

**MONITORING MECHANISM IN CORPORATE GOVERNANCE AND
THE EXTENT OF INTERNAL CONTROL INFORMATION
DISCLOSURE**

(Empirical Study on Companies Listed in IDX Period 2018)



Script By:

DITA MIRANDA FAISAL

01031181621055

ACCOUNTING

Proposed as One of the Requirements for Undergraduate Degree on Economics

**MINISTRY OF EDUCATION AND CULTURE
UNIVERSITY OF SRIWIJAYA
FACULTY OF ECONOMICS**

2020

COMPREHENSIVE EXAM APPROVAL LETTER

**MONITORING MECHANISM IN CORPORATE GOVERNANCE AND
THE EXTENT OF INTERNAL CONTROL INFORMATION
DISCLOSURE
(EMPIRICAL STUDY ON COMPANIES LISTED IN IDX PERIOD 2018)**

Composed by:

Name : Dita Miranda Faisal
NIM : 01031181621055
Faculty : Economics
Department : Accounting
Field of Study / Concentration : Accounting Information System

Approved for use in the comprehensive exam.

Date of approval

Supervisor

Date: December 11th, 2019

Chair



Dr. Tertiarto Wahyudi, S.E., MAFIS., Ak., CPA
NIP. 196310041990031002

Date: December 19th, 2019

Member



Arista Hakiki, S.E., M.Acc., Ak., CA
NIP. 197303171997031002

SCRIPT APPROVAL LETTER

**MONITORING MECHANISM IN CORPORATE GOVERNANCE AND
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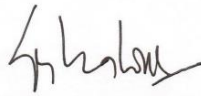
Composed by:

Name : Dita Miranda Faisal
NIM : 01031181621055
Faculty : Economics
Department : Accounting
Field of Study / Concentration : Accounting Information System

Has attended comprehensive exam on January 10th, 2020 and has been qualified
for graduation.

Comprehensive Exam Committees
Palembang, January 10th 2020

Chairman




Dr. Tertiarto Wahyudi, S.E., MAFIS., Ak., CPA
NIP. 196310041990031002

Member



Arista Hakiki, S.E., M.Acc., Ak., CA
NIP. 197303171997031002

Member



Aryanto, S.E., M.T.I., Ak
NIP. 197408142001121003

Acknowledging,
Head of Accounting Department



Arista Hakiki, S.E., M.Acc., Ak., CA
NIP. 197303171997031002

STATEMENT OF RESEARCH INTEGRITY

Here in undersign

Name : Dita Miranda Faisal
NIM : 01031181621055
Faculty : Economics
Department : Accounting
Field of Study / Concentration : Accounting Information System

Stating the fact that my script entitled:

**MONITORING MECHANISM IN CORPORATE GOVERNANCE AND
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Script Supervisor

Head : Dr. Tertiarto Wahyudi, SE, MAFIS., Ak., CPA
Member : Arista Hakiki, S.E., M.Acc., Ak., CA
Date of Comprehensive Exam : January 10th, 2020

Is truly the result of my work under guidance of supervisors. There is no other people's work in this script that I copied without mentioning the original sources.

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Palembang, January 10th 2019
Who gave the statement,



Dita Miranda Faisal
NIM. 01031181621055

MOTTO

“Allah does not burden a soul beyond that it can bear.”
(Q.S. 2:286)

“And whoever puts his trust upon Allah, then He is sufficient for him.”
(Q.S. 65:3)

“So plant your own gardens and decorate your own soul, instead of waiting for someone to bring you flowers.”
(Jorge Luis Borges)

“Effort makes you. You will regret someday if you don't do your best now. Don't think it's too late but keep working on it.”
(J.K.)

“When one thing ends, another begins.”
(A.R.)

I present this script for:

- **Allah SWT & Rasulullah Muhammad SAW**
- **My beloved parents**
- **My brothers and sisters**
- **My best friends**
- **Sriwijaya University**

PREFACE

Praise and thank to Allah SWT for the blessing and mercy that the author can complete the script entitled “**Monitoring Mechanism in Corporate Governance and the Extent of Internal Control Information Disclosure (Empirical Study on Companies Listed in IDX Period 2018)**”. This script is made as one of the requirements to achieve Bachelor Degree of Economics (S-1) in Economic Faculty, Sriwijaya University.

