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EFFECT OF INTERNAL AUDITOR INDEPENDENCE, AUDIT COMMITTEE AND INSTITUTIONAL OWNERSHIP TO THE INTERNAL CONTROL DISCLOSURE: A CASE STUDY CASE OF MANUFACTURING IDX COMPANY DURING PERIOD OF 2014-2016

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ABSTRACT

The purpose of this research is to examine the effect of the independence of internal auditors, audit committee, and institutional ownership disclosure on internal control. Disclosure of internal control was measured with Internal Control Disclosure Index. The population of this research was the manufacturing firms listed in Indonesia Stock Exchange during 2014-2016. The samples in this research were taken using purposive sampling method and the number of the samples fulfilling the criteria was 69. The mean value of the internal control disclosure is 58.69%. The result of multiple regression analysis testing show that the independence of the internal auditor and institutional ownership has a significant positive effect on internal control disclosure. The audit committees do not have any effects on internal controls on disclosure.

KEY WORDS

Independence, internal auditors, audit committee, institutional ownership, internal control disclosure.

The executor of work is required to improve the efficiency and good performance in order to provide security for its investors. Thus, companies in the small and large scale must have an effective internal control system to support effective and efficient operation of the company. In the financial statements found some cheating scandal that could mislead users of financial statements.

The companies that have go public in Indonesia will reveal internal control at the company's annual report. Government Institutions Capital Market Supervisory Agency and Financial Institution (Bapepam-LK) has issued Regulation No. XK6.2012 on Obligation to Submit Report For issuers or Public Companies. The regulation is a refinement of the previous regulations which are intended to improve the quality of information disclosure in the annual report of the Issuer and public companies as a source of important information for shareholders and the public in making investment decisions.

PT Akasha Wira International Tbk, PT Kimia Farma Tbk, and PT Indofarma Tbk is a partial example of a manufacturing company who commit fraud in financial statements. Companies that have a long business process is manipulating the information content of profit by increasing sales and improving the value of inventory so that the profits presented higher than the actual situation (Dipanusa, 2013). According to Moeller (2009), everything was falsified, concealed, or made-up, is a form of fraud.

Effective internal control is the first step for the company to fight against fraud attacks. With the implementation of good internal control, enterprise management has a reasonable assurance that the company's goal has been achieved, the financial statements presented have been fair, as well as laws and regulations relating met (Boynton, 2006). Internal controls have become the basis for the effectiveness of their operational processes and corporate finance (Moeller, 2009).

The internal auditor is a business unit within the company that is required to maximize the disclosure of internal control to help companies avoid frauds that can make companies face risks are not expected. The independence of an auditor is the ability to act on the integrity and objectivity. Integrity is a moral principle that is impartial, honest, and suggested

looking at the facts as they are. While objectivity is an attitude of impartiality in considering the facts, personal interest is not in fact facing (Barry, 2001).

In addition to internal auditors also needed as the audit committee of the supervisory committee for the audit committee has a great responsibility in preparing the audit, do ratifikasi of the internal control system, and resolving disputes in accounting rules. The audit committee serves to provide views on issues relating to financial policy, accounting and internal control (Pancawati H, 2010).

Means to create an effective internal control is also needed external parties participating in supervising the disclosure of internal control through institutional ownership. Institutional ownership is ownership by investors other than individual ownership and managerial ownership (Ujiyantho, 2007). The institutional shareholders will seek to improve oversight of the management of behavior in an effort to minimize the level of fraud that may arise which can decrease the value of the company. So with institutional ownership supervision carried out will be more effective and its effect on the broad disclosure of information by management.

Based on this background, the study entitled "Effect of Independence of Internal Auditors, the Audit Committee and Institutional Ownership to The Internal Control Disclosure on Manufacturing Company in Indonesia Stock Exchange Year 2014-2016.

Based on the description of the background of this research, the formulation of research problems that can be identified, as: Is the independence of the Internal Auditor, Audit Committee, and Institutional Ownership had effect on the Internal Control Disclosure?

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Jensen and Meckling (1976) define agency theory as a contract in which one or more persons (as the principal) to request the other party (as the agent) to carry out a number of jobs in the name of principle which involves delegating some decision-making authority to the agent. Furthermore, Jensen and Meckling (1976) states that the agency problem can arise between the agent and the principal because of the tendency of one party for selfish and conflicts arise when multiple interests meet in a joint activity. The existence of a conflict of interest between principal and agent because of their different objectives encourage asymmetry information. Jensen and Meckling (1976) stated that there are two types of asymmetry information, namely: (1) *Adverse Selection*, for the agent to know more information than the principal, (2) *Moral Hazard*, occur because of the separation principal with the agent in managing the company, so the principal do not fully know about the running of the company.

