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AUDIT COMMITTEE TOWARD INTERNAL CONTROL DISCLOSURE WITH THE EXISTENCE OF FOREIGN DIRECTORS AS MODERATION VARIABLE Totok Dewayanto Doctoral Programe of Economics, Universitas Sebelas Maret, Surakarta And lecturer of Faculty of Economics and Business, Universitas Diponegoro, Semarang, Indonesia totokdewayanto@gmail.com Hudi Kurniawanto Doctoral Programe of Economics, Universitas Sebelas Maret, Surakarta And lecturer of Politeknik Unggulan, Sragen, Indonesia hudi.kurniawanto@gmail.com Djoko Suhardjanto Faculty of Economics and Business Universitas Sebelas Maret, Surakarta, Indonesia djoko.suhardjanto@yahoo.com Setianingtyas Honggowati * Doctoral Programe of Economics, Faculty of Economics and Business, Universitas Sebelas Maret, Surakarta, Indonesia setianingtyas_27@yahoo.co.id Presented at: SIBR-RDINRRU 2017 (Sydney) Conference on Interdisciplinary Business and Economics Research, 15th - 16th April 2017, Sydney, Australia. ABSTRACT The purpose of this study to test the impact of the existence of foreign directors on the audit committee expertise relationship to the internal control disclosure. The object of research on non-financial public companies/banks listed on the Indonesia Stock Exchange in 2012-2015, with a purposive sampling technique and multiple regression analysis. This study was able to prove the impact of audit committee expertise on the internal control disclosure significantly and was able to test the role of moderating variable existence of foreign directors. Expertise of the audit committee and the existence of foreign directors were able to answer the increase in disclosures that reflect their internal control has implications for the quality of financial reporting is reliable and reduces the risk of the trust's financial information. The financial expertise of audit committee members showed something important in relation to the financial statements in order to reduce the complexity of the restatement of financial statements. Audit committee members who have knowledge of financial reporting has a greater likelihood of detecting material misstatements, also played a role in overseeing the financial reporting process more effectively. Keywords: Internal control disclosure, audit committee expertise, the existence of foreign directors. 1 INTRODUCTION Sarbanes-Oxley Act of 2002 (SOX 2002) into force on July 30, 2002, along with the increasing attention of investors on the integrity of the financial reporting of the company. The occurrence of cases of financial reporting irregularities scandal involving several major US companies, such as Enron, World Com, and public accounting firms (KAP) Big Five Arthur Andersen in the early 21st century has been the world aware of the importance of honesty in financial reporting. Accounting scandals that occurred in American companies have finally pushed the issuance of SOX in 2002 (Zhang et al., 2007). The disclosures required under SOX in 2002 mostly related to internal control (Zhang et al., 2007), and in the study focused on factors related to the internal control disclosure. According to Bronson et al., (2006) that the management's report on internal control voluntary (voluntary management reports on internal control / MRIC) is more common in large companies, which have the expertise for the audit committee, which held meetings with high frequency. In Indonesia, the implementation of internal control material weakness disclosure has not been met ecause they are voluntary (voluntary), but when an Indonesian company has been listed on the stock exchanges of New York Stock Exchange USA, the company must conduct internal control material weakness disclosure, because bound by the rules of SOX. In Indonesia alone, there are two companies that have been listed on the New York Stock Exchange (NYSE), PT Telkom and PT Indosat. Internal control material weakness disclosure made by the two companies will certainly motivate other companies that want to list on the NYSE (New York Stock Exchange). Until now Indonesia has no regulations governing internal control material weakness disclosure such as SOX 302 and 404, therefore in this study discusses the concept of voluntary. Although the Chairman of Bapepam-LK No. Kep-134 / BL / 2006 and has been renewed by the Chairman of Bapepam-LK No. Kep-431 / BL / 2012, has decided obligation to submit annual reports for listed companies or public companies, which are voluntary expect express adequate internal control over. According to Zhang et al., (2007) a company that has a quality audit committee will have less likelihood of experiencing problems with internal controls. The findings of Zhang et al. (2007) and Krishnan (2005). The audit committee in Indonesia is still relatively new compared to other countries in the world such as America, Britain, and Canada. Whereas the existence of an audit committee is important as one of the aspects of the implementation of good corporate governance (GCG). The audit committee was introduced by the government to certain state-owned enterprises in 1999. While Bapepam in 2000 began giving encouragement to companies that have gone public to have an audit committee. Based on the description of the background mentioned above, the research problem of this study is the importance of a comprehensive internal control disclosures voluntarily by the management company, which is beneficial in improving the reliability of financial reporting. Issues raised are: How does the existence of foreign directors in relation to the audit committee on the internal control disclosure. 