My sincere appreciation to many parties who have helped me to finish this script. Therefore, author would like to express gratitude to:

1. **Mr. Prof. Dr. Ir. H. Anis Saggaff, MSCE** as the Rector of Sriwijaya University.
2. **Mr. Prof. Dr. Taufiq Marwah, S.E., M.Si** as the Dean of Economics Faculty.
3. **Mr. Arista Hakiki, S.E., M.Acc., Ak., CA** as the Head of Accounting Department.
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9. All of examiners who have given critics and suggestion to fix this script.
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11. All of staffs of Economics Faculty who have helped me in preparing administration process.
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19. The organization that teaches me to not be afraid of challenges, **Sriwijaya Accounting Society**. Thank you for all the time we spent studying and entering various competitions together.
20. All of my friends in Accounting Department period 2016 who I cannot specify one by one. Thank you for all the help you have given me.
21. All of people related to the accomplishment of this script whose names author cannot mention one by one.

Author hopes that this script can be beneficial for many parties. Therefore, criticism and suggestion from all parties can improve this script for perfection will always be welcomed in the future.

Palembang, January 10th 2020



Dita Miranda Faisal
01031181621055

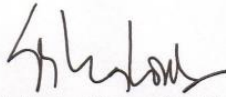
LETTER OF STATEMENT

We script supervisors state that the abstract of script from student

Name : Dita Miranda Faisal
NIM : 01031181621055
Faculty : Economics
Department : Accounting
Field of Study / Concentration : Accounting Information System

We check the spelling, grammar, and tenses. We agree for the abstract to be placed on the abstract sheet.

Chairman,



Dr. Tertiaro Wahyudi, S.E., MAFIS., Ak., CPA
NIP. 196310041990031002

Member,



Arista Hakiki, S.E., M.Acc., Ak., CA
NIP. 197303171997031002

Acknowledged by,
Head Of Accounting Departement



Arista Hakiki, S.E., M. Acc., Ak., CA
NIP. 197303171997031002

ABSTRACT

Monitoring Mechanism in Corporate Governance and the Extent of Internal Control Information Disclosure (Empirical Study on Companies Listed in IDX Period 2018)

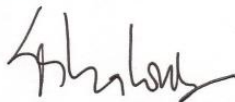
By:

Dita Miranda Faisal

This study aims to obtain empirical evidence and to analyze the influence of monitoring mechanism in corporate governance comprising of board of commissioner size, board of commissioner independency, and institutional ownership on the extent of internal control information disclosure. The type of data used in this study is secondary data obtained from the annual reports and annual financial statements published in Indonesia Stock Exchange website (idx.co.id). The sample in this study is 249 companies listed in IDX period 2018. This study uses multiple linear regression. Before being analyzed, the data is tested with normality test, multicollinearity test, and heteroscedasticity test. The result of this study shows that board of commissioner independency has a positive and significant influence on the extent of internal control information disclosure, meanwhile board of commissioner size and institutional ownership do not have significant influence on the extent of internal control information disclosure.


Keywords: *Monitoring Mechanism, Corporate Governance, Board of Commissioner, Institutional Ownership, Internal Control Disclosure*

Chairman,



Dr. Tertiarto Wahyudi, S.E., MAFIS., Ak., CPA
NIP. 196310041990031002

Member,



Arista Hakiki, S.E., M.Acc., Ak., CA
NIP. 197303171997031002

Acknowledged by,
Head Of Accounting Departement



Arista Hakiki, S.E., M. Acc., Ak., CA
NIP. 197303171997031002

ABSTRAK

Monitoring Mechanism in Corporate Governance and the Extent of Internal Control Information Disclosure (Empirical Study on Companies Listed in IDX Period 2018)


Oleh:

Dita Miranda Faisal

Penelitian ini bertujuan untuk mendapatkan bukti empiris dan menganalisis pengaruh mekanisme pengawasan pada tata kelola perusahaan yang terdiri atas ukuran dewan komisaris, independensi dewan komisaris, dan kepemilikan institusional terhadap luas pengungkapan informasi pengendalian internal. Jenis data yang digunakan pada penelitian ini adalah data sekunder yang diperoleh dari laporan tahunan dan laporan keuangan tahunan yang dipublikasi pada situs Bursa Efek Indonesia (idx.co.id). Sampel dalam penelitian ini adalah 249 perusahaan yang terdaftar di BEI selama tahun 2018. Penelitian ini menggunakan analisis regresi linier berganda. Sebelum data dianalisis, dilakukan uji normalitas, uji multikolinearitas, dan uji heteroskedastisitas. Hasil penelitian ini menunjukkan bahwa independensi dewan komisaris mempunyai pengaruh yang positif dan signifikan terhadap luas pengungkapan informasi pengendalian internal, sementara ukuran dewan komisaris dan kepemilikan institusional tidak memiliki pengaruh yang signifikan terhadap luas pengungkapan informasi pengendalian internal.