To overcome this, we used the agency cost which consists of monitoring costs, bonding costs, and residual loss. Monitoring costs are costs incurred and borne by the principal to monitor the agent's behavior, which is to measure, observe, and control the behavior of the agent. Bonding costs are the costs borne by the agent to establish and adhere to a mechanism that ensures that the agent will act in the interests of the principals. Residual loss is a sacrifice in the form of principal welfare losses as a result of differences in the decision and the decision of the principal agent. The independence of the Internal Auditor and Internal Control Disclosure

The independence by IAI through SPAP (2001: 220): "This standard requires the auditor be independent, that is not easily influenced, because he was carrying out work in the public interest (differentiated in terms he practiced as an internal auditor)". The independence of the internal auditor is an independent attitude possessed by the internal auditor, so as to assess objectively and in the absence keterpihakan at an interest so as to suppress the disclosure of internal control.

Research results of Adani Yusrina (2013) and Rizal Alfian (2014) matches the positive influence the independence of the internal auditor of the internal control.

H1: The Independence of Internal Auditor Positively Influences to The Internal Control Disclosure.

Decision of the Capital Market Supervisory Board No. 29 / PM / 2004 is an audit

committee formed by the board of directors for at least a member of the audit committee has the task of accounting education and management control of the company. The formation associated with the review of the company's internal control system, ensuring the quality of information disclosure and improve the effectiveness of the audit function.

Research results of Adani Yusrina (2013) and Febi Maulina (2014) found a significant influence on the results of internal control. Meanwhile, Amalia Wardhani (2010) get the results of the audit committee does not affect the internal controls were weak due to the organizational structure.

H2: Audit Committee Positively Influences to The Internal Control Disclosure.

Institutional ownership is ownership by financial institutions such as pension funds, mutual funds, insurance and other institutional ownership. The institutional shareholders will seek to improve oversight of the management of behavior in an effort to minimize problems that might arise agency (Jensen and Mecking, 1976).

Research results of Zulfikar, Rosiana. & Nariah (2015) to get the positive significant effect on the disclosure of internal control. Meanwhile, Amalia D Latifah (2013) to get the institutional ownership has significant negative effect on the disclosure of internal control as the number of institutions that control policies lead to a less transparent disclosure.

H3: Institutional Ownership Positively Influences to The Internal Control Disclosure.

Figure 1 – Conceptual Framework

METHODS OF RESEARCH

The independence of the internal auditor is an internal auditor impartiality on an interest. Internal auditors in charge of controlling and ensuring policies and procedures are in accordance with the decision of the agency's top management to minimize conflict. independence of internal auditors in this study was measured by the number of internal auditors in the company.

$$IAI = \sum \text{Auditor Internal in the Firm}$$

Decision of the Capital Market Supervisory Board No. 29 / PM / 2004 is an audit committee formed by the board of directors to perform supervisory tasks of corporate management. Bank Indonesia Regulation No. 08.14.2006 states that at least one member of the audit committee have the skills of accounting education.

$$ACEDU = \frac{\sum \text{Audit committee with accounting education background}}{\sum \text{Audit Committee in the firm}}$$

Institutional ownership is ownership by institutional investors other than individual ownership and managerial ownership. Institutional ownership has a very important role in minimizing teradi agency conflict between shareholders and management. Institutional ownership is measured by the percentage of institutional ownership in the company.

$$IO = \frac{\sum \text{Common stock owned by institution}}{\sum \text{Share issued}} \times 100\%$$

Disclosure of internal control is the disclosure of information relating to the implementation of the company's internal control conducted disclosed in the company's annual report. This study uses the Internal Control Disclosure Index (ICDI) was measured using a dummy, by giving a value of 1 for each item disclosed, and the value 0 for items that are not disclosed, then divide the total items disclosed to the maximum value of all the items that amounted to 18 criteria. Disclosure items are arranged based on the regulation XK6.2012 on the Obligation to Submit Annual Reporting for Listed Company public.

$$ICDI_j = \frac{\sum x_{ij}}{\sum n_j}$$

Where:

ICDI_j = Internal Control Disclosure Index company j;

n_j = Number of items that must be disclosed company n_j = 18 items;

x_{ij} = Dummy variable: 1 (if the item i disclosed); 0 (if the item i is not disclosed);

0 ≤ ICDI_j ≤ 1.

This study using purposive sampling method with the following criteria: (1) The manufacturing company which is consistently listed in the Indonesia Stock Exchange (BEI) during the period 2014-2016, (2) the Company issued its annual report for the period 2014-2016, (3) the Company provides data full on the variables used in the study. Samples obtained was number 69 the company's data.