2 LITERATUR REVIEW Agency theory is a synergy of economic theory, decision theory, sociology, and organizational theory. This theory was first used by Jensen and Meckling (1976). Agency theory is what has been used as the basis of the existing business practices. The main principle of agency theory is the relationship between an authority (principal) and the authorized parties (agent). Goal conflict of agency relationships in the form of distortion of information about the company resulted in the emergence of agency problems (agency problem) that implicates lead agency costs. (Jensen and Meckling, 1976). Jensen and Meckling (1976) states that the substantial shareholders are expected to have greater strength and encouragement to monitor management, because of their wealth associated with the company's financial performance. Fama and Jensen (1983) argues that the spread in the ownership poses a potential conflict between principal and agent. The agency problem can be reduced by substantial shareholders involved in monitoring or control activities on potential trouble (Shleifer and Vishny, 1986; Huddart, 1993). Thus the manager compelled to disclose more information on the annual report in order to reduce agency costs. Internal control research has been conducted by Zhang, et al (2007), which examines the truth of the relationship between the quality of the audit committee, auditor independence, and disclosure of the company's internal control weaknesses after the establishment of SOX. The study concluded that audit committees with financial expertise and financial or accounting expertise, have a smaller probability for experiencing internal control issues. Furthermore, the company has an independent auditor to have a greater likelihood of experiencing internal control issues. According to the recommendations of the Blue Ribbon Committee (BRC) 's (1999), to improve the effectiveness of the audit committee of a company, every audit committee should have at least one financial expert who highlighted the importance of knowledge in terms of finance and expertise of audit committee members other. Section 407 of SOX makes the recommendation of the BRC and require companies to disclose in periodic reports. The financial expertise of audit committee members that shows something important in relation to the complexity of the financial statements (Kalbers and Fogarty, 1993) and to reduce the restatement of financial statements (Abbott, et al., 2004). DeZoort and Salterio (2001) found those audit committee members who have knowledge of financial reporting and auditing will be able to understand judgment auditor and can provide support to the auditor in any disputes between auditors and management compared with auditors who do not have such knowledge. In addition, members who have more knowledge in the field of finance have a greater possibility to be able to indicate and detect material misstatements. Audit committee members with financial expertise may also play a role in overseeing the financial reporting process more effectively, such as detecting material misstatements (Scarbrough, et al., 1998; Raghunandan, et al., 2001). Abbott, et al., (2004) found a significant negative relationship between the audit committee has at least one member with financial expertise and reporting back the emergence of financial statements. While the research conducted Krishnan (2005) showed that the audit committee has financial expertise had less likely to be associated with the emergence of internal control issues. From the above, it formulated a hypothesis 1, namely: H1: Skills Audit Committee has a positive influence on Internal Control Disclosure. The existence of foreign directors on a company dramatically changes the balance of control of ownership (Ramaswamy, 2001). The participation of foreign directors of the company sending signals intention to expand globally. In particular, companies that are looking to establish a global market, will include foreign technology, or align themselves with foreign competitors who may want to internationalize their governance structure as a signal that management is serious about efforts to internationalize it. Foreign Directors have a unique knowledge and understanding of various strategies in overseas markets area a company wants. Knowledge and expertise they may be an added value for a company to apply it in the movement of expansion. Top managers may have information that is not owned or not understood by the owner (Chen et al., 1993). Base on this framework, the model is schematically illustrated as follows: Figure 1: Schematic Research Existence of Foreign Directors Audit Internal Control Committee Disclosure Expertise Source: Be developed by researchers RESEARCH METHODS The population of this research is all companies listed on the Indonesia Stock Exchange in the year 2009-2011 and fit in Indonesian Capital Market Directory (ICMD) 2009-2011. This is done because the whole industry is a company that reveals internal control. Samples were selected using purposive sampling with criteria: a). Nonfinancial corporations/banks listed on the Indonesia Stock Exchange (BEI) in 2012-2015. b). Publish the full annual report, including the internal control disclosure and available to the public. c). The company publishes about expertise of the audit committee and the existence of foreign directors. The analytical tool used to test the hypothesis is multiple linear regression. VARIABLE OPERATIONALIZATION Disclosure of the company's internal control seen from disclosure by the company in its annual report. If