Kata Kunci: *Monitoring Mechanism, Corporate Governance, Board of Commissioner, Institutional Ownership, Internal Control Disclosure*

Chairman,



Dr. Tertiarto Wahyudi, S.E., MAFIS., Ak., CPA
NIP. 196310041990031002

Member,



Arista Hakiki, S.E., M.Acc., Ak., CA
NIP. 197303171997031002

Acknowledged by,
Head Of Accounting Departement



Arista Hakiki, S.E., M. Acc., Ak., CA
NIP. 197303171997031002

RESEARCHER RESUME

Name : Dita Miranda Faisal
Gender : Woman
Birth Place and Date : Batam, May 10th 1999
Religion : Islam
Marital Status : Single
Address : Perumahan Centro Park Blok B No. 15, Jalan Pipa Sungai
Lais RT 026 RW 002, Kelurahan Jakabaring Selatan,
Kecamatan Rambutan, Kabupaten Banyuasin
Email Address : ditamirandaf@gmail.com



Formal Education

Elementary School : SD Negeri 158 Palembang (2003 – 2010)
Junior High School : SMP Negeri 1 Palembang (2010 – 2013)
Senior High School : SMA Negeri 1 Palembang (2013 – 2016)
Higher Education : Sriwijaya University, Faculty of Economics (2016 – 2020)

Non Formal Education

Advanced Accounting Course IAI (Ikatan Akuntan Indonesia)
Brevet A&B IAI (Ikatan Akuntan Indonesia)

Organization Experience

1. Member of Tax Center Universitas Sriwijaya
2. Member of Sriwijaya Accounting Society (SAS) Division of Ikatan Mahasiswa Akuntansi
3. Member of Generasi Baru Indonesia (GenBI)

TABLE OF CONTENTS

COMPREHENSIVE EXAM APPROVAL LETTER.....	ii
SCRIPT APPROVAL LETTER	iii
STATEMENT OF RESEARCH INTEGRITY	iv
MOTTO	v
PREFACE.....	vi
LETTER OF STATEMENT.....	ix
ABSTRACT	x
ABSTRAK.....	xi
RESEARCHER RESUME	xii
TABLE OF CONTENTS.....	xiii
LIST OF TABLES	xvi
LIST OF FIGURES.....	xvii
LIST OF APPENDICES.....	xviii
CHAPTER I INTRODUCTION	1
1.1. Research Background.....	1
1.2. Problem Formulation.....	9
1.3. Research Objectives	10
1.4. Research Contribution.....	10
1.4.1. Theoretical Contribution.....	10
1.4.2. Practical Contribution	11
CHAPTER II LITERATURE REVIEW	12
2.1. Agency Theory	12
2.2. Corporate Governance	13
2.3. Board of Commissioner	13
2.4. Independent Board of Commissioner.....	15
2.5. Institutional Ownership.....	16
2.6. Internal Control.....	16
2.7. COSO Internal Control Framework	17

2.8. Previous Researches	18
2.9. Research Framework	23
2.10. Hypothesis Development	24
2.10.1. Board of Commissioner Size and the Extent of Internal Control Information Disclosure	24
2.10.2. Board of Commissioner Independency and the Extent of Internal Control Information Disclosure.....	26
2.10.3. Institutional Ownership and the Extent of Internal Control Information Disclosure	28
 CHAPTER III RESEARCH METHODOLOGY	 30
3.1. Operationalization of Variable	30
3.1.1. Independent Variable	30
3.1.2. Dependent Variable	31
3.1.3. Control Variable	31
3.2. Population and Sample.....	32
3.3. Type and Source of Data.....	32
3.4. Method of Collecting Data.....	33
3.5. Data Analysis Tool	33
3.6. Method of Analysis	33
3.6.1. Descriptive Statistic Analysis	33
3.6.2. Classical Assumption Test	34
3.6.3. Multiple Linear Regression	35
3.6.4. Hypothesis Test	36
 CHAPTER IV ANALYSIS RESULT AND DISCUSSION	 38
4.1. Descriptive Statistic Analysis	38
4.2. Classical Assumption Test	39
4.3. Multiple Linear Regression	43
4.4. Hypothesis Test	45
4.5. Discussion	48
4.5.1. Board of Commissioner Size and the Extent of Internal Control Information Disclosure	48

