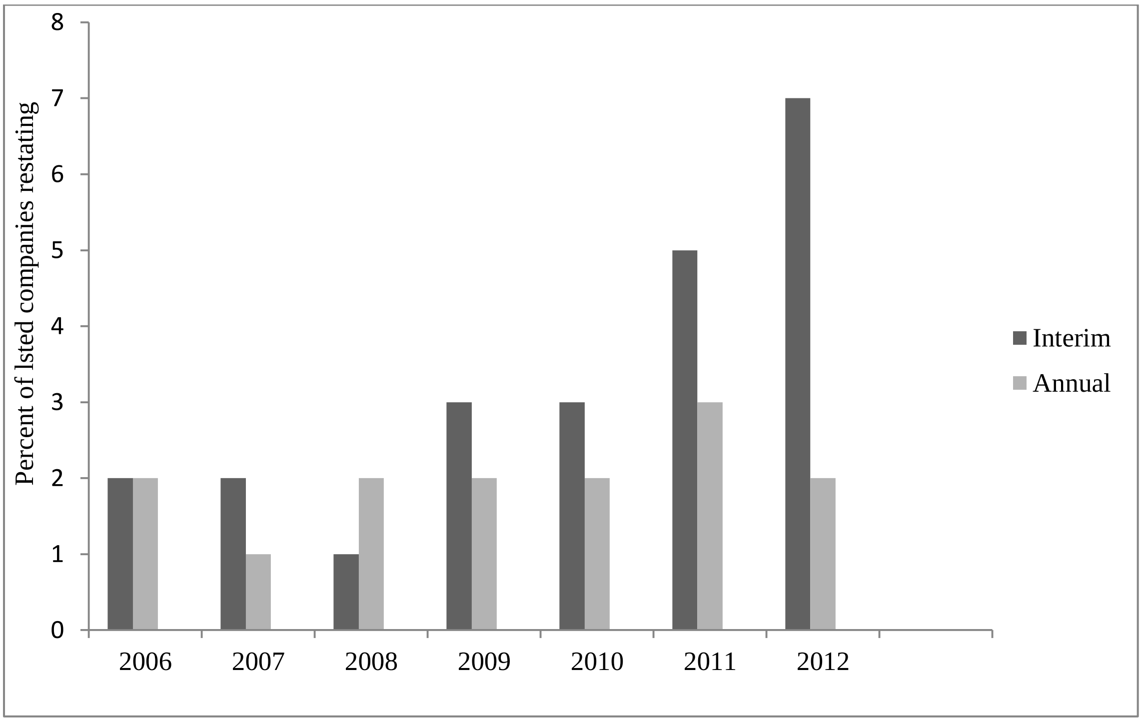
Figure 6.1 presents the trend of annual and interim restatements for the 2006-2012 period. As can be seen, while the number of incidents of both annual and interim restatements fluctuated in the 2006-2009 period (ranging from 6 to 12 cases per year), there was no great difference in the numbers between the two types. The difference in the numbers only became substantial starting in 2011. The incidence of annual restatements increased in 2011, but decreased gradually in 2012. In contrast, the incidence of interim restatements increased dramatically, rising from 24 cases in 2011 to 32 cases in 2012.

Figure 6.1 Restatement Announcements Identified (2006-2012)



The numbers of restatements are considered low, and are consistent with those in prior studies in developing countries (e.g., Abdullah et al. 2010; Alyousef and Almutairi, 2010; Chang et al., 2010). Compared with the US, the overall number of restatements seen in this study is much lower. However, the percentage of restatements made by listed companies in Indonesia is not much different from the percentage made by public listed companies in the US. As evidence, the percentage of US listed companies announcing annual financial restatements from 2002 to 2005 ranged from 3.7 percent to 6.8 percent (see GAO, 2006). Meanwhile, in Indonesia, the percentage of annual restatements from 2006 to 2012 ranged from 1 percent to 3 percent, while the percentage of interim restatements ranged from 1 percent to 7 percent. As depicted in Figure 6.2, the highest percentage of annual restatements, 3 percent, occurred in 2011. In terms of interim financial restatements, the highest percentage of restatements was 7 percent and occurred in 2012.

Figure 6.2 Distribution of Restatements by Year

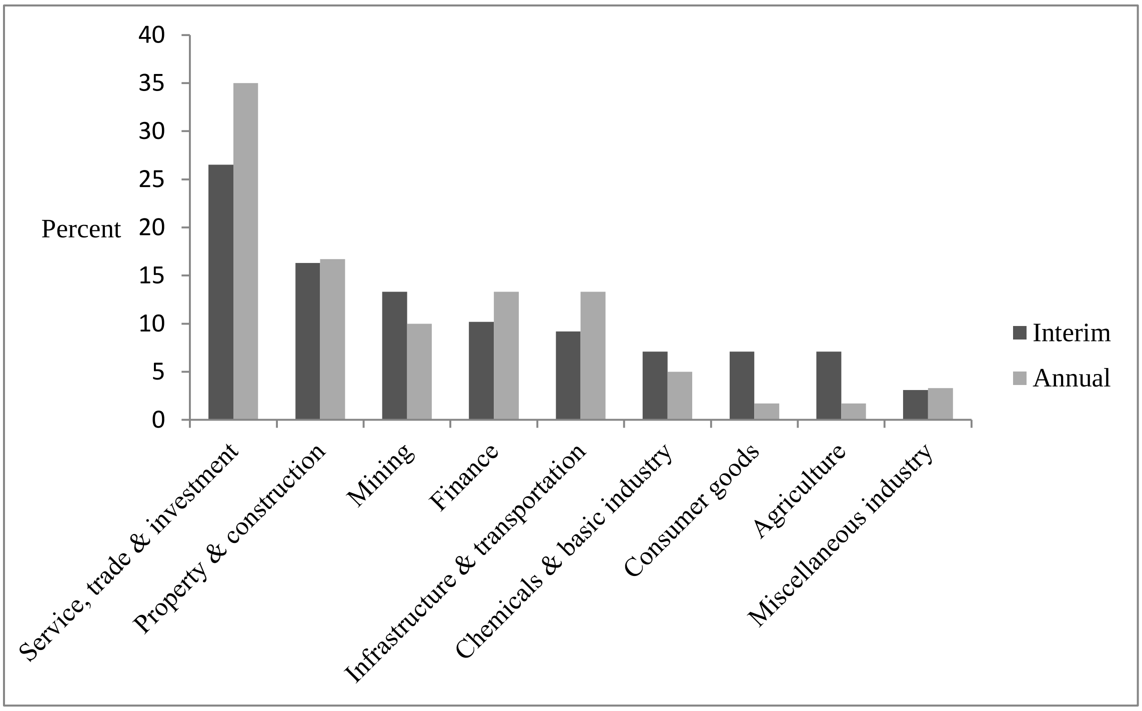


Source: Compiled by the author

Based on Figure 6.1 and Figure 6.2, interim restatements have dominated the incidence of restatements in Indonesia, except in 2008. This is contrary to the US where annual restatements dominate the incidence of restatements. As evidence, Cheffers et al. (2010) found that the percentage of annual restatements was higher than the percentage of interim restatements in the 2001-2009 period. This study assumes that the high incidence of restatements of interim financial statements may be due to the absence of an audit role for external auditors (which might serve as an alternative corporate governance mechanism) in the issuance of interim statements, (Claessens and Yurtoglu, 2013). In Indonesia, the IDX does not require the interim financial statements of public listed companies to be audited by external auditors. Therefore, the absence of a role for the external auditor might reduce the quality of the interim statements. In addition, the convergence of the implementation of new Indonesian accounting standards and International Financial Reporting Standards (IFRS) in 2011 might have contributed to the high number of restatements for that year. Meanwhile, annual restatements decreased in 2012, in contrast to the increase in interim restatements. One plausible explanation is that the study's period of observation ended on 30 June 2013 and annual restatements that occurred after that date were not included in the study sample.

Figure 6.3 presents the sample distribution by industry sector. As can be seen, the service sector contributed the highest percentage of both annual and interim restatements. This finding is consistent with most prior studies in the US (e.g., Agrawal and Chadha 2005; Archambeault et al., 2008; Marciukaityte et al., 2009; Amoah and Tang, 2010), and also with prior studies in developing countries (e.g., Abdullah et al. 2010; Alyousef and Almutairi, 2010). In terms of the industry sector with the lowest percentage of restatements, the miscellaneous industry sector contributed the lowest percentage of interim restatements. Meanwhile, the consumer goods and agriculture sectors had the lowest percentage of annual restatements.

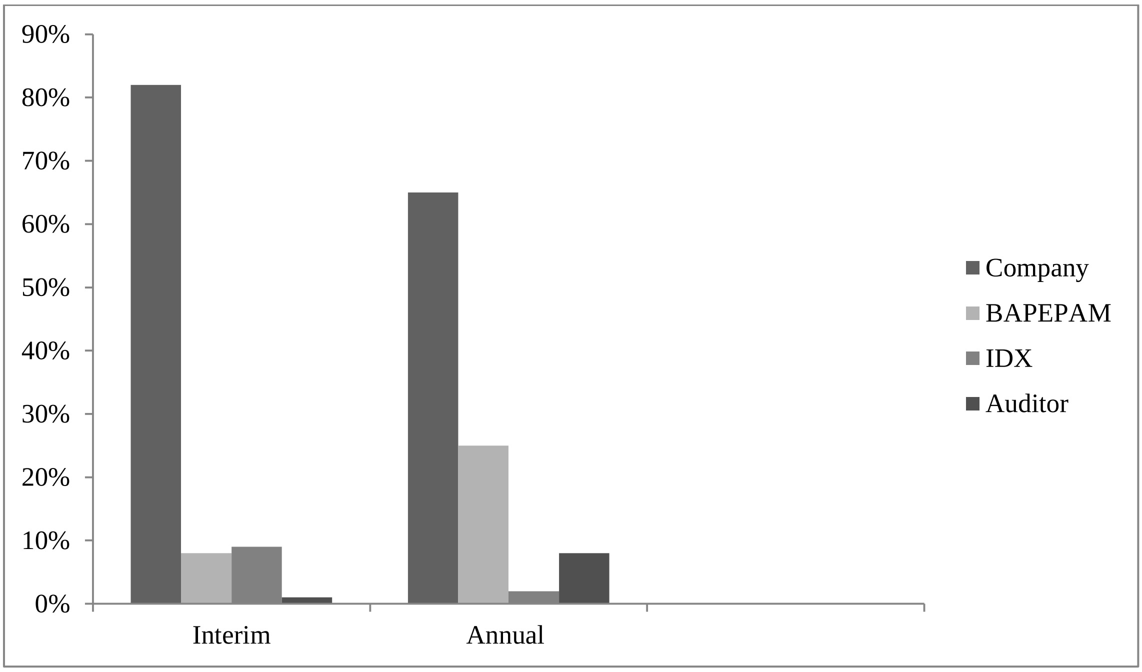
Figure 6.3 Distribution of Restating Companies across Industry Sectors



Source: Compiled by the author

Figure 6.4 presents the distribution of restatements by prompter, which is the agency or party responsible for prompting the restatement. Parties that can prompt the restatement of financial statements include the listed company itself, an external auditor, the BAPEPAM, or the IDX. As can be seen from the figure, most restatements were initiated by the companies themselves. This is known as voluntary restatement. The finding that the majority of restatements were voluntary is consistent with prior studies (see Agrawal and Chadha 2005; GAO, 2006; Marciukaityte et al., 2009; Flanagan et al., 2008). Voluntary restatements by a company might indicate the presence of a high quality of internal corporate governance by an audit committee and independent directors (Marciukaityte et al., 2009; Flanagan et al., 2008). With regard to external initiators, there is a difference in the prompters of interim restatements and annual restatements. For restatements of interim financials, the IDX prompted 9 percent of restatements, the BAPEPAM initiated 8 percent, and external auditors prompted 1 percent. With respect to the restatement of annual financial statements, the BAPEPAM prompted 25 percent, external auditors prompted 8 percent, and the IDX prompted 2 percent. External auditors seem to play a greater role in the restatement of annual financials as opposed to interim financials because there is no requirement for external auditors to audit interim financial statements. Nevertheless, several listed companies required their external auditor to perform a limited review of their interim financial statements.

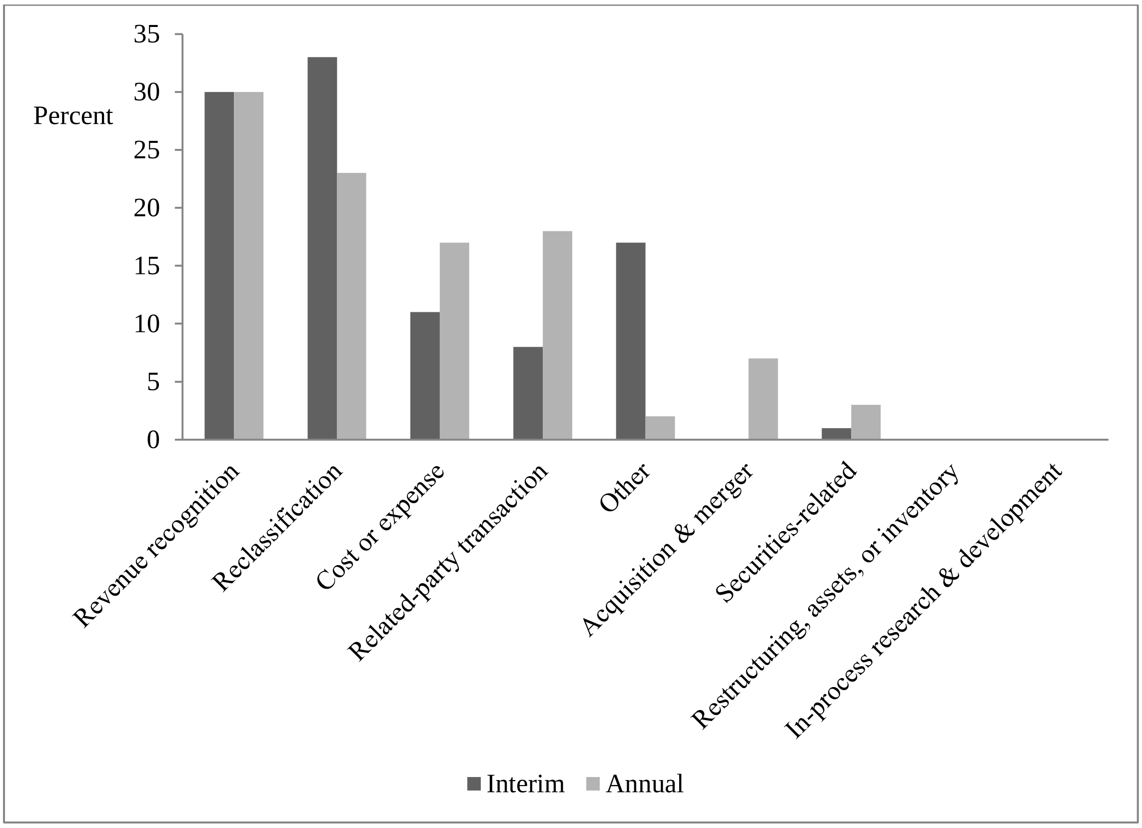
Figure 6.4 Prompters of Restatements (2006-2012)



Source: Compiled by the author

This study follows the GAO study (2006) in classifying the reasons for restatements. As depicted in Table 5.9 in Chapter 5, there are nine reasons for restatement, including: revenue recognition, reclassification, cost/expense, related-party transactions, acquisitions/mergers, securities-related, restructuring/assets/inventory, research and development, and other. As can be seen in Figure 6.5, interim financials were restated due to reclassification in 33 percent of cases. Restatements due to reclassification generally occur because companies make errors in the classification of items on their income statement, balance sheet, or cash flow statement. Revenue recognition (30 percent) is the next most frequently identified reason for restatements, followed by other (17 percent), cost or expense (11 percent), related-party transactions (8 percent), and securities-related (1 percent). On the other hand, revenue recognition is the most frequent reason for the restatement of annual financials (30 percent). This finding is consistent with prior studies in the US that also identified revenue recognition as the most frequent reason for the restatement of annual financial statements (GAO, 2006; Marciukaityte et al., 2009; Flanagan et al., 2008). Various items contribute to restatements due to revenue recognition reasons, including calculation errors and the misapplication of accounting standards. Although revenue recognition is the most frequent reason for restating annual financial statements, other reasons are also significant, including reclassification (23 percent), related-party transactions (18 percent), and cost or expense (17 percent). Meanwhile, acquisition or merger, securities-related, and other, are less frequent reasons for the restatement of annual financials, at 7 percent, 3 percent, and 2 percent, respectively. Related-party transactions constitute a relatively high percentage of restatements for both interim and annual financial statements. However, this reason has ranked low in some prior US studies (GAO, 2006; Marciukaityte et al., 2009; Flanagan et al., 2008). The characteristics of Indonesian public listed companies (i.e., they are mostly owned by families through pyramids and cross-ownership) might explain the higher percentage of restatements due to related-party transaction in Indonesia, as compared to the US.

Figure 6.5 Restatements by Reason (2006-2012)



Source: Compiled by the author

The descriptive statistics consist of mean, standard deviation, and also the mean difference between the restating firms and their control firms (see Table 6.22). In order to find an appropriate statistical technique for mean difference, it was necessary to assess the normality distribution of the continuous variables. To assess normality distribution, the Kolmogorov-Smirnov test was applied. Table 6.22 shows the results of the normality tests.

Table 6.22 Normality Test

Variable	Kolmogorov-Smirnov Z	Asymp. Sig.	Interpretation
BOC	4.584	0.000	not normal
BCS	5.078	0.000	not normal
AGE	1.272	0.079	normal
ROA	6.981	0.000	not normal
LEV	7.064	0.000	not normal
ACCIT_c	1.656	0.008	not normal
ACEFEC_c	3.078	0.000	not normal

Notes: ACCIT_c=audit committee compliance index total (centred); ACEFEC_c= audit committee effectiveness (centred); BOC=proportion of independent commissioners; BCS=board of commissioners size; AGE=listing age; ROA=return on assets; LEV=leverage.

As a rule of thumb, a variable is assumed normal if its significance level is greater than 0.05 (Coakes, Steed, and Dzidic, 2006). Among the seven continuous variables, only listing age (AGE) is assumed normal; all other variables, namely, proportion of independent commissioners (BOC), board of commissioners size (BCS), return on assets (ROA), leverage (LEV), the audit committee compliance index total (ACCIT_c), and audit committee effectiveness (ACEFEC_c) are not normal. Thus, the mean difference test for listing age (AGE) is a parametric test, namely, an independent t-test. The mean difference test for other continuous variables (BOC, BCS, ROA, LEV, ACCIT_c, ACEFEC_c) is a non-parametric test, namely, the Man-Whitney U test. Meanwhile, the categorical variable of family-controlled company with family members on the boards (FMLBOCD) is examined using the chi-square test for independence or relatedness.

Table 6.23 shows the results of the mean, standard deviation, and mean difference tests for the restating sample firms and their matched control firms. The presentation is divided into two to show the results for the continuous and categorical variables. In terms of the main variable**,** the control companies (as expected) had higher mean scores for the audit committee compliance index total (ACCIT_c), and audit committee effectiveness (ACEFEC_c) than those of the restating companies. The mean scores of the ACCIT_c and ACEFEC_c variables for the control companies were 0.004 and 0.008, respectively, whereas the scores for these same variables among restating companies were -0.004 and -0.008, respectively. Unfortunately, the mean difference of the two audit committee effectiveness indexes is not statistically significant. The insignificance of the indexes (ACCIT_c and ACEFEC_c) might provide preliminary evidence that the audit committee does not play a role in preventing restatements, which is consistent with prior studies in developing countries (e.g., Mohd-Saleh, Mohd-Iskandar, and Rahmat, 2005; Abdullah et al., 2010). Meanwhile, the family-controlled company with family members on the boards (FMLBOCD) variable presented some interesting findings. Coincidentally, the mean of the family-controlled company with family members on the boards (FMLBOCD) variable for both restating companies and control companies was the same, at 75.9. As a result, the mean difference of this variable was not statistically significant. With regard to the variables for the control companies, only listing age (AGE) was statistically significant at a level of 0.000. As predicted, restating companies had lower mean scores than their matched sample companies. It seems that the longer a company has been listed on the IDX, the easier it is for it to meet reporting requirements. The table shows an insignificant difference between restating companies and control companies with respect to other control variables, such as BOC, BCS, ROA and LEV. For example, the mean score of the proportion of independent commissioners (BOC) variable for restating companies was lower than that for the control companies; the difference, however, is not statistically significant. This might provide initial evidence that independent commissioners are ineffective in their roles.

Table 6.23 Descriptive Statistics

Variables	Restating Firms		Control Firms			
Continuous variables	Mean	Std. Dev	Mean	Std. Dev	T-stat.	*p*-value
AGE	10.894	7.014	14.327	5.886	4.713	0.000***
ACCIT_c	-0.004	0.225	0.004	0.215	-0.315	0.753
ACEFEC_c	-0.008	0.184	0.008	0.183	0.737	0.462
BOC	0.413	0.117	0.417	0.126	-0.038	0.969
BCS	3.780	1.629	3.820	1.546	-0.594	0.552
ROA	14.976	85.102	7.782	45.506	-0.469	0.639
LEV	0.56	0.53	0.84	3.51	-0.31	0.754
Categorical variables	Proportion (%)		Proportion (%)		χ^2	
	Dummy =1	Dummy =0	Dummy =1	Dummy =0		
FMLBOCD	75.9	24.1	75.9	24.1	0.000	1
N	158		158			

Notes: *** significant at 1 percent; ACCIT_c=audit committee compliance index total (centred); ACEFEC_c=audit committee effectiveness (centred); FMLBOCD=family-controlled company with family members on the boards; BOC=proportion of independent commissioners; BCS=board of commissioners size; AGE=listing age; ROA=return on assets; LEV=leverage.

6.3.1.2 Multicollinearity Test

Before running the logistic analysis, it was important to check the data for multicollinearity. To test this, the study used bivariate correlation and the variance inflation factor (VIF). The bivariate correlation used the Pearson product-moment. As a rule of thumb, a correlation value exceeding 0.70 can lead to a misleading result of regression due to a collinearity problem (Pallant, 2001; Leech et al., 2008). As depicted in Table 6.24, some variables in both the upper and lower parts are significantly correlated. However, none of these correlations has a value greater than 0.70. In terms of the VIF, multicollinearity exists when the VIF value is greater than 10 (Ghozali, 2005). As can be seen in Table 6.24, none of the VIF scores is greater than 10. In conclusion, based on the two tests, there is no multicollinearity among the variables.

Table 6.24 Correlation among Independent Variables

Variable	BOC	BCS	AGE	ROA	LEV	FMLBOCD	ACCE_c	VIF[a]
BOC	1	-.076	0.082	-0.038	0.071	-0.308**	0.016	1.133
BCS	-0.076	1	0.163**	0.109	-0.088	-0.074	0.245**	1.094
AGE	0.082	0.163**	1	0.011	0.012	-0.052	0.113*	1.045
ROA	-0.038	0.109	0.011	1	0.014	0.079	0.013	1.023
LEV	0.071	-0.088	0.012	0.014	1	0.022	-0.032	1.016
FMLBOCD	-0.308**	-0.074	-0.052	0.079	0.022	1	-0.132*	1.158
ACCIT_c	0.094	0.171**	0.123*	-0.042	0.026	-0.205**	-	1.087
VIF[b]	1.131	1.122	1.043	1.020	1.015	1.140	1.085	-

Notes: Lower part is bivariate correlation using ACCIT_c as a proxy for audit committee effectiveness, whereas upper part is bivariate correlation using ACEFEC as the proxy. VIF[a]=VIF scores using ACCIT_c as a proxy for audit committee effectiveness, whereas VIF[b] is VIF scores using ACEFEC. **, * correlation is significant at the 0.01 level and 0.05 level, respectively; ACCIT_c=audit committee compliance index total (centred); ACEFEC_c=audit committee effectiveness (centred); FMLBOCD=family-controlled company with family members on the boards; BOC=proportion of independent commissioners; BCS=board of commissioners size; AGE=listing age; ROA=return on assets; LEV=leverage.

6.3.2 Multivariate Analysis

A binary logistic regression analysis was done to address the research questions because the dependent variable (restatements) was binary. As discussed in Chapter 5, the study used hierarchical logistic regression to examine the main effects and the interaction of effects in separate models. The results of the logistic regression are presented in two main categories. The results of the logistic regression using the audit committee compliance index total (ACCIT) as a measurement of audit committee effectiveness are presented in the first main category, while the results of the logistic regression using an alternative measurement of audit committee effectiveness, namely, the audit committee effectiveness index (ACEFEC) are presented in the second main category. Each main category contains sub-categories, namely, a main analysis using all samples (316 cases), and a sensitivity analysis using reduced samples. The reduced samples consist of forced restatements (72 cases) and annual restatements (120 cases). Because the hierarchical logistic regression covers main effects and the interaction of effects, there are 12 models.

6.3.2.1 Evaluation of the Logistic Regression Models

One of the two conditions that should be fulfilled before running logistic regression is that the sample size must be adequate (Leech et al., 2008). As stated in Chapter 5, it is preferable to use a ratio of 10 to 1 (Tabachnick and Fidel, 2007; Peng et al., 2002). As can be seen in Table 6.25, all of the models meet this requirement. Models 1 and 2, the main models, have a ratio of 35 cases to 1. Similarly, Models 7 and 8 also have a ratio of 35 cases to 1. Meanwhile, other models, which are intended as sensitivity analyses, also have a ratio of at least 10 cases to 1. To keep a ratio at least of 10 to 1, the proportion of independent commissioners (BOC) variable is not included in the sensitivity analyses because this variable shows insignificant results in the main models and even has a high *p*-value.

As discussed in Chapter 5, in presenting logistic regression results, a study needs to assess: (1) the logistic model evaluation, (2) goodness-of-fit statistics, and (3) statistical tests of individual predictors. The following discussion presents the results of these assessments.

In terms of the evaluation of the logistic regression model, the study used a chi-square (χ^2) test, and the difference of their log-likelihood (times -2) for model comparison. The chi-square (χ^2) test is analogous to the F test in an OLS regression. As can be seen in Table 6.21, except for models using a sample of forced restatements, all models have a significant χ^2 value at 1 percent. This means that these models are significant when all independent variables in each model are entered simultaneously. It also indicates that at least one of the independent variables contributes to the prediction of the outcome (i.e., listing age or AGE). In terms of the models of forced restatements, the χ^2 value is significant at 10 percent or even higher (i.e., Model 4). A higher level of significance indicates a weaker prediction of the outcome. As evidence, listing age (AGE) has a significant value of 5 percent, which is higher than that in other models.

Table 6.25 Logistic Analysis of Audit Committee Effectiveness and Restatements
Dependent Variable: Restatements (REST)

		Audit Committee Compliance Index Total (ACCIT)						Audit Committee Effectiveness Index (ACEFEC)					
	Exp. Sign	Full sample		Forced restatements		Annual restatements		Full sample		Forced restatements		Annual restatements	
Variable		Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10	Model 11	Model 12
		ß	ß	ß	ß	ß	ß	ß	ß	ß	ß	ß	ß
BOC	-	0.19	0.14	-	-	-	-	0.20	0.19	-	-	-	-
		(0.850)	(0.889)					(0.843)	(0.852)				
BCS	+	0.026	0.02	-0.20	-0.28	0.27*	0.26*	0.04	0.03	-0.16	-0.23	0.28*	0.25*
		(0.731)	(0.788)	(0.196)	(0.107)	(0.060)	(0.073)	(0.647)	(0.683)	(0.313)	(0.184)	(0.054)	(0.093)
AGE	-	-0.08***	-0.08***	-0.10**	-0.11**	-0.11***	-0.10***	-0.08***	-0.08***	-0.10**	-0.10**	-0.11***	-0.10***
		(0.000)	(0.000)	(0.012)	(0.011)	(0.002)	(0.003)	(0.000)	(0.000)	(0.015)	(0.013)	(0.002)	(0.004)
ROA	-	0.00	0.00	0.00	0.01	0.01	0.01	0.00	0.00	0.00	0.01	0.01	0.01
		(0.359)	(0.359)	(0.571)	(0..460)	.339	(0.300)	(0.362)	(0.359)	(0.492)	(0.375)	(0.322)	(0.313)
LEV	+	-0.06	-0.06	0.06	-0.09	-0.12	-0.14	-0.07	-0.07	-0.06	-0.21	-0.15	-0.14
		(0.482)	(0.486)	(0.920)	(0.896)	(0.764)	(0.737)	(0.492)	(0.492)	(0.926)	(0.742)	(0.712)	(0.730)
AUD	-	-	-	-	-	-2.46***	-2.38***	-	-	-	-	-2.44***	-2.39***
						(0.000)	(0.000)					(0.000)	(0.000)
ACCIT_c	-	0.09	0.53	1.47	7.56	0.06	1.18	-0.29	0.16	-0.63	2.92	-0.39	1.28
		(0.874)	(0.656)	(0.289)	(0.107)	(0.951)	(0.337)	(0.669)	(0.899)	(0.695)	(0.342)	(0.723)	(0.443)
FMLBOCD	+	-0.06	-0.03	-0.90	-0.01	-0.17	-0.15	-0.08	-0.07	-1.26*	-0.93	-0.21	-0.22
		(0.845)	(0.922)	(0.216)	(0.996)	(0.721)	(0.750)	(0.781)	(0.826)	(0.081)	(0.216)	(0.654)	(0.650)
ACCIT_c*	+	-	-0.56	-	-6.71	-	-0.26	-	-0.61	-	-4.74	-	-2.79
FMLBOCD			(0.674)		(0.171)		(0.141)		(0.672)		(0.182)		(0.186)
Constant		0.93	0.94	2.76	2.24	1.11	0.99	0.90	0.90	2.94**	2.94**	1.07	1.04
		(0.161)	(0.157)	(0.023)	(0.073)	(0.171)	(0.220)	(0.175)	(0.176)	(0.016)	(0.015)	(0.190)	(0.201)

Table 6.25 (continued)

Variable	Exp. Sign	Audit Committee Compliance Index Total (ACCIT)						Audit Committee Effectiveness Index (ACEFEC)					
		(Full sample)		(Forced restatements)		(Annual restatements)		(Full sample)		(Forced restatements)		(Annual restatements)	
		Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10	Model 11	Model 12
χ2		23.85*** (0.001)	24.02*** (0.002)	11.72* (0.068)	13.70 (0.57)	30.57*** (0.000)	32.81*** (0.000)	24.00*** (0.001)	24.18*** (0.002)	10.73* (0.098)	12.53* (0.085)	30.68*** (0.000)	32.47*** (0.000)
-2 Log likelihood		414.224	414.047	88.092	86.109	135.791	133.547	414.066	413.887	89.100	87.287	135.669	133.890
Δ -2 Log likelihood		-	0.177	-	1.983	-	2.244	-	0.179	-	1.813	-	1.779
Hosmer and Lemeshow test		7.247 (0.510)	7.844 (0.449)	2.486 (0.962)	10.383 (0.239)	12.100 (0.147)	8.125 (0.421)	12.393 (0.135)	11.890 (0.156)	5.586 (0.693)	8.292 (0.405)	14.302 (0.074)	4.946 (0.763)
Nagelkerke R^2		0.097	0.098	0.200	0.231	0.300	0.319	0.098	0.098	0.184	0.213	0.301	0.316
Classification accuracy (%)		60.8	61.4	69.4	73.6	70.8	70.8	60.8	60.4	65.3	70.8	70.8	68.3
No. Observations		316		72		120		316		72		120	

Notes: p-value in parentheses; *, **, *** denote significance at the level of 0.10, 0.05 and 0.01, respectively; ACCIT_c=audit committee compliance index total (centred); ACEFEC_c=audit committee effectiveness index (centred); FMLBOCD=family-controlled company with family members on the boards; BOC=proportion of independent commissioners; BCS=board of commissioners size; AGE=listing age; ROA=return on assets; LEV=leverage; AUD=audit quality.

Since the study uses hierarchical logistic regression, it is necessary to assess whether adding an interaction variable in each model significantly improves the model. For a comparison of the models, the difference in their log-likelihood (times -2) or Δ -2 log likelihood was computed. As depicted in Table 6.25, the values of the Δ -2 log likelihood in all models are insignificant. This means that adding an interaction predictor (either ACCIT_c*FMLBOCD or ACEFEC_c*FMLBOCD) into the models does not significantly improve them. As evidence, none of the interaction predictors are significant at a certain level.

In terms of goodness of fit statistics, there are three criteria for evaluation, namely: Nagelkerke R^2, classification accuracy and Hosmer and Lemeshow's goodness of fit statistic. The Nagelkerke R^2 is useful in comparing two models that have the same data set. Thus, this study compared the main model's Nagelkerke R^2 value with that of the interaction model. As can be seen in Table 6.25, the Nagelkerke R^2 values range from 0.091 to 0.319. The logistic analyses using all the samples had the smallest increase in the Nagelkerke R^2 value compared to the other analyses. In contrast, the logistic analyses using the forced restatements sample provided the highest increase in the Nagelkerke R^2 value than the other analyses. In terms of classification accuracy, there was no significant improvement in the interactions model. Some interaction models increased by a small percentage or even decreased. This result is consistent with the result of the Δ -2 log likelihood described previously. In terms of the Hosmer and Lemeshow tests, all models had a significant value greater than 5 percent, indicating that the logistic models fit with the data.

6.3.2.2 Results of the Main Model Analysis

The main models (Models 1 and 2) used the audit committee compliance index total (ACCIT_c) as a measurement of audit committee effectiveness for the full sample. Model 1 consisted of the main variables, while Model 2 consisted of the main variables and the interaction variable (ACCIT_c*FMLBOCD).

In terms of individual predictors, the statistical significance of individual regression coefficients (i.e., ß) was examined using the Wald statistic (Hair et al., 2006). Based on Model 1 in Table 6.25, the audit committee compliance index total (ACCIT_c) is not a significant predictor of restatements. The audit committee compliance index total (ACCIT_c) has a positive coefficient sign and the *p*-value is 0.8740, which is higher than any significance levels. This was unexpected. In Model 2, the audit committee compliance index total (ACCIT_c) also produced the same result, which is not significantly associated with restatements. As a result, hypothesis H_5 in this study is not supported. Even though the duties of the audit committee are not restricted to only examining the financial statements, almost all audit committees in Indonesia state that their duty is to examine financial information (see Table 6.1). In line with the claims of other scholars (i.e., Chuanrommanee and Swierczek, 2007), it seems that the claims of corporate governance compliance presented in company documents do not reflect actual practice. In other words, the presence of audit committees in Indonesia might be just symbolic or for cosmetic purposes. As with the ACCIT_c variable, the family-controlled company with family members on the boards (FMLBOCD) variable also produced an insignificant result. Unexpectedly, the coefficient sign is a negative, and the *p*-values of this variable in Model 1 and Model 2 are 0.845 and 0.922, respectively, which are higher than the significance levels. In terms of the interaction variable, the results indicate that the interaction variable (ACCIT_c*FMLBOCD) is an insignificant predictor. Unexpectedly, the coefficient is a negative. This means that family control strengthens the negative association between audit committee effectiveness and financial restatements. However, the *p*-value of this interaction variable is 0.674, which is higher than the significance level. The finding of this interaction variable is in line with the results of the individual predictors, which also indicate the insignificant predictors. This finding is also consistent with the insignificance of the Δ -2 log likelihood, which is discussed in Section 6.3.2.1. Thus, hypothesis H_6 is not supported.

With regard to the control variables, only listing age (AGE) is significantly associated with restatements in both models. Listing age (AGE) has the lowest *p*-value (0.000) among all the predictors, meaning that it is the most significant predictor of restatements. As the main reason for restatements is deficiency in books or records (see Figure 6.5), it seems that older public listed companies tend to have better recording and/or record keeping. Older firms might also have long experience and learning processes that reduce the possibility of restatements. Meanwhile, other control variables have an insignificant association with restatements. An interesting finding regarding the insignificant control variables is that some control variables have coefficient signs that are the opposite of expectations. For example, the coefficient sign of the return on assets (ROA) variable is positive, which is contrary to expectations. This means that a higher return on assets (ROA) is associated with an increase in the probability of restatements. Another example is the proportion of independent commissioners (BOC) variable, which also has a positive coefficient sign. The positive sign means that a higher proportion of independent commissioners on the board of commissioners is associated with an increased likelihood of restatements. The insignificance of the proportion of independent commissioners (BOC) variable evidences the ineffectiveness of independent commissioners in Indonesia. This finding is consistent with prior studies on financial reporting quality in developing countries (e.g., Hashim and Devi, 2008; Siregar and Utama, 2008; Thoopsamut and Jaikengkit; 2009; Abdullah et al., 2010). Meanwhile, board of commissioners size (BCS) has a positive coefficient sign as expected. Unfortunately, this variable is not significantly associated with restatements in both models.

