CHAPTER II

LITERATURE REVIEW

A. Theoretical Foundation

1. Agency Theory

Jensen and Meckling (1976: 5) define agency theory as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is a good reason to believe that the agent will not always act in the best interests of the principal. The *principal* can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the aberrant activities of the agent. In addition in some situations it will pay the *agent* to expend resources (bonding costs) to guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions. Jensen and Meckling (1976: 6) further define agency costs as the sum of:

1) The monitoring expenditures by the principal
2) The bonding expenditures by the agent
3) The residual loss

Voluntary communication serves to reduce the information asymmetry between professional managers and stakeholders who typically do not have day-to-day information regarding the operational and strategic issues facing the corporation. (Debrency *et al.*, 2001: 6)

According Marston (2003: 25), agency costs can arise because of the conflicting interests of shareholders, managers and debtholders. Increased disclosure will reduce agency costs and information asymmetries.

Eisenhardt (1989: 58) argues that Agency theory is concerned with resolving two problems that can occur in agency relationships. The first is the agency problem that arises when (a) the desires or goals of the principal and agent conflict and (b) it is difficult or expensive for the principal to verify what the agent is actually doing. The problem here is that the principal cannot verify that the agent has behaved appropriately. The second is the problem of risk sharing that arises when the principal and agent have different attitudes toward risk. The problem here is that the principal and the agent may prefer different actions because of the different risk preferences.

2. Signaling Theory

According to Connelly *et al.* (2011: 39), Signaling theory is useful for describing behavior when two parties (individuals or organizations) have access to different information. Typically, one party, the sender, must choose whether and how to communicate (or signal) that information, and the other party, the receiver, must choose how to interpret the signal.

According to Suwardjono (2008: 583-584), Management will always try to disclose private information that according to them would be in great demand by investors and shareholders especially if the information is in the form of good news. Management is also interested in conveying information that can enhance the credibility and success of the company even though the information is not required to be disclosed.

Signaling theory explains why firms have an incentive to report voluntarily to the capital market even if there are no mandatory reporting requirements. Information disclosure is necessary in order to compete successfully in the market. Companies that perform well will have a strong incentive to report their operating results. Competitive pressures would also force other companies to report even if they did not have good results. Silence (a failure to report) would be interpreted as bad news. Companies with neutral news would be motivated to report their results in order to avoid being suspected of having poor results. This would leave only firms with bad news not reporting. Such a situation would also force "bad news" firms to disclose results in order to maintain credibility in the capital market (Wolk *et al.*, 2001: 101-102)

Wolk *et al.* (2001: 308) further adds that signaling theory appears to be largely consistent with the advocacy of greater disclosure. It is posited in signaling theory that firms with undisclosed "good news" information will attempt to distinguish themselves from firms not having "good news" by informing the market of their situation. The market, in turn, should reward these firms by favorable price upon their securities.

3. Financial Statements

a. Definition of Financial Statements

The statement of financial position also referred to as the balance sheet, reports the assets, liabilities, and equity of a business enterprise at a specific date. This financial statement provides information about the nature and amounts of investments in enterprises resources, obligations to creditors, and the equity in net resources. (Kieso *et al.*, 2011: 190)

The definition of financial statements according to *Persyaratan Standar Akuntansi Keuangan* (PSAK) No. 1 (Revised in the year 2009), "*Laporan keuangan adalah suatu penyajian terstruktur dari posisi keuangan dan kinerja keuangan suatu entitas.*" This defines financial statements as a structured representation of the financial position and financial performance of an entity.

According to Debrency *et al.*, (2001: 7), "Corporate financial statements are at the center of business reporting. Acting as a model to capture and organize financial information, financial statements package information in a structured manner that permits analysis of a wide range of trends and relationships. Investors use financial statements for various purposes such as a management performance evaluation, an early warning device, and an analytical tool."

Based on the definitions above, it can be summarized that financial statements are used in financial reporting and provides information to their users. The readers of the financial statements will be able to obtain the financial information they require for evaluation, warnings and analysis.

b. Objectives of Financial Statements

According to the conceptual framework of *Standar Akuntansi Keuangan* (2012: 3), there are three objectives of preparing financial statements:

1) To provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions.
2) Financial statements prepared for this purpose meet the common needs of users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non financial information.
3) Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the enterprise or whether to reappoint or replace the management.

c. Users of Financial Statements

According to the conceptual framework of *Standar Akuntansi Keuangan* (2012: 2), the users of financial statements include the present and potential investors, employees, lenders, suppliers, and other trade creditors, customers, governments and their agencies, and the public. They use financial statements in order to satisfy some of their different needs for information. These needs include:

1) Investors - the providers of risk capital and their advisers are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

2) Employees - employees and their representative groups are interested in information about the stability profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

3) Lenders - lenders are interested in information that enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

4) Suppliers and other trade creditors - suppliers and other trade creditors are interested in information that enables them to determine whether the amounts owing to them will be paid when due. Trade

creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuation of the enterprise as a major customer.

5) Customers - customers have an interest in information about the continuance of an enterprise, especially when they have a long-term involvement with, or are dependent on, the enterprise.

6) Governments and their agencies - governments and their agencies are interested in the allocation of resources and, therefore, the activities of the enterprises, determine taxation policies and as the basis for national income and similar statistics.