4.5.2. Board of Commissioner Independency and the Extent of Internal Control Information Disclosure.....	50
4.5.3. Institutional Ownership and the Extent of Internal Control Information Disclosure	52
4.6. Additional Analysis.....	53
CHAPTER V CONCLUSION AND SUGGESTIONS.....	57
5.1. Conclusion	57
5.2. Limitation.....	58
5.3. Suggestions	58
REFERENCES	60

LIST OF TABLES

Table 1. COSO 2013 Internal Control Framework	17
Table 2. Previous Researches	19
Table 3. Descriptive Statistics	38
Table 4. One-Sample Kolmogorov-Smirnov Test	39
Table 5. Multicollinearity Test	41
Table 6. Multiple Linear Regression.....	43
Table 7. T-Test Result.....	45
Table 8. Coefficient Determination Result	47
Table 9. T-Test Result based on Total Asset.....	54
Table 10. T-Test Result based on Net Income	55
Table 11. T-Test Result of Companies based on Listing Board.....	56

LIST OF FIGURES

Figure 1. Research Framework.....	24
Figure 2. Normal Probability Plot	40
Figure 3. Heteroscedasticity Test	42

LIST OF APPENDICES

Appendix 1. Research Sample and Data	61
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CHAPTER I

INTRODUCTION

1.1. Research Background

One important mechanism in providing complete and reliable information is the implementation of company's internal control system (Chang *et al.*, 2019). Internal control has an important role in managing the resources owned by the company in order to achieve the set goals, ensure that the financial statements presented are trustworthy, ensure that the company does not violate existing regulations, and reduce information asymmetry (Ahmad *et al.*, 2015; Mukhlisin and Annisa, 2018). Effective implementation of an internal control system can assure that the company operates and develops in a healthy manner (Leng and Ding, 2011). However, the implementation of the company's internal control cannot be known directly by parties outside the company (Rakhmayani and Faisal, 2019). Therefore, it is important for companies to disclose the information related to their internal control through their annual reports as complete and comprehensive as possible.

In order to reduce information asymmetry between management and shareholders, company must increase transparency because disclosure aids the investors to learn about company's internal affairs and thus, reducing the information gap between investors and management (Akhtaruddin *et al.*, 2009; Fadlillah and Harymawan, 2018). One of the important information that needs to be disclosed is information related to company's internal control. Agyei-Mensah

(2016) stated that disclosures related to company's internal control system have an important role in reducing the impact of information asymmetry problems and agency costs in the market. Information related to internal control system can ensure the stakeholders that the organization's financial statement is free from accounting deviation. If the company discloses the effectiveness of its internal control system, stakeholders will feel confident about the reliability of the financial statements issued by the company. Information related to internal control also can help the decision-making process by external parties and contribute to the improvement of internal control (Leng and Ding, 2011).

The accounting scandal committed by Enron, WorldCom and Arthur Andersen Public Accountant Firm had a great impact on the world of international business. With those scandals, the world became increasingly aware about the importance of internal control role in the company and the principle of transparency in the companies reporting. The congress of United States responded to those accounting scandals by issuing the Sarbanes-Oxley Act (SOX) in July 2002 (Altamuro and Beatty, 2010). The Sarbanes-Oxley Act (SOX) is enacted in 2002, symbolizing the internal control information disclosure in United States shift from voluntary disclosure to mandatory disclosure with the orientation to stimulate the improvement of internal controls, as to improve financial information reliability in providing investors with important insight for decision making (Xiaowen, 2012).

Several countries have followed US's step on the introduction of internal control reporting or disclosure. In 2006, the Shanghai Stock Exchange (SSE) and

Shenzhen Stock Exchange (SZSE) issued internal control guidelines for companies listed on SSE and SZSE. These guidelines change the internal control disclosure requirement for the companies registered in China from voluntary to mandatory (Leng and Ding, 2011). In addition, starting from 2008, Japan has also implemented an internal reporting system which applies to all companies registered in Japan (Nishizaki *et al.*, 2014). On December 31, 2012, Malaysia issued statement that serves as a guideline for company directors to make disclosures about risk management and internal control in the company's annual report (Ahmad *et al.*, 2015).