6.3.2.3 Sensitivity Analysis

Numerous sensitivity analyses were conducted to assess the robustness of the results of the main model. One analysis included the use of a reduced sample and an alternative measurement of audit committee effectiveness. The reduced sample included forced restatements, annual restatements and control of the effect of IFRS convergence. In another analysis, the study replaced the audit committee compliance index total (ACCIT) with the audit committee effectiveness index (ACEFEC), as a measurement of audit committee effectiveness. The logistic regression analysis using the audit committee effectiveness index (ACEFEC) employed a full sample, forced restatements and annual restatements. The analysis also examined the likelihood of endogeneity.

a. Forced Restatements

To check the robustness of the results, the study used a reduced sample, namely, restatements prompted by outside parties. As depicted in Figure 6.4, the dominant initiators of restatements were the companies themselves. Restatements initiated by this type of prompter are considered voluntary restatements, whereas restatements prompted by external parties (such as stock exchanges and auditors) are categorized as forced restatements (Marciukaityte et al., 2009). Voluntary restatements might indicate relatively stronger internal control and oversight by management, boards and audit committees (Palmrose, Richardson, and Scholz, 2004; Marciukaityte et al., 2009). In contrast, forced restatements may signal the presence of poor internal control because mechanisms such as independent directors or audit committees were unable to detect the likelihood of misstatements. Therefore, the study predicts that the audit committee has a weaker role in forced restatements than in total restatements consisting of both voluntary and forced restatements.

The results of the logistic regression analysis using the forced restatements sample are presented for Model 3 and Model 4 in Table 6.25. In general, the results are consistent with the prior analysis of Model 1 and Model 2. In terms of individual predictors, the audit committee compliance index total (ACCIT_c) has a positive coefficient sign and an insignificant association, which is consistent with the earlier analysis of Model 1 and Model 2. However, the *p*-values of the audit committee compliance index total (ACCIT_c) are lower than their values in the prior analysis of Models 1 and 2. It seems that the audit committee might play a stronger role in detecting financial statement misstatements in forced restatements than in restatements in total. Hence, this finding is contrary to expectations. Meanwhile, the presence of family members on the boards (FMLBOCD) variable has a negative and insignificant association with restatements, which is consistent with the prior analyses of Model 1 and Model 2. The interaction variable (ACCIT_c*FMLBOCD) consistently has a negative and insignificant association with restatements. Interestingly, the *p*-value is lower than that in the prior analysis. This means that the interaction between audit committee effectiveness and family control might have a stronger effect in forced restatements than in total restatements. In terms of the control variables, listing age (AGE) had a significant association with restatements, which is consistent with prior results.

b. Annual Restatements

In this study, the sample of restatements consisted of both annual restatements and interim restatements. The study could not examine the role of the external auditor in detecting restatements because, in Indonesia, interim financial statements are not required to be audited by the external auditor. In fact, external auditors might influence the effectiveness of the audit committee (Joshi and Wakil, 2004) and an effective audit committee is likely to demand a high level of audit quality (Abbott and Parker, 2000). In addition, some prior studies found that a Big Four auditor – as a proxy for audit quality – had a negative association with annual restatements (e.g., Chan, Farrell, and Lee, 2011; Schmidt and Wilkins, 2013). Therefore, the variable of audit quality (AUD) was added to the model.

In general, the results of the logistic regression analysis of the variables of concern using annual restatements indicated findings that were consistent with the results of the prior analysis. For Model 5 and Model 6, the audit committee compliance index total (ACCIT) is an insignificant predictor and has a positive coefficient. Meanwhile, the presence of family members on the boards (FMLBOCD) variable and the interaction variable (ACCIT_c*FMLBOCD) had a negative and insignificant association with restatements. Thus, the results of this analysis strengthen the results of the previous analysis.

There were some interesting findings in terms of the control variables. Unlike in the prior analysis, three control variables were significantly associated with annual restatements, namely: board of commissioners size (BCS), listing age (AGE), and audit quality (AUD). The board of commissioners size (BCS) variable is significantly associated with restatements, even though its *p*-value is 0.10. This finding is different from that of the prior analysis and might indicate that larger boards of commissioners are not more effective. Listing age (AGE) and audit quality (AUD) are negative and significant predictors, with *p*-values of 0.001. The significance of audit quality (AUD) indicates that external auditors, namely, the Big Four, play an important role in detecting financial statement misstatements in Indonesia.

c. Alternative Measurement of Audit Committee Effectiveness

As discussed in Section 5.4.2.1 in Chapter 5, the use of the audit committee compliance index total (ACCIT), which was extracted from the BAPEPAM-LK rules requirements, might not represent audit committee best practices. This is because the index consists only of the mandatory audit committee requirements and ignores the voluntary requirements. Therefore, for this sensitivity analysis, the audit committee compliance index total (ACCIT) was replaced with the audit committee effectiveness index (ACEFEC) as a measurement of audit committee effectiveness. As with the ACCIT, the logistic regression analyses performed on the ACEFEC included the analysis of the full sample, forced restatements, and annual restatements.

In general, the results of the logistic regression analysis using the ACEFEC were consistent with the prior analyses using the ACCIT. Audit committee effectiveness measured by the audit committee effectiveness index (ACEFEC), the presence of family members on the boards (FMLBOCD) variable and the interaction variable (ACEFEC*FMLBOCD) were still not significantly associated with restatements in all types of samples. In terms of the control variables, the results also provided consistent findings. Listing age (AGE) was a significant predictor in all models, with a *p*-value of 0.001. For annual restatements, audit quality was also significantly associated with restatements. Therefore, these results strengthen the results of the prior analyses using the ACCIT variable.

d. Control of the Effect of IFRS Convergence

As depicted in Figure 6.1, the number of restatements increased significantly in 2011. This study argues that the increase might be due to the implementation of new accounting standards that converged with those of the IFRS, as Indonesia is gradually converging its local GAAP with IFRS, starting with minimising the significant differences between the two. As of 1 January 2009, the Indonesian Financial Accounting Standards Board revised some local standards in order to comply with the IFRS; some of these revised standards became effective at 1 January 2011 (Wirahardja, 2010). Although restatements due to the application of accounting standards were removed from the sample, the remaining sample may still have been affected by the application of the new accounting standards. Therefore, the study eliminated restatements that occurred from 2011 onwards.

Table 6.26 Results of the Logistic Regression Analysis for Restatements for the Period 2006-2010

		Model 13 Main Model	Model 14 Interaction Model
Variable	Predicted Sign.	Coefficient	Coefficient
BOC	-	-0.368	-0.397
		(0.800)	(0.785)
BCS	+	0.076	0.071
		(0.435)	(0.469)
AGE	-	-0.103***	-0.103***
		(0.001)	(0.001)
ROA	-	-0.002	-0.002
		(0.553)	(0.564)
LEV	+	-0.015	-0.006
		(0.967)	(0.987)
FMLBOCD	+	-0.193	-0.176
		(0.654)	(0.682)
ACCIT_C	-	0.102	0.936
		(0.906)	(0.531)
ACCIT_c*FMLBOCD	+	-	-1.189
			(0.496)
Constant		1.278	1.259
		(0.158)	(0.163)
Nagelkerke R^2		0.115	0.118
Classification accuracy (%)		62.3	63.6
No. Observations		162	162

Notes: p-value in parentheses; *** denote significance at the level of 0 0.01; ACCIT_c= audit committee compliance index total (centred); ACEFEC_c=audit committee effectiveness index (centred); FMLBOCD=family-controlled company with family members on the boards; BOC=proportion of independent commissioners; BCS=board of commissioners size; AGE=listing age; ROA=return on assets; LEV=leverage.

As depicted in Table 6.26, the results of the logistic regression analysis of Model 13 and Model 14 are consistent, in general, with the results of the previous analyses. The audit committee effectiveness (ACCIT_c) variable and its interaction with the family control variable are insignificant predictors. Listing age (AGE) is still the most significant predictor among the control variables. In sum, the reduction of the sample to avoid the potential effect of IFRS convergence on restatements did not significantly change the result.

e. Endogeneity

It is assumed that the audit committee compliance index total (ACCIT_c) is likely endogenous. As explained in Chapter 4, the audit committee compliance index total (ACCIT_c) in this second research stage serves as the dependent variable in Research Stage 1. The results from Research Stage 1 prove that ACCIT_c is affected by some factors. Meanwhile, some other independent variables in Research Stage 1 also serve as independent variables in Research Stage 2. These include the proportion of independent commissioners (BOC), board of commissioners size (BCS), leverage (LEV), and family-controlled company with family members on the boards (FMLBOCD). Hence, it is possible that restatements (REST) and ACCIT_c are determined by some common factors. In other words, this study assumes that audit committee effectiveness and restatements are jointly determined (possess simultaneous endogeneity).

To check for potential endogeneity, this study adopted the method employed by Lisic et al. (2011). The Lisic study had adopted the approach of Carcello et al. (2011b) and Nikolaev (2010). Both approaches employed a two-step procedure. In the first step, a model that predicts the endogenous variable is developed. The residual is obtained, based on the analysis of the first step. In the second step, the residual is added to the restatements model. However, there is a slight difference between the process used by Carcello et al. (2011b) and the one used by Nikolaev (2010). Carcello et al. (2011b) just added the residual as an additional variable in the model, whereas Nikolaev (2010) used the residual to replace the endogenous variable in the model.

For the first step in this study, the model to predict ACCIT_c was developed. As discussed above, ACCIT_c is likely endogenous. In this model, ACCIT_c was the dependent variable, while the independent variables were BOC, BCS, AGE, ROA, LEV and FMLBOCD. This study added other variables that were significantly associated with ACCIT in Research Stage 1, namely, audit quality (AUD) and firm size (SIZE). In terms of results, only a few variables had a significant association with ACCIT_c. This finding is much different from the finding in Research Stage 1 where panel data was used. However, the different result is not the focus of this analysis. Importantly, the residual obtained from this step represents the uncontrolled determinants of the endogenous variable (Carcello et al., 2011b).

Table 6.27 First Step in the Endogeneity Test
Dependent Variable: Audit Committee Compliance Index Total (ACCIT_c)

Variable	Coefficient	t	Sig.
(Constant)	-0.468	-4.401	0.000***
BOC	0.043	0.430	0.668
BCS	-0.001	-0.159	0.874
AGE	0.002	1.378	0.169
ROA	-5.996	-0.035	0.972
LEV	0.004	0.857	0.392
FMLBOCD	-0.079	-2.749	0.006***
AUD	0.049	1.762	0.079**
SIZE	0.035	4.556	0.000***

Notes: *, **, *** indicates significance at the 0.10, 0.05 and 0.01 levels, respectively; ACCIT_c=audit committee compliance index total (centred); FMLBOCD=family-controlled company with family members on the boards; BOC=proportion of independent commissioners; BCS=board of commissioners size; AUD=audit quality; LEV=leverage; AGE=listing age; SIZE =firm size; ROA=return on assets.

In the second step, the residual obtained from the first step was added to the interaction models, which were named Model 15 and Model 16. As depicted in Table 6.28, the approach of Carcello et al. (2011b) was just to add the residual (Abn_ACCIT_c), whereas the approach of Nikolaev (2010) was to add the residual (Abn_ACCIT_c) to the model as a replacement for ACCIT_c. The results of both approaches were not significantly different. As can be seen for Model 15 and Model 16, the residual (Abn_ACCIT_c) and the interaction variable were not significantly associated with restatements. This is consistent with the results for Model 2 in Table 6.25. Meanwhile, the other variables in Models 15 and 16 provided findings consistent with the results for Model 2 in Table 6.25. In terms of R^2, the Nagelkerke R^2 values for Model 15 and Model 16 were not much different from the value for Model 2, indicating the insignificance of model improvement. In sum, these findings evidence that audit committee effectiveness (ACCIT_c) is not endogenously determined. In other words, the results for Model 2 in Table 6.25 are robust enough to control for the endogeneity of audit committee effectiveness (ACCIT_c).

Table 6.28 Second Step in the Endogeneity Test
Dependent Variable: Restatements (REST)

		Model 15 (Carcello et al., 2011b approach)	Model 16 (Nikolaev, 2010 approach)
Variable	Predicted Sign.	Coefficient	Coefficient
BOC	-	0.229	0.201
		(0.825)	(0.844)
BCS	+	0.047	0.029
		(0.591)	(0.701)
AGE	-	-0.080***	-0.082***
		(0.000)	(0.000)
ROA	-	0.002	0.002
		(0.406)	(0.360)
LEV	+	-0.063	-0.063
		(0.523)	(0.485)
FMLBOCD	+	-0.135	-0.067
		(0.692)	(0.818)
ACCIT_C	-	-0.644	-
		(0.764)	
ACCIT_c*FMLBOCD	+	-0.603	-
		(0.652)	
Abn_ACCIT_c	?	1.317	0.218
		(0.510)	(0.716)
Abn_ACCIT_c*FMLBOCD	?	-	0.376
			(0.876)
Constant	?	0.845	0.901
		(0.213)	(0.184)
Nagelkerke R^2		0.099	0.097
Classification accuracy (%)		60.1	61.4
No. Observations		316	316

Notes: p-value in parentheses; *, **, *** indicates significance at the 0.10, 0.05 and 0.01 levels, respectively; ACCIT_c=Audit committee compliance index total (centred); Abn_ACCIT_c=residual; FMLBOCD=family-controlled company with family members on the boards; AGE=listing age; BOC=proportion of independent commissioners; BCS=board of commissioners size; LEV=leverage; ROA=return on assets.

6.4 DISCUSSION

The main research focus was the compliance of Indonesian public listed companies with audit committee rules, and the impact of compliance on restatements. The findings of Research Stage 1 confirm that different family control models result in different effects with respect to the compliance of public listed companies with audit committee rules**.** The negative significance of the family members on the boards (FMLBOCD) variable confirms that combined ownership and control held by a family might serve as a control mechanism that reduces the need for an audit committee. This finding is in line with the alignment theory. Furthermore, this negative association between family control and compliance also supports the entrenchment theory. The negative and significant association proves that a family might prefer to implement poor corporate governance in order to pursue private benefits at the expense of minority shareholders. A family might not welcome the introduction of the Anglo-American corporate governance model as some of the model's structures are interpreted to mean a loss of family control (Storey, 1994; Maug, 1996). On the other hand, the separation between ownership and management, which is represented by the family-controlled company with professional management (non-family members) on the boards (PROFBOCD) variable, has a positive and significant association with compliance with audit committee rules. This positive association is consistent with the argument that family firms with professional management might create agency costs, as the potential interests of professional executives and the family as owner diverge (Chua et al., 2003; Bhattacharya and Ravikumar, 2004). Furthermore, altruism is weakened due to a lack of family ties (Chua et al., 2003). Thus, both professional management and the family are likely to rely on formal corporate governance mechanisms, such as audit committees.

The results from Research Stage 1 provide empirical evidence that foreign institutional investors play an important role in enhancing the effectiveness of formal corporate governance mechanisms in Indonesia. In general, foreign institutional investors serve as agents of change, or provide exogenous pressure that is resistant to the influence of local practice, in the improvement of corporate governance in developing countries (OECD, 2002; Aguilera and Cuervo-Cazurra, 2004; Chevailer et al., 2006). The findings of Research Stage 1 also confirm that not all types of foreign institutional investors improve corporate governance in Indonesia. The attribute of genuineness (authenticity), and the amount of shares owned by foreign institutional investors are important in the Indonesian environment. As can be seen in Table 6.10, the genuine large foreign institutional investor (GLFRG) variable has a positive and significant association with compliance; this is in line with hypothesis H_4. In contrast, foreign institutional ownership (FRGOWN), measured by the percentage of total shares owned by foreign institutional investors, is negative and insignificant. This implies that the measurement of foreign institutional investors based solely on the total shares owned by foreign institutional investors (FRGOWN) is not appropriate in the Indonesian institutional setting, as some of the investors might be owned by Indonesian offshore companies.

As expected, the politically connected independent commissioner (POLIC) variable is negatively and significantly associated with compliance. The appointment of an independent commissioner who was/is a former/current bureaucrat or former army officer/personnel might not increase the monitoring function of the board as suggested by agency theory. This type of independent commissioner is appropriate for playing an external role, as suggested by resource dependence theory. The results of the analysis of the politically connected independent commissioner (POLIC) variable are in contrast to those of the analysis of the independent commissioner with financial expertise (ICED) variable. The latter indicate a positive and significant association with the audit committee compliance index total (ACCIT). The presence of independent commissioners with an accounting education background, or who are CPA holders, might increase compliance with audit committee rules. This would be in line with agency theory. It seems that the appointment of an independent commissioner, whether a politically connected person or someone with financial expertise, is dependent on some other factors, such as firm size and family control. For example, larger family firms might need more resources and security for their business activities. In addition, the combination of control and ownership in the hands of the family reduces type 1 agency costs, causing formal corporate governance mechanisms such as board independence and the presence of an audit committee to be less important. In this situation, the appointment of former bureaucrats or army officers/personnel as independent commissioners might provide the company with more benefits than appointing independent commissioners with financial expertise.

Based on the results of the analysis of restatements, the audit committee compliance index total (ACCIT_c) variable has a positive coefficient sign and is an insignificant predictor of restatements. The sensitivity analysis produced a consistent result. This finding is in line with the Abdullah et al. (2010) Malaysian study. However, the finding is contrary to some prior studies in Indonesia that also employed an audit committee index to measure audit committee effectiveness. For example, Ika and Ghazali (2012) indicated that audit committee effectiveness was negatively associated with the timeliness of reporting. Similarly, Sarumaha and Hermawan (2013) revealed that audit committee effectiveness was negatively associated with financial distress. It seems that a different proxy for financial reporting quality might yield different results for audit committee effectiveness. In addition, the insignificance of the association between audit committee effectiveness and restatements supports the argument that studies on corporate governance need to employ an "open system" approach (see Aguilera et al., 2008). Hence, the insignificance provides justification for the need to explore the interaction of audit committee effectiveness with other corporate governance mechanisms, as opposed to simply examining the effect of each individual audit committee characteristic as advocated by some scholars (i.e., DeZoort et al., 2002; Turley and Zaman, 2004; Bédard and Gendron, 2010).

The interaction of the family control and audit committee effectiveness (ACCIT_c * FMLBOCD) variables reveals a negative coefficient sign and an insignificant association, which is contrary to hypothesis $H_{6.}$ Hypothesis H_6 predicted that family control will weaken the negative association between audit committee effectiveness and restatements. Instead of weakening it, the interaction of family control and audit committee effectiveness might strengthen it. Thus, hypothesis H_6 is not supported.

There are three plausible explanations with regard to the insignificance of audit committee effectiveness, and its interaction with family control. First, the insignificance might be evidence that the presence of an audit committee is just symbolic or for cosmetic purposes (Cohen et al., 2004; Haron et al, 2005). This is in line with the claims of some scholars (e.g., Backman, 1999; Peng, 2004; Rosser, 2003; Sam, 2007) that corporate governance in East Asia often resembles the Anglo-American model in form, but not in substance. The finding, therefore, supports institutional theory rather than agency theory. Based on institutional theory, corporate governance mechanisms such as audit committees may be ceremonial, designed solely to enhance external legitimacy without being coupled to an actual oversight role (Cohen et al., 2008; Beasley et al., 2009). Second, the insignificance of audit committee effectiveness as a predictor of restatements casts doubt on the validity of restatements as a proxy for financial reporting quality in Indonesia. To determine the effectiveness of the audit committee, this study examined whether the effectiveness of audit committees is associated with restatements as a proxy for financial reporting quality. This is based on the argument that an effective audit committee will reduce the opportunistic behaviour of management, thereby improving the quality of the financial statements. In other words, a more effective audit committee will reduce type 1 agency problems (principle-agent problems), resulting in higher financial reporting quality. However, the agency problem in developing countries in Asia, including Indonesia, is a type 2 agency problem that occurs between controlling shareholders and minority shareholders (Young et al., 2008; Jaggi et al., 2009; Chen et al., 2011). As a result, different types of agency costs raise doubts about the validity of restatements.

Third, investors and regulators in Indonesia might not perceive restatements as actual events with serious consequences. As discussed in Section 4.4 in Chapter 4, this study assumes that restatements are a good proxy for financial reporting quality. Reasons for this include: 1) they are a popular proxy for financial reporting quality in the US, and 2) actual events indicate a visible form of impaired financial reporting quality (Cao et al., 2010; DeFond, 2010). However, the insignificance of audit committee effectiveness might indicate that restatements have not been perceived by investors in Indonesia as actual events that have serious consequences. Unlike in the US, investors in Indonesia are less reliant on financial information and are more likely to consider other factors such as rumours, insider trading and market anomalies (Prabowo, 2000). In addition, they also tend to show irrational behaviour because their decisions are influenced by psychological factors such as overconfidence, loss aversion, cognitive dissonance, representativeness bias and self-attribution bias (Ady et al., 2013). These characteristics may affect their view of the importance of the restatements. Unfortunately, no prior Indonesian studies have examined this issue.

In terms of the control variables, listing age (AGE) and audit quality (AUD) are significant predictors. Listing age is consistently associated with restatements in all models; it seems that older public listed companies tend to have better recording and record keeping, as well as long experience and learning processes that reduce the possibility of restatements (Alyousef and Almutairi, 2010). On the other hand, new firms might face greater pressure (including pressure to boost their earnings) when listed on a stock exchange (Carcello and Nagy, 2004b), and this might cause managers to restate the company's financial statements (Abbott et al., 2004; Carcello et al., 2011b). Audit quality is significantly associated with annual restatements, indicating that the Big Four accounting firms (as a proxy for audit quality) have an important role to play in detecting restatements in Indonesia. In this context, the external auditor plays a key role in independently ensuring sound financial reporting that is in line with resource dependence theory (Cohen et al., 2008). This finding supports the argument that external auditors (i.e., the Big 5 auditors) play a corporate governance role in Asia (Fan and Wong, 2005).

The proportion of independent commissioners, as a control variable, produces an inconclusive result. In Research Stage 1, the proportion of independent commissioners variable is positive, and is significantly associated with compliance with audit committee rules. In contrast, in Research Stage 2, this variable is not significantly associated with restatements. Like the audit committee, it seems that independent commissioners merely serve a symbolic purpose. There are two possible explanations for these results. First, public listed companies appoint independent commissioners solely to comply with regulations (Siregar and Utama, 2008). Second, the dominance of family-based controlling shareholders at listed companies might render the oversight function of the board of commissioners ineffective; independent commissioners might have a limited direct effect, as controlling shareholders will not allow commissioners any real influence on the board (Berglöf and Claessens, 2006). However, this finding supports prior studies in Indonesia (i.e., Parulian, 2004; Siregar and Utama, 2008).

6.5 CONCLUSION

This chapter has presented the various statistical analyses for both Research Stage 1 and Research Stage 2. The examination of the determinants of compliance of public listed companies with audit committee rules, the focus of Research Stage 1, used the FGLS method to test the hypotheses. Meanwhile, the examination of audit committee effectiveness and restatements, the focus of Research Stage 2, used matched pair logistic regression analysis to test the hypotheses. In addition, both research stages also employed sensitivity analysis to check the robustness of the results. Based on the sensitivity analysis, the results of both Research Stage 1 and Research Stage 2 are robust.

In Research Stage 1, there is evidence that the compliance and effectiveness of public listed companies with audit committee rules are influenced by other corporate governance mechanisms. The findings are consistent with the bundle of corporate governance theory which states that the effectiveness of corporate governance is dependent on the effectiveness of a bundle of corporate governance mechanisms, rather than on the effectiveness of a sole mechanism. Even though the implementation of the audit committee is mandatory for all public listed companies in Indonesia, mimicking the US “one size fits all” approach, the level of compliance of public listed companies is unsatisfactory. Except for the aspect of audit committee membership, the level of compliance of public listed companies with audit committee rules is relatively low. This indicates that Indonesia’s public listed companies might practice their own bundle of corporate governance, based on a cost-benefit trade off, to achieve optimal efficiency and effectiveness. Thus, in adopting audit committee rules, companies might not necessarily be complying with all requirements, and might consider the interrelation between the audit committee and other corporate governance mechanisms, both formal and informal. By using multiple theories to develop the hypotheses, this study evidences that family control, board characteristics (i.e., politically connected independent commissioners) and foreign institutional investors affect compliance with audit committee rules.

In Research Stage 2, the study found that audit committee effectiveness is not associated with restatements (as a proxy for financial reporting quality). The finding evidences that the level of compliance with audit committee rules presented in formal corporate documents might not indicate actual practice. This finding supports the argument that corporate governance mechanisms in emerging economies often resemble those of developed countries in form, but not in substance. Moreover, this study could not prove that the effectiveness of the audit committee in preventing restatements is also affected by other corporate governance mechanisms, namely, family control. This means that, in the context of restatements, informal corporate governance mechanisms might not affect audit committee effectiveness.

The following chapter summarises the study and the key research findings. Chapter 7 presents a discussion of the study's implications on knowledge and for policy makers, and investors. The discussion is followed by the study's limitations, and recommendations for future research.

CHAPTER 7

CONCLUSION

7.1 INTRODUCTION

This chapter comprises six additional sections. Section 7.2 summarises the study and key research findings. Section 7.3 discusses the implications of the study for knowledge, and for policy makers and investors in Indonesia. A discussion of the limitations of the study is presented in Section 7.4. This is followed by recommendations for future research in Section 7.5. The chapter concludes with Section 7.6.

7.2 SUMMARY OF THE STUDY

The East Asian financial crisis of 1997-98 paved the way for the IMF and the World Bank to promote Anglo-American corporate governance in Asia. Specific features of the Asian business environment, such as poor corporate governance, high concentrated ownership with control in the hands of families, and close relationships between government and businesses (cronyism) were blamed as the root problems of the crisis. In response to the crisis, the IMF actively advised affected countries to reform their corporate governance systems, and advocated use of the Anglo-American corporate governance model as a solution since the model had worked well and showed its superior ability to allocate resources and monitor corporate behaviour in the more developed Western economies. Consequently, corporate governance reform was made one of the prerequisites that affected Asian countries had to adopt in order to obtain IMF and World Bank assistance.

Indonesia is an example of an affected country that reformed its corporate governance regime under the mandate of the IMF and the World Bank. While the country implemented radical legal reforms to improve corporate governance, corporate governance reforms in Indonesia did not show satisfactory progress. Far too often, international surveys placed Indonesia at the bottom of corporate governance rankings. It was often commented that Indonesia had quite good corporate governance standards and regulations but that implementation of the standards and regulations remained a fundamental problem.

Academic literature indicated a number of factors that contributed to ineffective corporate governance reform in Indonesia. The specific unique features of the Indonesian business environment were considered to have impeded the implementation of the Anglo-American corporate governance model. Such features include the predominance of relationship-based systems (*guanxi*) associated with highly personal networking, cronyism, high concentrated ownership by families, and special relationships between family businesses and political power. These features were deemed unsuitable for the implementation of the Anglo-American corporate governance model. However, it was perceived that foreign investors, supported by international financial institutions and Western governments, supported the country's corporate governance reforms.

In the extant literature, the effect of the Indonesian business environment (i.e., family control, collusion between politicians-bureaucrats and the owners of domestic conglomerates, and foreign investors) on compliance with corporate governance regulations has not been widely examined by prior studies. The dominance of agency theory in corporate governance studies was partly blamed for the lack of focus of prior studies on the institutional context within which such reforms occurred. In fact, agency problems in the Indonesian context are different from those in the developed countries.

In the Indonesian environment, agency problems occur between controlling shareholders and minority shareholders; such problems are referred to as agency problems type 2. Furthermore, prior studies did not consider corporate governance practice as an interrelated mechanism that was affected by various actors. As a result, only a limited number of studies actually examined the relevant institutional factors such as family control, foreign ownership, and collusion between businesses and politicians in Indonesia.

To date, stock exchanges around the world have widely adopted the establishment of audit committees by their listed companies. Historically, the audit committee is from the US and is one of the mechanisms in the Anglo-American corporate governance model. It is possible that the audit committee may be ineffective in Indonesia because the country's business environment is different from that of the US, thus the first part of the current research examined what factors influence the compliance of public listed companies with audit committee rules in Indonesia. As to whether audit committees actually work in practice, the second part of the research examined the association between compliance with audit committee rules and financial reporting quality (using restatements of financial statements as a proxy). It has often been argued that corporate governance compliance in emerging economies with weak legal enforcement was merely symbolic and not reflective of actual practice. Therefore, comprehensive research that simultaneously examines relevant factors affecting compliance and its association with accounting outcomes – such as financial reporting quality – is timely.

The three objectives of the research were: (1) to examine the association between public listed companies with specific business characteristics (namely family control, politically connected independent commissioners, and foreign institutional investors) and level of the compliance of public listed companies with audit committee rules; (2) to examine whether the compliance, which also indicates the level of audit committee effectiveness, is associated with financial reporting quality; (3) to examine the influence of family control on the association between audit committee effectiveness and restatements of financial statements. Thus, this research was divided into two interrelated stages: Research Stage 1 examined the determinants of compliance of public listed companies with audit committee rules, and Research Stage 2 examined the association between the level of such compliance and restatements of financial statements. In Research Stage 1, independent variables derived from business characteristics specific to the Indonesian setting were examined. These included family control, politically connected independent commissioners and foreign institutional investors. Meanwhile, in Research Stage 2, compliance with audit committee rules was adopted as a proxy for audit committee effectiveness, while financial statement restatements were a proxy for financial reporting quality. The effect of the interaction between audit committee effectiveness and family control on financial reporting quality was examined in this stage.

Hypotheses were developed premised on multiple theories as complements to the dominant agency theory. These complementary theories included the bundle of corporate governance theory and the institutional theory. The use of multiple theories enabled the research to reconcile the conflicting findings of prior studies (which were based on agency theory), and helped to better understand the interrelationships among various actors and mechanisms affecting the Indonesian corporate governance system.

The results of the hypotheses testing are summarised in Table 7.1. As can be seen, the results of the determinants of compliance of public listed companies (Research Stage 1) support all the hypotheses. On the other hand, the results of audit committee effectiveness and restatements (Research Stage 2) do not support the two hypotheses.

Table 7.1 Summary of Hypothesis Testing Results

Hypothesis	Test used	Result	Supports/does not support hypothesis
H_1 *Family controlled companies with family members represented on boards are less likely to comply with audit committee rules.*	FGLS	Negative significant at p<0.01 (Table 6.10)	Supports the hypothesis
H_2 *Family controlled companies with non-family members represented on the boards are more likely to comply with audit committee rules.*	FGLS	Positive significant at p<0.05 (Table 6.10)	Supports the hypothesis
H_3 *Public listed companies with a politically connected independent commissioner are less likely to comply with audit committee rules.*	FGLS	Negative significant at p<0.01 (Table 6.10)	Supports the hypothesis
H_4 *Public listed companies with a large genuine foreign institutional investor are more likely to comply with audit committee rules.*	FGLS	Positive significant at p<0.05 (Table 6.10)	Supports the hypothesis
H_5 *There is a negative association between audit committee effectiveness and financial restatements.*	Logistic regression	Positive and not significant (Table 5.21)	Does not support the hypothesis
H_6 *The negative association of audit committee effectiveness and financial restatements is reduced when a company is controlled by family and the family members are present on the boards.*	Logistic regression	Negative and not significant (Table 5.21)	Does not support the hypothesis

Source: compiled by the author

The results of Research Stage 1 indicate the significant association between family control, politically connected independent commissioners, genuine large foreign institutional investors, and compliance with audit committee rules. It is not surprising to note that family control and politically connected independent commissioners indicate a negative and significant association with compliance, whilst genuine large foreign institutional investors have a positive and significant association with such compliance.

Most importantly, the research shows that different types of family control have different effects on the compliance of public listed companies with audit committee rules. Specifically, the presence of family members on the boards of family-controlled companies (meaning that combined ownership and control is in the hands of the family) significantly reduces the compliance of public listed companies with audit committee rules. In contrast, the presence of professional management (as opposed to family members) on the boards of family-controlled companies is positively associated with the compliance of public listed companies with audit committee rules. This finding implies that combined ownership and control in the hands of family members might serve as an alternative corporate governance mechanism that may make a formal corporate governance mechanism, such as an audit committee, less effective. The negative significance of the politically connected independent commissioner variable provides evidence that the role of the independent commissioner is to emphasise the harnessing of external resources (resource dependency theory) rather than to monitor (agency theory). This explains the decreased level of adherence to rules. Meanwhile, the significance of genuine large foreign institutional investors clearly shows that researchers must discern the authenticity of such investors; it is clear that while not all foreign institutional investors in Indonesia enhance corporate governance practice, the genuine ones do. Therefore, this research demonstrates that the corporate governance system in Indonesia tends to default towards a “family market-based system” (see Khan’s 1999 schema in Chapter 2), although foreign institutional investors seek to support the “equity market-based system” that has been formally adopted in the rules for audit committees.

In Research Stage 2, the results reveal that audit committee effectiveness is insignificantly associated with restatements. It seems that the presence of audit committees in Indonesia is just symbolic or for cosmetic purposes. This finding supports institutional theory that audit committees are designed to enhance external legitimacy without being coupled with an actual oversight role. In addition, the study finds that family control does not significantly weaken the association between audit committee effectiveness and restatements. Therefore, the study was unable to provide evidence that informal corporate governance mechanisms might affect the effectiveness of formal corporate governance mechanisms (i.e., the audit committee).

In terms of the control variables, listing age (AGE) and audit quality (AUD) are significant predictors. Listing age is consistently associated with restatements in all models. It seems that older public listed companies tend to do a better job of recording transactions, and their long experience and learning processes might account for the reduced possibility of restatements (Alyousef and Almutairi, 2010). On the other hand, new firms might face greater pressure – particularly pressure to boost earnings – when listed on a stock exchange (Carcello and Nagy, 2004b), and this might cause managers to restate the financial statements (Abbott et al., 2004; Carcello et al., 2011b). Audit quality is significantly associated with annual restatements, indicating that the use of the Big Four audit firms (as a proxy for audit quality), plays an important role in detecting restatements in Indonesia. In this context, the external auditor plays a key role in independently ensuring sound financial reporting that is in line with the resource dependence theory (Cohen et al., 2008). This finding supports the argument that external auditors (i.e., the Big 5 auditors) play a corporate governance role in Asia (Fan and Wong, 2005).

7.3 IMPLICATIONS OF THE STUDY

7.3.1 Implications for Knowledge

In general, this study provides empirical evidence that the establishment of audit committees by public listed companies is influenced by other corporate governance mechanisms. The establishment of audit committees as one of the mechanisms of corporate governance is not isolated or independent from other mechanisms; this is consistent with the view espoused in the bundle of corporate governance theory (Jensen, 1993; David and Useem, 2002; Filatotchev, 2007; Ward et al., 2009). In a weak legal enforcement regime, even though compliance with audit committee rules is mandatory, public listed companies might consider the effectiveness and efficiency of their bundle of corporate governance practices in complying with the audit such rules. Briefly, the findings support the argument of Aguilera et al. (2008) that there is no one best way to achieve the effectiveness of corporate governance, and those governance arrangements are varied across companies and their environments.

As corporate governance is considered as a bundle of practices and is affected by the organisational environment, the use of agency theory as the dominant theory in explaining the difference in corporate governance practice across companies is inadequate. The closed system of agency theory tends to focus solely on two actors (i.e., shareholders and managers), with little attention devoted to how agency problems may vary across diverse tasks and resource environments, the life cycle of organisations, or different institutional environments. Whilst agency theory continues to remain applicable in certain jurisdictions, it merely presents a partial view of the world, ignoring the complexity of organisations. Therefore, by using multiple theories as complements to agency theory, this research demonstrated that the effectiveness of corporate governance is determined by a wider group of organisational-related actors. It also acknowledged the importance of exploring the interrelationships between various actors and the mechanisms that affect corporate governance systems in specific institutional settings. The complementary theories, such as the bundle of corporate governance theory and the institutional theory, were used as underlying theories to explain the determinants of the compliance of public listed companies with audit committee rules, and the association of compliance with financial reporting quality. The use of multiple theories extends the studies on corporate governance, particularly studies in Indonesia which have been dominated by agency theory.