Data used in the study of secondary data, the annual report of companies listed on the Indonesian Stock Exchange (BEI) in the period 2014-2016. Data obtained from the website of Indonesia Stock Exchange www.idx.co.id,^[1,5]

Descriptive statistics are directly related to data collection and measures of centralization of data and presentation of results of measures of central tendency of the data. Descriptive statistics were used to describe and provide a general overview of statistical research data for each variable in the study. Applications used for processing data in this research is the application of SPSS 20.0.

This study uses multiple regression analysis were used to measure the relationship between two or more variables and show the direction of the relationship between the dependent and independent variables (Ghozali, 2011). Prior to the calculation of multiple regression analysis to determine the effect of the independent variable on the dependent variable is bersasa together, it will be held the classical assumption test. Classic assumption test is done in order to meet the nature of regression estimation that is BLUES (Best Linear Unbiased Estimation). Classic assumption test consisting of: (1) Normality Test; (2) Test Multicollinearity; (3) Test Heteroskedasticity; and (4) Test of autocorrelation. Regrsinya equation as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

Where:

Y = Disclosure of Internal Control;

α = constant;

β₁...β_n = Coefficient regression direction;

X₁ = Internal Auditor Independence;

X₂ = the Audit Committee;

X₃ = Institutional Ownership;

e = Residual Error.

RESULTS AND DISCUSSION

Based on empirical testing, the result for the descriptive statistical information which includes the minimum value, maximum value, average value, and standard deviation. Descriptive statistics in Table 1 show the disclosure of internal control (PPI) has the lowest

value of 0.2778 and 1.0000 highs. The lowest value disclosure of internal control is owned by PT. Light Wilmar Indonesia Tbk. occurred in 2014, while the greatest value disclosure of internal control is owned by PT. Indopoly Swakarsa Industry Tbk and PT. Tiga Pilar Sejahtera Food Tbk. occurred in 2016. The average PPI owned the entire company during the year of follow-up samples is 0.586957 with a standard deviation is 0.1887539. It shows the distribution of PPI data has the degree of variation of 32.16% which indicates that the data obtained tend relatively homogeneous or have the same tendency among companies sampled.

Table 1 – Descriptive statistics

n/n	N	Minimum	maximum	mean	Std. deviation
PPI	69	.2778	1.0000	.586957	.1887539
IAI	69	1	37	6.30	8.026
ACEDU	69	.0000	1.0000	.502415	.3494776
INSOWN	69	.1400	74.0800	24.832743	19.2190622

Source: Data processed, 2017.

The independence of the internal auditor has the lowest value (minimum) of 1 (one) and the highest (maximum) of 37 (thirty-seven). Based on the statistical processing, the value of the average (mean) of the number of internal auditors amounted to 6.30 and has standard deviation of 8.026. From these data, the degree of variation of internal auditor independence can be seen at 127.39%, which means that data is processed is heterogeneous in that the data relative to vary between companies.

Table 2 – Classic Assumption Test

(1) Normality Test

	Residual unstandardized
N	69
Kolmogorov-Smirnov Z	.552
Asymp. Sig. (2-tailed)	.921

(2) Test Results autocorrelation

dU	dW	4 - dU	RESULTS	CONCLUSION
1.7343	1,813	2.2657	$dU \leq dW \leq 4 - dU$	NO AUTOCORRELATION

(3) Multicollinearity Test

Model		collinearity Statistics	
		tolerance	VIF
1	(Constant)	-	-
	IAI	.753	1,328
	ACEDU	.926	1,080
	INSOWN	.954	1049

(4) Heteroscedasticity Test

Model		Coefficients unstandardized		standardized Coefficients	t	Sig.
		B	Std. Error	beta		
1	(Constant)	.031	.227		.138	.891
	IAI	-.001	.002	-.100	-.750	.456
	ACEDU	.064	.031	.246	2,041	.055
	INSOWN	-.001	.001	-.229	-1921	.059

Source: Data processed, 2017.

Accounting background audit committee has the lowest value (minimum) of 0 (zero) and highest value (maximum) of 1 (one). Based on the statistical processing, the value of the average (mean) of the number of internal auditors amounted 0,502415 and have standard deviation of 0.3494776. From these data, the degree of variation accounting educational backgrounds of the audit committee can be seen at 69.56%, which means the data are homogeneous or have the same inclination relative data between companies.

Institutional ownership has the lowest value (minimum) at 0.1400 and the highest value

(maximum) of 74.08. The lowest value indicated by PT Mayora Indah Tbk. (MYOR) in 2013 is 0.14% and the highest value indicated by PT Kabelindo Murni Tbk (KBLM) in 2013 which is 74.8%. The average value (mean) of the sample firms of institutional ownership amounted to 24.832743 and has a standard deviation of 19.2190622. Institutional ownership has a degree of variation of 77.4%, which means the data are homogeneous, i.e. have relatively similar trend among companies sampled.