In Indonesia, the regulation governing matters that must be disclosed in the company's annual report are issued by Otoritas Jasa Keuangan through Peraturan OJK No. 29/POJK.04/2016 regarding Annual Reports of Issuers or Public Companies. However, the regulation does not regulate the issuer or public company to disclose the information about company's internal control system. OJK then issued Surat Edaran OJK No. 30/SEOJK.04/2016 about Form and Content of Annual Reports of Issuers or Public Companies. The circular letter states that disclosure about company's internal control system is a part of corporate governance disclosure. Disclosure of internal control contained in this circular letter includes financial and operational controls, compliance with laws and regulations, as well as a review of the effectiveness of the company's internal control. However, the rule still does not explain the provisions of the internal control content that must be disclosed by the company. Thus, companies can choose the internal control information that will be presented as long as the three

minimum items are fulfilled; making the extent of internal control information disclosure can vary between companies.

One of the internal control cases in Indonesia is the case that happened in PT. Askrindo, a company formed by the government to help the development of micro, small, and medium business units (UMKM). In general, PT. Askrindo is engaged in bank loans guarantee sector. The company was hit by a case of alleged embezzlement of funds amounting to 400 billion involving the finance director and chief financial investment. The financial manipulation occurred within 2004-2009 and surfaced to public in 2011. Cases like this can occur because there are various possibilities of weak control and supervision carried out by the board of commissioners. If the monitoring mechanism in good corporate governance runs well, it is possible that the existing internal control is able to reflect good monitoring activities as well.

ASEAN Corporate Governance Scorecard Country Reports and Assessment 2015 by Asian Development Bank (ADB) states that there are 5 main components in the corporate governance scorecard, which are rights of shareholders, equitable treatment of shareholders, roles of stakeholders, disclosure and transparency, and responsibilities of the board. The scorecard categorizes internal control disclosure as a part of the responsibilities of the board component. In that section, Indonesia received a score of 20.99, and ranked 5th out of the 6 countries assessed, namely Thailand, Singapore, Malaysia, Philippines, Indonesia and Vietnam. The report states that companies in Indonesia still have to make improvements on the internal control disclosure (Asian Development Bank, 2017).

Several studies have been conducted to look at the factors that influence then extent of internal control disclosure, including corporate governance mechanisms (Leng and Ding, 2011; Ahmad *et al.*, 2015; Zulfikar *et al.*, 2015; Agyei-Mensah, 2016; Dewayanto *et al.*, 2017; Ismail and Ardiyanto, 2017; Rakhmayani and Faisal, 2019) and corporate characteristics (Xiaowen, 2012; Agyei-Mensah, 2016). Inconsistencies are still found among the findings of previous studies, some of the inconsistencies are regarding the influence of board size, board independency, and institutional ownership toward the extent of internal control information disclosure.

The role of corporate governance is needed to establish sound internal control and disclose information related to internal control for external users. Agyei-Mensah (2016) stated that disclosure of internal control is closely related to corporate governance. Corporate governance encompasses the controls and procedures that exist to ensure that management acts in the interest of shareholders. In addition to reducing the likelihood that management, acting in its self-interest, taking actions that deviate from maximizing the value of the firm, corporate governance mechanisms also affect the information disclosed by the firm to its shareholders. Effective governance should enhance accountability, transparency, and ultimately result in more disclosure, both voluntary as well as mandatory (Rao *et al.*, 2012). It is suggested that under intensive monitoring environments, the information asymmetry stemming from managers' opportunistic behaviors and intention to retain important information for their own benefits are more likely to be reduced, leading to a better disclosure (Ho and

Wong, 2001). According to Agyemang *et al.* (2013), a company that embarks on good corporate governance practice offers essential information to its equity holders and other stakeholders in order to minimize information asymmetry.

Based on the explanation of aspects and function of corporate governance related to the disclosure of internal control which emphasize on the monitoring function of corporate governance, the discussion about corporate governance in this study will be focused on the monitoring mechanism in corporate governance. The monitoring mechanism consists of internal mechanism and external mechanism. The internal mechanism in this study is represented by board of commissioner size and independency, whereas the external mechanism is represented by institutional ownership.

One of the monitoring mechanisms in corporate governance is board of commissioner. In the two-tier system, the difference between the policy making and implementation functions with the oversight function is clear; the function of policy making and its implementation is carried out by the board of directors, while the function of supervision of the policies implementation by the board of directors is carried out by the board of commissioners (Fadlillah and Harymawan, 2018). The board of commissioners is responsible for the enforcement and implementation of the internal control system and ensuring the reliability of information disclosed (Leng and Ding, 2011). Zulfikar *et al.*, (2015) stated that the size of the board of commissioners greatly influences control and supervision activities. A large number of boards of commissioners can bring together a combination of expertise so as to improve the quality of disclosure of information

conveyed (Suhardjanto and Dewi, 2011). Research conducted by Siagian and Ghozhali (2012) and Suhardjanto *et al.*, (2012) found a positive influence of the number of commissioners towards information disclosure.