The study demonstrates that restatements, which were widely employed by prior studies in the US, might not be a valid proxy for financial reporting quality in Indonesia due to a different type of agency problem. This implies that selection of the proxy for financial reporting quality is critical. Financial reporting quality is an unobserved event and scholars employ various measures of quality depending on their research questions, as there is no measure of financial reporting quality that is superior for all decision models (Dechow, Ge, and Schrand, 2010). Thus, the validity of the proxy is one of the challenges in the selection of the proxy (DeFond, 2010).

7.3.2 Implications for Policy Makers in Indonesia

With respect to enhancing the audit committee, the research findings provide useful input for Indonesian regulators in three areas: (i) the efficacy of the mandatory approach of audit committee rules; (ii) the importance of the disclosure of foreign ownership and the need to enhance enforcement of ultimate ownership disclosures; and (iii) the need to fine-tune the independence aspect of company directors and commissioners. These are elaborated next.

7.3.2.1 Efficacy of the Mandatory Approach of Audit Committee Rules

The research findings indicate that the effectiveness of the BAPEPAM-LK's mandatory, rules-based approach to the establishment and operation of audit committees is questionable. While this approach mimics that of the US and conforms to the international trend, study results cast doubt on its efficacy. The study demonstrates that the compliance of Indonesian public listed companies with audit committee rules varies among companies and is affected by Indonesia's unique institutional environment. In addition, the study found that company size matters: large and small companies have different characteristics that influence their compliance with audit committee rules. In fact, compliance with all audit committee requirements might be costly for smaller listed companies. A similar observation was made by US scholars (e.g., Holmstrom and Kaplan, 2003; Zhang, 2007; Smith, 2007) with respect to SOX (2002). This study's results imply that different public listed companies have different contextual factors that affect their compliance with audit committee rules, as well as the effectiveness of the audit committee itself. These findings support the view of Aguilera et al. (2008) that corporate governance practices are affected by organizational environments. Similarly, Globerman, Peng, and Shapiro (2011) argued that understanding the institutional framework in which organizations operate is important in achieving effective corporate governance reforms in Asia. As a result, this raises doubts as to the appropriateness of the mandatory approach as a solution for reforming audit committee rules in Indonesia.

In this respect, it is reasonable to suggest that the BAPEPAM-LK consider the introduction of a flexible approach in implementing audit committee rules. This suggestion is in line with that advocated by Aguilera et al. (2011), which urged policy makers to introduce flexibility in the corporate governance system, thus allowing companies to adopt governance practices aligned to their contingencies, but with clear enforcement mechanisms to guarantee desired outcomes. Similarly, Iskander and Chamlou (1999) argued that corporate governance reforms have proved most effective when they have focused on the fundamentals and when they have combined this approach with incentives for firms to take voluntary action.

The flexible approach to compliance with audit committee rules may be considered by allowing public listed companies to comply with the requirements of the job duties of the audit committee that are deemed relevant by the companies. As noted in Table 6.1 in Chapter 6, examining financial information was the audit committee duty that achieved the highest level of compliance among committee duties. This shows that the standardization of audit committee job duties produces unsatisfactory results. It is thus arguable that the low level of compliance with other duties set forth in the audit committee rules may be because such duties may not meet the companies' needs. Therefore, the BAPEPAM-LK might consider allowing public listed companies to comply with selected audit committee rules that are the most appropriate to their organisational needs, with a more complete list of job duties in audit committee rules serving as a "best practice" guide. This approach will enable public listed companies to design efficient and effective job duties for their audit committees. On the other hand, membership and disclosure requirements should be mandatory for all public listed companies, as these two requirements are important elements of audit committee effectiveness (DeZoort et al., 2002; Bédard and Gendron, 2010). In short, the flexible approach is a mixed approach that combines both mandatory and voluntary requirements. Mandatory requirements would consist of fundamental audit committee requirements (i.e., membership and disclosure), whereas voluntary requirements would include job duties that are selected by individual companies based on their unique needs.

7.3.2.2. Foreign Institutional Investor and Ultimate Ownership Disclosures

This study provides evidence that the genuineness of foreign institutional investors is an important element in considering the effectiveness of corporate governance mechanisms. Prior studies have not addressed this peculiar feature of the Indonesian business environment. The presence of this group of foreign investors obscures the application of the institutional theory, as shown in this study. The current study proves that this type of foreign institutional investor does not improve corporate governance practice; it is only when genuine institutional investors are taken into account that the utility of the institutional theory is supported. Therefore, it is recommended that the BAPEPAM-LK set a requirement for the disclosure of the ultimate shareholders of foreign institutional investors. The need for an ultimate ownership disclosure requirement is also advocated by the World Bank (2010). Furthermore, the Indonesian Tax Office (ITO) has had difficulties, to date, in preventing tax avoidance by Indonesians through the establishment of special purpose interests. Therefore, this study's method of identifying the ultimate ownership of foreign institutional investors might be adopted by the ITO.

7.3.2.3. Independence of Company Directors and Commissioners

The presence of politically connected independent commissioners reduces the company's adherence to audit committee rules, whereas the presence of independent commissioners with accounting education or who are CPA holders has a positive association with compliance. In effect, the lack of financial expertise amongst politically connected independent commissioners has resulted in the low rate of corporate compliance with audit committee rules. However, considering Indonesia as an emerging economy, directors and commissioners play an important role in the provision of resources to the company (Young et al., 2001). Therefore, if a public listed company has only one independent commissioner, the BAPEPAM-LK needs to urge the company to appoint another person with financial expertise and the ability to develop wide relationships with external parties, as opposed to appointing someone solely on the basis of his/her political connections.

7.3.3 Implications for Investors

The research findings also provide useful insights for the investment community. Generally, investors are concerned with corporate governance practice when making their investment decisions. In assessing the effectiveness of the corporate governance mechanisms of certain public listed companies, investors might consider the presence of family control, the type of foreign institutional investors that have already invested in the company, and the characteristics of company commissioners (i.e., the political connectedness and financial expertise of independent commissioners).

Investors need to be more vigilant and do their homework in assessing the corporate governance practices of the investee/potential investee company. Clearly, company explications of their corporate governance practices in their annual reports cannot serve as the sole basis for assessing the quality of the company’s corporate governance because what is written in the annual reports may not reflect actual practices. Investors need to confirm company information with other references, such as IDX announcements, announcements of public listed companies to the IDX and news in the media.

7.4 LIMITATIONS OF THE STUDY

As is common with all research studies, this research has a few limitations which are identified below. Future research may be able to extend this research and address its limitations.

7.4.1 Unavailability of Data Prior to 2006

Wooldridge (2009) argued that panel data is useful in evaluating the effect of certain policies by examining two periods: the period before and the period after implementation of the policy. However, in Research Stage 1 (the study on the determinants of compliance), the focus is on examining the immediate period of audit committee reforms because of the lack of complete data for the period before audit committee reforms were enacted (before 2006).

7.4.2 Limited Data Sources to Trace Ultimate Controlling Shareholders

Families in Indonesia might establish control over a firm through pyramid structures and cross-holdings among firms (Claessens et al., 2000). These types of ownership structures made it difficult to identify the ultimate shareholders of public listed companies. In addition, there was no regulation in Indonesia in the period of observation regarding the disclosure of ultimate controlling shareholders. As a result, the study simply relies on formal documents, such as annual reports and prospectuses, in tracing the ultimate controlling shareholders. This might provide unsatisfactory results.

7.5 SUGGESTIONS FOR FUTURE STUDY

This research sought to specifically examine the aspect of compliance with audit committee rules in the Indonesian corporate governance system. Future studies can extend this research by exploring other elements within the context of emerging economies. Suggestions for future research are discussed next.

7.5.1 Distinguishing Foreign Ownership Held by Financial Institutions and Non-Financial Institutions

Whilst this study examined the effect of large genuine foreign institutional investors, future studies may want to examine if ownership by different types of foreign institutional investors (e.g., financial institutions and non-financial institutions) has an effect on corporate governance. For example, these two types of foreign investors might have different investment philosophies and horizons (Douma, et al., 2006). They might also have different responses to corporate governance practices. Ananchotikul (2006) found that foreign financial institutional investors (not industrial joint ventures) had a significant effect on corporate governance improvement. In contrast, foreign corporate investors (joint venture firms) with large shares, have a negative and significant effect on corporate governance practice.

7.5.2 Extending the Investigation of Politically Connected Independent Commissioners

Given the utility of the resource dependence theory in this study, future research may consider examining the relationship between the presence of politically connected independent commissioners and firm performance. This study provides evidence that the presence of politically connected independent commissioners has a negative and significant association with compliance with audit committee rules. Whilst this suggests that this type of independent commissioner may not be appropriate to play a role in monitoring the company, the resource dependence theory shows that the presence of politically connected independent commissioners provides companies with benefits such as protection or special treatment, including access to outside capital, and preserving monopolistic strategies (Husnan, 2001). It may be argued that such resources could possibly lead to better company performance.

7.5.3 Extending the Study of Determinants of Compliance by Examining Sub Samples

The study suggests that future studies make a comparative analysis of two sets of sub samples. One analysis might compare the level of compliance of state-owned enterprises and family-controlled companies with audit committee rules. In the current study, state-owned enterprises were excluded from the sample because they are subject to different audit committee regulations. In addition, state-owned enterprises are strictly monitored by the Ministry of State-Owned Enterprises Indonesia, which serves as an additional corporate governance mechanism. As such, state-owned enterprises are assumed to have a high level of compliance with audit committee regulations. A second analysis in a future study might involve a comparison between public listed companies with high levels of compliance with audit committee regulations and public listed companies with low levels of compliance. The comparative analysis would include each component of the audit committee compliance index, as well as the effect of politically connected independent commissioners and their financial expertise. The analysis would provide further insight into understanding the determinants of compliance.

7.5.4 Use of a Different Proxy for Financial Reporting Quality

Future research may consider some other proxy for financial reporting quality that matches with agency problem type 2. As discussed in Section 6.4, restatements might not be a valid proxy for financial reporting quality because the agency problem in Indonesia is different from that in developed countries. High concentrated corporate ownership in Indonesia leads to agency problems that occur between controlling shareholders (or families) and minority shareholders. In this situation, the controlling shareholders have an incentive to engage in expropriation, which is defined as a process of using control rights or other controls to maximize private benefits by distributing wealth from other parties (Claessens et al., 2000). One method of expropriation is through related-party transactions (Munir and Gul, 2010). On the other hand, corporate governance mechanisms are supposed to constrain opportunistic behaviour. As such, a future study might examine whether audit committee effectiveness is associated with related-party transactions.

7.5.5 Exploring the Consequences of Restatements

The results of Research Stage 2 indicate that restatements might not be a good proxy for financial reporting quality because investors in Indonesia might not consider restatements as important enough to influence their decision making. However, no prior study has been conducted in Indonesia to examine this issue. Meanwhile, some scholars in the US have found that restatements are associated with serious consequences, such as market reaction (GAO, 2006), CFO voluntary turn over (Collins et al., 2009), audit committee compensation (Archambeault et al., 2008), auditor turn over (Hennes, Leone, and Miller, 2010) and litigation (Palmrose and Scholz, 2004). Therefore, a future study might explore whether restatements in Indonesia cause serious consequences.

7.5.6 Exploring the Qualitative Dimension

This study employs a quantitative research approach in both stages. Some interesting findings in this study might benefit from further clarification using the qualitative approach. For example, this study uses archival data to reveal that family control affect the compliance public listed companies with the audit committee rules. In fact, archival methods are not well suited for analysing processes (Carcello et al., 2011a). Hence, further studies using qualitative methods, such as field studies or interviews, might examine how family control influences the compliance.

7.6 CONCLUSION

This research investigated the determinants of the compliance of public listed companies with audit committee rules and their effect on financial reporting quality. The research found that family control, foreign institutional investors, and politically connected independent commissioners are associated with compliance, implying that the implementation of certain corporate governance mechanisms in Indonesia might be affected by other corporate governance mechanisms. Notwithstanding, the study supports the argument that the absence of strong legal enforcement results in informal institutions, such as relational ties, family connections and government contacts, playing an important role in shaping corporate governance in an emerging economy such as Indonesia. Valuable insights have been obtained that suggest that the adoption of the Anglo-American corporate governance model – a model predicated solely on agency theory without accommodating institutional differences and organisational factors evidenced in the Indonesian business environment and organisational practice – might impede further progress in Indonesian corporate governance reform efforts.

REFERENCES

Abbott, L. J., & Parker, S. (2000). Auditor selection and audit committee characteristics. *Auditing: A Journal of Practice & Theory*, *19*(2), 47-66.

Abbott, L. J., Park, Y., & Parker, S. (2000). The effects of audit committee activity and independence on corporate fraud. *Managerial Finance*, *26*(11), 55-67.

Abbott, L. J., Parker, S., & Peter, G. F. (2004). Audit committee characteristics and restatements. *Auditing: A Journal of Practice and Theory, 23*(1), 69-87.

Abdul Wahab, E. A., How, J. C. Y., & Verhoeven, P. (2007). The impact of the Malaysia code of corporate governance: Compliance, institutional investors and stock performance. *Journal of Contemporary Accounting & Economics*, *3*(2), 106-129.

Abdullah, S. N., Yusof, N. Z. M., & Nor, M. N. M. (2010). Financial restatements and corporate governance among Malaysian listed companies. *Managerial Auditing Journal*, *25*(6), 527-552.

Achmad, T., Rusmin, R., Neilson, J., & Tower, G. (2009). The iniquitous influence of family ownership structures on corporate performance. *The Journal of Global Business Issues*, *3*(1), 41-49.

Adams, M. (1997). Determinants of audit committee formation in the life insurance industry: New Zealand Evidence. *Journal of Business Research*, *38*(2), 123–129.

ADB (2006). *Indonesia: Financial governance and social security reform program*. Retrieved February 7, 2011, from http://www.adb.org/Documents/PCRs/INO/33399-INO-PCR.pdf.

Ady, S.U, Sudarma, M., Salim, U., & Aisyah, S (2013). Psychology's factors of stock buying and selling behavior in Indonesia Stock Exchange (phenomenology study of investor behavior in Surabaya). *IOSR Journal of Business and Management, 7(3),11-22.*

Agoglia, C. P., Doupnik, T. S., & Tsakumis, G. T. (2011). Principles-based versus rules-based accounting standards: The influence of standard precision and audit committee strength on financial reporting decisions. *The Accounting Review*, *86*(3), 747-767.

Agrawal, A., & Chadha, S. (2005). Corporate governance and accounting scandal. *Journal of Law and Economics*, *48*(2), 371-406.

Agrawal, A., & Knoeber, C. R. (2001). Do some outside directors play a political role? *Journal of Law & Economics, 44*(1), 179-198.

Aguilera, R. V., & Cuervo-Cazurra, A. (2004). Codes of good corporate governance worldwide: What is the trigger? *Organization Studies*, *25*(3), 417-446.

Aguilera, R. V., & Cuervo-Cazurra, A. (2009). Codes of good governance. *Corporate Governance: An International Review*, *17*(3), 376–387.

Aguilera, R. V., Desender, K. A., & Kabbach-Castro, L. R. (2011). *A configurational approach to comparative corporate governance.* Retrieved December 20, 2011 from http://ssrn.com/abstract=1797142

Aguilera, R. V., Filatotchev, I., Gospel, H., & Jackson (2008). An organizational approach to comparative corporate governance: Costs, contingencies, and complementarities. *Organization Science, 19*(3), 475-492.

Aguilera, R. V., & Jackson, G. (2003). The cross-national diversity of corporate governance: Dimensions and determinants. *Academy of Management Review*, *28*(3), 447-465.

Ahrens, T., Filatotchev, I., & Thomsen, S. (2011). The research frontier in corporate governance. *Journal of Management & Governance*, *15*(3), 311-325.

Aiken, L. S., & West, S. G. (1991). *Multiple regression: Testing and interpreting interactions.* Newbury Park: Sage Publications.

Akarak, P., & Ussahawanitchakit, P. (2010). Audit committee effectiveness and firm credibility: An empirical investigation of Thai-listed firms. *International Journal of Business Research*, *10*(2), 38-63.

Al-Abbas, M. A. (2009). Corporate governance and earnings management: An empirical study of the Saudi market. *The Journal of American Academy of Business*, *15*(1), 301-310.

Al-Mudhaki, J., & Joshi, P. L. (2004). The role and functions of audit committees in the Indian corporate governance: Empirical findings. *International Journal of Accounting*, *8*(1), 33-47.

Al–Twaijry, A. A. M., Brierley, J. A., & Gwilliam, D. R. (2002). An examination of the role of audit committees in the Saudi Arabian corporate sector. *Corporate Governance: An International Review*, *10*(4), 288–297.

Alves, C., & Mendes, V. (2004), Corporate governance policy and company performance: The Portuguese case. *Corporate Governance: An International Review*, *12*(3), 290–301.

Alyousef, H. Y., & Almutairi, A. R. (2010). An empirical investigation of accounting restatements by public companies: Evidence from Kuwait. *International Review of Business Research Papers*, *6*(1) 513 ‐ 535.

Amoah, N. Y. (2012). Option grants and investor reaction to restatement-induced litigation. *Review of Accounting and Finance*, 11(1), 40 – 52.

Amoah, N. Y., & Tang, A. P. (2010). Board, audit committee and restatement-induced class action lawsuits. *Advances in Accounting, Incorporating Advances in International Accounting*, *26*(2), 155-169.

Ananchotikul, S. (2006). *Does foreign investment really improve corporate governance? Evidence from Thailand* (Job market paper). California:

Department of economics University Berkeley. Retrieved June 1, 2007 from http://emlab.berkeley.edu/users/webfac/gourinchas/e281_f06/Bo.pdf.

Anand, A. I. (2005). *Voluntary vs. mandatory corporate governance: Towards an optimal regulatory framework*. Retrieved October 10, 2010 from http://law.bepress.com/expresso/eps/566.

Anderson, K. L., Deli, D. N., & Gillan, S. L. (2003). *Boards of directors, audit committees, and the information content of earnings* (Working paper). Delaware: Weinberg Centre for Corporate Governance, University of Delaware. Retrieved February 10, 2010, from http://papers.ssrn.com/abstract_id=444241

Anderson, C. W., Jandik, T., & Makhija, A. K. (2001). Determinants of foreign ownership in newly privatized companies in transition economies. *Financial Review, 36*, 161-175.

Anderson, R. C., Mansi, S. A., & Reeb, D. M. (2004). Board characteristics, accounting report integrity, and cost of debt. *Journal of Accounting and Economics, 37*, 315-342.

Anderson, R. C, & Reeb, D. M. (2003). Founding-family ownership and firm performance: Evidence from the S&P 500. *Journal of Finance*, 58(3), 1301-1328.

Aoki, M. (1994). The Japanese firm as a system of attributes: A survey and research Agenda. In Aoki, M., & Dore, R. (eds.) *The Japanese Firm: Sources of competitive strength* (pp. 11-40). Oxford: Oxford University Press.

Archambeault, D., DeZoort, F. T., & Hermanson, D. R. (2008). Audit committees incentive compensation and accounting restatements. *Contemporary Accounting Research*, *25*(4), 965-992.

Arcot, S. R., & Bruno, V. G. (2007). One size does not fit all: Evidence from corporate governance. *Journal of Empirical Legal Studies*, *4*(4), 1041 – 1057.

Arellano, M., & Bover, O. (1995). Another look at the instrumental variable estimation of error-component models. *Journal of Econometrics*, 68, 29–51.

Ariff, A. M., Ibrahim, M. K., & Othman, R. (2007). Determinants of firm level governance: Malaysian evidence. *Corporate Governance*, *7*(5), 562 – 573.

Arthaud-Day, M. L., Certo, S. T., Dalton C. M., & Dalton, D. R. (2006). A changing of the guard: Executive and director turnover following corporate financial restatements. *Academy Management Journal*, *49*(6), 119-136.

Baber, W. R., Kang, S-H., & Liang, L. (2005). *Strong boards, management entrenchment, and accounting restatemen*t. Retrieved on November 10, 2010 from http://zsbapp.baruch.cuny.edu/download/Accountancy/BKLJuly20.pdf

Babic, V. (2003). *Corporate governance problems in transition economies* (Social science research seminar 2). Winston-Salem: Wake Forest University. Retrieved January 12, 2011, from http://www.afic.am/CG/CGProblemsInTransitionEconomies.pdf

Backman, M. (1999). *Asian eclipse: Exposing the dark side of business in Asia*. Singapore: Wiley.

Bank Indonesia (1999). *Peraturan Bank Indonesia No. 1/6/PBI/1999 tentang penugasan direktur kepatuhan dan penerapan standar pelaksanaan fungsi audit intern bank umum.* Retrieved March 10, 2010, from www.bi.go.id/biweb/utama/peraturan/pbi-1-6-1999.pdf

Bank Indonesia. (2003). *Peraturan Bank Indonesia No. 5/25/PBI/2003 tentang penilaian kemampuan dan kepatutan.* Retrieved on March 10, 2010, from www.bi.go.id/biweb/utama/peraturan/pbi-52503.pdf.

Bank Indonesia. (2006a). *Peraturan Bank Indonesia No. 8/4/PBI/2006 tentang pelaksanaan good corporate governance bagi bank umum*. Retrieved April 12, 2010, from www.iicg.org/asset/doc/pbi8406.pdf

Bank Indonesia. (2006b). *Peraturan Bank Indonesia No. 8/14/PBI/2006 tentang perubahan atas PBI No. 8/4/PBI/2006 tentang pelaksanaan good corporate governance bagi bank umum.* Retrieved March 12, 2010 from www.iicg.org/asset/doc/pbi_81407.pdf.

BAPEPAM (1996a). *Keputusan ketua BAPEPAM No. Kep-03/PM/1996 tentang tata cara pembuatan peraturan oleh bursa efek.* Retrieved June 12, 2010, from www.bapepam.go.id/old/hukum/peraturan/III/III.A.2.pdf

BAPEPAM. (1996b). *Keputusan ketua BAPEPAM No Kep-38/PM/1996 tentang laporan tahunan.* Retrieved August 12, 2010, from www.bapepam.go.id/old/hukum/peraturan/VIII/VIII.G.2.pdf.

BAPEPAM. (2000). *Surat edaran No. SE-03/PM/2000 tentang rekomendasi untuk perusahaan publik membentuk komite audit*. Jakarta: BAPEPAM

BAPEPAM. (2003). *Keputusan ketua BAPEPAM No Kep-41/PM/2003 tentang pembentukan dan pedoman pelaksanaan kerja komite audit.* Retrieved August 12, 2008, from www.bapepam.go.id/old/old/news/Des2003/IX.I.5.pdf.

BAPEPAM. (2004). *Keputusan ketua BAPEPAM No. Kep-29/PM/2004 tentang pembentukan dan pedoman pelaksanaan kerja komite audit.* Retrieved February 25, 2007, from www.bapepam.go.id/old/hukum/peraturan/IX/IX.I.5.pdf.

BAPEPAM-LK (2006). *Keputusan ketua BAPEPAM No. Kep-134/BL/2006 tentang kewajiban penyampaian laporan tahunan bagi emiten atau perusahaan publik*. Retrieved March 17, 2007, from www.bapepam.go.id/old/hukum/peraturan/X/X.K.6.pdf.

BAPEPAM-LK (2011). *Capital market and NBFIs development*. Retrieved November 28, 2011, from http://www.bapepam.go.id/bapepamlk/others/market_update/Market_Update_30-Sept-2011.ppt

Baum, C. (2010). *Heteroskedasticity test in panel data*. Retrieved January 10, 2011, from http://www.stata.com/statalist/archive/2010-07/msg01530.html

Baum, C.F., Schaffer, M. E., & Stillman, S. (2003). Instrumental variable and GMM: Estimation and testing. *The Stata Journal*, *3*(1), 1-31.

Baxter, P. (2010). Factors associated with the quality of audit committees. *Pacific Accounting Review, 22*(1), 57 – 74.

Baxter, P., & Cotter, J. (2009). Audit committees and earnings quality. *Accounting & Finance, 49*(2), 267-290.

Beasley, M. S. (1996). An empirical analysis of the relation between the board of director composition and financial statement fraud. *The Accounting Review,* 71 *(4)*, 443-465.

Beasley, M. S., Carcello, J. V., Hermanson, D. R., & Lapides, P. D. (2000). Fraudulent financial reporting: Consideration of industry traits and corporate governance mechanisms. *Accounting Horizons, 14*(4), 441-454.

Beasley, M. S., Carcello, J. V., Hermanson, D. R., & Neil, T. L. (2009). The audit committee oversight process. *Contemporary Accounting Research*, *26*(1), 65-122.

Beasley, M. S., & Salterio, S. E. (2001). The relationship between board characteristics and voluntary improvements in audit committee composition and experience. *Contemporary Accounting Research, 18*(4), 539–570.

Bebchuk, L., Kraakman, R., & Triantis, G (2000). Stock pyramids, cross-ownership, and dual class equity: The creation and agency costs of separating control from cash flow rights. In Randall K. Morck (eds.), *Concentrated Corporate Ownership* (pp. 295-318). Chicago: University of Chicago Press.

Bédard J., Chtourou, S. M., & Courteau, L. (2004). The effect of audit committee expertise, independence, and activity of aggressive earnings management. *Auditing: A Journal of Practice and Theory*, *23*(2), 13-35.

Bédard, J., & Gendron, Y. (2010). Strengthening the financial reporting system: Can audit committees deliver? *International Journal of Auditing*, *14*(2), 174-210.

Berglöf, E., & Claessens, S. (2006). Enforcement and good corporate governance in developing countries and transition economies. *The World Bank Research Observer, 21*(1), 123-150.

Berthelot, S., Morris, T., & Morrill, C. (2010). Corporate governance rating and financial performance: A Canadian study. *Corporate Governance*, *10*(5), 635-646.

Bertrand, M., Johnson, S., Samphantharak, K., & Schoar, A. (2008). Mixing family with business: A study of Thai business groups and the families behind them. *Journal of Financial Economics*, *88*(3), 466-498.

Bhattacharya, U., & Ravikumar, B. (2004). *From cronies to professionals: The evolution of family firms*. Retrieved October 30, 2009, from http://ssrn.com/abstract=306130 or doi:10.2139/ssrn.306130

Bianchi, M., Ciavarella, A., Novembre, V., & Signoretti, R. (2010). Compliance for the Italian listed companies and the corporate governance codes. *Bancaria Special Issue, 3,* 45-55.

Bisman, J. (2010). Post-positivism and accounting research: A (personal) primer on critical realism. *Australasian Accounting Business & Finance Journal, 4*(4), 3-25.

Bisnis Indonesia. (September 11, 2003). *Segudang tantangan: Special report on good governance.*

Black, B., Jang, H., & Kim, W. (2006). Does corporate governance affect firms' market values? Evidence from Korea. *Journal of Law, Economics and Organisation*, *22* (2), 366–413.

Block, J. H. (2011). How to pay non-family managers in large family firms: A principal-agent model. *Family Business Review, 24*(1), 9-27.

Blue Ribbon Committee (1999). *Improving the effectiveness of corporate audit committee.* Retrieved March 20, 2008, from www.nyse.com/pdfs/blueribb.pdf.

Bokpin, G. A., & Isshaq, Z. (2009). Corporate governance, disclosure and foreign share ownership on the Ghana Stock Exchange. *Managerial Auditing Journal, 24*(7), 688 – 703.

Bradbury, M. E. (1990). The incentives for voluntary audit committee formation. *Journal of Accounting and Public Policy*, *9*, 19–36.

Bradbury, M. E., Mak, Y. T., & Tan, S. M. (2006). Board characteristics, audit committee characteristics and abnormal accruals. *Pacific Accounting Review*, *18*(2), 47- 68.

Braiotta, L. (2004). The impact of US requirements for audit committees on the structure and membership of non-U.S audit committees. *Advances in International Accounting*, *17*,119-135.

Braiotta, L., & Zhou, J. (2006). An exploratory study of the effects of the Sarbanes-Oxley Act, the SEC and United States Exchange(s) rules on audit committee alignment. *Managerial Auditing Journal*, *21*(2), 166-190.

Braiotta, L., & Zhou, J. (2008). An exploratory study of the effects of the European Union 8th Directive on Company Law on audit committees: Evidence from EU companies listed on the US stock exchanges. *Advances in Accounting, incorporating Advances in International Accounting*, 24, 262-271.

Brand, V. (2009). Empirical business ethics research and paradigm analysis. *Journal of Business Ethics*, *86*(4), 429-449.

Brown, R. A. (2004). Conglomerates in contemporary Indonesia: Concentration, crisis and restructuring. *South East Asia Research, 12*(3), 378-407.

Bruno, V. G., & Claessens, S. (2010). Corporate governance and regulation: Can there be too much of good thing? *Journal of Financial Intermediation*, *19*(4), 461-482.

Bryan, D. M., Liu, C., & Tiras, S. L. (2004). *The Influence of independent and effective audit committees on earnings quality*. Retrieved January 10, 2011, from http://ssrn.com/abstract=488082

Bukit, R. B., & Iskandar, T. M., (2009). Surplus free cash flow, earnings management and audit committee. *International Journal of Economics and management, 3*(1), 204-223.

Bunniss, S., & Kelly, D. R. (2010). Research paradigms in medical education research. *Medical Education*, 44(4), 358–366.

Burks, J. J. (2010). Disciplinary measures in response to restatements after Sarbanes–Oxley. *Journal of Accounting and Public Policy*, *29*(3), 195-225.

Cadbury Committee (1992). *Report of the committee on the financial aspects of corporate governance.* London: Gee.

Cai, H. (2007). Bonding, law enforcement and corporate governance in China. *Stanford Journal of Law, Business & Finance, 13*(1), 82-120.

Callen, J. L., Livnat, J., & Segal, D. (2006). Accounting restatements: Are they always bad news for investors? *The Journal of Investing*, 1593), 57-68.

Cameron, A. C., & Trivedi, P. K. (2005). *Microeconometrics: Methods and application*. New York: Cambridge university press.

Cameron, A. C., & Trivedi, P. K. (2009). *Microeconometrics using stata*. Texas: Stata press.

Cao, Y., Myers, L. A., & Omer, T. C. (2010). *Does company reputation matter for financial reporting quality? Evidence from restatements*. Retrieved January 10, 2011, from http://ssrn.com/abstract=1317343.

Carcello, J. V., Hermanson, D. R., & Neal, T. L. (2002). Disclosure in audit committee charters and reports. *Accounting Horizons*, *16*(4), 291-304.

Carcello, J. V., Hermanson, D. R., & Ye, Z. (2011a). Corporate governance research in accounting and auditing: Insights, practice, implications, and future research directions. *Auditing: A Journal of Practice & Theory, 30*(3), 1-31.

Carcello, J. V., Hollingsworth, C. W., & Neal, T. L. (2006). Audit committee financial experts: A closer examination using firm designation. *Accounting Horizons*, *20* (4), 351-373.

Carcello, J. V., & Nagy, A. L.. (2004a). Client size, auditor specialization and fraudulent financial reporting. *Managerial Auditing Journal*, *19*(5), 651-668.

Carcello, J. V., & Nagy, A. L. (2004b). Audit firm tenure and fraudulent financial reporting. *Auditing: A Journal of Practice and Theory*, *23*(2), 55-69.

Carcello, J. V., Neal, T. L., Palmroze, Z-V., & Scholz, S. (2011b). CEO involvement in selecting board members, audit committee effectiveness, and restatements. *Contemporary Accounting Research*, *28*(2), 396-430.

Carney, M. (2005). Corporate governance and competitive advantage in family-controlled firms. *Entrepreneurship Theory and Practice,* 29(3), 249-265.

Carson, E. (2002). Factors Associated with the development of board sub–committees. *Corporate Governance: An International Review*, *10*(1), 4–18.

Cavana, R. Y., Sekaran, U., & Delahaye, B. L. (2001) *Applied business research: Qualitative and quantitative methods.* Milton: John Wiley & Sons Australia.

Cernat, L. (2004). The emerging European corporate governance model: Anglo-Saxon, Continental, or still the century of diversity?, *Journal of European Public Policy, 11*(1), 147-166.

Chan, K. C., Farrell, B. R., & Lee, P. (2011). Trends of accounting restatements during the period 2000-2007 and Big Four/Five auditors. *Journal of Business & Economics Research (JBER)*, *7*(8), 91-98.

Chang, J-C., & Sun, H-L. (2009). Crossed-listed foreign firms' earnings informativeness, earnings management and disclosures of corporate governance information under SOX. *The International Journal of Accounting, 44*(1), 1-32.

Chang, J-C., & Sun, H-L. (2010). Does the disclosure of corporate governance structures affect firms' earnings quality? *Review of Accounting and Finance, 9* (3), 212-243.

Chang, R-D., Wei, J-T., Wu, H-H., & Teng, C-C. (2010). Restatements, family ownership and forced turnover of related parties of financial statements. *African Journal of Business Management*, *4*(13), 2705-2717.

Chatterjee, D. (2011). Audit committee observation/recommendations versus practice as a compliance of corporate governance in India. *DLSU Business & Economics Review*, 20(2), 67-78.

Chau, G., & Leung, P. (2006). The impact of board composition and family ownership on audit committee formation: Evidence from Hong Kong. *Journal of International Accounting, Auditing and Taxation*, *15*(1), 1-15.

Chava, S., & Roberts, M. (2008). How does financing impact investment? The role of debt covenants. *The Journal of Finance*, 63(5), 2085-2121.

Cheffers, M., Whalen, D., & Usvyatsky, O. (2010). *2009 Financial restatements: A nine year comparison*. Audit Analytics Sales (February).

Chen, D. H., Fan, J. P. H., & Wong, T. J. (2006). Decentralization and the structure of Chinese corporate boards: Do politicians jeopardize board professionalism and firm performance? In A.S. Tsui, Y. Bian, & L. Cheung (eds.), *China's domestic* *private firms: Multi-disciplinary perspectives on management and performance* (pp. 147-170). New York: M.E. Sharpe, Inc.

Chen, K. Y., Elder, R. J., & Hsieh, Y-M. (2007). Corporate governance and earnings management: The implications of corporate governance best-practice principles for Taiwanese listed companies. *Journal of Contemporary Accounting and Economics, 3*(2), 73-105.

Chen, L., Kilgore, A., & Radich, R. (2009). Audit committees: Voluntary formation by ASX non-top 500. *Managerial Auditing Journal*, *24*(5), 475 – 493.

Chen, V. Z., Li, J., & Shapiro, D. M. (2011). Are OECD-prescribed 'good corporate governance practices' really good in an emerging economy? *Asia Pacific Journal of Management*, *28*(1), 115-138.

Chen, X., Harford, J., & Li, K. (2007). Monitoring: Which institutions matter? *Journal of Financial Economics, 86*, 279-305.

Chenhall, R. H., & Moers, F. (2007). The issue of endogeneity within theory-based, quantitative management accounting research. *European Accounting Review*, *16*(1), 173-195.

Cheung, S. Y. L., & Chan, B. Y. (2004). Corporate governance in Asia. *Asia-Pacific Development Journal, 11*(2), 1-31.

Chevalier, A., Prasetyantoko, A. & Rokhim, R. (2006). *Foreign ownership and corporate governance practice in Indonesia*. Paper presented at Globalization, public policy and multi-jurisdiction governance – The need for a common approach conference, Université Paris-IX Dauphine, Paris. Retrieved May 12, 2008, from www.dauphine.fr/globalisation/prasetyantoko.pdf.

Chien, A. (2008). The effect of board characteristics on foreign ownership: Empirical evidence from Taiwan. *International Research Journal of Finance and Economics, 22*, 92-105.

Chipalkatti, N., Le, Q. V., & Rishi, M. (2007). Portfolio flows to emerging capital markets: Do corporate transparency and public governance matter? *Business and Society Review*, *112*, 227-249.

Chizema, A. (2011). The influence of ownership structure on the implementation of national codes of corporate governance: Development of research propositions. *International Journal of Management*, *28*(4), 238-253.

Chrisman, J. J., Chua, J. H., & Litz, R. A. (2004). Comparing the agency costs of family and non-family firms: Conceptual issues and exploratory evidence. *Entrepreneurship Theory and Practice*, *28*(4), 335–354.

Chrisman, J. J., Chua, J. H., & Sharma, P. (2005). Trends and directions in the development of a strategic management theory of the family firm. *Entrepreneurship Theory and Practice, 29*(5), 555–576.

Christiansen, H & Koldertsova, A. (2009).The role of stock exchanges in corporate governance. *Financial Market Trends*. Retrieved June 12, 2013 from www.oecd.org/finance/financial-markets/43169104.pdf

Chua, C. (2008). *Chinese big business in Indonesia: The state of capital*. New York: Routledge.