during the year the company with a detailed disclosure of the rules COSO (1992), then the company is identified as being in the detailed disclosure in its internal controls. These measurements were performed by using index (Internal Control Disclosure Index / ICDI). ICDI is almost similar to the ICRS (Internal Control Reporting Score) developed by Deumes (2008). Internal control disclosure is expressed as the dependent variable by size: integrity and ethical values, understanding of the board of directors of the responsibility and supervision, management philosophy and operating style, support the organization structure ineffective internal controls, the competence of financial reporting, authority and management responsibility / employees, policies and human resources practices designed, financial reporting purposes and the criteria for risk identification, financial reporting risks, the risk of fraud, integration with risk assessment, selection and development of activity, policies and procedures, information technology, financial reporting information, information control internal While the independent variables in this study, namely expertise of the audit committee. according to Defond et al. (2005), Krishnan and Visvanathan (2008), Dhaliwal et al. (2010), that the audit committee is an audit committee financial expertise who has experience as an investment banker, a financial analyst a measurement used is the number of people who have a role as an audit committee financial expertise based. Measurements using the audit committee expertise: expertise in finance measure of the percentage of audit committee members who are experts in accounting and finance. Moderating variables are variables other than the independent variables were allegedly also influence the dependent variable. In this moderating variable research used is the existence of foreign directors on the company. measurement by calculating the amount of the existence of foreign directors. If the company uses foreign directors (foreign directors), it will count the number of foreign personnel directors. Methods using multiple regression analysis, the model of the equation: $Y = \alpha + \beta2\ \beta1X + Z + X*Z + e$ Note: α: constanta, β: regression coefficient Y: Internal Control Disclosure X: The audit committee expertise Z: The existence of foreign directors X * Z: Interactions e: error RESULTS AND DISCUSSION Normality test results based on the graph histogram and normal probability plots indicate that the data is spread around the diagonal line and follow the direction of the diagonal line . Meanwhile, data on the histogram graph showing a normal distribution pattern. Furthermore, the Kolmogorov-Smirnov (K-S) indicates that the value of the Kolmogorov-Smirnov test was significant at 0.397 and 0.762. Thus, it can be concluded that the regression model to meet the assumptions of normality of data. Multicollinearity test results demonstrate the value of tolerance of each independent variable values greater than 10% (Tolerance values> 0.1). Meanwhile, VIF value of each independent variable has a value of less than 10 (VIF<10). Thus, it can be concluded that there is no multicollinearity on each variable. The test results by test Gleisjer heteroscedasticity generate residual coefficients are not significant, meaning free from heteroscedasticity. Similarly, autocorrelation test that returns a value Durbin- Watson is in the region there is no autocorrelation. Based on the results of multiple regression analysis regression equation: $Y = 0.605 + 1.542\ X + Z + 0{,}041\ X*Z + e$ Based on the above equation can know that there are positive audit committee variables (X) by the interaction of the existence of foreign directors and audit committee (X * Z). Results of regression analysis to test the feasibility of the model obtained figures probability/significance of 0.000 <0.05, so the hypothesis 1 and hypothesis 2 is acceptable. CONCLUSION This study was able to prove the impact of audit committee expertise on the internal control disclosure significantly and was able to significantly test variable moderation existence of foreign directors. Thus expertise of the audit committee and the existence of the directors of foreign able to address the increase in disclosures to reflect the existence of good internal control, so that the implications for the financial reporting is reliable and quality can reduce the risks to confidence in the financial information that is incorrect, as it is accepted by stakeholders. The financial expertise of audit committee members that shows something important in relation to the complexity of the financial statements to reduce the restatement of financial statements. Audit committee members who have knowledge of financial reporting more in finance has a greater possibility to be able to indicate and detect material misstatements. Audit committee members with financial expertise may also play a role in overseeing the financial reporting process more effectively, such as there is detect material misstatements. RESEARCH LIMITATIONS AND SUGGESTIONS TO COME Limitations of this study on the measurement of internal control disclosure using only items on the COSO 1992, so that research results are less reflects the existence of corporate governance rules (code) Indonesia. Expected future studies using the measurement taking rules (code of corporate governance) on the internal control disclosure issued by the Financial Services Authority in Indonesia, to comply with existing regulations. REFERENCE

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