The board of commissioners may consist of commissioners who are not originated from an affiliated party, known as independent commissioner. Coming from the outside of company, independent commissioners act as a controlling mechanism that supervise the company (Agyei-Mensah, 2016). The existence of independent commissioners is expected to encourage and create a more objective climate, and to place fairness as the main principle in observing the interests of non-major shareholders and other stakeholders. Independent commissioners are not affiliated with management, so they are more likely to encourage companies to disclose more information to outside investors (Eng and Mak, 2003). Independent commissioners also have more incentive uphold their reputation. According to Arena *et al.* (2015), based on agency theory, independent members of the board should support the disclosure to investors in order to communicate that the independent members of the board of commissioners have properly supervised the management, which may also benefit the reputation of the independent commissioners in the eyes of stakeholders and in turn can impact the value of commissioners in the labor market. Ahmad *et al.* (2015) found on their research that the proportion of independent commissioner has a positive influence on disclosure of internal control and risk management.

A company is also monitored by parties outside the company, including the shareholders who own parts of the company in varying degrees of ownership.

Disclosure is also closely related to the ownership structure in order to reduce agency problems (Fadlillah and Harymawan, 2018). The presence of institutional investors is highly relevant within the ownership structure since generally institutional investors assume command as traditional owners, which enables them to exercise more direct control over the company's managers (Hidalgo *et al.*, 2011). Increased outside ownership serves to monitor managers' actions, thus reducing the likelihood that managers, acting in their own interests, keeping important information for themselves (Akhtaruddin *et al.*, 2009). Research conducted by Akhtaruddin *et al.* (2009) on nonfinancial companies in Malaysia shows that institutional ownership has a positive influence on voluntary disclosure. Dewayanto *et al.* (2017) also found on their research that institutional ownership positively and significantly influences internal control disclosure.

There are also other factors that can influence the extent of internal control information disclosure. The size of a company can influence the extent of the disclosure by the company, since larger companies tend to disclose more information since they are faced with more public scrutiny than smaller companies (Alsaeed, 2006). The other factor that can influence the extent of internal control information disclosure is company's performance. Xiaowen (2012) explained the scenario where companies with good performance tend to disclose more information regarding internal control in order to discern themselves from companies with poorer performance. Ahmad *et al.* (2015) views that good performance companies have almost complete governance structure that

will lead to better disclosure of internal control and also have sufficient resources to put up with the cost of information disclosure.

The issuance of latest regulation in Indonesia that includes rules regarding internal control disclosure, the yet to be optimal practice of internal control disclosure in Indonesian companies according to the Asian Development Bank report, and the inconsistency of the results of previous studies regarding board size, board independence, and institutional ownership on the internal control disclosure becomes the background of this research. Based on the background that had been mentioned, the researcher intended to examine “**Monitoring Mechanism in Corporate Governance and the Extent of Internal Control Information Disclosure**”. Researcher will use companies listed in IDX period 2018 as sample. Since there are other factors that can also affect the extent of internal control information disclosure, company size and company performance will be used as control variable in this study.

1.2. Problem Formulation

This study examines the influence of monitoring mechanism on corporate governance, comprising board of commissioner size, board of commissioner independency, and institutional ownership on the extent of internal control information disclosure. This research will have the following problem formulation:

1. How does the board of commissioner size influence the extent of internal control information disclosure?

2. How does the board of commissioner independency influence the extent of internal control information disclosure?
3. How does the institutional ownership influence the extent of internal control information disclosure?

1.3. Research Objectives

Based on the problem formulation that has been described, the objectives of this research are as follows:

1. To analyze the influence of board of commissioner size on the extent of internal control information disclosure.
2. To analyze the influence of board of commissioner independency on the extent of internal control information disclosure.
3. To analyze the influence of institutional ownership on the extent of internal control information disclosure.

1.4. Research Contribution

1.4.1. Theoretical Contribution

The study empirically analyzes the relationship between monitoring mechanism in corporate governance and internal control information disclosure in order to provide some empirical evidence for understanding the determining factors influencing the extent of internal control information disclosure, and also to provide some reference for information providers, information users, and regulators.

1.4.2. Practical Contribution

The findings of the study may get the company and regulators to pay more attention regarding the role of corporate governance, especially the monitoring mechanism, on ensuring an adequate disclosure of internal control information.

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