Chua, J. H., Chrisman, J. J., & Sharma, P. (2003). Succession and non succession concerns of family firms and agency relationship with nonfamily managers. *Family Business Review, 16*(2), 89- 107.

Chua, W. F. (1986). Radical developments in accounting thought. *The Accounting Review*, *61*(4), 601-632.

Chuanrommanee, W. L., & Swierczek, F. W. (2007). Corporate governance in ASEAN financial corporations: Reality or illusion? *Corporate Governance: An International Review*, *2*(2), 272-283.

Claessens, S. (2006). Corporate governance and development. *World Bank Research Observer, 21*(1), 91-122.

Claessens, S., & Fan, J. P. H. (2002). Corporate governance in Asia: A survey. *International Review of Finance, 3*(2), 71-103.

Claessens, S., Fan, P. H. J., Djankov, S., & Lang, H. P. L. (1999). *On expropriation of minority shareholders: evidence from East Asia*. Retrieved July 12, 2013, from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=202390

Claessens, S., Djankov, S., & Lang, L. H. P. (2000). The separation of ownership and control in East Asian corporations. *Journal of Financial Economics, 58*, 81–112.

Claessens, S., & Yurtoglu, B. B. (2012). Corporate governance in emerging markets: A survey. *Emerging Markets Review, 15*, 1-33.

Coakes, S. J., Steed, L., & Dzidic, P. (2006). *SPSS 13.0 for windows: Analysis without anguish*. Sydney: John Wiley & Sons Australia.

Cohen, J., Krishnamoorthy, G., & Wright, A. M. (2004). The corporate governance mosaic and financial reporting quality. *Journal of Accounting Literature. 23*. 87-152.

Cohen, J., Krishnamoorthy, G., & Wright, A. M. (2008). Form versus substance: The implications for auditing practice and research of alternative perspectives on corporate governance. *Auditing: A Journal of Practice &Theory, 27*(2), 181–198.

Cohen, J., Hoitash, U., Krishnamoorty, G., & Wright, A. (2010). *The association between audit committee industry expertise and financial restatements*. Retrieved February 14, 2011, from http://ssrn.com/abstract=1567453

Cohen, J., Hoitash, U., Krishnamoorty, G., & Wright, A. (2011). *Does Audit Committee Industry Expertise Affect the Likelihood of Financial Restatements?* Retrieved December 24, 2011, from http://ssrn.com/abstract=1567453

Collier, P. A. (1993). Factors affecting the formation of audit committees in major UK listed companies. *Accounting and Business Research*, *23*(91A), 421–430.

Collier, P. A. (1996). The rise of the audit committee in UK quoted companies: A curious phenomenon? *Accounting, Business and Financial History*, *6*, 121 – 140.

Collier, P. A., & Zaman, M. (2005). Convergence in European corporate governance: The audit committee concept. *Corporate Governance: An International Review*, *13* (6), 753-768.

Collins, D., Masli, A., Reitenga, A. L., & Sanchez, J. M. (2009). Earnings restatements, the Sarbanes-Oxley Act, and the disciplining of chief financial officers. *Journal of Accounting, Auditing & Finance*, *24*(1), 1-34.

Colpana, A. M., Yoshikawab, T., Hikinoc, T., & Miyoshi, H. (2007). Japanese corporate governance: structural change and financial performance. *Asian Business & Management*, *6*, 89–113.

Committee on the Financial Aspects of Corporate Governance. (1992). *Report with Code of Best Practice* (Cadbury Report). London: Gee Publishing.

Corbetta, G., & Salvato, C. (2004). Self-serving or self-actualizing? Models of man and agency costs in different types of family firms: A commentary on "Comparing the agency costs of family and non-family firms: Conceptual issues and exploratory evidence". *Entrepreneurship Theory and Practice*, *28*(4), 355–362.

Credit Lyonnais Securities Asia (2007). *Corporate governance watch 2007*. Retrieved March 10, 2008, from: https://www.clsa.com/public/library/pdf/CLSA_ACGA_CGWatch2007_Extract.pdf.

Credit Lyonnais Securities Asia (2010). *Corporate governance watch 2010.* Retrieved February 10, 2011, from http://www.acgaasia.org/public/files/CG_Watch_2010_Extract_Final.pdf.

Crotty, M. (1998). *The foundations of social research: Meaning and perspective in the research process.* Sydney: Allen and Unwin.

Da Silveira, A. D. M., Leal, R. P. C., Carvalhal-da-Silva, A. L., & De C. Barros, L. A. (2010). Endogeneity of Brazilian corporate governance quality determinants. *Corporate Governance*, *10*(2), 191 – 202.

Daily, C. M., & Dollinger, M. J. (1992). An empirical examination of ownership structure in family and professionally managed firms. *Family Business Review*, *5*(2), 117-136.

Daily, C. M., Dalton, D. R., & Canella, A. A. (2003). Corporate governance: Decades of dialogue and data. *Academy Management Review*, *28*(3), 371-382.

Dam, L., Scholtens, B., & Sterken, E. (2007). Corporate governance and international location decisions of multinational enterprises. *Corporate Governance: An International Review*, *15*(6), 1330-1347.

Daniel, W. E. (2003). Corporate governance in Indonesian listed companies: A problem of legal transplant. *Bond Law Review*, *5* (1), 345-375.

Daniri, M. A. (2005). *Indonesian corporate governance: Challenges and the road head* (Dinner speech). Bali, Indonesia: Asian Round Table on Corporate Governance. Retrieved March 5, 2010, from http://www.governance-indonesia.com/donlot/masdaniri_gcg.pdf.

Davidson III, W. N., Xie B., & Xu, W. (2004). Market reaction to voluntary announcements of audit committee appointments: The effect of financial expertise. *Journal of Accounting and Public Policy*, *23*(4), 279-293.

Davidson, R., Goodwin-Stewart, J., & Kent, P. (2005). Internal governance structures and earnings management. *Accounting and Finance, 45*(2), 241-267.

Davis, G. F., & Useem, M. (2002). Top management, company directors and corporate control. In A. Pettigrew, H. Thomas, & R. Whittington (eds.), *Handbook of strategy and management* (pp 232-260). London: Sage Publications Ltd.

Dechow, P., Ge, W., & Schrand, C. (2010). Understanding earnings quality: A review of the proxies, their determinants and their consequences. *Journal of Accounting and Economics*, *50*(2), 344-401.

Dechow, P. M., Sloan, R. G., & Sweeney, A. P. (1996). Causes and consequences of earnings manipulation: An analysis of firms subject to enforcement actions by the SEC. *Contemporary Accounting Research*, *13*(1), 1-36.

DeFond, M. L. (2010). Earnings quality research: Advances, challenges and future research. *Journal of Accounting and Economics*, *50*(2-3), 402-409.

DeFond, M. L., Hann, R. N., & Hu, X. (2005). Does the market value financial expertise on audit committees of board of directors. *Journal of Accounting Research*, *43*(2), 153-193.

DeFond, M. L., & Jiambalvo, J. (1991). Incidence and circumstances of accounting errors. *The Accounting Review, 66*(3), 643-655.

DeFond., M. L., & Jiambalvo, J. (1994). Debt covenant violation and manipulation of accruals. *Journal of Accounting and Economics, 17(1-2)*: 145-176.

Deloitte (2009). *International tax and business guide: Indonesia*. Retrieved January 15, 2011, from http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Intl%20Tax%20and%20Business%20Guides/dtt_tax_guide_indonesia_2009.pdf

Deloitte (2011). *International tax and business guide: BVI highlights*. Retrieved March 28, 2011, from http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Intl%20Tax%20and%20Business%20Guides/2011/dtt_tax_highlight_2011_BVI.pdf.

Demsetz, H., & Lehn, K. (1985). The structure of corporate ownership: Causes and consequences. *Journal of Political Economy*, *93*(6), 1155-1177.

Dercon, B. (2007). Corporate governance after the Asian crisis: Querying the Indonesian environment. *Managerial Law*, *49*(4), 129-140.

Dewi, C., N., & Gudono. (2013). Audit committee effectiveness and fraud occurrence. *The Indonesian Journal of Accounting Research, 16*(1), 18-38.

DeZoort, F. T. (1997). An investigation of audit committees' oversight responsibilities. *Abacus*, *33*(2), 208-227.

DeZoort, F. T., Hermanson, D. R., Archambeault, D. S., & Reed, S. A. (2002). Audit committee effectiveness: A synthesis of the empirical audit committee literature. *Journal of Accounting Literature*, *21*, 38-75.

Dhaliwal, D., Naiker, V., & Navissi, F. (2010). The association between accruals quality and the characteristics of accounting experts and mix of expertise on audit committees. *Contemporary Accounting Research*, *27*(3), 787–827.

Dichev, I., & Skinner, D. (2002). Large-sample evidence on the debt covenant hypothesis. *Journal of Accounting Research, 40*(4), 1091–1123.

Dieleman, M., & Sachs, W. (2006). Oscillating between a relationship-based and a market-based model: The Salim Group. *Asia Pacific Journal of Management*, *23*, 521–536.

DiMaggio, P. J., & Powell, W. W. (1983). The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields. *American Sociological Review, 4*(2), 147–160.

Doh, J. P., & Guay, T. R. (2006). Corporate social responsibility, public policy, and NGO activism in Europe and the United States: An institutional-stakeholder perspective. *Journal of Management Studies*, *43*(1), 47-73.

Donoher, W. J. (2009). Firm founders, boards, and misleading disclosures: An examination of relative power and control. *Journal of Managerial Issues*, *21*(3), 309-306.

Douma, S., George, R., & Kabir, K. (2006). Foreign and domestic ownership, business groups, and firm performance: Evidence from a large emerging market. *Strategic Management Journal*, *27*(7), 637-657.

Drobetz, W., Schillhofer, A., & Zimmermann, H. (2004). Corporate governance and expected stock returns: Evidence from Germany. *European Financial Management*, *10* (2), 267–293.

Drukker, D. M. (2003). Testing for serial correlation in linear panel-data models. *Stata Journal*, 3, 168–177.

Dyer, W. G. (1989). Integrating professional management into a family owned business. *Family Business Review*, *2*(3), 221-235.

Dyer, W. G. (2003). The Family: The missing variable in organizational research. *Entrepreneurship Theory and Practice*, *27*(4), 401–416.

Effendi, M. A. (2005). Peranan komite audit dalam meningkatkan kinerja perusahaan. *Jurnal Akuntansi Pemerintahan*, *1*(1), 51-57.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *The Academy of Management Review, 14*(1), 57-74.

Engel, E., Hayes, R. M., & Wang, X. (2007). The Sarbanes-Oxley Act and firms going-private decisions. *Journal of Accounting and Economics*, *44*(1-2), 116-145.

Engel, E., Hayes, R. M., & Wang, X. (2010). Audit committee compensation and the demand for monitoring of financial reporting process. *Journal of Accounting and Economics*, 49(1-2), 136-154.

Evana, E., Andriyanto, R. W., & Marbun, B. S. (2007). The Influence of financial performance (leverage), foreign ownership and company growth toward quality of corporate governance implementation. *Jurnal Akuntansi & Investasi*, *8*(1), 14-29.

Fama, E., & Jensen, M. (1983). Separation of ownership and control. *Journal of Law & Economics*, *26*(2), 301-25.

Fan, J. P. H., & Wong, T. J. (2002). Corporate ownership structure and the informativeness of accounting earnings in East Asia. *Journal of Accounting and Economics*, *33*, 401–425.

Fan, J. P. H., & Wong, T. J. (2005). Do external auditors perform a corporate governance role in emerging market? Evidence from East Asia. *Journal of Accounting Research*, *43*(1), 35-72.

Fan, J. P. H., Wong, T. J., & Zhang, T. (2007). Politically-connected CEOs, corporate governance and post-IPO performance of China's newly partially privatized firms. *Journal of Financial Economics* 84, 330-357.

Farber, D. B. (2005). Restoring trust after fraud: Does corporate governance matter? *The Accounting Review*, *80*(2), 539-561.

Felo, A. J., Krishnamurthy, S., & Solieeri, S. A. (2003). *Audit committee Characteristics and the perceived quality of financial reporting: An empirical analysis*. Retrieved January 6, 2007, from http://ssrn.com/abstract=401240

Fichtner, J. R. (2010). The recent international growth of mandatory audit committee requirements. *International Journal of Disclosure and Governance*, *7*, 227-243.

Filatotchev, I. (2007). Corporate governance and the firm's dynamics: Contingencies and complementarities. *Journal of Management Studies, 44*, 1041–1056.

Finegold, D., Benson, G. S., & Hecht, D. (2007). Corporate boards and company performance: Review of research in light of recent reforms. *Corporate Governance: An International Review, 15*(5), 865-878.

Fitriasari, D. (2007). *Pengaruh aktivitas dan financial literacy komite audit terhadap jenis manajemen laba.* Paper presented at Simposium Nasional Akuntansi X, Makassar, Indonesia.

Flanagan, D. J., Muse, L. A., & O'Shaughnessy, K. C. (2008). An overview of accounting restatement activity in the United States. *International Journal of Commerce and Management*, *18* (4), 363 – 381.

Florou, A., & Galarniotis, A. (2007). Benchmarking Greek corporate governance against different standards. *Corporate Governance, 15* (5), 979-998.

Flynn, R. (2009). Perceptions of non-profit financial reporting quality: The impact of audit committees' personal ties and audit firm size. *Review of Business Research*, 9(2), 86-94.

Fogarty, J., & Kalbers, L. (1998). Organizational and economic explanations of audit committee oversight. *Journal of Managerial Issues*, *10(2)*, 129-150.

Forum for Corporate Governance Indonesia (2001). *Peranan dewan komisaris dan komite audit dalam pelaksanaan corporate governance.* Retrieved August 10, 2007, from http://www.fcgi.or.id/news/files/FCGI_Booklet_II.pdf

Franses, P. H. (2005). Diagnostics, expectation, and endogeneity. *Journal of Marketing Research*, XLII, 27-29.

Garay, U., & González, M. (2008). Corporate governance and firm value: The case of Venezuela. *Corporate Governance: An International Review*, *16*(3).194-209.

Gendron, Y., Bédard, J., & Gosselin, M. (2004). Getting inside the black box: A field study of practices in "effective" audit committees. *Auditing: A Journal of Practice & Theory*, *23(March)*, 153-171.

Ghozali, I. (2006). *Analisis multivariate lanjutan dengan program SPSS*. Semarang: Badan Penerbit Universitas Diponegoro.

Gillan, S. L. (2006). Recent developments in corporate governance: An overview. *Journal of Corporate Finance*, 12, 381-402.

Globerman, S., Peng, M. K., & Shapiro, D. M. (2011). Corporate governance and Asian companies. *Asia Pacific Journal of Management*, *28*(1), 1-14.

Goddard, A. R., & Masters, C. (2000). Audit committees, Cadbury Code and audit fees: An empirical analysis of UK companies. *Managerial Auditing Journal*, *15*(7), 358-371.

Government Accountability Office (GAO) (2006). *Financial restatements: Update of public company trends, market impacts, and regulatory enforcement activities* (GAO-06-678). Washington, DC: Report to Congressional Committees.

Greco, G. (2011). Determinants of board and audit committee meeting frequency: Evidence from Italian companies. *Managerial Auditing Journal, 26*(3), 208-229.

Greene, W.H. (2002). *Econometric analysis* (5th ed.). New York, US: Prentice Hall.

Gürbüz, A. O., Aybars, A., & Kutlu, O. (2010). Corporate governance and financial performance with a perspective on institutional ownership: Empirical evidence from Turkey. *Journal of Applied Management Accounting Research*, *8*(2), 21-37.

Guriev, S., Lazareva, O., Rachinsky, A., & Tsouhlo, S. (2003). *Concentrated ownership, market for corporate control and corporate governance.* Retrieved May 4, 2012, from: www.nes.ru/~sguriev/CGRussia.pdf

Gujarati, D. N. & Porter, D. C. (2009). *Basic econometrics* (5th ed.). New York, US: McGraw-Hill, Inc.

Gul, F.A. (2006). Auditors' response to political connections and cronyism in Malaysia. *Journal of Accounting Research*, *44(*5), 931–963.

Gul, F. A., Srinidhi, B., & Tsui, J. (2007). *Do female directors enhance corporate board monitoring? Some evidence from earnings quality* (Working paper). Hong Kong: The Hong Kong Polytechnic University.

Gurunlu, M., & Gursoy, G. (2010). The influence of foreign ownership on capital structure of non-financial firms: Evidence from Istanbul Stock Exchange. *The IUP Journal of Corporate Governance*, *9* (4), 21-29.

Hair, J. F., Black, W. C., Babin, R. E., Anderson, R. E., & Tatham, R. L. (2006). *Multivariate data analysis* (6th ed.). New Jersey: Pearson Education, Inc.

Hanani, A. (2005). Indonesian business groups: The crisis in progress. In S-J. Chang (eds.), *Business groups in East Asia: Financial crisis, restructuring, and new growth.* New York: Oxford University Press.

Haron, H., Jantan, M., & Pheng, E. G. (2005). Audit committee compliance with Kuala Lumpur Stock Exchange listing requirements. *International Journal of Auditing*, *9*, 187-200.

Hart, O. (1995). Corporate governance: Some theory and implications. *The Economic Journal*, *15*(430), 678-689.

Hashim, H. A., & Devi, S. S. (2008). Board independence, CEO duality and accrual management: Malaysian evidence. *Asian Journal of Business and Accounting*, *1* (1), 27-46.

HassabElnaby, H. R., Said, A., & Wolfe, G. (2007). Audit committee oversight responsibilities post Sarbanes-Oxley Act. *American Journal of Business*, *22*(2), 19-23.

He, L, Labelle, R., Piot, C., & Thornton, D. B. (2009). Board monitoring, audit committee effectiveness, and financial reporting quality: Review and synthesis of empirical evidence. *Journal of Forensic & Investigative Accounting*, *1*(2), 1-41.

Hennes, K., Leone, A., & Miller, B. (2010). *Accounting restatements and auditor accountability* (Working Paper). Retrieved May 3, 2013, from http://www.kellogg.northwestern.edu/accounting/papers/Leone.pdf

Henry, D. (2010). Agency costs, ownership structure and corporate governance compliance: A private contracting perspective. *Pacific-Basin Finance Journal*, *18*, 24–46.

Hermawan A., A. (2009). *Pengaruh efektifitas dewan komisaris dan komite audit, kepemilikan oleh keluarga, dan peran monitoring bank terhadap kandungan informasi laba.* (Unpublished doctoral's thesis). University of Indonesia, Jakarta, Indonesia

Hermawan, A., A., & Adinda, G., N. (2012). The effect of board characteristics and audit committee existence on earnings quality of Indonesian state-owned enterprises. Retrieved May 3, 2013, from http://ssrn.com/abstract=2135051

Hji Panayi, C., & Avi-Yonah, R. S. (2010). Rethinking treaty-shopping: Lessons for the European Union (Working paper). Retrieved June 15, 2011, from http://ssrn.com/abstract=1531192

Holmstrom, B., & Kaplan, S. (2003). The state of U.S. corporate governance: What's right and what's wrong. *Journal of Applied Corporate Finance*, *15,* 8-20.

Hooper, K. (2006). Positivist, interpretive and case study research. In S. Susela Devi, K. Hooper, & H. Davey (eds.), *Accounting theory & practice: A Malaysian perspective* (pp. 67-85). Kuala Lumpur: Pearson Education.

Hooper, V. J. (2002). *The Washington consensus and emerging economies*. Retrieved January 10, 2011, from http://ssrn.com/abstract=297181

Hoyle, R. H. (1995). *Structural equation modelling: Concepts, issues, and applications*. Thousand Oaks: Sage Publications, Inc.

Hribar, P., & Collins, D. W. (2002). Errors in estimating accruals: Implications for empirical research. *Journal of Accounting Research*, *40*(1), 105-134.

Huafang, X., & Jianguo, Y. (2007). Ownership structure, board composition and corporate voluntary disclosure: Evidence from listed companies in China. *Managerial Auditing Journal*, *22*(6), 604-619.

Husnan, S. (2001). Indonesia, in the Asian Development Bank. (2001). *Corporate governance and finance in East Asia: A study of Indonesia, Republic Korea, Malaysia, Philippines, and Thailand: Volume 2 (Country studies).* Retrieved March 20, 2010, from http://www.adb.org/Documents/Books/Corporate_Governance/Vol2/Preliminaries.pdf.

Ibrahim, D. N., Raman, K. J., & Saidin, S. F. (2009). Audit committee characteristics and quality of unaudited financial accounts. *Singapore Management Review, 3*(2), 19-33.

IDX (2004). *Annual report 2004*. Retrieved January 27, 2011, from http://www.idx.co.id/Portals/0/StaticData/AboutUs/AnnualReport/FileDownload/Annual-Report_2004.pdf

IDX (2010a). *Annual report 2010*. Retrieved September 25, 2011, from http://www.idx.co.id/Portals/0/StaticData/AboutUs/AnnualReport/FileDownload/Annual-Report_2010.pdf

IDX (2010b). *Indonesia capital market structure*. Retrieved January 17, 2011, from http://www.idx.co.id/Home/AboutUs/IndonesiaCapitalMarketStructure/tabid/73/language/en-US/Default.aspx

IMF (2000). *Letter of Intent of the government of Indonesia.* Retrieved January 06, 2009, from http://www.imf.org/external/np/loi/2000/idn/01/

Ika, S.R., & Ghazali, N. A. M. (2012). Audit committee effectiveness and timeliness of reporting: Indonesian evidence. *Managerial Auditing Journal*, *27*(4), 403 – 424.

Iskander, M. R., & Chamlou, N. (1999). *Corporate governance: A framework for implementation: Overview.* Washington: Secretariat of global corporate governance forum.

Ismail, H., Iskandar, T. M., & Rahmat, M. M. (2008). Corporate reporting quality, audit committee and quality of audit. *Malaysian Accounting Review, 7* (1), 21-42.

Iu, J., & Batten, J. (2001). The Implementation of OECD corporate governance principles in post-crisis Asia. *Journal of Corporate Citizenship, 4,* 47-62.

Jaggi, B., & Leung, S. (2007). Impact of family dominance on monitoring of earnings management by audit committees: Evidence from Hong Kong. *Journal of International Accounting, Auditing and Taxation, 16*, 27-50.

Jaggi, B., Leung, S., & Gul, F. (2009). Family control, board independence and earnings management: Evidence based on Hong Kong firms. *Journal of Accounting and Public Policy*, *28*(4), 281-300.

Jakarta Stock Exchange (2000). *Keputusan direktur BEJ No. Kep-315/BEJ/06-2000 tentang komisaris independen, komite audit, dam sekretaris perusahaan*. Jakarta: BEJ.

Jakarta Stock Exchange (2001). *Keputusan direktur BEJ No. No. Kep-339/BEJ/07-2001 tentang komisaris independen, komite audit, dam sekretaris perusahaan.* Jakarta: BEJ.

Jao, R., & Pagalung, G. (2011). Corporate governance, ukuran perusahaan, dan leverage terhadap manajemen laba perusahaan manufaktur Indonesia. *Jurnal Akuntansi & Auditing*, *8*(1), 1-94

Jaswadi, J., Billington, N., & Sofocleous, S. (2012). Corporate governance and accounting irregularities: Evidence from the two-tiered board structure in indonesia. *Asia-Pacific Management and Business Application*, *1*(1), pp-3-25.

Jensen, M. (1993). The modern industrial revolution, exit, and the failure of internal control systems. *Journal of Finance*, *48*(3), 831-80.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behaviour, agency costs and ownership structure. *Journal of Financial Economics, 3,* 305–360.

Jeon, J. Q., Lee, C., & Moffett, C. M. (2010). Effects of foreign ownership on pay out policy: Evidence from the Korean market. *Journal of Financial Markets*, *14*(2), 344-375.

Jiraporn, P., & Dadalt, P. J. (2009). Does founding family control affect earnings management? *Applied Economics Letters*, *16,* 113-119.

Johnson, J. L., Daily, C. M., & Ellstrand, A. E. (1996). Boards of directors: A review and research agenda. *Journal of Management*, *22*(3), 409-438.

Johnson, V.N., Khurana, I. K., & Reynolds, J. K. (2002). Audit-firm tenure and the quality of financial reports. *Contemporary Accounting Research*, *19*(4), 637-660.

Joshi, P. L, & Wakil, A. (2004). A study of the audit committees' functioning in Bahrain: Empirical findings. *Managerial Auditing Journal*, *19*(7), 832-858.

Kabbach De Castro, L. R., & Crespi Cladera, R. (2011). *Understanding non-compliance with corporate governance codes.* Paper presented at Academy Management Annual Meeting, Texas, US.

Kalbers, L. P., & Fogarty, T. J. (1998). Organizational and economic explanations of audit committee oversight. *Journal of Managerial Issue*, *10*(2), 129-150.

Kale, J. R., Ciceksever, B., & Ryan, H. E. (2006). *Corporate governance, debt, and activist institutions*. Retrieved May 2, 2012, from: http://ssrn.com/abstract=891410 or http://dx.doi.org/10.2139/ssrn.891410

Kang, W. S., Kilgore, A., & Wright, S. (2011). The effectiveness of audit committee for low- and mid-cap firms. *Managerial Auditing Journal*, *26*(7), 623-650.

Karim, I. A., & Rakhmat, I. F. (2005). *Disposal of assets: The aftermath of the economic crisis in Indonesia*. Retrieved January 20, 2011, from www.karimsyah.com/imagescontent/article/20050923100946.pdf

Karra, N., Tracey, P., & Phillips, N. (2006). Altruism and agency in the family firm: Exploring the role of family, kinship, and ethnicity. *Entrepreneurship Theory and Practice*, *30*(1), 861-877.

Kawai, M. (2000). The Resolution of the East Asian crisis: Financial and corporate sector restructuring. *Journal of Asian Economics*, *11*, 133–168.

Keinath, A. K., & Walo, J. C. (2004). Audit committee responsibilities: Focusing on oversight, open communications, and best practices. *The CPA Journal*, *74*(11), 22-28.

Khan, H. (1999). *Corporate governance of family-based businesses in Asia: Which road to take?* (Unpublished manuscript). Colorado, US: University of Denver. Retrieved August 10, 2010, from http://www.du.edu/korbel/hkhan/pdf_files/2002julyFamily.pdf

Khanchel, I. (2007). Corporate governance: measurement and determinant analysis. *Managerial Auditing Journal*, *22* (8), 740 – 760.

Khanna, T., & Palepu, K. (1999). *Emerging market business groups, foreign investors, and corporate governance* (Working paper No. W6955). Massachusetts: National Bureau of Economic Research (NBER). Retrieved March 20, 2008, from http://www.nber.org/papers/w6955

Kim, I. J., Eppler-Kim, J., Kim, W. S., & Byun, S. J. (2010). Foreign investors and corporate governance in Korea. *Pacific-Basin Finance Journal, 18,* 390-402.

Kim, S., Sul, W., & Kang, S. A. (2010). Impact of foreign institutional investors on dividend policy in Korea: A stock market perspective. *Journal of Financial Management and Analysis*, *23*(1), 10-26.

Kinney Jr, W. R., & McDaniel, L. S. (1989). Characteristics of firms correcting previously reported quarterly earnings. *Journal of Accounting and Economics, 11*(1), 71-93.

Kinney, W. R., Palmrose, Z. V., & Scholz, S. (2004). Auditor independence, non-audit services, and restatements: was the US Government right? *Journal of Accounting Research*, *42*(3), 561-588.

Klein, A. (2002a). Audit committee, board of director characteristics, and earnings management. *Journal of Accounting and Economics, 33*(3), 375-400.

Klein, A. (2002b). Economic determinants of audit committee independence. *The Accounting Review*, *77*(2), 435-452.

Klein, S. B., & Bell, F.A. (2007). Non-family executives in family business: A literature review. *Electronic Journal of Family Business, 1*(1): 19-37.

Kleinbaum, D. G. (1994). *Logistic regression: self-learning text*. New York: Springer-Verlag.

Kline, R. B. (1998). *Principles and practice of structural equation modelling*. New York: Guilford Press.

Koslowski, P. (2009). The ethics of corporate governance: A continental European perspective. *International Journal of Law and Management*, 51(1), 27 – 34.

Koh, P-S., Laplante, S. K., & Tong, Y. H. (2007). Accountability and value enhancement roles of corporate governance. *Accounting and Finance, 47,* 305-333.

Kouwenberg, R. (2006). Does voluntary corporate governance code adoption increase firm value in emerging markets? Evidence from Thailand. Retrieved August 20, 2011, from www.set.or.th/en/regulations/cg/files/CG_Research_Paper_DrRoy.pdf

KPMG (2009). *The impact of tax treaty trends in the Asia-Pacific funds sector*. Retrieved January 21, 2011, from http://www.kpmg.com/SG/en/IssuesAndInsights/ArticlesPublications/Documents/Tax_ImpactOfTaxTreatyTrends.pdf

KPPMASATU (2010). *Cara benar untuk dapatkan fasilitas tax treaty*. Retrieved February 1, 2011, from http://www.kpppmasatu.go.id/index.php?option=com_content&task=view&id=88&Itemid=161

Krambia-Kapardis, M., & Psaros, J. (2006). The implementation of corporate governance principles in an emerging economy: A critique of the situation in Cyprus. *Corporate Governance: An International Review*, *14*(2), 126–39.

Krishnan, G., & Visvanathan, G. (2008). Does the SOX definition of an accounting expert matter? The association between audit committee directors' accounting expertise and accounting conservatism. *Contemporary Accounting Research, 25*(3), 827-857.

Krishnan, G., & Visvanathan, G. (2009). Do Auditors price audit committee’s expertise? The case of accounting versus non accounting financial experts. *Journal of Accounting, Auditing, and Finance*. *24*(1), 115-144.

Krishnan, J. (2005). Audit committee quality and internal control: An empirical analysis. *The Accounting Review*, *80*(2), 649-675.

Kuala Lumpur Stock Exchange (2001). *Listing requirements of Kuala Lumpur Stock Exchange*. Retrieved August 15, 2010, from http://www.klse.com.my/website/bm/regulation/rules/listing_requirements/downloads/LR_MBSB.pdf

Kuppusamy, K., Nazim, M., & Shanmugam, B. (2003). Audit committees in Malaysia and the Blue Ribbon Committee Report: A comparative study. *International Journal of Management, 20*(4), 509-514.

Kurniawan, D. M., & Indriantoro, N. (2000). *Corporate Governance in Indonesia.* Paper presented at The Second Asian Roundtable on Corporate Governance, Hong Kong. Retrieved August 15, 2008, from http://www.oecd.org/dataoecd/6/62/1931154.pdf

Lam, K. C., Sami, H., & Zhou, H. (2012). The role of cross-listing, foreign ownership and state ownership in dividend policy in an emerging market. *China Journal of Accounting Research*, *5*, 199-216.

Larcker, D. F., & Rusticus, T. O. (2007). Endogeneity and empirical accounting research. *European Accounting Review*, 16(1), 207-215.

Le Breton-Miller, I., Miller, D., & Steier, L. P. (2004). Toward an integrative model of effective FOB succession. *Entrepreneurship: Theory & Practice*, *28*(4), 305-328.

Leech, N. L., Barret, K. C., & Morgan, G. A. (2008). *SPSS for Intermediate Statistics: Use and Interpretation*. (3rd ed.). New York: Lawrence Erlbaum Associates Taylor and Francis Group.

Leone, A. J., & Liu, M. (2010). Accounting irregularities and executive turnover in founder‐managed firms. *The Accounting Review*, *85*(1), 287-314.

Leuz, C., Lins, K. V., & Warnock, F. E. (2010). Do foreigners invest less in poorly governed firms? *The Review of Financial Studies, 23*(3), 3245-3285.

Li, K., & Broshko, E. B. (2006), *Corporate governance requirements in Canada and the United States: A legal and empirical comparison of the principles-based and rules-based approaches* (Working paper). British Columbia: Sauder School of Business. Retrieved February 19, 2011, from http://ssrn.com/abstract=892708

Li, Y., Kao, J. L., & Bandyopadhyay, S. P. (2010). Effects of regulation and internal monitoring on earnings quality: Evidence from the 2002 Sarbanes-Oxley Act. *Journal of Academy of Business and Economics, 10*(5), 97-110.

Lin, J. W., Li, J. F., & Yang, J. S., (2006). The effect of audit committee performance on earnings quality. *Managerial Auditing Journal*, *21*(9), 921-933.

Lin, J. W., Kang, G., & Roline, A. (2009). The effects of the Blue Ribbon Committee and the Sarbanes Oxley Act of 2002 on the characteristics of the audit committees and the board of directors. *Advances in Accounting, Finance and Economics, 2*(1), 1-11.

Lin, P. T., Hutchinson, M. R., & Percy, M. (2009). *The role of the audit committee and institutional investors in constraining earnings management: Evidence from Chinese firms listed in Hong Kong.* Paper presented at Accounting & Finance Association of Australia and New Zealand Annual Conference, Adelaide, Australia. Retrieved July 20, 2011, from http://eprints.qut.edu.au/37996/

Lin, S-H., & Hu, S-Y. (2007), A family member or professional management? The choice of a CEO and its impact on performance. *Corporate Governance: An International Review*, *15*(6), 1348–1362.

Lindsey, T. (2004). Legal infrastructure and governance reform in post-crisis Asia: The case of Indonesia. *Asian-Pacific Economic Literature*, 18(1), 12-40.

Lipton, L., & Lorsch, J. (1992). A modest proposal for improved corporate governance. *The Business Lawyer*, *48*, 59–77.

Lisic, L. L., Neal, T., & Zhang, Y. (2011). *Audit committee expertise and restatements: The moderating effect of CEO power.* Retrieved January 06, 2011, from http://www.isarhq.org/papers/PS-08_Lisic_Neal_Zhang_ISAR_2011.pdf

Liu, M. H. C., & Zhuang, Z. (2011). Management earnings forecast and the quality of analysts' forecasts: The moderating effect of audit committees. *Journal of Contemporary Accounting & Economics*, *7*(1), 31-45.

Lo, A. W. Y., Wong, R. M. K., & Firth, M. (2010). Can corporate governance deter management from manipulating earnings? Evidence from related-party sales transactions in China. *Journal of Corporate Finance*, *16*(2), 225-253.

Loftus, J. A., & Purcell, J. A. (2008). Post-Asian financial crisis reforms: An emerging new embedded-relational governance model. *Accounting, Business & Financial History, 18*(3), 335-355.

Lubatkin, M. H., Ling, Y., & Schulze, W. S. (2007), An organizational justice-based view of self-control and agency costs in family firms. *Journal of Management Studies*, *44*(6), 955–971.

MacNeil, I., & Li, X. (2006), "Comply or explain": Market discipline and non-compliance with the Combined Code. *Corporate Governance: An International Review, 14,* 486–496.

Mangena, M., & Pike, R., (2005). The effect of audit committee shareholding, financial expertise and size on interim financial disclosure. *Accounting and Business Research*, *35*(4), 327-345.

Mangena, M., & Tauringana, V. (2007), Disclosure, corporate governance and foreign share ownership on the Zimbabwe Stock Exchange. *Journal of International Financial Management & Accounting*, *18*, 53–85.

Marciukaityte, D., Szewczyk, S. H., & Varma, R. (2009). Voluntary vs. forced financial restatements: The role of board independence. *Financial Analysts Journal*, *65*(5), 1-5.

Marra, A., Mazzola, P., & Prenape, A. (2011). Board monitoring and earnings management pre- and post-IFRS. *The International Journal of Accounting*, 46(2), 205-230.

Maug, E. (1996). Corporate control and the market for managerial labour: On the decision to go public. *European Economic Review*, *40*(3), 1049-1057.

McCarthy, D., & Puffer, S. (2008). Interpreting the ethicality of corporate governance decisions in Russia: Utilizing integrative social contracts theory to evaluate the relevance of agency theory norms. *Academy of Management Review*, *33*(1), 11-31.

Menon, K., & Williams, J. D. (1994). The use of audit committees for monitoring. *Journal of Accounting and Public Policy, 13*, 121–139.

Meyer, J., & Rowan, B. (1977). Institutional organizations: Formal structures as myths and ceremonies. *American Journal of Sociological, 83*(2), 840–863.