Based on the classic assumption test by using the Kolmogorov-Smirnov test, Durbin-Watson test, Run Test, and test Glejer note that the data used in this study the distribution data are normal and valid.

Table 3 – The Results of Multiple Linear Regression Model

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	beta		
1	(Constant)	-.179	.401	-.447	.656
	IAI	.011	.003	4,269	.000
	ACEDU	.071	.055	1,289	.202
	INSOWN	.002	.001	2,099	.040

Coefficient Determination Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.622 ^a	.387	.349	.1523145	1.813

Source: Data processed, 2017.

Based on the table, equation influence the independence of the internal auditor, the audit committee, and institutional ownership on the disclosure of internal control, sebgai follows:

$$PPI = - 0,179 + 0,011 IAI + 0,071 ACEDU + 0,002 INSOWN + \text{error}$$

Based on Table 3, the value of Adjusted R Square of 0.349 (34.9%). This suggests that the independent variables used in this study may explain the disclosure of internal control (PPI) amounted to 34.9%, while the remaining 65.1% influenced by other variables that are not used in this study.

Hypothesis 1: The independence of the Internal Auditor Positively Influence to the Internal Control Disclosure.

The hypothesis of this study aimed to examine the effect of the internal auditor independendensi (IAI) on the disclosure of internal control (PPI). From the regression results are presented Table 3 it can be concluded that the independence of the internal auditor (IAI) effect on the disclosure of internal control. This can be seen by the significant value of count (Sig.) of 0.000. This demonstrates the significant value count <error rate (0.05). This marks the independence of the internal auditor significant effect on the disclosure of internal control at the 95% confidence level.

Number of auditors can increase independence with increasingly diverse findings and opinions by internal auditors can streamline management measures in the disclosure of information. Based on the calculated value and the significance of the regression coefficients to see the effect of the internal auditor independence on the disclosure of internal control, it can be concluded that the independence of the internal auditor has a positive effect on the disclosure of internal control and proved significant.

Hypothesis 2: Audit Committee Positively Influence to The Internal Control Disclosure.

The hypothesis of this study aimed to examine the effect of the audit committee (ACEDU) on the disclosure of internal control (PPI). From the regression results are presented Table 3 it can be concluded that the audit committee accounting background but not significant effect on the disclosure of internal control. This can be seen by signifikanansi count (Sig.) Of 0.202. This demonstrates the significant value count > error rate (0.05). This marks the audit committee accounting background but not significant effect on the disclosure of internal control.

Background regression coefficient value accounting for 0,071 audit committee concluded the audit committee accounting background can increase the Disclosure of Internal Control (PPI) and the positive impact on the PPI. The audit committee accounting background has a high competence in reviewing the company's internal control system and ensures the quality of information disclosure, no significant results occurred because the educational background of accounting audit committee can not give a guarantee for the disclosure of internal control is effective or ineffective. The audit committee seeks accounting background to perform its role as a corporate function corresponding commitment and experience. Based on the calculated value and the significance of the regression coefficients to see the effect of an accounting background audit committee on disclosure of internal control, it can be concluded that audit committees effect but not significant to the disclosure of internal control.

Hypothesis 3: Institutional Ownership Positively Influence to The Internal Control Disclosure.

The hypothesis of this study aimed to examine the effect of institutional ownership (INSOWN) on the disclosure of internal control (PPI). From the regression results are presented Table 3 it can be concluded that institutional ownership (INSOWN) effect on the disclosure of internal control. This can be seen by the significant value of count (Sig.) Of 0,040. This demonstrates the significant value count <error rate (0.05). This indicates institutional ownership has a significant effect on the disclosure of internal control at the 95% confidence level.

Institutional ownership regression coefficient of 0.002 can be concluded institutional ownership can increase the Disclosure of Internal Control (PPI) and the positive impact on the PPI. Increasing the institutional share holders institutions'll attempt to improve oversight of the management of behavior in an effort to minimize agency problems that may arise. Based on the calculated value and the significance of the regression coefficients to see the influence of institutional ownership on the disclosure of internal control, it can be concluded that institutional ownership affects the disclosure of internal control and proved significant.

CONCLUSION

This study examines the effect of the independence of the internal auditor, the audit committee, and institutional ownership on the disclosure of internal control. The following are the conclusions of this study:

- The test results and analysis indicate that the independence of the internal auditor proxied by the number of internal auditors affect the significance level of 5%;
- The test results and analysis indicate that the audit committee is proxied by the educational background of the audit committee of accounting does not affect the significance level of 5%;
- The test results and the analysis show that institutional ownership proxied by the percentage of institutional ownership affects the significance level of 5%.

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