Mileva, E. (2007). *Using Arellano–Bond dynamic panel GMM estimators in stata*. Retrieved May 20, 2011, from http://www.fordham.edu/economics/mcleod/Elitz-Using Arellano%E2%80%93BondGMMEstimators.pdf

Minister of State Owned Enterprises. (2002). *Keputusan Mentri Badan Usaha Milik Negara No. 103/MBU/2002 tentang pembentukan komite audit bagi badan usaha milik negara.* Retrieved January 7, 2007, from http://www.bumn.go.id/wp-content/fbumn/1190264142.pdf

Mohd-Saleh, N., Mohd-Iskandar, T., & Rahmat, M.M. (2005). Earnings management and board characteristics: Evidence from Malaysia. Jurnal Pengurusan, *24,* 77-103.

Munir, S., & Gul, R. J. (2011). *Related party transactions, family firms and firm performance: Some Malaysian evidence*. Retrieved June 7, 2013, from http://ssrn.com/abstract=1705846 or http://dx.doi.org/10.2139/ssrn.1705846

Murhadi, W. R. (2009). Studi pengaruh good corporate governance terhadap praktik earnings management pada perusahaan terdaftar di PT Bursa Efek Indonesia. *Jurnal Manajemen dan Kewirausahaan*, *11*(1), 1-10.

Murhadi, W. R. (2010). *Good corporate governance and earnings management practices: An Indonesian cases*. Retrieved September 24, 2011, from http://ssrn.com/abstract=1680186

Mustapha, M., & Ahmad, A. C. (2011). Agency costs of debt and monitoring. *International Review of Business Research Papers, 7*(4), 118-129.

Mustafa, S. T., & Youssef, N. B., (2010). Audit committee financial expertise and misappropriation of assets. *Managerial Auditing Journal, 25*(3), 208-225.

Myers, J. N., Myers, L. A., Palmrose, Z. V., & Scholz, S. (2005). The length of auditor-client relationships and financial statement restatements. Retrieved August 25, 2013, from: http://www.acctwkshop.cox.smu.edu/acctwkshop/W20052006/mmps.pdf

Myers, P. M., & Ziegenfuss, D. E. (2006). Audit committee pre-Enron efforts to increase the effectiveness of corporate governance. *Corporate Governance*, *6*(1), 49 – 63.

Nasution, M. & Setiawan, D. (2007). *Pengaruh corporate governance terhadap manajemen laba di industri perbankan Indonesia.* Paper presented at Simposium Nasional Akuntansi X, Makassar, Indonesia.

National Committee on Corporate Governance (2001). *Indonesia's code corporate governance*. Retrieved March 19, 2007, from http://www.governance-indonesia.com/content/view/87/49/lang,en/.

National Committee on Corporate Governance (2002). *Guideline for audit committee.* Retrieved February 19, 2008, from http://www.governance-indonesia.com/content/view/87/49/lang,en/

National Committee on Corporate Governance (2004). *Corporate governance guideline for Indonesian banking*. Retrieved February 19, 2010, from http://www.governance-indonesia.com/content/view/87/49/lang,en/

National Committee on Governance (2004). *Corporate governance guideline for insurance.* Retrieved February 19, 2008, from http://www.governance-indonesia.com/content/view/87/49/lang,en/

National Committee on Governance (2004). *Guideline for independent commissioner*. Retrieved February 19, 2008, from http://www.governance-indonesia.com/content/view/87/49/lang,en/

National Committee on Governance (2006). *Indonesian code corporate governance*. Retrieved January 19, 2010 from http://www.fcgi.or.id/news/files/Indonesia_Code_of_GCG_2006.pdf

Niemi, L. (2005). Audit effort and fees under concentrated client ownership: Evidence from four international audit firms. *The International Journal of Accounting, 40*(4), 303-323.

Nikolaev, V. V. (2010), Debt covenants and accounting conservatism. *Journal of Accounting Research, 48*(1), 51–89.

Ning, Y., Davidson III, W. N., & Wang, J. (2010). Does optimal corporate board size exist? An empirical analysis. *Journal of Applied Finance*, 20, 57-69.

Norman, C., Rose, J. M., & Suh, I. (2011). The effects of disclosure type and audit committee expertise on Chief Audit Executives' tolerance for financial misstatements. *Accounting, Organizations & Society*, 36(2), 102-108.

North, D. (1991). Institutions. *Journal of Economic Perspectives,* 5(1), 97-112.

Nuryanah, S. (2004). *Analisis hubungan board governance dengan penciptaan nilai perusahaan: Studi kasus perusahaan-perusahaan tercatat di BEJ.* (Unpublished master's thesis). University of Indonesia, Jakarta, Indonesia.

OECD (1999). *Harmful tax competition: An emerging global issue*. Retrieved January 3, 2011, from www.oecd.org/dataoecd/33/0/1904176.pdf

OECD (2002). *Foreign direct investment for development: Maximising benefits. minimising costs.* Retrieved July 10, 2009, from http://www.oecd.org/dataoecd/47/51/1959815.pdf

OECD (2004). OECD principles of corporate governance. Retrieved October 10, 2009, from http://www.oecd.org/dataoecd/32/18/31557724.pdf

OECD (2007). *Asia: Overview of corporate governance framework in 2007*. Retrieved October 12, 2010, from www.oecd.org/dataoecd/21/4/40162910.pdf.

Oler, D. K., Oler, M. J., & Skousen, C. J. (2010). Characterizing accounting research. *Accounting Horizons*, *24*(4), 635-670.

Omran, M. (2009). Post-privatization corporate governance and firm performance: The role of private ownership concentration, identity and board composition. *Journal of Comparative Economics*, *37,* 658-673.

Osma, B. G., & Noguer, B. G. -d. -A. (2007). The Effect of the board composition and its monitoring committees on earnings management: Evidence from Spain. *Corporate Governance: An International Review*, *15*(6), 1413–1428.

Owens-Jackson, L., Robinson, D., & Shelton, S. W. (2009). The association between audit committee characteristics, the contracting process and fraudulent financial reporting. *American Journal of Business*, *24*(1), 57-65.

Pallant, J. (2001). *SPSS: Survival manual*. Buckingham: Open University Press

Palmrose, Z., & Scholz, S., (2004). The circumstances and legal consequences of non-GAAP reporting: Evidence from restatements. *Contemporary Accounting Research*, 21, 139–180.

Palmrose, Z. V., Richardson, V. J., &. Scholz, S. (2004). Determinants of market reactions to restatement announcements. *Journal of Accounting and Economics*, *37*(1), 59–89.

Pamudji, S., & Trihartati, A. (2009). Pengaruh independensi dan efektivitas komite audit terhadap manajemen laba: Studi empiris pada perusahaan manufaktur yang terdaftar di BEI. *Jurnal Akuntansi dan Auditing*, *6*(1), 38-54.

Pandit, G. M., Subrahmanyam, V., & Conway, G. M. (2005). Audit committee reports before and after the Sarbanes-Oxley Act: A study of companies listed on the NYSE. *The CPA Journal*, 42-44.

Pandit, G. M, Subrahmanyam, V., & Conway, G. M. (2006). Are the audit committee reports disclosing enough after the Sarbanes-Oxley Act? *Managerial Auditing Journal*, *21*(1), 34-45.

Park, H. M. (2009). *Linear regression models for panel data using SAS, Stata, LIMDEP, and SPSS* (Working paper). Bloomington: The University Information Technology Services (UITS) Center for Statistical and Mathematical Computing, Indiana University. Retrieved June 10, 2011, from http://www.indiana.edu/~statmath/stat/all/panel/panel.pdf

Parulian, S.R. (2004). *Analisis hubungan antara komite audit dan komisaris independen dengan praktek manajemen laba: Studi empiris perusahaan di BEJ*. (Unpublished master's thesis). University of Indonesia, Jakarta, Indonesia.

Pass, C. (2006). The revised combined code and corporate governance: An empirical survey of 50 large UK companies. *Managerial Law*, *48*(5), 467-478.

Patrick, H. (2001). *Corporate governance and the Indonesian financial system: a Comparative perspective* (Discussion paper). New York: APEC Study Centre Columbia Business School. Retrieved January 10, 2007, from www.columbia.edu/cu/business/apec/publications/h.patrick3.PDF

Peasnell, K. V., Pope, P. F., & Young, S. (2000). Accrual management to meet earnings targets: UK evidence pre- and post-Cadbury. *British Accounting Review, 32*(4), 415-445.

Peasnell, K. V., Pope, P. F., & Young, S. (2005). Board monitoring and earnings management: Do outside directors' influence abnormal accruals? *Journal of Business Finance and Accounting*, *32*(7) & (8), 1311-1346.

Peng, C-Y. J., Lee, K. L., & Ingersoll, G. M., (2002). An Introduction to logistic regression analysis and reporting. *The Journal of Education Research*, *96*(1), 3-14.

Peng, M. W. (2003). Institutional transitions and strategic choices. *Academy of Management Review*, 28(2), 275-296.

Peng, M. W. (2004). Outside directors and firm performance during institutional transitions. *Strategic Management Journal*, *25*, 453–71.

Petra, S. T. (2007). The effects of corporate governance on the in formativeness of earnings. *Economics of Governance*, *8*(2), 129 – 152.

Pfeffer, J. (1973). Size, composition, and function of hospital boards of directors: A study of organization-environment linkage. *Administrative Science Quarterly, 18*(3), 349-364.

Pfeffer, J., & Salancik, G. (1978). *The external control of organizations*. New York: Harper.

Pincus, K., Rusbarsky, M., & Wong, J. (1989). Voluntary formation of corporate audit committees among NASDAQ firms. *Journal of Accounting and Public Policy, 8*, 239–265.

Piot, C. (2004). The Existence and Independence of audit committees in France. *Accounting & Business Research*, *34*(3), 223-246.

Piot, C., & Janin, R. (2007). External auditors, audit committees and earnings management in France. *European Accounting Review*, *16*(2), 429–454.

Pittman, R. (1977). Market structure and campaign contributions. *Public Choice*, *31*(1), 37-58.

Pomeroy, B., and Thornton, D. (2008). Meta-analysis and the accounting literature: The case of audit committee independence and financial reporting quality. *European Accounting Review*, *17*(2), 305-330.

Poza, E. J., Alfred, T., & Maheshwari, A. (1997). Stakeholder perceptions of culture and management practices in family and family firms - A preliminary report. *Family Business Review*, *10*(2), 135–155.

Prabowo, T. (2000). Dissemination of information di Pasar Modal. *Media Akuntansi*, *10* (VII),

Price, R., Roman, F. J., & Rountree, B. (2011). The impact of governance reform on performance and transparency. *Journal of Financial Economics*, *99*(1), 76-121.

Pucheta-Martinez, M., & Fuentes, C. (2007). The impact of audit committee characteristics on the enhancement of the quality of financial reporting: An empirical study in the Spanish context. *Corporate Governance*, *15*(6), 1394-1412.

Puri, R., Trehan, R., & Kakkar, H. (2010). Corporate governance through audit committee: A study of the Indian corporate sector. *The IUP Journal of Corporate Governance*, IX(1&2), 47-56.

Qin, B. (2007). The influence of audit committee financial expertise on earnings quality: US Evidence. *The Icfai Journal of Audit Practice, 4*(3), 8-28.

Rachmawati, A., & Triamotko, H. (2007). *Analisis faktor-faktor yang mempengaruhi kualitas laba dan nilai perusahaan.* Paper presented at Simposiun Nasional Akuntansi X, Makassar, Indonesia.

Raghunandan, K., & Rama, D. V. (2007). Determinants of audit committee diligence. *Accounting horizons*, *21*(3), 265-279.

Rahman, R. A., & Ali, F. H. (2006). Board, audit committee, culture and earnings management: Malaysian evidence. *Managerial Auditing Journal*, *21*(7), 783-804.

Rahmat, M. M., Iskandar, T. M., & Saleh, N. M. (2009). Audit committee characteristics in financially distressed and non-distressed companies. *Managerial Auditing Journal*, *24*(7), 624 – 638.

Rainsbury, E. A., Bradbury, M. E., & Cahan, S. F. (2008). Firm characteristic and audit committees complying with “best practice’ membership guidelines. *Accounting and Business Research*, *38*(5), 393-408.

Rainsbury, E. A., Bradbury, M. E., & Cahan, S. F. (2009). The impact of audit committee quality on financial reporting quality and audit fees. *Journal of Contemporary Accounting & Economics*, *5*, 20–33.

Rajan, R., & Zingales, L. (1998) Which capitalism? Lessons from the East Asian crisis. *Journal of Applied Corporate Finance*, *11*, 40–48.

Rama, M. (2007). *The impact of corporate governance reforms on two Asia-Pacific Stock Exchanges* (Working paper). Sydney: University of Technology. Retrieved August 20, 2010, from: www. *ehsanz.econ.usyd.edu.au/papers/DelaRama.pdf*

Rasyid, A. (2012). *Corporate governance, audit firm size and restated financial statement in Indonesia Stock Exchange*. Retrieved August 20, 2013, from: http://ssrn.com/abstract=2182253

Rediker, K. J., & Seth, A. (1995). Boards of directors and substitution effects of alternative governance mechanisms. *Strategic Management Journal*, 16, 85‑99.

Rezaee, Z., Olibe, K. O., & Minmier, G. (2003). Improving corporate governance: The role of audit committee disclosure. *Managerial Auditing Journal*, *18*(6/7), 530-537.

Richardson, S. A., Tuna, A. I., & Wu, M. (2002). *Predicting earnings management: The case of earnings restatements.* Retrieved December 12, 2011, from http://ssrn.com/abstract=338681 or doi:10.2139/ssrn.338681

Roberts, G. H. (2004) Convergent capitalisms? The internationalisation of financial markets and the 2002 Russian corporate governance code. *Europe-Asia Studies*, *56*, 1235–1248.

Robinson, R., & Hadiz, V. R. (2004). *Reorganizing power in Indonesia: The politics of oligarchy in the age of markets*. London: Routledge.

Rodrik, D. (2001). The global governance of trade as if development really mattered. Retrieved December 15, 2010, from http://gopher.mtholyoke.edu/courses/epaus/econ213/rodrikgovernance.PDF

Romanus, R. N., Maher, J. J., & Fleming, D. M. (2008). Auditor industry specialization, auditor changes, and accounting restatements. *Accounting Horizons*, *22*(4), 389-413.

Rosser, A. (2003). Coalitions, convergence, and corporate governance reform in Indonesia. *Third World Quarterly*, *24*(2), 319-337.

Rosser, A. (2005). The political economy of corporate governance in Indonesia. In H.K. Leong. (eds.), *Reforming corporate governance in Southeast Asia: Economics, politics, and regulations* (pp. 180-199). Singapore: Institute of South East Asian Studies.

Rowland, G. (2002). Earnings management, the SEC, and corporate governance: Director liability arising from the audit committee report. *Columbia Law Review*, *102*, 168 – 207.

Roybark, H. M., (2010). *Financial restatements: An analysis pre-and post-Sarbanes-Oxley (2000-2009).* Retrieved June 10, 2011, from http://ssrn.com/abstract=1863284

Rusmin, R., Tower, G., Achmad, T., & Neilson, J. (2011). Concentrated family ownership structures weakening corporate governance: A developing country story. *Corporate Ownership & Control*, *8*(2), 94-105.

Sahlan, L. A. (2011). The Malaysian listing requirement reforms and earnings management practices of public listed firms. *The IUP Journal of Corporate Governance*, X(2), 7-36.

Saleh, N. M., Iskandar, T. M., & Rahmat, M. M. (2007). Audit committee characteristics and earnings management: Evidence from Malaysia. *Asian Review of Accounting*, *15*(2), 147-163.

Saliva, C. (2003). Foreign listings, corporate governance, and equity valuations. *Journal of Economics and Business*, *55*, 463-485.

Salvato, C. (1999). *Boards of directors in family firms: Mimicry or resource dependence reduction?* (Working paper). Arkansas: Small Business Advancement National Center, University of Central Arkansas. Retrieved May 01, 2012, from http://www.sbaer.uca.edu/research/icsb/1999/67.pdf

Sam, C. Y. (2007). Corporate governance reforms in the post-1997 Asian Crisis: Is there really a convergence to the Anglo-American model? *Global Economic Revi*ew, *36*(3), 267-285.

Sarbanes-Oxley Act. (2002). Retrieved February 10, 2008 from http://news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf

Sarkar, J., & Sarkar, S. (2000). Large shareholders activism in corporate governance in developing countries. *International Review of Finance*, *1*(3), 161-194.

Sarumaha, S., & Hermawan, A. A. (2013). *The Influence of Board and Audit Committee Effectiveness and Bank Monitoring on Financial Distress.* Paper presented at American Accounting Association Annual Meeting and Conference on Teaching and Learning in Accounting, California. Retrieved August 01, 2013, from http://aaahq.org/AM2013/abstract.cfm?submissionID=1727

Sato, Y. (2004). Corporate ownership and management in Indonesia: Does it change? In C. Basri & Pierre van der Eng (eds.), *Business in Indonesia: New challenges, old problems* (pp.158-177). Singapore: Institute of Southeast Asian Studies.

Schmidt, J., & Wilkins, M. S. (2012). Bringing darkness to light: The influence of auditor quality and audit committee expertise on the timeliness of financial statement restatement disclosures. *Auditing: A Journal of Practice & Theory*, *32*(1), 221-244.

Schultz, E. L., Tan, D. T., & Walsh, K. D. (2010). Endogeneity and the corporate governance-performance relation. *Australian journal of Management*, *35*(2), 145-163.

Schulze, W. S., Lubatkin, M. H., Dino, R. N., & Buchholtz, A. K. (2001). Agency relationships in family firms: Theory and evidence. *Organization Science*, 12(2), 99–116.

Sharma, V., Naiker, V., & Lee, B. (2009). Determinants of audit committee meeting frequency: Evidence from a voluntary governance system. *Accounting Horizons*, *23*(3), 245-263.

Sharma, V. D., Sharma, S. D., & Ananthanarayanan, U. (2011). Client importance and earnings management: The moderating role of audit committees. *Auditing: A Journal of Practice & Theory*, *30*(3), 125-156.

Shaukat, A. (2008). *To comply or not to comply: Evidence on changes and factors associated with the changes in compliance with the UK Code of Corporate Governance*. Retrieved August 10, 2010, from http://ssrn.com/abstract=1101412

Shleifer, A., & Vishny, R. W. (1997). A survey of corporate governance. *Journal of Finance*, *52*, 737–782.

Siahaan, F., O. (2013). The effect of investment opportunity set, the presence of audit committee, the composition of independent commissioner, and managerial ownership on profit quality. *International Journal of Business and Social Science*, *4*(9), 210-216

Siagian, F. T., & Tresnaningsih, E. (2011). The impact of independent directors and independent audit committees on earnings quality reported by Indonesian firms. *Asian Review Accounting*, 19(3), 192-207.

Siallagan, H., & Machfoedz, M. (2006). *Mekanisme corporate governance, kualitas laba dan nilai perusahaan.* Paper presented at Simposium Nasional Akuntansi 9, Padang, Indonesia.

Singh, A., & Zammit, A. (2006). Corporate governance, crony capitalism and economic crises: Should the US business model replace the Asian way of "doing business"? *Corporate Governance: An International Review*, *14*(14), 220–233.

Siregar, S. V, & Bachtiar, Y., S. (2005). The role of corporate governance in preventing misstated financial statement. *Jurnal Akuntansi dan Keuangan Indonesia*, *2*(1), 159-173.

Siregar, S. V., & Utama, S. (2008). Type of earnings management and the effect of ownership structure, firm size, and corporate-governance practices: Evidence from Indonesia. *The International Journal of Accounting*, *43*, 1-27.

Smaili, N., & Labelle, R. (2009). *Preventing and detecting accounting irregularities: The role of corporate governance*. Retrieved February 25, 2009, from http://ssrn.com/abstract=1324143

Smith, J. K. (2007). Evaluating the boundaries of SEC regulation. *Journal of Corporate Finance*, *13*, 189-194.

Smith, L. M. (2006). Audit committee effectiveness: Did the Blue Ribbon Committee recommendations make a difference? *International Journal Accounting, Auditing and Performance Evaluation*, *3*(2), 240–251.

Soederberg, S. (2003). The promotion of 'Anglo-American' corporate governance in the South: who benefits from the new international standard? *Third World Quarterly*, 24(1), 7-27.

Song, J., & Windram, B. (2004). Benchmarking audit committee effectiveness in financial reporting. *International Journal of Auditing*, *8*(3), 195-205.

Sori, Z. M., Deris, M. R., & Saad, S. S. M. (2005). *Compliance of audit committee requirements: A review of the practices of companies listed on the KLSE*. Retrieved March 10, 2008, from http://ssrn.com/abstract=855804

Sori, Z. M., Mohamad, S., & Hamid, M. A. A. (2001). Compliance of audit committee requirements: A brief review of the practice. *Journal of Malaysian Institute of Accountants*, *14*(5), 4-7.

Sori, Z. M., Mohamad, S., & Saad, S. S. M. (2007). *Audit committee practices in Malaysian large firms*. Retrieved March 1, 2008, from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1031076

Spira, L. (1998). An evolutionary perspective on audit committee effectiveness. *Corporate Governance: An International Review*, *6*(1), 29–38.

Srinivasan, S. (2005). Consequences of financial reporting failure for outside directors: Evidence from accounting restatements and audit committee members. *Journal of Accounting Research, 43*(2), 291–334.

Stata Press. (2009). *Stata longitudinal-data/panel-data reference manual: Release 11*: Stata Press.

Storey, D. J. (1994). New firm growth and bank financing. *Small Business Economics, 6*(2), 139-150.

Sun, J., Liu, G., & Lan, G. (2011). Does female directorship on independent audit committees constrain earnings management? *Journal of Business Ethics*, *99*(3), 369-382.

Susiana & Herawaty. (2007). *Analisis pengaruh independensi, mekanisme corporate governance, dan kualitas audit terhadap integritas laporan keuangan.* Paper presented at Simposium Nasional Akuntansi X, Makassar, Indonesia.

Sweeney, A. (1994). Debt-covenant violations and managers' accounting responses. *Journal of Accounting and Economics, 17,* 281–308.

Tabachnick, B. G., & Fidell, L. S. (2007). *Using multivariate statistics* (5th Ed.). Boston: Allyn and Bacon.

Tabalujan, B. S. (2002). Family capitalism and corporate governance of family controlled listed companies in Indonesia. *UNSW Law of Journal, 25*(2), 486-514.

Teen, M. Y. (2007). *Improving the implementation of corporate governance practices in Singapore.* Retrieved January 28, 2007, from www.mas.gov.sg/resource/news_room/press_releases/2007/CG_Study%20_Executive_Summary_260607.pdf

Thiruvadi, S., & Huang, H-W. (2011). Audit committee gender differences and earnings management. *Gender in Management: An International Journal, 26*(7), 483-498.

Thoopsamut, W., & Jaikengkit, A. (2009). Audit committee characteristics, audit firm size and quarterly earnings management in Thailand. *Oxford Journal*, *8*(1), 3-12.

Ting, W., Yen, S. H., & Chiu, C. L. (2008). The Influence of qualified foreign institutional investors on the association between default risk and audit opinions: Evidence from the Chinese Stock Market. *Corporate Governance: An International Review, 16*(5), 400-415.

Tribo, J. A., Berrone, P., & Surroca, J. (2007). Do the type and number of block holders influence R&D investments? New Evidence from Spain. *Corporate Governance: An International Review, 15*(5), 828-842.

Tsamenyi, M., Enninful-Adu, E., & Onumah, J. (2007). Disclosure and corporate governance in developing countries: Evidence from Ghana. *Managerial Auditing Journal, 22*(3), 319-334.

Turley, S., & Zaman, M. (2004). The corporate governance effect of audit committees. *Journal of Management and Governance*, *8*, 305-332.

Turley, S., & Zaman, M. (2007). Audit committee effectiveness: informal processes and behavioural effects. *Accounting, Auditing, & Accountability Journal*, *20*(5), 765-788.

Turpin, R. A., & DeZoort, F. T. (1998). The characteristics of firms that voluntary include an audit committee report in their annual report. *International Journal of Auditing, 2*(1), 35-48.

Udayasankar K. (2008). The foundations of governance theory: A case for the resource-dependence perspective. *Corporate Ownership & Control*, *5*(4), 164-172.

Undang-Undang Republik Indonesia No. 8/1995. *Pasar modal.* Retrieved January 15, 2011, from http://www.bapepam.go.id/pasar_modal/regulasi_pm/uu_pm/index.htm.

Undang-Undang Republik Indonesia No. 4/1998. *Kepailitan*. Retrieved January 13, 2011, from www.dpr.go.id/uu/uu1998/UU_1998_4.pdf

Undang-Undang Republik Indonesia No. 23/1999. *Bank Indonesia.* Retrieved January 13, 2011, from http://www.bi.go.id/biweb/html/uu231999_id/index.html.

Undang-Undang Republik Indonesia No. 19/2003. *Badan usaha milik negara*. Retrieved January 2, 2011, from http://www.bpkp.go.id/unit/hukum/uu/2003/19-03.pdf

Undang-Undang Republik Indonesia No. 25/2007. Penanaman modal. Retrieved December 28, 2010, from http://www.setneg.go.id/index.php?option=com_perundangan&id=1600&task=detail&catid=1&Itemid=42&tahun=2007.

Undang-Undang Republik Indonesia No. 36/2008. *Perubahan keempat atas Undang-Undang No. 7/1983 tentang pajak penghasilan.* Jakarta: Sekretariat Negara.

Utama, S. (2003). Corporate governance, disclosure and its evidence in Indonesia. *Usahawan*, *5*, 11-12.

Utama, S., & Leonardo Z. F. (2004). Evidence on audit committee composition and audit committee effectiveness among listed companies in the Jakarta Stock Exchange. *Jurnal Akuntansi dan Keuangan Indonesia*, *1*(2), 128-142.

Utama, S., & Leonardo Z. F. (2006). Audit committee composition, control of majority shareholders and their impact on audit committee effectiveness: Indonesia evidence. *Jurnal Riset Akuntansi Indonesia*, *9*(1), 21-34.

Uzun, H., Szewczyk, S. H., & Varma, R. (2004). Board composition and corporate fraud. *Financial Analysts Journal*, *60*(3), 33-43.

Vafeas, N. (2000). Board structure and the informativeness of earnings. *Journal of Accounting and Public Policy*, *19*(2), 139-160.

Vafeas, N. (2005). Audit committees, boards, and the quality of reported earnings. *Contemporary Accounting Research*, *22*(4), 1039-1122.

Van den Berghe, L. A. A., & Carchon, S. (2003). Agency relations within the family business system: An exploratory approach. *Corporate Governance: An International Review*, *11*(3), 171–180.

Van den Berghe, L. A. A., & Levrau, A. (2003). Measuring the quality of corporate governance: In search of a tailor made approach? *Journal of General Management*, *28*(3), 71–86.

Van der Zahn, J-L.W., Singh, H., & Singh, I. (2008). Association between independent audit committee members' human-resource features and under pricing: The case of Singapore IPOs from 1997-2006. *Journal of Human Resource Costing & Accounting*, *12*(3), 179 – 212.

Van Lent, L. (2007). Endogeneity in management accounting research: A comment. *European Accounting Review*, *16*(1), 197-205.

Wang, D. (2006). Founding family ownership and earnings quality. *Journal of Accounting Research*, *44*, 619-656.

Watts, R., & Zimmerman, J. (1986). *Positive accounting theory*. Englewood Cliffs, NJ: Prentice-Hall.

Ward, A. J., Brown, J. A., & Rodriguez, D. (2009). Governance bundles, firm performance, and the substitutability and complementarity of governance mechanisms. *Corporate Governance: An International Review*, *17*(5), 646–660.

Wardhani, R. (2008). *Tingkat konservatisme akuntansi di Indonesia dan hubungannya dengan karakteristik dewan sebagai salah satu mekanisme corporate governance*. Paper presented at Simposium Nasional Akuntansi 11, Pontianak, Indonesia.

Wardhani, R., & Joseph, H. (2010). *Karakteristik pribadi komite audit dan praktik manajemen laba.* Paper presented at Simposium Nasional Akuntansi 13, Purwokerto, Indonesia.

Webb, E. (2008). Sarbanes-Oxley compliance and violation: An empirical study. *Review of Accounting and Finance*, *7*(1), 5-23.

Weimer, J., & Pape, J. C. (1999). A taxonomy of systems of corporate governance. *Corporate Governance: An International Review, 7(2)*, 152–166.

Wells, S. (1999). *Moving toward transparency: Capital market in Indonesia*. Retrieved March 15, 2007, from www.adb.org/Documents/Books/Rising_to/Indonesia/indo-cap.pdf

Wiggins, V., & Poi, B. (2001). How do I test for panel-level heteroskedasticity and autocorrelation? Retrieved 20 January, 2011, from http://www.stata.com/support/faqs/stat/panel.html

Willekens, M., Bauwhede, H. V., & Gaeremynck, A. (2004). Voluntary audit committee formation and practices among Belgian listed companies. *International Journal of Auditing*, *8*(3), 207–222.

Wintoki, M. B., Linck, J., & Netter, J. (2007). *Endogeneity and the dynamics of corporate governance* (Working paper). Retrieved August 12, 2011, from http://69.175.2.130/~finman/Orlando/Papers/Endogeneity_Governance.pdf.

Wintoki, M. B., Linck, J., & Netter, J. (2009). Endogeneity and the dynamics of corporate governance. Paper presented at the European Summer Symposium in Financial Market, Gerzensee, Switzerland. Retrieved August 10, 2011, from http://www.cepr.org/meets/wkcn/5/5567/papers/LinckFinal.pdf

Wirahadja, Roy Iman, (2010), Adopsi IAS 41 dalam Rangkaian Konvergensi IFRS di Indonesia. Retrieved August 10, 2013 from http://www.iaiglobal.or.id/prinsip_akuntansi/seminar_ias41/1-Adopsi%20IAS%2041%20dalam%20Rangkaian%20Konvergensi%20IFRS%20di%20Indonesia-%20Roy%20Iman%20W.pdf

Woejcik, D., Clark, G. L., & Bauer, R. (2005). *Corporate governance and cross-listing: evidence from European companies*. Retrieved September 2007, from http://ssrn.com/abstract=593364

Wooldridge, J. M. (2002). *Econometric analysis of cross section and panel data*. London: The MIT press Cambridge.

Wooldridge, J. M. (2009). *Introductory econometrics: A modern approach (*4th ed.) Cincinnati: South-Western College Publication.

World Bank (2004). *Indonesia: Report on the observance of standards and codes (ROSC)*. Retrieved February 3, 2011, from www.worldbank.org/ifa/rosc_cg_idn.pdf

World Bank (2010). *Indonesia: Report on the observance of standards and codes (ROSC)*. Retrieved February 5, 2011, from www.worldbank.org/ifa/rosc_cg_idn_2010.pdf

Wulandari, D., & Zulaikha (2012). Pengaruh karakteristik dewan komisioner dan komite audit terhadap tingkat konservatisme akuntansi. *Diponegoro Journal of Accounting*, *1*(2), 1-14.

Xie, B., Davidson III, W. N., & DaDalt, P. J. (2003). Earnings management and corporate governance: The role of the board and the audit committee. *Journal of Corporate Finance*, *9*(3), 295-316.

Yang, J. S., & Krishnan, J. K. (2005). Audit committees and quarterly earnings management. *International Journal of Auditing*, *9*, 201-219.

Yermack, D. (1996). Higher market valuation of companies with a small board of directors. *Journal of financial economics*, *40*(2), 185-211.

Yoshikawa, T., & Rasheed, A. A. (2009). Convergence of corporate governance: Critical review and future directions. *Corporate Governance: An International Review, 17*(3), 388–404.

Yoshikawa, T., Rasheed, A. A., & Del Brio, E. B. (2010). The impact of firm strategy and foreign ownership on executive bonus compensation in Japanese firms. *Journal of Business Research*, *63*, 1254-1260.

Young, M. N., Ahlstrom, D., Bruton, G. D, & Chan, E. S. (2001). The resources dependence, service and control functions of board of directors in Hong Kong and Taiwanese firms. *Asia Pacific Journal of Management*, *18*, 223-244.

Young, M. N., Peng, M. W., Ahlstrom, D., Bruton, G. D., & Jiang, Y. (2008). Corporate governance in emerging economies: A review of the principle-principle perspective. *Journal of Management Studies, 45*(1), 233–243.

Yuka, K. (2010). Theories and realities of Asian corporate governance: From “transplantation” to the Asian best practices. *Procedia Social and Behavioral Science*, *2,* 6883-6895.

Zadkovich, J. (2007). Mandatory requirements, voluntary rules and “please explain”: A corporate governance quagmire. *Deakin Law Review*, *12*(2), 23-29.

Zahra, S., & Pearce, J. (1989). Boards of directors and corporate financial performance: A review and integrative model. *Journal of Management*, *15*(2), 291-334.

Zaini, A. (2002). Banyaknya bekas pejabat, militer, dan politisi masuk perusahaan publik. *Koran Tempo*. Retrieved November, 29 2011, from http://www.infoanda.com/linksfollow.php?lh=AFFSVgZdBFBX

Zaman, M., Hudaib, M., & Haniffa, R. (2011). Corporate governance quality, audit fees and non-audit services fees. *Journal of Business Finance & Accounting*, *38*(1/2), 165-197.

Zhang, I. X. (2007). Economic Consequences of the Sarbanes-Oxley Act of 2002, *Journal of Accounting and Economics*, *44*(1-2), 74-115.

Zhang, Y., Zhou, J., & Zhou, N. (2007). Audit committee quality, auditor independence, and internal control weaknesses. *Journal of Accounting and Public Policy*, *26* (3), 300-327.

Zhizhong, H., Juan, Z., Yanzhi, S., & Wenli, X. (2011). Does corporate governance affect restatement of financial reporting? Evidence from China. *Nankai Business Review International*, *2*(3), 289-302.

Zhuang, J. (1999). *Some conceptual issues of corporate governance* (EDRC Briefing Notes No. 13). Retrieved January 1, 2011, from http://www.adb.org/Documents/EDRC/Briefing_Notes/BN013.pdf.

Zoromé, A. (2007). *Concept of offshore financial centers: In search of an operational definition*. Retrieved January 4, 2011, from http://ssrn.com/abstract=986815

LIST OF PUBLICATIONS

Conference Proceedings

Widagdo, A. K., & Devi, S. D. (2008). Audit Committee Reforms in Indonesia: *Level of Compliance and Its Determinants.* Proceeding 14th Asian Academic Accounting Association Conference, 27-30 October, 2013, Penang, Malaysia.

Widagdo, A. K., & Devi, S. D. (2009). *Determinants of Indonesian Public Listed Companies' Compliance with Audit Committee Rules: Indonesian Evidence*. Proceeding 1st Annual Conference World Accounting Frontiers Series (WAFS), 15-18 July, 2009, Macau.

Widagdo, A. K., & Devi, S. D. (2008). *Determinants of Indonesian Public Listed Companies' Compliance with Audit Committee Rules: The Role of Ownership Structure and Board Commissioner Characteristic.* Proceeding 9th Asian Academic Accounting Association Conference, 29 November-01 December, 2008, Dubai, UEA.

Widagdo, A. K., & Devi, S. D. (2008). *An Exploratory Study of Factors Affecting Public Listed Companies' Compliance with Audit Committee Rules: Indonesian Evidence.* Proceeding 20th Asian Pacific Conference on International Accounting Issues, 09-12 November, 2008, Paris, France.

APPENDIX A: LITERATURE REVIEW

Table A.1 Summary of the Prior Studies on Compliance with Audit Committee Regulation in Mandatory Regime

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method: Sample	Research Method: Method of Analysis	Main Findings or Significant Variables
Beasley and Salterio (2001)	To examine the relationship of board characteristics and voluntary improvement of audit committee composition that is exceeded minimum mandated level.	Board characteristics (outside director in the board, board size, CEO duality)	Outside director in AC and AC experience.	627 Canadian listed companies in 1994	Multinomial ordered probit regression and multiple regression.	Outside director in AC: outside director in the board (+), CEO duality (-). AC experience: outside director in the board (+), board size (+), CEO duality (-).
Sori et al. (2001) (Malaysia)	To examine the compliance level of listed companies with KLSE listing requirements on formation and structure of AC.	-	-	556 listed firms consist of 335 in main board and 221in second board for period of 1991-1998.	Descriptive statistic	Most companies comply with the requirements concerning AC formation, independence of member and chairperson, and low turn over. However, lack of activities report of AC is found.

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Research Method Method of Analysis	Main Findings or Significant Variables
Carcello et al. (2002) (US)	(1) To examine the compliance of AC disclosure contained in AC charters and reports as mandated SEC final rule (1999). (2) To examine determinant factors of voluntary disclosure.	AC meeting, AC independence, Big 5, firm size, financial distress, exchange, industry	AC voluntary disclosure	150 companies listed on the NYSE, AMEX, and NASDAQ (each 50) in 2000.	• Descriptive statistic • Logistic regression	There is a high level of compliance with mandatory AC disclosures, but difference of content between charter and reports. Voluntary disclosures are more common for depository institutions, larger companies, and companies with more independent ACs.
Klein (2002b) (US)	To examine economic determinants of AC independence as mandated by NYSE and NASDAQ listing requirements (1999).	Board size and board independence, growth opportunities, consecutive losses, leverage, CEO on compensation committee, substitute monitoring mechanisms, and firm size.	AC independence	803 large US firms for period of 1991-1993 (before enactment of the requirement)	Multiple regression	Board size (+), percentage of outsiders on the board (+), growth opportunities (-), losses (-), presence substitute monitoring mechanisms (-). In short, one size did not fit all in AC.

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Research Method Method of Analysis	Main Findings or Significant Variables
Rezaee et al. (2003) (US)	To examine to what extent listed companies are in compliance with AC disclosure requirements as mandated by the SEC rule.	-	-	94 companies of Fortune 100 companies in 2002	Descriptive statistic	The majority of AC composition, structure, and meeting, and qualification are in compliance with requirement of SEC and the stock exchanges.
Al-Mudhaki and Joshi (2004) (India)	To examine the composition, focus and functions of AC, the effects of meetings and the criteria used in the selection of members by Indian listed companies.	-	-	73 Indian listed companies	Descriptive statistic	Even mandatory, only 56.2 percent companies establish AC. There is a lack of independent representation on the AC. The functions of ACs are still concentrated in the traditional area of accounting. The main criteria used for membership of an AC are: experience and knowledge of business, experience of holding similar positions and accounting and finance expertise.
Braiotta (2004) (US)	To investigate whether the U.S. requirements for AC structure and composition provide incentives for non-U.S. manufacturing firms to align their audit committee with U.S. requirements.	-	-	52 non-U.S. manufacturing firms in 1998	Univariate test.	ACs composition of the non-U.S. manufacturing firms is not closely aligned with the new requirements of the BRC for U.S. firms. Non-U.S. firms will need to exhibit greater alignment of their AC composition and AC qualifications with U.S. requirements.

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method		Main Findings or Significant Variables
				Sample	Method of Analysis	
Keinath and Walo (2004) (US)	To observe AC oversight responsibilities through the annual report before the passage of SOX and new SEC rule.	-	-	98 domestic listed companies on NASDAQ 100 as of August 2002	Descriptive statistic	The ACs are not fulfilling their oversight responsibilities for which they will soon be responsible. The ACs had to significantly expand their responsibilities to just cover practices required by SOX and NASDAQ.
Utama and Leonardo (2004) (Indonesia)	To provide empirical evidence of AC composition and AC effectiveness of listed companies in JSX.	-	-	33 listed companies in 2003	Descriptive statistic	Majority of companies comply with JSX requirement about the minimum number of AC, their independence, and their expertise (finance or accounting background). However, ACs are not yet effective in their authority, resources, and efforts.
Haron et al.(2005) (Malaysia)	(1) To examine the extent of companies' compliance with KLSE listing requirement in relation to AC. (2) To examine differences of the compliance between distress companies and non-distress companies.	-	-	120 companies in 2002	Descriptive statistic and univariate statistic.	The level of compliance of listed companies with all AC listing requirements is satisfactory. There is no significant difference in the level compliance between financially distressed and non- financially distressed companies.

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Method of Analysis	Main Findings or Significant Variables
Pandit et al.(2005) (US)	To examine whether any difference of content of AC disclosures between period of before and after SEC rule (April 2003).	-	-	100 listed companies on NYSE for the period of 2003 and 2004	Descriptive statistic	The mandatory disclosure mandated by SEC is satisfactory. However, there is a variation in the level of voluntary disclosures.
Sori et al. (2005) (Malaysia)	To examine the disclosure of AC report and the level of compliance with KLSE listing requirements (2001) regarding the AC requirements.	-	-	818 listed companies in 2002	Descriptive statistic	The compliance is satisfactory; however, very few companies provide more than what is expected in the AC report by listing requirements. Companies in sector finance, technology, and infrastructure project companies as well as companies in the main board have greater initiatives to provide value added statements to users.
Sori, Mohamad, and Saad (2007) (Malaysia)	To examine the level of compliance of listed companies with newly amended KLSE listing requirements.	-	-	795 listed companies in 2002	Descriptive statistic	High level of compliance in terms of composition, independence, and chairperson. However, Malaysian corporations are more likely to comply with the minimum requirements imposed by regulatory bodies rather than upkeep corporate governance.

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method		Main Findings or Significant Variables
				Sample	Method of Analysis	
Braiotta and Zhou (2006) (US)	(1) To investigate the impact of the recommendations of the BRC on AC alignment. (2) To investigate the impact of the SOX on AC alignment.	AC size, director compensation, AC independence, AC meetings, AC financial expertise and governance expertise, earnings management.	AC alignment	129 listed companies in 1999, 2000, and 2002.	Logistic regression	For the BRC period, firms with AC alignment have larger total assets, have higher leverage and are more likely listed in NASDAQ. For the SOX period, AC alignment is more likely to be associated with larger AC, higher directors' compensation, higher AC independence, and more AC meetings. Firms experiencing audit committee alignment in 2002 are associated with less earnings management.
Carcello et al. (2006) (US)	(1) To examine the extent of disclosures related to AC financial expert (ACFE) in the first year of the SOX take effect. (2) To examine determinant factors of ACFE disclosures.	-	-	400 companies drawn from some stock exchanges in 2003	Descriptive statistic and logistic regression.	Compliance with the SEC's financial expert disclosure rule is high, but transparency of the disclosure regarding the ACFE's background is limited. Most ACFEs does not have a background in accounting or finance. ACFE is positively associated with firm size, being in a litigious industry, and having an active AC.

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method		Main Findings or Significant Variables
				Sample	Method of Analysis	
Myers and Ziegenfuss (2006) (US)	To determine whether ACs begin to accept more responsibility for corporate governance before such behaviour became mandatory (in the period of immediately preceding the Enron scandal).	-	-	296 different organizations from GAIN database	Descriptive statistic	ACs' responsiveness to each of eight effectiveness steps of BRC is surprisingly high.
Pandit et al. (2006) (US)	To examine AC reports of a sample of companies listed on the NYSE and to determine the extent to which these reports contain voluntary disclosures that would indicate compliance with the Sarbanes-Oxley Act (SOX) and the rules imposed by the SEC and NYSE.	-	-	100 listed companies on NYSE in 2004	Descriptive statistic	The findings reveal a significant diversity in the form and content of AC report. The mandatory disclosures are also varied from minimum required compliance to more voluntary disclosure.

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method		Main Findings or Significant Variables
				Sample	Method of Analysis	
Smith (2006) (US)	To measure the change in AC behaviour (and presumably effectiveness) subsequent to implementing the BRC recommendations.	-	-	200 firms listed on NASDAQ exchange listing for period of 1999-2000	Descriptive statistic	AC frequency meetings increase after the BRC. It implies that the implementation of the BRC recommendations have improved AC effectiveness.
Utama and Leonardo (2006) (Indonesia)	To examine the impact of AC composition and the control of firm governance on AC effectiveness (ACE).	AC composition, percentage shares owned by controlling, commissioner representing majority shareholders, directors representing majority shareholders, appointment chair of board and CEO by controlling shareholders, length of presence of AC.	ACE (authority, resources and efforts)	33 companies listed on JSX in 2003	Multiple regression	Significant results: AC composition (+), commissioner representing majority shareholders (-), appointment chair of the board and CEO being appointed by the majority shareholders (-), length of AC presence (+).

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Method of Analysis	Main Findings or Significant Variables
HassabElnaby et al. (2007) (US)	(1) To investigate the trends in AC activities in the periods preceding and following the passage of SOX. (2) To examine whether ACs are effective in executing their assigned oversight responsibilities in the post-SOX era	-	-	681 firms listed on NYSE, AMEX, and NASDAQ in 2004	Descriptive statistic	AC makes a substantial commitment to increase their assigned responsibilities over the period of 2001 to 2004. However, they need to do more to meet the many additional challenges facing them in a post-SOX environment. In general, the intent of SOX-for ACs to be more involved and active in the oversight role of an organization is becoming institutionalized.
Raghunandan and Rama (2007) (US)	To examine the determinants of audit committee meeting number.	Firm size, firm growth, insider ownership, block holdings, leverage, loss, litigiousness, financing, AC size, AC expertise (accounting and non accounting), board size, CEO duality, board meeting, board independence.	AC meeting number	319 firms from the S&P SmallCap600 in 2003	Multiple regression	Firm size (+), block holdings (+), litigious industries (+), board meeting (+), AC size (+), AC accounting expert (+).

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Method of Analysis	Main Findings or Significant Variables
Lin, Kang et al. (2009) (US)	To examine whether or not the Blue Ribbon Committee recommendations in 1999 and the Sarbanes Oxley Act requirements of 2002 have a significant effect on the characteristics of the board of directors and the AC.	-	-	1400 firms for period of 1996-2005	Descriptive statistic	Both BRC and SOX provide significant changes in many characteristics of AC and board director. However, the BRC's recommendations do not cause as many significant changes as the SOX requirements.
Engel, Hayes, & Wang (2010) (US)	To examine association of monitoring demand and AC compensation.	Audit fee, post-SOX, AC expertise, AC meeting number, ROA, leverage	AC compensation	3295 firm-year observations of listed companies in US for period of 2000-2004	Multiple regression	Audit fee (+), post-SOX (+).
Puri et al. (2010) (India)	To examine the effectiveness of AC in the Indian corporate sector.	-	-	10 listed companies in India	Descriptive statistic	There is a high compliance of listed companies with audit committee requirements. AC plays effective corporate governance role.

Table A.1 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method		Main Findings or Significant Variables
				Sample	Method of Analysis	
Chatterjee (2011) (India)	To examine the compliance of listed companies in India with audit committee requirements	-	-	50 listed companies in India	Descriptive statistic	Even though most companies have audit committee, their role is limited due to the lack of expertise and time.

Source: Compiled by the author
Note: AC= audit committee

Table A.2 Summary of the Prior Studies on Compliance with Audit Committee Regulation in Non-Mandatory Regime

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method: Sample	Research Method: Method of Analysis	Main Findings or Significant Variables
Pincus et al. (1989) (US)	To examine the incentives for voluntary formation of AC in the US as recommended by National Commission on Fraudulent Financial Reporting (NCFFR).	Agency costs of equity, agency costs of debt, board characteristics, auditor reputation, and participation in National Market System.	Presence of AC	84 listed companies on NASDAQ over-the counter companies in 1986	Logistic regression	Percentage managerial ownership of the company's stock (-), leverage (+), firm size (+), proportion of outside directors to total directors (+), big eight auditors (+), and participation in the National Market System (+).
Bradbury (1990) (New Zealand)	To examine the incentives for voluntary formation of AC by using agency theory framework in New Zealand.	Agency costs of equity, agency costs of debt, board characteristics, and auditor reputation.	Presence of AC	135 listed companies in 1981	Logistic regression	Number of directors on the board and inter corporate ownership (+).
Collier (1993) (UK)	(1) To investigate whether audit committees were randomly distributed among major UK companies. (2) To identify possible reasons why some companies have formed ACS while others have not formed ACs.	Agency costs of equity, agency costs of debt, economies of scale in monitoring costs, dominant CEO, auditor reputation.	Presence of AC	142 companies in UK in 1991.	Logistic regression	Agency costs of equity (+), agency costs of debt (+), and director pressure to reduce information asymmetries (+).

Table A.2 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Method of Analysis	Main Findings or Significant Variables
Menon and Williams (1994) (US)	To examine factors associated with firms' reliance on ACs.	Firm size, agency costs of equity, agency costs of debt, board characteristics, and auditor reputation.	Reliance on AC (an index consist of meeting and composition) .	199 firms over the counter for period of 1986-1987.	Logistic regression	Many of the firms do not appear to rely on ACs. Proportion outside director (+), big eight auditors (+).
Goddard and Masters (2000). (US)	To examine how the audit fee change with the existence of an audit committee and adherence to the Cadbury Code.	Presence of AC, firm size, complexity of company, firm risk, auditor type, and ownership.	Audit fee	233 listed companies in 1994 and 223 listed companies in 1995.	Multiple regression	Size is the main determinant of the presence of an AC. There is no evidence that audit committees, whether adhering to the Cadbury Code or not, has any overall effect on audit fees.
Al–Twaijry et al. (2002). (Saudi Arabia)	To examine the role of ACs in the Saudi Arabian corporate sector as recommended by Ministerial Resolve 903.	-	-	Non random sample 33 research interviews (academics, internal auditor, and external auditor)	Qualitative method	The requirements of AC as set out in Ministerial Resolve 903 lack clarity regarding terms of reference and restriction on the scope of work, independence, and working relationship with internal and external auditor. AC is formed to comply with the rule by presenting favourable appearance instead of attempting to improve corporate governance.

Table A.2 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Method of Analysis	Main Findings or Significant Variables
Carson (2002) (Australia)	To examine factors associated with the presence of board sub-committees, specifically audit, remuneration and nomination committees.	Big 6 auditors, non-executive directors, non-executive chairman, number of inter corporate relationships of the board and shareholder type, leverage, board size, and firm size.	Presence of AC, remuneration committee, and nomination committee	361 listed companies in Australia.	Logistic regression	For AC and remuneration committee: Big 6 auditors (+), and the number of inter corporate relationships of the directors of the board (+). For nomination committee: board size (+) and leverage (+).
Joshi and Wakil (2004) (Bahrain)	To examine the extent to which listed companies in Bahrain have adopted and complied with the standard AC's practices as recommended by the BRC	-	-	30 listed companies on Bahrain stock exchange and 7 audit firms	Descriptive statistic	Size, type of auditors and industry type influence the establishment of AC. Most of companies claim that they comply with large BRC's recommendations. However, audit firms negate that claim.

Table A.2 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Method of Analysis	Main Findings or Significant Variables
Piot (2004). (France)	To investigate the determinants of ACs formation in France.	Agency costs of equity, agency costs of debt, investment opportunity set, board characteristics, firm size, auditor reputation, business complexity, institutional pressure.	Presence of AC	285 listed companies in 1997	Logistics regression	Insider ownership (-), quality financial reporting (-), whole corporate governance environment (-). Leverage (+) if company has high investment opportunity set, board size (+), firm size (+), auditor reputation (+), diversity company operation (+).
Willekens et al. (2004) (Belgia)	To investigate some factors that are associated with voluntary AC formation in a non-Anglo-Saxon environment where AC formation is voluntary, even for listed companies.	Agency costs of equity, agency costs of debt, board characteristics, auditor reputation, firm size, industry effects.	Presence of AC	70 listed companies in Belgian Stock Exchange matched with control companies for period of 2001-2002	Logistic regression	Most Belgian-listed companies do not comply with the recommendations of the Brussels Stock Exchange regarding ACs. Proportion of independent directors (+), external auditor reputation (+).

Table A.2 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method		Main Findings or Significant Variables
				Sample	Method of Analysis	
Chau and Leung (2006) (Hong Kong)	To investigate empirically the relationship between three major corporate governance attributes (family shareholding, non-executive directors and independent chairman) and the existence of ACs.	Family ownership, independent chairman, non-executive directors.	Presence of AC	397 listed companies at Hong Kong Stock Exchanges for in 2002	Logistic regression	Independent director (+). At the medium level of family shareholding, the convergence-of-interest effect is dominant and AC existence decreases. At a high level of family shareholding, the entrenchment effect is dominant and as a result, AC existence increases.
Braiotta and Zhou (2008) (Europe)	To examine determinants of AC alignment caused by European Directive 8th.	AC size, AC independence, AC financial expertise, AC multiple directorship, board characteristics (i.e. independence and size), firm size, leverage.	AC alignment	European firms listed in US stock exchange consist of 309 firm-year observations for period of 2002-2004.	Logistic regression	AC financial expertise (-), board size (-), board independence (-), AC multiple directorship (+).

Table A.2 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Method of Analysis	Main Findings or Significant Variables
Rainsbury et al. (2008) (New Zealand)	To investigate demand and supply characteristics associated with firms that voluntarily established ACs meeting 'best practice' membership guidelines in New Zealand.	Demand factors: leverage, executive director shareholdings, block holders, big five auditors, growth opportunities. Supply factors: board size, independent board directors.	Set of best practice membership guidelines recommended by New Zealand Securities Commission (i.e. all non-executive directors, a majority of independent directors, and financial expert member).	56 companies which listed at NZX in 2001	Logistic regression	Supply factors: board size (+), board independence (+). Demand factors: no significant findings.
Chen et al. (2009) (Australia)	To examine the relationship between firm characteristics and incentives for the voluntary formation of ACs by non-top 500 firms listed on the Australian Stock Exchange (ASX).	Agency costs of debt, agency costs of equity, economies scale in monitoring costs, information asymmetry, dominant CEO, and auditor reputation.	Presence of AC	224 non-top 500 firms listed on the ASX in 2005	Logistic regression	Leverage (+), firm size (+), board size (+), the proportion of independent directors (+), independent board chair (+).

Table A.2 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method Sample	Method of Analysis	Main Findings or Significant Variables
Sharma et al. (2009) (New Zealand)	To examine the determinants of the frequency of AC meeting in New Zealand.	Agency costs of debt, board characteristics (size, independence, and shares ownership), AC characteristics (size, independence, expertise, and multiple directorships), ownership types, auditor reputation, and regulation.	Frequency of AC meeting	96 firm-year observations in the period of 2004-2005	Multiple regression	AC characteristics (chair is independent director, independent member, size, multiple directorship) (-), auditor reputation (-), management ownership (+), institution ownership (+).
Baxter (2010) (Australia)	To examine whether several indicators of AC quality are associated with a number of supply and demand factors.	Supply factors: board characteristics. Demand factors: agency costs of debt, auditor reputation, and agency costs of equity.	AC quality (independence, expertise, size and activity)	200 listed companies on ASX in 2001	Multiple regression	Many Australian listed companies are already complying with several of the ASX Corporate Governance Council's recommendations relating to AC. Board characteristics (independence, expertise, activity and size) (+).

Table A.2 (continued)

Author(s) and Country	Research Objectives	Main Independent Variables	Dependent Variables	Research Method		Main Findings or Significant Variables
				Sample	Method of Analysis	
Greco (2011) (Italy)	To examine the determinants of audit committee meeting frequency	Ownership concentration, insider ownership, board size, CEO duality, board independence, firm size, leverage, age, ROA	AC meeting frequency	179 non financial listed companies on the Italian Stock Exchange in 2007	Multiple regression	Insider ownership (-), proportion independent director (+), firm size (+).

Source: Compiled by the author
*Note***:** AC= audit committee

Table A.3 Summary of the Prior Studies on Audit Committee Characteristics and Financial Reporting Quality in Developed Countries

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Earnings management	Klein (2002a) (US)	687 firms for the cross-sectional tests and 683 firms for the time-series tests based on the Standard & Poor 500 as of March 31, 1992 and 1993.	AC independence	AC independence (-)
	Anderson et al. (2003) (US)	The sample consists of 1241 firms in 2001 as covered by the Investor Responsibility Research Centre (IRRC).	AC size, AC independence, AC meetings, interaction AC meeting and AC independence.	AC size (-), AC independence (+), AC meeting (-).
	Xie et al. (2003) (US)	282 firms based on the 500 Standard and Poor's firms index in 1992, 1994, and1996.	AC meeting, AC size, AC independence, AC corporate members, AC investment bank members, AC finance director members, AC bank director members, AC legal director members.	AC corporate members (having outside corporate director position) (-), AC meeting (-).
	Bedard et al. (2004) (US)	300 firms in 1996 representing 3 groups of which 100 firms each: (1) the highest (+) (income-increasing) accruals, (2) the highest (-) (income-decreasing) accruals, and (3) the control group, the group with the accruals closest to 0.	AC financial expertise, AC multiple directorship, AC firm expertise, AC independence (50-99% independence, 100% independence, stock options), AC activity (mandate, meetings, members>2).	AC financial expertise (-), AC multiple directorship (-), AC 100 percent independence (-), AC stock options (+), AC mandate (statement contains a clear mandate stating AC responsibility of both financial statements and external audit) (-).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Earnings management	Davidson, Goodwin-Stewart, Kent (2005) (Australia)	434 firms listed on ASX in 2000.	Presence of AC, AC independence, AC meeting number, AC size.	Presence of AC (-)
	Peasnell et al. (2005) (UK)	1271 firm-year observations of listed companies in UK for period of 1993-1996.	Presence of AC, interaction of AC presence and pre-managed earnings.	None
	Yang and Krishnan (2005) (US)	896 firms over 5 years, from 1996 to 2000.	AC independence, AC meeting, AC financial expertise, AC stock ownership, AC multiple directorship, AC tenure, AC size.	AC multiple directorship (-), AC stock ownership (+), AC tenure (-).
	Gul et al. (2007) (US)	1293 firm-year observations of listed companies in US for period of 2001-2002	Presence of female director in AC	Presence of female director in AC(-)
Earnings management and future firm performance	Koh et al. (2007) (Australia)	2259 firm-year observations listed on both the Connect 4 and Aspect Fin Analysis databases from 1998 to 2002.	AC meeting, AC independence.	• Abnormal accruals: AC meeting and AC member composition (-). • Future performance: AC meeting and AC member composition (+).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Earnings management	Piot and Janin (2007) (France)	102 non-financial firms listed on the French Stock Market in the period of 1998-2002.	Presence of AC, AC independence	Presence of AC (-)
	Osma and Noguer (2007) (Spain)	155 firm-year observations in the period of 1999–2001.	AC independence (a majority of independent directors, a majority of institutional directors)	None
	Qin (2007) (US)	460 firms in the period of 1998-2002 (prior to the implementation of SOX).	AC expertise using two definitions of SEC initial and final rules (type I: the expert with previous positions such as public accountant, auditor, principal/CFO, controller, or principal/chief accounting officer; type II includes more eligible positions such as presidents/CEOs, professional financial analysts, investment bankers and venture capitalists), AC financial expertise.	AC expertise as defined in type I (+), AC financial expertise (+).
	Braiotta and Zhou (2008) (US)	European firms listed on US stock exchange consist of 309 firm-year observations for period of 2002-2004.	AC alignment	AC alignment (-)

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Earnings management	Baxter and Cotter (2009) (Australia)	72 companies to test the presence of AC variable and 309 companies to test the AC characteristics variables. Both samples were in 2001, in the period of before AC formation was made mandatory (in 2003) in Australia.	Presence of AC, AC independence, AC expertise, AC meeting, and AC size.	AC formation is significant (-), AC expertise (proportion of AC members with accounting expertise) (-).
Earnings management and earnings informativeness	Chang and Sun (2009) (US)	• Earnings informativeness: 96 cross-listed foreign firms in the period of pre-SOX and 106 cross-listed foreign firms in the period of post-SOX. • Discretionary accruals: 89 cross-listed foreign in the period of pre-SOX and 93 cross-listed foreign firms in the period of post-SOX.	AC independence, AC size, AC financial expertise.	• Earnings informativeness in the post-SOX: AC independence (+). • Discretional accrual in the post-AC: AC independence (-).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Earnings management and earnings informativeness	Chang and Sun (2010) (US)	• Earnings informativeness: 1059 firms in the period of pre-SOX and 1098 firms in the period of post-SOX. • Discretional accruals: 1006 firms in the period pre-SOX and 1052 firms in the period post-SOX.	AC independence, AC financial expertise.	• Earnings informativeness in the post-SOX: AC financial expert (+), AC independence (+). • Discretional accruals in the post-SOX: AC financial expertise (-).
Earnings management	Li et al. (2010) (US)	6654 firm-year observations of listed companies in 2001 (pre-SOX) and 2004 (post-SOX).	AC expertise, AC independence, and composite index consist of AC expertise and AC independence.	AC independence (-)
	Dhaliwal et al. (2010) (US)	770 firms in the post period of SOX (2004-2006)	AC accounting expertise, AC finance expertise, AC supervisory expertise, AC independence, AC size, AC meeting number, AC shares ownership, AC tenure, and multiple directorships of AC member.	AC accounting expertise (-), AC independence (-), AC tenure (-). Accounting experts who (a) are independent from the firm, (b) hold low levels of multiple directorships, and (c) have a lower tenure in their firms (-).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Earnings management	Kang, Kilgore, and Wright (2011) (Australia)	288 low-and mid-cap firms listed on the ASX in 2006	Presence of AC, AC independence, AC expertise, AC meeting number, AC size.	AC independence (-), AC expertise (-), AC meeting number (-).
	Marra, Mazzola, and Prenape (2011) (Italy)	Pre-IFRS: 444 listed companies for period of 2003-2004. Post-IFRS: 444 listed companies for period of 2005-2006.	Presence of AC, AC expertise, interaction of presence of AC with IFRS.	Presence of AC (-), AC expertise (-), interaction of AC presence and IFRS (-).
	Sharma, Sharma, and Ananthanarayanan (2011) (New Zealand)	224 firm-year observations of listed companies on New Zealand Stock Exchange (NZSX) for the period of 2004-2005.	AC best practice index (as moderating variable of the association between the economic importance of a client to the auditor and earnings management)	AC best practice serve the moderating variable
	Sun *et al*. (2011) (Canada)	525 firm-year observations for the period of 2003-2005	Proportion female independent directors in AC	None
	Thiruvadi and Huang (2011) (US)	320 firms from the S&P Small Cap 600 in 2003	Female director in AC	Female director in AC (-)

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Restatements	Agrawal and Chadha (2005) (US)	A match pair of 159 restated earnings firms in 2000 and 2001 and non-restated firms.	AC independence, AC financial expertise.	AC financial expertise (-)
	Baber et al. (2005) (US)	185 restating firms in the period of 1997-2002 and 1487 control firms.	AC independence, AC financial expertise	None
	Arthaud-Day et al. (2006) (US)	A match pair of 116 firms filing a restatement from January 1, 1998, through December 31, 1999 and 116 non-restated firms.	AC turnover following the occurrence of restatements	AC turnover (+)
	Lin *et al*. (2006) (US)	A match pair of 212 restated earnings firms in the first year of AC disclosures is made mandatory in the US (in 2000) and 212 non- restated firms.	AC independence, AC size, AC financial expertise, AC meeting, percentage of common stock shares held by the AC members.	AC size (at least four members) (-)
	Archambeault et al. (2008) (US)	153 restating firms due to intentional or unintentional misstatements in the originally filed financial statements and 153 control firms in the period of 1999-2002.	AC short-term stock option grant, AC long-term stock option grant, AC independence, AC expertise, AC meeting.	AC short-term stock option grant (+), AC long-term stock option grant (+), AC independence (percentage of outside directors) (-).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Restatements	Marciukaityte et al. (2009) (US)	187 restated earnings firms over January 1997 to June 2002, which comprise of 130 voluntary restating firms and 57 forced restating firms.	AC independence (log of the number of independent members, proportion of independent members), AC meeting (at least four times), independent financial expert of AC.	Determinants of restatements for full sample: proportion of independent members (+). Determinants of voluntary vs. forced restatements: log of the number of independent members (+), and proportion of independent members (+).
	Romanus et al. (2008) (US)	A match pair of 456 restated earnings firms in the period of 1998-2003and non-restated firms.	AC size, AC independence, AC financial expertise, AC meeting.	AC financial expertise (both continuous and dichotomous measurement of AC expertise) (-), AC meeting (-).
	Amoah and Tang (2010) (US)	143 restating firms between January 1, 1997 and June 30, 2002 of which 41 firms announced restatements-induced class action (US).	AC independence, AC meetings, AC accounting expert, AC financial expert, AC member's independence.	None

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Restatements	Cohen et al. (2010) (US)	606 public companies during 2005 of which 136 companies announced restatements.	AC industry expert (AC members who have experience with a company that is in the same two digit SIC code as the company where he serve as an AC member), percentage of AC financial expert, percentage of AC supervisory financial expert (member who has at least one of the following qualifications: CEO, chief operating officer, chairman of the board or a president of a company and is not an accounting financial expert), AC size, AC independence, the interaction between AC industry expert and auditor industry expert.	AC industry expert (-), the combination between AC industry expertise and AC accounting or supervisory financial expertise (-), the interaction between AC industry expert and auditor industry expert (-).
	Carcello Neal et al. (2011) (US)	104 restating firms for period of 2000-2001	AC independent, AC size, AC meeting, and AC financial expertise.	AC independent (-), AC financial expertise (-), AC size (-). AC is effective when the CEO is not formally involved in selecting board members.

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Restatements	Cohen et al. (2011)	18941 firms-year observation in period of 2001-2007	AC industry expert, AC financial expert, AC supervisory financial expert, AC size, AC independence.	AC industry expertise (-), interaction AC industry expertise and AC supervisory financial expert (-).
	Lisic et al. (2011)	1918 firms-year observation fro period of 2004-2005	AC financial expert, AC size, AC number of meeting.	Interaction AC financial expert and CEO power (+)
Fraudulent financial statements	Beasley (1996) (US)	A matched pair of 75 frauds and 75 non-fraud firms in the period of 1980-1991.	Presence of AC	None
	Dechow et al. (1996) (US)	92 firms in US sanctioned by the SEC Accounting and Auditing Enforcement Releases (AAERs) and 92 non-sanctioned firms.	Presence of AC	Presence of AC (-)
	Abbott et al. (2000) (US)	A matched pair of 78 firms sanctioned by the SEC AAERs for period of 1980-1996 and 78 non-sanctioned firms.	An index consists of AC meeting and AC independence.	The combination of AC meeting (at least two per year) and independence (members are not insiders) (-).
	Beasley et al. (2000) (US)	Fraud firms during 1987 to 1997 in 3 industry sectors: 25 financial service firms, 19 technology companies, and 22 health-care companies.	Presence of AC, AC independence, AC meeting number.	AC existence (AC formation) (-), AC independence (all members are outsiders), number of AC meetings (-).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Fraudulent financial statements	Abbott et al. (2004) (US)	A matched pair of 88 firms that restated financial statement in 1991 to 1999 and 88 non-restated firms.	AC independence, AC size, AC financial expertise, AC meeting.	AC independence (all members are independent) (-), AC meeting (at least four meetings in a year) (-), AC expertise (at least 1 financial expertise) (-).
	Farber (2005) (US)	A matched pair of 87 firms sanctioned by the SEC AAERs in1997 and 87 non-sanctioned firms.	AC meeting number, AC size, AC expertise, AC independence.	In a year prior to fraud detection, fraud firms have fewer AC independent members, AC meetings, and AC expertise. In three years after fraud detection, fraud firms have similar AC independence member and exceed the control firms in the number of audit committee meetings.
	Smaili and Labelle (2009) (Canada)	107 firms identified as reporting issuers in default by the Canadian Securities Administrators and the Ontario Securities Commission is matched with 107 other control firms.	AC independence, AC financial literate, and composite index consist of AC independence and AC financial literate.	AC financial literate (-), interaction between auditor and audit committee index (-).
	Owens-Jackson et al. (2009) (US)	A matched pair of 50 frauds and 50 non-fraud firms in the period of 1994-2001.	AC independence, AC expertise, AC meeting, AC governance experience (average number of boards of directors on which AC members have served), AC tenure.	AC independence (the proportion of independent directors on the AC) (-), AC meeting (average number of AC meetings per year) (-).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Perceived financial reporting quality by the Association for Investment Management and Research (AIMR) of analysts	Felo et al. (2003) (US)	119 firms from the 1992-1993 and 130 firms from the 1995-1996 AIMR Review of Corporate Reporting Practices.	AC independence, AC expertise, AC size.	• Perceived score 1995-96: AC expertise (+) • Perceived score 1992-93: none
Earnings informativeness and earnings transparency	Bryan, Liu, and Tiras (2004) (US)	• Earnings informativeness: 1291 firm-year observations of companies listed on the 1996 Fortune 500 for period of 1996-2000 • Earnings transparency: 1295 firm-year observations of companies listed on the 1996 Fortune 500 for period of 1996-2000.	AC independence, AC financial literate, AC meeting number, AC multiple directorships.	• Earnings informativeness: AC independence (+), AC financial literate (+) • Earnings transparency: AC independence (+), AC meeting number (+).
Level of interim financial disclosure (score of disclosure index)	Mangena and Pike (2005) (UK)	Interim report of 262 UK listed companies	Shareholding of AC members, AC expertise, AC size.	AC expertise (at least one) (+), Percentage of shares owned by AC members (-).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Poor earnings quality: small earnings increases and negative earnings avoidance	Vafeas (2005) (US)	252 firms between 1994 and 2000 based on *Fortune 500* survey	Percentage of AC insiders, percentage of AC active business executives, percentage of members with other AC experience, AC size AC meeting, AC stock ownership, AC tenure, AC multiple directorships, AC multiple committee membership.	Small earnings increase: percentage of AC insiders (+), percentage of active business executives (+), AC meetings (-), stock ownership of AC member (-), AC multiple directorships (-). Negative earnings avoidance : AC stock ownership (-), AC tenure (+), AC size (-).
Earnings informativeness	Petra (2007) (US)	765 firm-year observations of large firm based Forbes 500 for period of 1996-1998.	AC independence	None.
Qualified audit report	Pucheta-Martinez and Fuentes (2007) (Spain)	380 firm-year observations of listed companies in Spain for the period of 1999-2001.	AC formation, AC size, percentage of AC independence member, the proportion of large shareholder representatives in AC.	AC size (number of members) (+), AC independence (the proportion of independent members) (-) affected firms received qualifications for error and non-compliance issues.
Conservatism	Krishnan and Visvanathan (2008) (US)	929 firms for period of 2000-2002	AC financial expertise, AC independence, AC size, AC meeting number	AC financial expertise (+)

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Account reclassification	Flynn (2009) (US)	61 donors of non profit organizations (experiment)	AC member personal ties to organization	AC member personal ties (-)
Companies subject to adverse rulings by the Financial Reporting Review Panel (FRRP)	Song and Windram (2004) (UK)	54 companies subjects to press notice of FRRP for period of 1991-2000 in UK .	AC financial literate, AC meeting number, AC multiple directorships	None
Aggressive accounting choices (the total score of accounting choices that delay the recognition of expenses in comparison with other policies or estimates permitted within GAAP)	Rainsbury et al. (2009) (New Zealand)	87 New Zealand firms in 2001 when no regulations or listing rules existed for ACs	An index of AC best practice (comprises solely non-executive directors, the majorities are independent directors, and it includes an accounting expert)	None
Misappropriation of assets	Mustafa and Youssef (2010) (US)	A matched pair of 28 companies experiencing misappropriation of assets from 1987 to 1998 in the US and 28 control companies in same size, industry, and time period.	AC financial expertise, AC independence, AC independence members with financial expertise, AC independent members with non-financial expertise, AC tenure.	AC financial expertise (-),AC independence (-),AC independence members with financial expertise (-), AC tenure (-).

Table A.3 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Aggressive financial report decision (lease classification decision)	Agoglia, Doupnik, and Tsakumis (2011) (US)	Experiment with participants consists of 96 experienced financial statement preparers.	The strength of AC	When standard is precise, CFOs are less likely to report aggressively in the presence of a strong audit committee than a weak AC. AC has no effect when the standard is less precise.
Quality of analysts' forecast	Liu and Zhuang (2011) (US)	25667 firm-quarter observations of listed companies in US for period of 1998-2005	Number of directors in AC divided by board size, AC independent, AC accounting expertise, AC meeting number.	AC independence (+), AC accounting expertise (+), AC meeting number (+). AC has a moderating effect on the association between the issuance of management earnings forecasts and the quality of analysts' forecasts.
Misstatement tolerance	Norman, Rose, and Suh (2011) (US)	76 Chief Audit Executives (CAEs) and deputy of CAEs (experiment) (US).	AC financial expertise	None

Source: Compiled by the author
Note: AC= audit committee

Table A.4 Summary of the Prior Studies on Audit Committee Characteristics and Financial Reporting Quality in Developing Countries

Proxies for Financial Reporting Quality	Author(s) and Country of the Study	Sample	AC Related Variables	AC Significant Variables
Earnings management	Bradbury, Mak, and Tan (2006) (Singapore and Malaysia)	271 listed companies in Singapore and 279 listed companies in Malaysia in 2000	AC independence	AC independence
	Rahman and Ali (2006) (Malaysia)	97 firms listed on the Main Board of Bursa Malaysia over the period of 2002-2003	AC independence, AC meeting, AC financial expertise.	None
	Siallagan and Machfoedz (2006) (Indonesia)	197 firm-year observations of listed companies on IDX for period of 2000-2004.	Presence of AC	The presence of AC (+)
	Rachmawati and Triatmoko (2007) (Indonesia)	181 firm-year observations of listed companies on IDX for period 2001-2005	Presence of AC	None
	Chen et al. (2007) (Taiwan)	2237 firm-year observations of companies listed on Taiwan Stock Exchange for period of 2000-2003	AC financial expertise	AC financial expertise (-)
	Fitriasari (2007) (Indonesia)	93 firms listed on IDX in 2004	AC index, AC meeting, AC financial literacy.	None
	Jaggi and Leung (2007) (Hong Kong)	523 companies listed on Hong Kong Stock Exchanges for period of 1999-2000	Presence of AC	Presence of AC (-)

Table A.4 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country	Sample	AC Related Variables	AC Significant Variables
Earnings management	Nasution and Setiawan (2007) (Indonesia)	100 firm-year observations of banks listed on IDX for period of 2001-2005	The presence of AC	The presence of AC (-)
	Saleh et al. (2007) (Malaysia)	561 firms listed on the Bursa Malaysia in 2001	AC meeting, AC size, AC accounting expertise, AC independence, interaction between AC expertise and AC meeting.	AC independence (the presence of a fully independent AC) (-), interaction between AC expertise and AC meeting (the proportion of AC members with accounting knowledge multiply by frequency of AC meetings) (-).
	Siregar and Utama (2008) (Indonesia)	144 listed companies on IDX for period of 1995-1996, and 1999-2002	Presence of AC	None
	Al-Abbas (2009) (Saudi Arabia)	78 joint stock companies listed on Saudi Stock Exchange for the period of 2005-2007	AC size, AC independence	None
	Bukit and Iskandar (2009) (Malaysia)	155 companies listed on Bursa Malaysia in 2001	AC independence, interaction AC independence and surplus free cash flow.	AC independence (-), AC weakens the positive relationship between surplus free cash flow and earnings management.

Table A.4 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country	Sample	AC Related Variables	AC Significant Variables
Earnings management	Lin, Hutchinson et al. (2009) (Hong Kong)	208 firm-year observations of listed companies on Hong Kong Stock Exchange for period of 2004-2008	Presence of AC, AC financial expertise, AC meeting number, AC size, government officials on AC.	AC independence (-), AC expertise (-), AC size (-), government official on AC (+). AC size is negatively and significantly associated with abnormal accruals only when there are government officials on the AC.
	Murhadi (2009) (Indonesia)	384 firm-year observations of listed companies on IDX for period of 2005-2007	Presence of AC	None
	Pamudji and Trihartati (2009) (Indonesia)	168 firm-year observations of listed companies on the IDX for period of 2005-2007	AC independence, AC financial expertise, AC meeting, AC multiple directorship.	None
	Thoopsamut and Jaikengkit (2009) (Thailand)	457 firm-year observations of listed companies on Thailand Stock Exchange for period of 2005-2006	AC meeting number, AC tenure, AC financial expertise.	AC tenure (-)
	Murhadi (2010) (Indonesia)	384 firm-year observations of listed companies on the IDX for period of 2005-2007	Presence of AC	None

Table A.4 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country	Sample	AC Related Variables	AC Significant Variables
Earnings management	Wardhani and Joseph (2010) (Indonesia)	115 firm-year observations of listed companies on the IDX for period of 2005-2008	Age of AC chair, AC financial expertise, AC member experience as partner of public accounting firm, AC member education level, AC member experience as management.	AC financial expertise (-), AC member experience as partner of public accounting firm (+).
	Sahlan (2011) (Malaysia)	276 firm-year observations of listed companies on the Bursa Malaysia for period of 1994-2007	AC independence	AC independence (+)
	Siagian and Tresnaningsih (2011) (Indonesia)	80 listed companies on the JSX for the period of 1999-2004	AC independence	AC independence (-)
	Jao and Pagalung (2011) (Indonesia)	112 firm-year observations of listed companies on IDX for period of 2006-2009	AC meeting number	AC meeting number (-)
	Hermawan and Adinda (2012) (Indonesia)	111 state-owned companies listed on IDX for the period of 2009-2010	Presence of AC	None

Table A.4 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country	Sample	AC Related Variables	AC Significant Variables
Conservatism	Susiana and Herawaty (2007) (Indonesia)	280 firm-year observations of listed companies on IDX for period of 2000-2003	Presence of AC	None
	Wardhani (2008) (Indonesia)	235 firm-year observations of listed companies on IDX for period of 2003-2006	Presence of AC	The presence of AC (+)
	Wulandari and Zulaikha (2012) (Indonesia)	33 firm-year observations of listed companies for the period of 2008-2010	AC meeting number; AC financial expertise	AC meeting number (+); AC financial expertise (+)
Restatements	Veronica and Bachtiar (2005) Indonesia	160 listed companies on IDX in the period of 2001-2002	Presence of AC	None
	Abdullah et al. (2010) (Malaysia)	31 restating firms during the period of 2002-2005 and 31 matched control companies listed on Bursa Malaysia	AC independence (all AC members are independent)	AC independence (+)
	Zhizhong et al. (2011) (China)	880 restating firms during period of 2002-2006 and 4347 matched control firms listed on Shenzhen and Shanghai Securities Markets.	Presence of AC	The effectiveness of AC depends on independence of the board

Table A.4 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country	Sample	Proxies for Financial Reporting Quality	Author(s) and Country
Company received the financial report award (NACRA award)	Ismail et al. (2008) (Malaysia)	A matched pair of 54 companies with good annual reports and with 54 companies with poor annual reports in 2002 in Malaysia.	AC financial literate, AC meeting, AC multiple directorships, AC independence, interaction between AC independence and external auditors.	AC multiple directorships (+)
Accuracy of unaudited year-end quarterly accounts	Ibrahim et al. (2009) (Malaysia)	261 listed companies on Bursa Malaysia in 2004	AC financial expert ratio, AC multiple directorships, AC size, AC meeting number, AC independence.	AC size (+), AC multiple directorships (+).
Financial statement efficiency.	Akarak and Ussahawanitchakit (2010) (Thailand)	146 companies listed on Thai Stock Exchange	AC effectiveness index comprise five dimensions: 1) financial reporting preparation reliability, 2) internal audit effectiveness, 3) business risk management efficiency, 4) regulation practices achievement and 5) independence auditing process.	AC effectiveness index (+)
Manipulation of transfer prices in related-party sales transactions	Lo et al. (2010) (China)	266 listed companies on Shanghai Stock exchange in 2004	Presence of AC, AC financial expertise	AC financial expertise (-)

Table A.4 (continued)

Proxies for Financial Reporting Quality	Author(s) and Country	Sample	AC Related Variables	AC Significant Variables
Accounting irregularities	Jaswadi, Billington, and Sofocleous (2012) (Indonesia)	78 firm-year observations in the period of 2000-2009	AC size, proportion of independent members of AC, AC leadership, AC financial expert , AC financial literacy, and interaction of AC with board of directors, board of commissioners, and auditor	AC financial expert (-), interaction of AC and board of commissioners
Profit quality	Siahaan (2013) (Indonesia)	181 firm-year observations in the period of 2006-2008	Presence of AC	None
Fraud	Dewi and Gudono (2013) (Indonesia)	31 state-owned companies listed on IDX in the period of 2007-2010	AC member expertise, AC size , and AC effectiveness	AC effectiveness (-)
Timeliness of reporting	Ika and Ghazali (2012) (Indonesia)	211 firm-year observations of non-financial companies listed on IDX in 2008	AC effectiveness	AC effectiveness (-)
Earning informativeness	Hermawan (2009) (Indonesia)	Listed companies on IDX	AC effectiveness	AC effectiveness (+)

Source: Compiled by the author
Note: AC: audit committee

APPENDIX B: LIST OF SAMPLE

Table B.1 List of Sample of Research Stage 1

No.	Code	Company	ACCIT Score		
Agriculture, Forestry and Fishing			2006	2007	2008
1	AALI	Astra Agro Lestari Tbk	0.57	0.73	0.73
2	UNSP	Bakrie Sumatra Plantations Tbk	0.68	0.68	0.90
3	CPRO	Central Proteinaprima Tbk	0.00	0.80	0.80
4	DSFI	Dharma Samudera Fishing Ind. Tbk	0.63	0.63	0.63
5	IIKP	Inti Kapuas Arowana (Inti Indah Karya Plasindo) Tbk	0.20	0.57	0.57
6	LSIP	PP London Sumatera Tbk	0.20	0.35	0.52
Animal Feed and Husbandry					
7	CPDW	Cipendawa Agroindustri Tbk	0.47	0.47	0.47
8	CPIN	Charoen Pokphand Indonesia Tbk	0.78	0.95	0.95
9	JPFA	JAPFA Tbk	0.30	0.68	0.68
10	MAIN	Malindo Feedmil Tbk	0.47	0.47	0.47
11	MBAI	Multibreeder Adirama Indonesia Tbk	0.35	0.68	0.68
12	WAPO	Wahana Phonix Mandiri Tbk	0.47	0.63	0.63
Mining and Mining Services					
13	APEX	Apexindo Pratama Duta Tbk	0.95	0.90	0.78
14	ATPK	ATPK Resources Tbk	0.42	0.58	0.95
15	BUMI	Bumi Resources Tbk	0.95	0.95	0.95
16	CTTH	Citatah Industri Marmer Tbk	0.47	0.47	0.47
17	ENRG	Energi Mega Persada Tbk	0.78	0.95	0.78
18	INCO	INCO Tbk	0.90	0.90	0.90
Constructions					
19	PTRO	Petrosea Tbk	0.78	0.95	0.95
20	TOTL	Total Bangun Persada Tbk	0.95	0.68	0.68
21	TRUB	Truba Manunggal Engineering Tbk	0.20	0.25	0.47
Food and Beverages					
22	ADES	Ades Waters Indonesia Tbk	0.20	0.20	0.15
23	AQUA	Aqua Golden Mississippi Tbk	0.62	0.62	0.68
24	CEKA	Cahaya Kalbar Tbk	0.25	0.35	0.35
25	DAVO	Davomas Abadi Tbk	0.35	0.25	0.25
26	DLTA	Delta Djakarta Tbk	0.57	0.73	0.73
27	FAST	Fast Food Indonesia Tbk	0.25	0.25	0.25
28	INDF	Indofood Sukses Makmur Tbk	0.62	0.62	0.62
29	MYOR	Mayora Indah Tbk	0.20	0.25	0.25
30	MLBI	Multi Bintang Indonesia Tbk	0.62	0.78	0.73
31	PTSP	Pioneerindo Gourmet Int. Tbk	0.42	0.42	0.42
32	PSDN	Prasidha Aneka Niaga Tbk	0.35	0.68	0.68
33	SKLT	Sekar Laut Tbk	0.25	0.52	0.52
34	SIPD	Sierad Produce Tbk	0.83	0.67	1.00
35	SMAR	SMART Tbk	0.63	0.85	0.85
36	AISA	Tiga Pilar Sejahtera Food Tbk	0.40	0.40	0.52
37	TBLA	Tunas Baru Lampung Tbk	0.30	0.30	0.30
38	ULTJ	Ultra Jaya Milk Tbk	0.25	0.30	0.47
Tobacco Manufacturers					
39	BATI	BAT Indonesia Tbk	0.62	0.62	0.62
40	GGRM	Gudang Garam Tbk	0.52	0.52	0.52

Table B.1 (continued)

No.	Code	Company	ACCIT Score		
Tobacco Manufacturers			2006	2007	2008
41	HMSP	HM Sampoerna Tbk	0.57	0.73	0.78
42	RMBA	Bentoel International Investama Tbk	0.63	0.63	0.68
Textile Mill Products					
43	ARGO	Argo Pantes Tbk	0.52	0.52	0.90
44	CNTX	Century Textile Industry Tbk	0.68	0.85	0.85
45	ERTX	Eratex Djaja Limited Tbk	0.57	0.57	0.62
46	HDTX	Panasia Indosyntec Tbk	0.37	0.37	0.37
47	PAFI	Panasia Filament Inti Tbk	0.37	0.37	0.37
48	RDTX	Roda Vivatex Tbk	0.52	0.52	0.52
49	SSTM	Sunson Textile Manufacture Tbk	0.68	0.68	0.68
50	TFCO	TIFICO Tbk	0.37	0.90	0.90
Apparel and Other Textile Products					
51	MYTX	APAC Citra Centertex Tbk	0.25	0.20	0.20
52	ESTI	Ever Shine Textile Industry Tbk	0.68	0.68	0.85
53	FMII	Fortune Mate Indonesia Tbk	0.47	0.47	0.78
54	MYRX	Hanson International Tbk	0.52	0.52	0.30
55	SRSN	Indo Acidatama Tbk	0.80	0.85	0.85
56	INDR	Indorama Syntetics Tbk	0.80	0.80	0.75
57	KARW	Karwell Indonesia Tbk	0.20	0.20	0.20
58	PBRX	Pan Brothers Tbk	0.68	0.73	0.73
59	BIMA	Primarindo Asia Infrastr Tbk	0.10	0.10	0.10
60	BATA	Sepatu Bata Tbk	1.00	0.95	0.95
Lumber and Wood Products					
61	BRPT	Barito Pacific Timber Tbk	0.37	0.35	0.35
62	SULI	Sumalindo Lestari Jaya Tbk	0.62	0.78	0.78
63	TIRT	Tirta Mahakam Resources Tbk	0.47	0.47	0.47
Paper and Allied Products					
64	FASW	Fajar Surya Wisesa Tbk	0.68	0.68	0.68
65	INKP	Indah Kiat Pulp & Paper Tbk	0.68	0.68	0.68
66	TKIM	Pabrik Kertas Tjiwi Kimia Tbk	0.68	0.68	0.68
67	SPMA	Suparma Tbk	0.85	0.85	0.85
68	SAIP	Surabaya Agung Indonesia Pulp Tbk	0.47	0.63	0.63
Chemical and Allied Products					
69	AKRA	AKR Corporation Tbk	0.52	0.52	0.83
70	BUDI	Budi Acid Jaya Tbk	0.30	0.63	0.80
71	CLPI	Colorpak Indonesia Tbk	0.20	0.20	0.20
72	ETWA	Eterindo Wahanatama Tbk	0.47	0.47	0.52
73	LTLS	Lautan Luas Tbk	0.68	0.63	0.78
74	POLY	Polysindo Eka Perkasa Tbk	0.20	0.20	0.20
75	SOBI	Sorini Corporation Tbk	0.57	0.57	0.68
76	UNIC	Unggul Indah Cahaya Tbk	0.80	0.80	0.80
Adhesive					
77	DPNS	Duta Pertiwi Nusantara Tbk	0.52	0.68	0.68
78	EKAD	Ekadharma International Tbk	0.42	0.68	0.68
79	KKGI	Resource Alam Indonesia Tbk	0.37	0.42	0.47

Table B.1 (continued)

No.	Code	Company	ACCIT Score		
Plastics and Glass Products			2006	2007	2008
80	AKPI	Argha Karya Prima Industry Tbk	0.68	0.68	0.68
81	AMFG	Asahimas Flat Glass Tbk	0.73	0.90	0.90
82	APLI	Asiaplast Industries Tbk	0.85	0.80	0.80
Plastics and Glass Products					
83	BRNA	Berlina Tbk	0.00	0.45	0.45
84	DYNA	Dynaplast Tbk	0.52	0.80	0.80
85	FPNI	Fatrapolindo Nusa Industri Tbk	0.42	0.58	0.95
86	IGAR	Kageo Igar Jaya Tbk	0.37	0.37	0.37
87	LMPI	Langgeng Makmur Industry Tbk	0.20	1.00	1.00
88	LAPD	Lapindo International Tbk	0.25	0.25	0.25
89	SIMA	Siwani Makmur Tbk	0.57	0.57	0.57
90	TRST	Trias Sentosa Tbk	0.58	0.58	0.68
Cement					
91	SMCB	Holcim Indonesia Tbk	0.73	0.78	0.78
92	INTP	Indocement Tunggal Prakasa Tbk	0.85	0.85	0.85
Metal and Allied Products					
93	BTON	Betonjaya Manunggal Tbk	0.68	0.68	0.85
94	CTBN	Citra Tubindo Tbk	0.85	0.80	0.80
95	JPRS	Jaya Pari Steel Tbk	0.47	0.47	0.85
96	LION	Lion Metal Works Tbk	0.47	0.47	0.47
97	LMSH	Lion Mesh Prima Tbk	0.30	0.30	0.30
98	PICO	Pelangi Indah Canindo Tbk	0.45	0.45	0.45
Metal and Allied Products					
99	TBMS	Tembaga Mulia Semanan Tbk	0.20	0.20	0.47
100	TIRA	Tira Austenite Tbk	0.85	0.85	0.90
Fabricated Metal Products					
101	KICI	Kedaung Indah Canindo Tbk	0.20	0.68	0.68
102	KDSI	Kedawung Setia Industrial Tbk	0.52	0.78	0.73
Stone, Clay, Glass and Concrete Products					
103	ARNA	Arwana Citramulia Tbk	0.95	0.90	0.95
104	IKAI	Intikeramik Alamasri Industri Tbk	0.52	0.85	0.90
105	MLIA	Mulia Industrindo Tbk	0.63	0.63	0.63
106	TOTO	Surya Toto Indonesia Tbk	0.20	0.52	0.63
Cables					
107	KBLI	GT Kabel Indonesia Tbk	0.47	0.73	0.73
108	JECC	Jembo Cable Company Tbk	0.68	0.73	0.73
109	KBLM	Kabelindo Murni Tbk	0.52	0.52	0.52
110	IKBI	Sumi Indo Kabel Tbk	0.95	0.95	0.95
111	VOKS	Voksel Electric Tbk	0.47	0.90	0.95
Electronic and Office Equipment					
112	ASGR	Astra Graphia Tbk	0.95	0.95	0.95
113	MTDL	Metrodata Electronics Tbk	0.75	0.75	0.85
114	MLPL	Multipolar Corporation Tbk	0.73	0.73	0.68
Automotive and Allied Products					
115	ASII	Astra International Tbk	0.57	0.57	0.73
116	AUTO	Astra Otoparts Tbk	0.63	0.73	0.78

Table B.1 (continued)

No.	Code	Company	ACCIT Score		
Automotive and Allied Products			2006	2007	2008
117	BRAM	Branta Mulia Tbk	0.68	0.90	0.90
118	GJTL	Gajah Tunggal Tbk	0.37	0.37	0.37
119	GDYR	Goodyear Indonesia Tbk	0.47	0.47	0.47
120	HEXA	Hexindo Adiperkasa Tbk	0.85	0.78	0.95
121	IMAS	Indomobil Sukses Int. Tbk	0.47	0.78	0.78
122	INTA	Intraco Penta Tbk	0.47	0.57	0.90
123	LPIN	Multi Prima Sejahtera Tbk	0.68	0.68	0.68
124	MASA	Multistrada Arah Sarana Tbk	0.73	0.73	0.73
125	NIPS	Nipress Tbk	0.57	0.57	0.57
126	ADMG	Polychem Indonesia Tbk	0.68	0.63	0.63
127	PRAS	Prima Alloy Steel Tbk	0.52	0.85	0.68
128	SQMI	Allbound makmur Tbk	0.20	0.20	0.20
129	SMSM	Selamat Sempurna Tbk	0.80	0.80	0.80
130	SUGI	Sugi Samapersada Tbk	0.20	0.20	0.20
131	TURI	Tunas Ridean Tbk	0.85	0.90	0.90
132	UNTR	United Tractors Tbk	0.95	0.78	0.78
Photographic Equipment					
133	INTD	Inter Delta Tbk	0.20	0.20	0.20
134	MDRN	Modern Photo Film Company Tbk	0.40	0.78	0.78
135	KONI	Perdana Bangun Pusaka Tbk	0.57	0.73	0.73
Pharmaceuticals					
136	DVLA	Darya-Varia Laboratoria Tbk	0.10	0.10	0.10
137	KLBF	Kalbe Farma Tbk	0.47	0.63	0.63
138	MERK	Merck Tbk	0.20	0.68	0.63
139	PYFA	Pyridam Farma Tbk	0.47	0.52	0.52
140	SCPI	Schering Plough Indonesia Tbk	0.00	0.00	0.20
Consumer Goods					
141	TCID	Mandom Indonesia Tbk	0.68	0.68	0.68
142	MRAT	Mustika Ratu Tbk	0.83	0.83	0.78
143	UNVR	Unilever Indonesia Tbk	0.52	0.90	0.73
Transportation Services					
144	APOL	Arpeni Pratama Ocean Line Tbk	0.58	0.42	0.42
145	CMPP	Centris Multi Persada Pratama Tbk	0.52	0.52	0.68
146	HITS	Humpuss Intermoda Transp. Tbk	0.42	0.42	0.52
147	IATA	Indonesia Air Transport Tbk	0.30	0.30	0.35
148	MIRA	Mitra Rajasa Tbk	0.40	0.40	0.57
149	TMAS	Pelayaran Tempuran Emas Tbk	0.80	0.80	0.80
150	RIGS	Rig Tenders Tbk	0.80	0.80	0.85
151	SMDR	Samudera Indonesia Tbk	0.30	0.30	0.30
152	SAFE	Steady Safe Tbk	0.00	0.45	0.78
153	ZBRA	Zebra Nusantara Tbk	0.20	0.20	0.52
Telecommunication					
154	BTEL	Bakrie Telecom Tbk.	0.78	0.78	0.83
155	EXCL	Excelcomindo Pratama Tbk	0.95	0.95	0.95
156	IATG	Infoasia Teknologi Global Tbk	0.25	0.30	0.30
157	FREN	Mobile-8 Telecom Tbk	0.63	0.63	0.80

Table B.1 (continued)

No.	Code	Company	ACCIT Score		
Whole Sale and Retail Trade			2006	2007	2008
158	ALFA	Alfa Retailindo Tbk	0.30	0.20	0.42
159	TMPI	AGIS Tbk	0.20	0.20	0.47
160	AIMS	Akbar Indo Makmur Stimec Tbk	0.20	0.20	0.20
161	EPMT	Enseval Putra Megatrading Tbk	0.68	0.68	0.63
162	FISH	FKS Multi Agro Tbk	0.57	0.73	0.73
163	HERO	Hero Supermarket Tbk	0.47	0.47	0.62
164	MPPA	Matahari Putra Prima Tbk	0.68	0.90	0.78
165	SDPC	Millenium Pharmacon Int. Tbk	0.68	0.85	0.68
166	MAPI	Mitra Adiperkasa Tbk	0.52	0.68	0.68
167	MICE	Multi Indocitra Tbk	0.40	0.57	0.57
168	META	Nusantara Infrastructure Tbk	0.20	0.20	0.20
169	RALS	Ramayana Lestari Sentosa Tbk	0.57	0.57	0.57
Whole Sale and Retail Trade			2006	2007	2008
170	RIMO	Rimo Catur Lestari Tbk	0.20	0.57	0.57
171	TGKA	Tigaraksa Satria Tbk	0.95	0.95	0.95
172	TKGA	Toko Gunung Agung Tbk	0.37	0.47	0.37
173	WICO	Wicaksana Overseas Int. Tbk	0.20	0.20	0.20
Credit Agencies Other than Bank					
174	ADMF	Adira Dinamika Multi Finance Tbk	0.90	0.90	0.90
175	BFIN	BFI Finance Indonesia Tbk	0.68	0.85	0.85
176	BBLD	Buana Finance Tbk	0.90	0.90	0.90
177	MTFN	Global Financindo Tbk	0.80	0.80	0.73
178	CFIN	Clipan Finance Indonesia Tbk	0.00	0.68	0.68
179	DEFI	Danasupra Erapacific Tbk	0.52	0.52	0.52
180	GSMF	Equity Development Investment Tbk	0.15	0.68	0.68
181	INCF	Indo Citra Finance Tbk	0.42	0.42	0.42
182	MFIN	Mandala Multifinance Tbk	0.35	0.35	0.35
183	MITI	Mitra Investindo Tbk	0.30	0.30	0.30
184	LPPF	Pacific Utama Tbk	0.68	0.68	0.68
185	SMMA	Sinar Mas Multiartha Tbk	0.47	0.47	0.47
186	TRUS	Trust Finance Indonesia Tbk	0.20	0.47	0.47
187	WOMF	Wahana Ottomitra Multiartha Tbk	0.20	0.20	0.20
Securities					
188	ARTA	Arthavest Tbk	0.68	0.68	0.68
189	AKSI	Asia Kapitalindo Securities Tbk	0.25	0.25	0.40
190	BCAP	Bhakti Capital Indonesia Tbk	0.57	0.52	0.47
191	BHIT	Bhakti Investama Tbk	0.52	0.67	0.67
192	HADE	Hortus Danavest Tbk	0.47	0.47	0.47
193	KREN	Kresna Graha Securindo Tbk	0.57	0.63	0.63
194	LPPS	Lippo Securities Tbk	0.68	0.68	0.68
195	UNIT	United Capital Indonesia Tbk	0.15	0.15	0.25
196	APIC	Artha Pacifik Internasional Tbk	0.37	0.47	0.37
197	PEGE	Panca Global Securities Tbk	0.78	0.95	0.95
198	PANS	Panin Sekuritas Tbk	0.62	0.62	0.62
199	RELI	Reliance Securities Tbk	0.25	0.25	0.20

Table B.1 (continued)

No	Code	Company	ACCIT Score		
Securities			2006	2007	2008
200	TRIM	Trimegah Securities Tbk	0.73	0.73	0.78
201	YULE	Yulie Sekurindo Tbk	0.67	0.67	0.83
Insurance					
202	ABDA	Asuransi Bina Dana Arta Tbk	0.42	0.47	0.15
203	ASBI	Asuransi Bintang Tbk	0.75	0.75	0.75
204	ASDM	Asuransi Dayin MitraTbk	0.68	0.85	0.68
205	AHAP	Asuransi Harta Aman Pratama Tbk	0.35	0.68	0.85
206	ASJT	Asuransi Jasa Tania Tbk	0.15	0.15	0.15
207	AMAG	Asuransi Muti Artha Guna Tbk	0.47	0.52	0.57
208	ASRM	Asuransi Ramayana Tbk	0.40	0.40	0.45
209	LPGI	Asuransi Ramayana Tbk	0.63	0.80	0.68
210	MREI	Maskapai Reasuransi Indonesia Tbk	0.52	0.67	1.00
211	PNIN	Panin Insurance Tbk	0.47	0.63	0.63
212	PNLF	Panin Life Tbk	0.47	0.47	0.42
213	POOL	Pool Advista Indonesia Tbk	0.85	0.85	0.85
Real Estate and Property					
214	ELTY	Bakrieland Development Tbk	0.95	1.00	1.00
215	BIPP	Bhuwanatala Indah Permai Tbk	0.68	0.90	0.90
Real Estate and Property			2006	2007	2008
216	BMSR	Bintang Mitra Semestaraya Tbk	0.30	0.30	0.30
217	CKRA	Ciptojaya Kontrindoreksa Tbk	0.20	0.25	0.63
218	CTRA	Ciputra Development Tbk	0.40	0.62	0.47
219	CTRS	Ciputra Surya Tbk	0.47	0.52	0.47
220	KARK	Karka Yasa Profilia Tbk	0.00	0.20	0.20
221	DILD	Dharmala Intiland Tbk	0.68	0.68	0.68
222	DART	Duta Anggada Realty Tbk	0.20	0.90	0.90
223	DUTI	Duta Pertiwi Tbk	0.63	0.63	0.68
224	OMRE	Indonesia Prima Property Tbk	0.52	0.52	0.85
225	JIHD	Jakarta International Hotels & Development Tbk	0.63	0.63	0.68
226	JRPT	Jaya Real Property Tbk	0.35	0.35	0.40
227	JSPT	Jakarta Setiabudi International Tbk	0.63	0.68	0.68
228	KIJA	Kawasan Industri Jababeka Tbk	0.57	0.57	0.57
229	KPIG	Kridaperdana Indahgraha Tbk	0.42	0.57	0.57
230	LAMI	Lamicitra Nusantara Tbk	0.30	0.30	0.30
231	LPCK	Lippo Cikarang Tbk	0.63	0.63	0.63
232	LPKR	Lippo Karawaci Tbk	0.85	0.63	0.63
233	MAMI	Mas Murni Indonesia Tbk	0.68	0.85	0.68
234	MDLN	Modernland Realty Tbk	0.52	0.52	0.52
235	MTSM	Metro Supermarket Realty Tbk	0.25	0.25	0.25
236	PTRA	New Century Development Tbk	0.30	0.57	0.57
237	PWON	Pakuwon Jati Tbk	0.62	0.85	0.68
238	PWSI	Panca Wiratama Sakti Tbk	0.47	0.30	0.47
239	PNSE	Pudjiadi & Sons Estate Tbk	0.30	0.52	0.52
240	PUDP	Pudjiadi Prestige Limited Tbk	0.42	0.42	0.42
241	RBMS	Ristia Bintang Mahkotasejati Tbk	0.42	0.42	0.47
242	RODA	Roda Panggon Harapan Tbk	0.20	0.20	0.20
243	BKSL	Sentul City (d/h Bukit Sentul Tbk)	0.42	0.58	0.53

Table B.1 (continued)

No.	Code	Company	ACCIT Score		
244	SMRA	Summarecon Agung Tbk	0.68	0.85	0.85
245	SSIA	Surya Semesta Internusa Tbk	0.80	0.80	0.80
246	SIIP	Suryainti Permata Tbk	0.52	0.52	0.47
247	SMDM	Suryamas Dutamakmur Tbk	0.52	0.52	0.85
Hotel and Travel Services					
248	ANTA	Anta Express Tour & Travel Tbk	0.63	0.68	0.90
249	BAYU	Bayu Buana Tbk	0.52	0.52	0.52
250	SHID	Hotel Sahid Jaya International Tbk	0.42	0.63	0.63
251	PANR	Panorama Sentrawisata Tbk	0.20	0.57	0.62
252	PLIN	Plaza Indonesia Realty Tbk	0.78	0.95	0.95
253	SONA	Sona Topas Tourism Industry Tbk	0.30	0.30	0.30
Holding and Other Investment Companies			2006	2007	2008
254	ALKA	Alakasa Industrindo Tbk	0.73	0.73	0.73
255	BMTR	Bimantara Citra Tbk	0.57	0.52	0.57
256	BNBR	Bakrie & Brothers Tbk	0.57	0.73	0.90
257	PLAS	Palm Asia Corpora Tbk	0.30	0.30	0.25
Others					
258	ABBA	Abdi Bangsa Tbk	0.45	0.45	0.45
259	ARTI	Arona Binasejati Tbk	0.25	0.25	0.42
260	ASIA	Asiana Grain International Tbk	0.25	0.20	0.00
261	CENT	Centrin Online Tbk	0.63	0.68	0.68
262	CITA	Cipta Panelutama Tbk	0.25	0.25	0.25
263	CMNP	Citra Marga Nusaphala PersadaTbk	0.73	0.73	0.73
264	DNET	Dyviacom Intrabumi Tbk	0.15	0.15	0.15
265	FORU	Fortune Indonesia Tbk	0.20	0.57	0.52
266	GEMA	Gema Grahasarana Tbk	0.00	0.80	0.68
267	IDKM	Indosiar Karya Media Tbk	0.90	0.90	0.90
268	INDX	Indoexchange Tbk	0.37	0.47	0.63
269	ITTG	Integrasi Teknologi Tbk	0.57	0.42	0.42
270	JTPE	Jasuindo Tiga Perkasa Tbk	0.63	0.63	0.63
271	LMAS	Limas Centric Indonesia Tbk	0.47	0.47	0.52
272	LPLI	Lippo E-Net Tbk	0.63	0.63	0.63
273	RAJA	Rukun Raharja Tbk	0.47	0.47	0.47

Note: ACCIT = audit committee compliance index total.

Table B.2 Detail Sample for Period 2006-2012

	2006		2007		2008		2009		2010		2011		2012			Total
	I	A	I	A	I	A	I	A	I	A	I	A	I	A		
Restating companies	17	23	14	24	13	20	37	59	74	66	83	65	89	74		658
Less																
• Annual report revisions	-	(5)	-	(7)	-	(2)	-	(16)	-	(16)	-	(21)	-	(10)		(77)
• Bank	-	(3)	(1)	(2)	(1)	(3)	(1)	(3)	(7)	(5)	(10)	(6)	(8)	(10)		(60)
• State –owned enterprise	-	(1)	-	-	-	(1)	-	(1)	(3)	(3)	(2)	(3)	(1)	(4)		(19)
• Multiple restatements	(1)	-	-	(1)	(1)	-	(4)	-	(3)	-	(3)	(1)	(6)	(1)		(21)
• Unspecified	-	-	(2)	-	(2)	-	(5)	(12)	(11)	(8)	(7)	(4)	(7)	(7)		(65)
• Non GAO reasons																
▪ Accounting policy change	-	-	-	-	-	-	-	-	-	(2)	(2)	(1)	-	(2)		(7)
▪ Interrelated transaction	-	-	-	(3)	-	(1)	-	(5)	-	(2)	(1)	-	-	-		(12)
▪ Revision or additional disclosure in notes of financial statements	(1)	(1)	-	(1)	(1)	-	(6)	(2)	(3)	-	(2)	(2)	(5)	(3)		(27)
▪ Wording correction	(6)	(7)	(3)	(4)	(3)	(2)	(2)	(8)	(13)	(7)	(5)	(5)	(12)	(9)		(86)
▪ Mathematical correction	-	-	-	(1)	-	-	-	-	-	-	-	(1)	-	-		(2)
▪ Problem in sending files	(2)	-	-	-	(1)	(2)	(8)	(3)	(22)	(13)	(27)	(9)	(18)	(19)		(124)
Sub total	7	6	8	5	4	9	11	9	12	10	24	12	32	9		
• Interim															98	
• Annual															60	
Total																158

Note: I=interim financial statements; A=annual financial statements

Table B.3 List of Sample of Research Stage 2 (Annual Financial Statements Restatement)

No	Restatement Company		Control Company	
	2006			
1	ELTY	Bakrieland Development Tbk	SMRA	Summarecon Agung Tbk
2	EXCL	Excelcomindo Pratama Tbk	FREN	Mobile-8 Telecom Tbk
3	GJTL	Gajah Tunggal Tbk	INDR	Indorama Syntetics Tbk
4	TMPI	AGIS Tbk	ASGR	Astra Graphia Tbk
5	TRUB	Truba Manunggal Engineering Tbk	KIJA	Kawasan Industri Jababeka Tbk
6	SUGI	Sugi Samapersada Tbk Tbk	KONI	Perdana Bangun Pusaka Tbk
	2007			
7	AIMS	Akbar Indo Makmur Stimec Tbk	INTD	Inter Delta Tbk
8	BMTR	Bimantara Citra Tbk	BNBR	Bakrie & Brothers Tbk
9	HADE	Hortus Danavest Tbk	PNIN	Panin Insurance Tbk
10	SIMA	Siwani Makmur Tbk	LMSH	Lion Mesh Prima Tbk
11	SONA	Sona Topas Tourism Industry Tbk	PANR	Panorama Sentrawisata Tbk
	2008			
12	BNBR	Bakrie & Brothers Tbk	UNTR	United Tractors Tbk
13	IGAR	Kageo Igar Jaya Tbk	DSUC	Daya Sakti Unggul Corporation Tbk
14	LCGP	Laguna Cipta Griya Tbk	BIPP	Bhuwanatala Indah Permai Tbk
15	OKAS	Ancora Indonesia Resources Tbk	MAMI	Mas Murni Indonesia Tbk
16	SMMA	Sinar Mas Multiartha Tbk	BHIT	Bhakti Investama Tbk
17	SSIA	Surya Semesta Internusa Tbk	CTRS	Ciputra Surya Tbk
18	ARTI	Arona Binasejati Tbk	APEX	Apexindo Pratama Duta Tbk
19	UNSP	Bakrie Sumatra Plantations Tbk	LSIP	PP London Sumatera Tbk
20	SHID	Hotel Sahid Jaya Int. Tbk	FAST	Fast Food Indonesia Tbk
	2009			
21	ARTI	Arona Binasejati Tbk	KKGI	Resource Alam Indonesia Tbk
22	BUMI	Bumi Resources Tbk	INCO	INCO Tbk
23	ELTY	Bakrieland Development Tbk	SMRA	Summarecon Agung Tbk
24	ITMA	Sumber Energi Andalan Tbk	GMCW	Grahamas Citrawisata Tbk
25	META	Nusantara Infrastructure Tbk	TMPI	AGIS Tbk

Table B.3 (continued)

No		Restatement Company		Control Company
26	SHID	Hotel Sahid Jaya Int. Tbk	FAST	Fast Food Indonesia Tbk
27	SMMT	Golden Eagle Energy Tbk	DNET	Dyviacom Intrabumi Tbk
28	TRUB	Truba Manunggal Engin.Tbk	APOL	Arpeni Pratama Ocean Line Tbk
29	BMTR	Bimantara Citra Tbk	MLPL	Multipolar Corporation Tbk
	2010			
30	BMTR	Bimantara Citra Tbk	MLPL	Multipolar Corporation Tbk
31	JTPE	Jasuindo Tiga Perkasa Tbk	TIRA	Tira Austenite Tbk
32	MFIN	Mandala Multifinance Tbk	TRIM	Trimegah Securities Tbk
33	MTFN	Global Financindo Tbk	HADE	Hortus Danavest Tbk
34	PNIN	Panin Insurance Tbk	PNLF	Panin Life Tbk
35	PNSE	Pudjiadi & Sons Estate Tbk	CLPI	Colorpak Indonesia Tbk
36	RAJA	Rukun Raharja Tbk	RIMO	Rimo Catur Lestari Tbk
37	SMMT	Golden Eagle Energy Tbk	INDX	Indoexchange Tbk
38	TOTL	Total Bangun Persada Tbk	LPCK	Lippo Cikarang Tbk
39	DNET	Dyviacom Intrabumi Tbk	ASIA	Asiana Grain International Tbk
	2011			
40	ARII	Atlas Resources Tbk	CNKO	Central Korporindo Int. Tbk
41	ARTI	Arona Binasejati Tbk	PTRO	Petrosea Tbk
42	BAPA	Bekasi Asri Pemula Tbk	RBMS	Ristia Bintang Mahkotasejati Tbk
43	BAYU	Bayu Buana Tbk	CLPI	Colorpak Indonesia Tbk
44	BPFI	Batavia Prosperindo Finance Tbk	ASDM	Asuransi Dayin MitraTbk
45	BRMS	Bumi Resources Minerals Tbk	BMTR	Bimantara Citra Tbk
46	KARW	Karwell Indonesia Tbk	BIMA	Primarindo Asia Infrastr. Tbk
47	LCGP	Laguna Cipta Griya Tbk	MTSM	Metro Supermarket Realty Tbk
48	META	Nusantara Infrastructure Tbk	TMPI	AGIS Tbk
49	PNIN	Panin Insurance Tbk	PNLF	Panin Life Tbk
50	TRIL	Triwira Insanlestari Tbk	PUDP	Pudjiadi Prestige Limited Tbk
51	DNET	Dyviacom Intrabumi Tbk	INTD	Inter Delta Tbk
	2012			
52	AMAG	Asuransi Muti Artha Guna Tbk	ABDA	Asuransi Bina Dana Arta Tbk
53	BIPP	Bhuwanatala Indah Permai Tbk	LCGP	Laguna Cipta Griya Tbk
54	EXCL	Excelcomindo Pratama Tbk	FREN	Mobile-8 Telecom Tbk
55	LAPD	Lapindo International Tbk	TMAS	Pelayaran Tempuran Emas Tbk

Table B.3 (continued)

No		Restatement Company		Control Company
56	LPKR	Lippo Karawaci Tbk	ELTY	Bakrieland Development Tbk
57	META	Nusantara Infrastructure Tbk	TGKA	Tigaraksa Satria Tbk
58	RUIS	Radiant Utama Interinsco Tbk	KKGI	Resource Alam Indonesia Tbk
59	ULTJ	Ultra Jaya Milk Tbk	SIPD	Sierad Produce Tbk
60	SIMA	Siwani Makmur Tbk	LMSH	Lion Mesh Prima Tbk

Table B.4 List of Sample of Research Stage 2 (Interim Financial Statements Restatement)

No	Restatement Company		Control Company	
	2006			
1	ASJT	Asuransi Jasa Tania Tbk	MREI	Maskapai Reasuransi Indonesia Tbk
2	CTRA	Ciputra Development Tbk	KLBF	Kalbe Farma Tbk
3	CTRS	Ciputra Surya Tbk	MDLN	Modernland Realty Ltd Tbk
4	ICON	Island Concepts Indonesia Tbk	BAYU	Bayu Buana Tbk
5	LTLS	Lautan Luas Tbk	AKRA	AKR Corporation Tbk
6	MFIN	Mandala Multifinance Tbk	TRIM	Trimegah Securities Tbk
7	PANR	Panorama Sentrawisata Tbk	WICO	Wicaksana Overseas Int. Tbk
	2007			
8	ATPK	ATPK Reources Tbk	CTTH	Citatah Industri Marmer Tbk
9	CENT	Centrin Online Tbk	TKGA	Toko Gunung Agung Tbk
10	PKPK	Perdana Karya Perkasa Tbk	KKGI	Resource Alam Indonesia Tbk
11	RDTX	Roda Vivatex Tbk	GDYR	Goodyear Indonesia Tbk
12	SUGI	Sugi Samapersada Tbk	RIMO	Rimo Catur Lestari Tbk
13	TKIM	Pabrik Kertas Tjiwi Kimia Tbk	INKP	Indah Kiat Pulp & Paper Tbk
14	TRIM	Trimegah Securities Tbk	CFIN	Clipan Finance Indonesia Tbk
15	WEHA	Panorama Transportasi Tbk	CMPP	Centris Multi Persada Pratama Tbk
	2008			
16	AISA	Tiga Pilar Sejahtera Food Tbk	AQUA	Aqua Golden Mississippi Tbk
17	DSUC	Daya Sakti Unggul Corporation Tbk	TIRT	Tirta Mahakam Resources Tbk
18	FPNI	Fatrapolindo Nusa Industri Tbk	TRST	Trias Sentosa Tbk
19	MIRA	Mitra Rajasa Tbk	BTEL	Arpeni Pratama Ocean Line Tbk
	2009			
20	AKRA	AKR Corporation Tbk	PLIN	Plaza Indonesia Realty Tbk
21	ATPK	ATPK Resources Tbk	CTTH	Citatah Industri Marmer Tbk
22	BISI	Bisi International Tbk	IIKP	Inti Kapuas Arowana (Inti Indah Karya Plasindo) Tbk
23	BPFI	Batavia Prosperindo Finance Tbk	ASDM	Asuransi Dayin MitraTbk
24	CKRA	Ciptojaya Kontrindoreksa Tbk	TOTL	Total Bangun Persada Tbk
25	FMII	Fortune Mate Indonesia Tbk	PWSI	Panca Wiratama Sakti Tbk
26	LCGP	Laguna Cipta Griya Tbk	RBMS	Ristia Bintang Mahkotasejati Tbk

Table B.4 (continued)

No	Restatement Company		Control Company	
27	INVS	Inovisi Infracom Tbk	SAFE	Steady Safe Tbk
28	PSDN	Prasidha Aneka Niaga Tbk	STTP	Siantar TOP Tbk
29	TRUS	Trust Finance Indonesia Tbk	PEGE	Panca Global Securities Tbk
30	UNSP	Bakrie Sumatra Plantations Tbk	LSIP	PP London Sumatera Tbk
	2010			
31	ABBA	Abdi Bangsa Tbk	BAYU	Bayu Buana Tbk
32	ARTI	Arona Binasejati Tbk	KKGI	Resource Alam Indonesia Tbk
33	BAPA	Bekasi Asri Pemula Tbk	RBMS	Ristia Bintang Mahkotasejati Tbk
34	BIPP	Bhuwanatala Indah Permai Tbk	LCGP	Laguna Cipta Griya Tbk
35	BUVA	Bukit Uluwatu Villa Tbk	ASGR	Astra Graphia Tbk
36	CKRA	Ciptojaya Kontrindoreksa Tbk	LPCK	Lippo Cikarang Tbk
37	ITTG	Integrasi Teknologi Tbk	TMPO	Tempo Inti Media Tbk
38	KBLM	Kabelindo Murni Tbk	CNTX	Century Textile Industry Tbk
39	KICI	Kedaung Indah Canindo Tbk	PYFA	Pyridam Farma Tbk
40	MYRX	Hanson International Tbk	BIMA	Primarindo Asia Infrastr. Tbk
41	OMRE	Indonesia Prima Property Tbk	LAMI	Lamicitra Nusantara Tbk
42	RMBA	Bentoel International Investama Tbk	MYOR	Mayora Indah Tbk
	2011			
43	ATPK	ATPK Resources Tbk	PKPK	Perdana Karya Perkasa Tbk
44	BAPA	Bekasi Asri Pemula Tbk	RBMS	Ristia Bintang Mahkotasejati Tbk
45	BCIP	Bumi Citra Permai Tbk	BMSR	Bintang Mitra Semestaraya Tbk
46	BIPP	Bhuwanatala Indah Permai Tbk	OMRE	Indonesia Prima Property Tbk
47	BRAU	Berau Coal Energy Tbk	ENRG	Energi Mega Persada Tbk
48	CSAP	Catur Sentosa Adiprana	MTDL	Metrodata Electronics Tbk
49	CTTH	Citatah Industri Marmer Tbk	CITA	Cipta Panelutama Tbk
50	DSFI	Dharma Samudera Fishing Ind. Tbk	IIKP	Inti Kapuas Arowana (Inti Indah Karya Plasindo) Tbk
51	ETWA	Eterindo Wahanatama Tbk	TIRT	Tirta Mahakam Resources Tbk
52	GOLD	Golden Retailindo Tbk	RAJA	Rukun Raharja Tbk.
53	GTBO	Garda Tujuh Buana Tbk	MITI	Mitra Investindo Tbk
54	GMCW	Grahamas Citrawisata Tbk	ITTG	Integrasi Teknologi Tbk
55	HRUM	Harum Energy Tbk	BIPI	Benakat Petroleum Energy Tbk

Table B.4 (continued)

No		Restatement Company		Control Company
56	INPP	Indonesian Paradise Property Tbk	LPLI	Lippo E-Net Tbk
57	JTPE	Jasuindo Tiga Perkasa Tbk	TIRA	Tira Austine Tbk
58	KICI	Kedaung Indah Canindo Tbk	PYFA	Pyridam Farma Tbk
59	KKGI	Resource Alam Indonesia Tbk	RUIS	Radiant Utama Interinsco Tbk
60	MIRA	Mitra Rajasa Tbk	IATA	Indonesia Air Transport Tbk
61	PICO	Pelangi Indah Canindo Tbk	INAI	Indal Aluminium Industry Tbk
62	POOL	Pool Advista Indonesia Tbk	TMPO	Tempo Inti Media Tbk
63	SCMA	Surya Citra Media Tbk	TGKA	Tigaraksa Satria Tbk
64	SQMI	Renuka Coalindo Tbk	ALKA	Alakasa Industrindo Tbk
65	TRUS	Trust Finance Indonesia Tbk	PEGE	Panca Global Securities Tbk
66	WOMF	Wahana Ottomitra Multiartha Tbk	MFIN	Mandala Multifinance Tbk
	2012			
67	ABBA	Abdi Bangsa Tbk	BAYU	Bayu Buana Tbk
68	APOL	Arpeni Pratama Ocean Line Tbk	CMNP	Citra Marga Nusaphala PersadaTbk
69	APLN	Agung Podomoro Land Tbk	CTRA	Ciputra Development Tbk
70	ASRM	Asuransi Ramayana Tbk	LPGI	Asuransi Ramayana Tbk
71	BFIN	BFI Finance Indonesia Tbk	WOMF	Wahana Ottomitra Multiartha Tbk
72	BKSL	Sentul City (d/h Bukit Sentul Tbk)	DILD	Dharmala Intiland Tbk
73	BWPT	BW Plantation Tbk	SGRO	Sampoerna Argo Tbk
74	CMPP	Centris Multi Persada Pratama Tbk	WEHA	Panorama Transportasi Tbk
75	CPIN	Charoen Pokphand Indonesia Tbk	SMCB	Holcim Indonesia Tbk
76	DLTA	Delta Djakarta Tbk	SKLT	Sekar Laut Tbk
77	DSFI	Dharma Samudera Fishing Ind. Tbk	IIKP	Inti Kapuas Arowana (Inti Indah Karya Plasindo) Tbk
78	GLOB	Global Teleshop Tbk	LPLI	Lippo E-Net Tbk
79	GTBO	Garda Tujuh Buana Tbk	ARTI	Arona Binasejati Tbk
80	JPFA	JAPFA Tbk	FASW	Fajar Surya Wisesa Tbk
81	KPIG	Kridaperdana Indahgraha Tbk	RODA	Roda Panggon Harapan Tbk
82	LMAS	Limas Centric Indonesia Tbk	FORU	Fortune Indonesia Tbk
83	MDLN	Moderland Realty Tbk	SSIA	Surya Semesta Internusa Tbk
84	MICE	Multi Indocitra Tbk	LPPS	Lippo Securities Tbk

Table B.4 (continued)

No		Restatement Company		Control Company
85	MITI	Mitra Investindo	CTTH	Citatah Industri Marmer Tbk
86	MTFN	Global Financindo Tbk	HADE	Hortus Danavest Tbk
87	MTLA	Metropolitan Land Tbk	CKRA	Ciptojaya Kontrindoreksa Tbk
88	PUDP	Pudjiadi Prestige Limited Tbk	PNSE	Pudjiadi & Sons Estate Tbk
89	RMBA	Bentoel International Investama Tbk	MYOR	Mayora Indah Tbk
90	SAFE	Steady Safe Tbk	ZBRA	Zebra Nusantara Tbk
91	SCCO	Sucaco Tbk	KBLI	GT Kabel Indonesia Tbk
92	SDMU	Sidomulyo Selaras Tbk	MIRA	Mitra Rajasa Tbk
93	TMPI	AGIS Tbk	MTDL	Metrodata Electronics Tbk
94	TOBA	Toba Bara Sejahtera Tbk	BIPI	Benakat Petroleum Energy Tbk
95	TOTL	Total Bangun Persada Tbk	LPCK	Lippo Cikarang Tbk
96	TRIL	Triwira Insanlestari Tbk	SDPC	Millenium Pharmacon Int. Tbk
97	TRUB	Truba Manunggal Engineering Tbk	HITS	Humpuss Intermoda Transp. Tbk
98	WICO	Wicaksana Overseas Int. Tbk	TKGA	Toko Gunung Agung Tbk

APPENDIX C: INDONESIAN OFFSHORE COMPANIES

Table C. List of Indonesian Offshore Companies

No	Code	Year	Name of Company	Jurisdiction	Source
1	BUMI	2006-2007	Willow finance Ltd	Cayman Islands	Business magazine
2	APEX	2008	Mira international holdings Pte Ltd	Singapore	PLC’s annual report; PLC’s announcement to IDX
3	BAYU	2004-2007	ABN AMRO Bank N.V. Singapore*	Singapore	PLC’s annual report
4	SHID	2007-2009	Merchiston Group Ltd	Singapore	Judgment
5	RBMS	2004-2009	Aussie Properties Ltd	British Virgin Islands	PLC’s announcement to IDX
6	BNBR	2008	Long Haul Holding Ltd	Charlestown, Nevis	PLC’s annual report
7	INDF	2000-2009	CAB Holdings Ltd	Mahe, Seychelles	PLC’s holding website
8	SMDM	2009-2009	Asia Capital Holding Ltd	Mahe, Seychelles	Judgment
9	LPGI	2002-2009	Pacific Asia Holding Ltd	Cook Islands	Business magazine
10	JAPFA	2003-2009	Pacific Focus Enterprise Ltd	British Virgin Islands	PLC’s annual report
11	MITI	2007-2009	Olive Crest Corporation Ltd	British Virgin Islands	Business magazine
12	MREI	2004-2009	ABN Amro Bank NV*	Singapore	PLC’s announcement to IDX
13	SIIP	2005-2009	Eastlion Worldwide Ltd	Singapore	Monthly shares announcement
14	GJTL	2006-2009	Denham Pte Ltd	Singapore	Securities broker research
15	ENRG	2005-2008	UBS AG*	Singapore	PLC’s annual report
16	ABDA	2004-2009	ABN Amro Bank NV*	Singapore	Monthly shares announcement; PLC’s announcement to IDX
17	RMBA	2008	Bella Sapphire Ventures Ltd	Mahe, Seychelles	PLC’s announcement to IDX
18	PTSP	2003-2009	Deutsche Bank*	Singapore	Monthly shares register

Table C (continued)

No	Code	Year	Name of Company	Jurisdiction	Source
19	CEKA	2006-2009	Trade Sound Investment Ltd	British Virgin Islands	PLC's announcement to IDX
20	ZBRA	2005-2009	Beautex offshore Inc. Ltd	British Virgin Islands	Business newspaper; PLC's announcement to IDX
21	DART	2006-2008	Quay Capital Ltd	British Virgin Islands	Judgment
22	PWON	2006-2009	BSL Investment Inc.	British Virgin Islands	Judgment
			Burgami Investments Ltd	British Virgin Islands	Judgment
23	OMRE	2006-2009	First Pacific Capital Group Ltd	Hong Kong	ICRIS document; Judgment
24	CKRA	2008-2009	Citra Group Pte Ltd	Singapore	ACRA document
25	TRIM	2007-2008	Demerara Limited	Hong Kong	Business magazine
26	BKSL	2007-2009	Athena Offshore Holding Ltd	British Virgin Islands	PLC's announcement to IDX
27	LMAS	2005-2009	Cantaloupe Assets Ltd	British Virgin Islands	PLC's Prospectus
28	LPPF	2000-2009	Pacific Asia Holdings Ltd	Cook Islands	Business magazine
29	SMMA	2004-2009	JBC International Finance Ltd	Mauritius	PLC's announcement to IDX
30	LPPS	2001-2009	Pacific Asia Holdings Ltd	Mauritius	Business magazine
31	RELI	2006-2009	Reliance Financial Holdings Ltd	British Virgin Islands	PLC's prospectus
32	ADES	2008-2009	Sofos Pte Ltd	Singapore	PLC's announcement to IDX; ACRA document
33	PSDN	2006-2009	Innovest offshore Ventures Ltd	British Virgin Islands	PLC's announcement to IDX
34	SKLT	2006-2009	Omnistar Investment Holdings Ltd	Singapore	Judgment

Table C (continued)

No	Code	Year	Name of Company	Jurisdiction	Source
35	HDTX	2006-2007	Evercon Overseas Ltd	Labuan, Malaysia	PLC's announcement to IDX
		2007-2009	Mercury Capital International Inc.	British Virgin Islands	PLC's announcement to IDX
		2008-2009	Abernova Overseas Ltd	Jersey, Channel Islands	PLC's announcement to IDX
36	PAFI	2005-2009	Abernova Overseas Ltd	Jersey, Channel Islands	PLC's announcement to IDX
		2006-2009	Evercon Overseas Ltd	Labuan, Malaysia	PLC's announcement to IDX
37	BRPT	2007-2009	Magna Resources Corporation Pte Ltd	Singapore	ACRA document
38	TIRT	2006-2009	Eton Asset Management Ltd	British Virgin Islands	Monthly shares announcement
39	DYNA	2004-2007	HSBC Fund Services*	Hong Kong	PLC's announcement to IDX
40	JPRS	2007-2009	International Magnificent Fortune Ltd	Hong Kong	Not registered at ICRIS
41	KICI	2000-2009	DK Lim & Sons Investment Pte Ltd	Singapore	ACRA document
42	IKAI	2007-2009	Best Achievement Investment Ltd	Hong Kong	ICRIS document; PLC's announcement to IDX
43	KBLI	2003-2009	Javas Premier Venture Capital Ltd	Labuan, Malaysia	Judgement
44	VOKS	2007-2009	Perfect Prospect Ltd	Singapore	PLC's announcement to IDX
45	MLPL	2001-2009	Across Asia Ltd	Cayman Islands	Business magazine
46	IMAS	2008-2009	Citibank*	Singapore	PLC's announcement to IDX
47	ADMG	2005-2006	HSBC Trustee*	Singapore	PLC's annual report; PLC's announcement to IDX

Table C (continued)

No	Code	Year	Name of Company	Jurisdiction	Source
48	INTA	2006-2009	Pristine Resources International Pte Ltd.	Singapore	ACRA document
			Westwood Finance Inc.	Mahe Seychelles	Judgment
50	MYTX	2004-2009	Growth Solution Ltd	Samoa	Judgment
51	BMSR	2003-2008	Share haven finance Ltd	British Virgin Islands	PLC's announcement to IDX
52	LPIN	2001-1009	Pacific Asia Holding ltd	Cook island	Business magazine
53	PICO	2004-2009	Hammond Holdings Ltd	Samoa	Judgment
54	MTFN	2003-2009	BFC CPV Ltd	Labuan Malaysia	PLC's web
55	GSMF	2003-2009	Equity Global International Ltd	Hong Kong	ICRIS document
56	MTSM	2001-2009	Bara Pte Ltd	Singapore	ACRA document
57	ASIA	2005-2007	Wellstead Investment Pte Ltd	Singapore	PLC's announcement to IDX
		2008-2009	Rich Achieve Enterprises Ltd	Hong Kong	PLC's announcement to IDX
58	CITA	2007-2009	Richburg Enterprise Pte Ltd	Singapore	Short prospectus of PLC
59	ITTG	2008-2009	Goodwill investment service	Marshall Islands	Tender offer document of PLC

* Custodian bank or nominee on behalf of Indonesian

Note: PLC= public listed company

APPENDIX D: RESULTS OF PANEL DATA ANALYSIS

Table D.1 Results of Panel Data for Model 1

Variable	Exp. Sign	Without Year Dummy			With Year Dummy			With Lag Dependent Variable			GMM-sys
		Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	
$ACCIT_{(t-1)}$	+	-	-	-	-	-	-	0.758***	-0.015	0.569***	0.006
								(0.000)	(0.674)	(0.000)	(0.920)
FMLBOCD	-	-0.026	-0.178***	-0.061***	-0.025	-0.131	-0.055**	-0.005	-0.074*	-0.012	0.013
		(0.125)	(0.000)	(0.006)	(0.134)	(0.001)	(0.011)	(0.694)	(0.071)	(0.465)	(0.918)
GLFRG	+	0.020	0.015	0.024	0.017	0.014	0.017	0.013	-0.005	0.017	0.137
		(0.304)	(0.657)	(0.291)	(0.363)	(0.649)	(0.434)	(0.348)	(0.892)	(0.330)	(0.110)
POLIC	-	-0.049***	-0.018	-0.032	-0.049***	-0.026	-0.032*	-0.024*	-0.025	-0.029	-0.024
		(0.009)	(0.495)	(0.116)	(0.007)	(0.288)	(0.096)	(0.092)	(0.474)	(0.101)	(0.739)
Control variable											
ICED	+	0.032*	0.026	0.035*	0.031*	0.032	0.035**	0.024*	-0.027	0.020	0.058
		(0.080)	(0.238)	(0.054)	(0.082)	(0.114)	(0.040)	(0.077)	(0.365)	(0.222)	(0.230)
BOC	+	0.215***	0.127**	0.166***	0.202***	0.069	0.124**	0.024	0.052	0.023	-0.014
		(0.000)	(0.045)	(0.002)	(0.000)	(0.238)	(0.014)	(0.573)	(0.249)	(0.623)	(0.913)
BCS	+	0.017***	0.003	0.009	0.018***	0.004	0.012**	-0.003	0.010	0.001	0.000
		(0.001)	(0.695)	(0.125)	(0.000)	(0.578)	(0.030)	(0.373)	(0.819)	(0.852)	(0.976)
AUD	+	0.073***	-0.023	0.033	0.079***	0.012	0.052***	0.027**	0.007	0.039**	0.087
		(0.000)	(0.455)	(0.109)	(0.000)	(0.679)	(0.008)	(0.039)	(0.234)	(0.016)	(0.203)
LOSS	-	-0.028	0.001	-0.006	-0.033*	-0.003	-0.012	-0.008	0.017	-0.010	0.025
		(0.139)	(0.946)	(0.683)	(0.076)	(0.823)	(0.352)	(0.554)	(0.441)	(0.478)	(0.398)
Sqrt	+	-0.071**	0.004	-0.047	-0.073**	-0.030	-0.059*	-0.013	-0.034	-0.029	0.027
LEV		(0.037)	(0.935)	(0.209)	(0.029)	(0.507)	(0.092)	(0.610)	(0.441)	(0.331)	(0.676)

Table D.1 (continued)

Variable	Exp. Sign	Without Year Dummy			With Year Dummy			With Lag Dependent Variable			GMM-sys
		Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	
SIZE	+	0.027***	0.068***	0.043***	0.024***	0.026**	0.027***	0.009**	0.045***	0.014***	0.045**
		(0.000)	(0.000)	(0.000)	(0.000)	(0.017)	(0.000)	(0.018)	(0.000)	(0.002)	(0.022)
Year Dummy											
2007	+	-	-	-	0.074***	0.073***	0.074***	-	-	-	-
					(0.000)	(0.000)	(0.000)				
2008	+	-	-	-	0.101***	0.096***	0.098***	-	-	-	-
					(0.000)	(0.000)	(0.000)				
Constant		0.088	-0.290*	-0.055	0.075	0.217	0.097	0.064	0.018	0.092	-0.068
		(0.215)	(0.060)	(0.534)	(0.280)	(0.151)	(0.266)	(0.227)	(0.909)	(0.158)	(0.773)
F		19.71***	6.84***	-	20.05***	15.22***	-	107.50***	2.63***	-	1.72*
		(0.000)	(0.000)		(0.000)	(0.000)		(0.000)	(0.0033)		(0.068)
R^2		0.1944	0.110	0.175	0.228	0.1453	0.218	0.6865	0.0945	0.6738	-
Wald chi2(10)		-	-	115.09	-	-	-	-	-	-	-
Wald chi2(11)		-	-	-	-	-	-	-	-	562.66	-
Wald chi2(12)		-	-	-	-	-	245.23	-	-	-	-
Prob > chi2		-	-	0.000	-	-	0.000	-	-	0.000	-
N		828	828	828	828	828	828	552	552	552	552
No. Instruments		-	-	-	-	-	-	-	-	-	45
No. Groups		-	-	-	-	-	-	-	-	-	276
AR(1) test		-	-	-	-	-	-	-	-	-	7.59***
											(0.002)
Hansen test of over-identification		-	-	-	-	-	-	-	-	-	76.31***
											(0.000)

Table D.2 Results of Panel Data for Model 2

Variable	Exp. Sign	With Year Dummy			Without Year Dummy			With Lag Dependent Variable			GMM-sys
		Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	
$ACCIT_{(t-1)}$	+	-	-	-	-	-	-	0.758***	-0.017	0.571***	0.069***
								(0.000)	(0.649)	(0.000)	(0.315)
PROFBOCD	+	0.028	0.033	0.025	0.316	0.048	0.038	0.000	-0.048	0.002	0.078
		(0.231)	(0.424)	(0.374)	(0.168)	(0.209)	0.153	(0.982)	(0.212)	(0.925)	(0.536)
GLFRG	+	0.031	0.024	0.039*	0.028	0.020	0.030	0.015	0.003	0.021	0.146*
		(0.098)	(0.492)	(0.078)	(0.124)	(0.534)	0.154	(0.271)	(0.933)	(0.216)	(0.056)
POLIC	-	-0.048	-0.011	-0.030	-0.048***	-0.022	-0.031	-0.024*	-0.018	-0.028	-0.015
		(0.010)	(0.689)	(0.138)	(0.008)	(0.375)	0.112	(0.095)	(0.596)	(0.108)	(0.815)
Control variable											
ICED	+	0.032	0.022	0.033*	0.031*	0.030	0.034**	0.024*	-0.033	0.019	0.062
		(0.080)	(0.323)	(0.067)	(0.080)	(0.143)	(0.045)	(0.080)	(0.182)	(0.232)	(0.231)
BOC	+	0.214	0.166	0.178***	0.200***	0.094	0.133***	0.025	0.053	0.026	-0.030
		(0.000)	(0.009)	(0.001)	(0.000)	(0.111)	(0.008)	(0.550)	(0.359)	(0.580)	(0.813)
BCS	+	0.017	0.004	0.009	0.180***	0.005	0.012**	-0.003	0.010	0.001	-0.005
		(0.001)	(0.664)	(0.107)	(0.000)	(0.523)	(0.024)	(0.379)	(0.256)	(0.844)	(0.776)
AUD	+	0.075	-0.018	0.036*	0.081***	0.017	0.056***	0.027**	0.006	0.039**	0.070
		(0.000)	(0.552)	(0.076)	(0.000)	(0.555)	(0.004)	(0.040)	(0.844)	(0.017)	(0.350)
LOSS	-	-0.027	-0.003	-0.007	-0.032*	-0.008	-0.014	-0.008	0.017	-0.010	0.020
		(0.149)	(0.826)	(0.615)	(0.082)	(0.597)	(0.289)	(0.549)	(0.233)	(0.466)	(0.466)
Sqrt	+	-0.072	0.007	-0.045	-0.075**	-0.028	-0.058	-0.012	-0.035	-0.028	0.003
LEV		(0.034)	(0.892)	(0.227)	(0.025)	(0.545)	(0.101)	(0.627)	(0.437)	(0.352)	(0.954)
SIZE	+	0.027	0.066	0.042***	0.023***	0.023**	0.026***	0.009**	0.043***	0.014***	0.036**
		(0.000)	(0.000)	(0.000)	(0.000)	(0.037)	(0.000)	(0.019)	(0.000)	(0.003)	(0.044)

Table D.2 (continued)

Variable	Exp. Sign	Without Year Dummy			With Year Dummy			With Lag Dependent Variable			GMM-sys
		Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	
Year Dummy											
2007	+	-	-	-	0.074*** (0.000)	0.075*** (0.000)	0.074*** (0.000)	-	-	-	-
2008	+	-	-	-	0.102*** (0.000)	0.100*** (0.000)	(0.100)*** 0.000	-	-	-	-
Constant		0.070 (0.313)	-0.416 (0.007)	0.100 (0.246)	0.059 (0.385)	0.147 (0.330)	0.057 (0.503)	0.059 (0.250)	-0.010 (0.948)	0.082 (0.198)	0.231 (0.928)
F		19.60*** (0.000)	4.91*** (0.000)	-	20.01*** (0.000)	14.13*** (0.000)	-	107.45*** (0.000)	2.49*** (0.0061)	-	1.48 (0.138)
R^2		0.194	0.128	-	0.228	0.193	-	0.6864	0.0878	0.6743	-
Wald chi2(10)		-	-	108.63	-	-	-	-	-	-	-
Wald chi2(11)		-	-	-	-	-	-	-	-	564.60	-
Wald chi2(12)		-	-	-	-	-	239.46	-	-	-	-
Prob > chi2		-	-	0.000	-	-	0.000	-	-	0.000	-
N		828	828	828	828	828	828	552	552	552	552
No. Instruments		-	-	-	-	-	-	-	-	-	45
No. Groups		-	-	-	-	-	-	-	-	-	276
AR(1) test		-	-	-	-	-	-	-	-	-	6.94*** (0.000)
Hansen Test of Over-Identification		-	-	-	-	-	-	-	-	-	84.01*** (0.000)

Table D.3 Results of Panel Data for Model 3

Variable	Exp. Sign	Without Year Dummy			With Year Dummy			With Lag Dependent Variable			GMM-sys
		Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	
$ACCIT_{(t-1)}$	+	-	-	-	-	-	-	0.759***	-0.016	0.570***	0.022
								(0.000)	(0.659)	(0.000)	(0.728)
FMLBOCD	-	-0.033**	-0.180***	-0.066***	-0.032**	-0.138***	-0.063***	-0.007	-0.068*	-0.015	0.030
		(0.045)	(0.000)	(0.003)	(0.043)	(0.000)	(0.003)	(0.551)	(0.097)	(0.334)	(0.824)
FRGOWN	+	-0.000	-0.000	0.000	-0.000	-0.001	-0.000	0.000	0.000	0.000	0.001
		(0.570)	(0.860)	(0.876)	(0.306)	(0.116)	(0.171)	(0.643)	(0.514)	(0.737)	(0.132)
POLIC	-	-0.051***	-0.019	-0.033	-0.052***	-0.029	-0.035*	-0.024*	-0.026	-0.030*	-0.059
		(0.006)	(0.486)	(0.109)	(0.005)	(0.243)	(0.074)	(0.086)	(0.452)	(0.090)	(0.388)
Control variable											
ICED	+	0.030*	0.025	0.034*	0.029	0.028	0.033*	0.023*	-0.025	0.018	0.070
		(0.097)	(0.262)	(0.062)	(0.101)	(0.169)	(0.052)	(0.089)	(0.300)	(0.255)	(0.139)
BOC	+	0.218***	0.130**	0.167***	0.207***	0.074	0.127**	0.023	0.049	0.023	0.011
		(0.000)	(0.041)	(0.002)	(0.000)	(0.203)	(0.012)	(0.580)	(0.399)	(0.626)	(0.930)
BCS	+	0.018***	0.004	0.009	0.019***	0.006	0.013**	-0.003	0.009	0.001	0.009
		(0.000)	(0.654)	(0.110)	(0.000)	(0.416)	(0.018)	(0.400)	(0.327)	(0.812)	(0.569)
AUD	+	0.081***	-0.024	0.036*	0.087***	0.009	0.057***	0.029**	0.008	0.042***	0.070
		(0.000)	(0.441)	(0.073)	(0.000)	(0.749)	(0.003)	(0.025)	(0.794)	(0.009)	(0.415)
LOSS	-	-0.026	0.001	-0.005	-0.030	-0.003	-0.011	-0.008	0.017	-0.010	0.012
		(0.168)	(0.933)	(0.707)	(0.100)	(0.853)	(0.403)	(0.555)	(0.240)	(0.489)	(0.653)
Sqrt	+	-0.070**	0.004*	-0.047	-0.072**	-0.032	-0.060*	-0.013	-0.034	-0.029	-0.069
LEV		(0.039)	(0.0942)	(0.207)	(0.030)	(0.484)	(0.088)	(0.618)	(0.441)	(0.336)	(0.208)
SIZE	+	0.027***	0.069***	0.043***	0.024***	0.031***	0.029***	0.009**	-0.034***	0.014***	0.034*
		(0.000)	(0.000)	(0.000)	(0.000)	(0.006)	(0.000)	(0.023)	(0.000)	(0.003)	(0.066)

Table D.3 (continued)

Variable	Exp. Sign	Without Year Dummy			With Year Dummy			With Lag Dependent Variable			GMM-sys
		Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	Pooled OLS	Fixed Effects	Random Effects	
Year Dummy											
2007	+	-	-	-	0.075*** (0.000)	0.074*** (0.000)	0.074*** (0.000)	-	-	-	-
2008	+	-	-	-	0.103*** (0.000)	0.098*** (0.000)	0.101*** (0.000)	-	-	-	-
Constant		0.097 (0.170)	-0.301* (0.055)	-0.051 (0.564)	0.084 (0.226)	0.179 (0.239)	0.096 (0.271)	0.068 (0.198)	0.044 (0.778)	0.097 (0.138)	0.037 (0.877)
F		19.62*** (0.000)	6.82*** (0.000)	-	20.07*** (0.000)	15.47*** (0.000)	-	107.30*** (0.000)	2.67*** (0.0029)	-	2.37*** (0.008)
R^2		0.194	0.109	0.173	0.228	0.144	0.217	0.6861	0.0950	0.6735	-
Wald chi2(10)		-	-	113.86	-	-	-	-	-	-	-
Wald chi2(11)		-	-	-	-	-	-	-	-	560.14	-
Wald chi2(12)		-	-	-			246.90			-	-
Prob > chi2		-	-	0.000	-	-	0.000	-	-	0.000	-
N		828	828	828	828	828	828	552	552	552	552
No. Instruments		-	-	-	-	-	-	-	-	-	45
No. Groups		-	-	-	-	-	-	-	-	-	276
AR(1) test		-	-	-	-	-	-	-	-	-	7.31*** (0.000)
Hansen test of over-identification		-	-	-	-	-	-	-	-	-	81.59*** (0.000)

Note: p value is in parenthesis; *, **, *** indicates significance at the 0.10, 0.05 and 0.01 respectively; R^2 for fixed effects and random effects are overall. ACCIT= audit committee compliance index total; FMLBOCD = family-controlled company with family members on the boards; PROFBOCD = family-controlled company with professional management; GLFRG = genuine large foreign institutional investor; FRGOWN=total percentage shares held by foreign institutional investors; POLIC=politically connected independent commissioner; ICED= independent commissioner financial expertise; BOC = proportion of independent commissioners; BCS = board of commissioners size; AUD = audit quality; LOSS = financial loss; LEV= leverage; SIZE = firm size.