7) Public - Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

d. Qualitative Characteristics of Financial Information

According to the conceptual framework of *Standar Akuntansi Keuangan* (2012: 5-8), qualitative characteristics are the attributes that make the information provided in financial statements useful to the users. The qualitative characteristics of financial information are:

1) Understandability - An essential quality of the information provided in financial statements is that is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

2) Relevance - to be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. The predictive and confirmatory roles of information are interrelated.

Information about financial position and past performance is frequently used as the basis for predicting future financial position and performance and other matters in which users are directly interested, such as dividend and wage payments, security price movements and the ability of the enterprise to meet its commitments as they fall due. To have predictive value, information need not to be in the form of an explicit forecast. The ability to make predictions from financial statements is enhanced, however, by the manner in which information on past transactions and events is displayed. For example, the predictive value of the income statement is enhanced if unusual, abnormal and infrequent items of income or expense are separately disclosed.

a) Materiality - the relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. For example, the reporting of a new segment may affect the assessment of the risks and opportunities facing the enterprise irrespective of the materiality of the results achieved by the new segment in the reporting period. In other cases, both the nature and materiality are important, for example, the amounts of inventories held in each of the main categories that are appropriate for business.

    Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

3) Reliability - to be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could

reasonably be expected to represent. Information may be relevant but also unreliable in nature or representation that its recognition may be potentially misleading. For example, if the validity and amount of a claim for damages under a legal action are disputed, it may be inappropriate for the enterprise to recognize the full amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

a) Faithful Representation - To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that results in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria.

   Most financial information is subject to some risk of being less faithful representation of that which it purports to portray. This is not due to bias, but rather PSAK to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events. In certain cases, the measurement of the financial effects of items could be so uncertain that enterprises generally would not recognize them in the financial statements.

b) Substance Over Form - If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form.

c) Neutrality - to be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by selection of presentation of information, they influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

d) Prudence - the preparers of financial statements do, however, have contend with the uncertainties that inevitably surround many events and circumstances. Such uncertainties are recognized by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

e) Completeness - to be reliable, the information is financial statements must be completed within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

4) Comparability - users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of financial effect of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in consistent way for different enterprise.

e. Components of the financial Statements

According to the IAS 1 - Presentation of Financial Statements as issued on 1 January 2012 and matched with the *Standar Akuntansi Keuangan* of Indonesia, a complete set of financial statements comprises:

a) a statement of financial position as at the end of the period;

b) a statement of profit and loss and other comprehensive income for the period;

c) a statement of changes in equity for the period;

d) a statement of cash flows for the period;

e) notes to financial statements, comprising a summary of significant accounting policies and other explanatory information; and

f) a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

4. Disclosure

a. Definition of Disclosure

Evans (in Suwardjono 2008: 578) defines disclosure as supplying information in the financial statements, including the statements themselves, the notes to financial statements, and the supplementary disclosures associated with the statements. It does not extend to the public or private statements made by management or information provided outside the financial statements.

Wolk *et al.* (2001: 302) interprets the definition of disclosure as follows, broadly interpreted, disclosure is concerned with information in both the financial statements and supplementary communications including footnotes, post statement events, management's discussion and analysis of operations for the forthcoming year, financial and operating forecasts, and additional financial statements covering segmental disclosure and extensions beyond historical cost.

SFAC No. 5 paragraph 9 (in Wolk *et al.* 2001: 302), defines disclosure as presentation of information by means other than recognition in the financial statements, which is contrasted with recognition in the financial statements themselves and this is the aspect of disclosure that we largely concentrate upon.

Hendriksen and Van Breda (1992: 854) define the word disclosure as the release of information. Accountants tend to use the word in a slightly more restrictive sense to mean the release of financial information about a company within a financial report, generally the annual report. The term is sometimes further restricted to mean the information not contained in financial statements themselves.

b. Levels of Disclosure

How much information should be disclosed is dependent in part upon the expertise of the reader. The Statement of Financial Accounting Concepts No. 1, for instance, has held that information being disclosed in financial reports should be:

> *"comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence"*

The level of disclosure also depends upon the standard deemed most desirable. Three concepts of disclosure generally proposed are *adequate, fair* and *full disclosure.*

The most commonly used of these expressions is adequate disclosure, but this implies a minimum amount of disclosure congruous with the negative objective of making the statements not misleading. Fair and full disclosure are more positive concepts. Fair disclosure implies an ethical objective of providing equal treatment for all potential readers.

Full disclosure implies the presentation of all relevant information. To some, full disclosure means the presentation of superfluous information and is, therefore, inappropriate. Too much information they say, is harmful in that the presentation of unimportant details hides the significant information and makes the financial reports difficult to interpret. However appropriate disclosure of information significant to investors and others should be adequate, fair, and full. There is no real difference among these concepts if they are used in proper context.

A positive objective is to provide the users of financial statements with significant and relevant information to aid them in making decisions in the best possible way with the limitation that the benefits should exceed the costs. This implies that information that is not material or relevant is omitted to make the presentations meaningful and understandable. (Hendriksen and Van Breda, 1992: 856)

c. Mandatory Disclosure

Mandatory disclosure refers to the disclosure that must be done by a company which includes disclosing their financial statements, notes to financial statements and supplementary information. (Suwardjono, 2008: 583)

Internet financial reporting in Indonesia is done mandatorily, in accordance with the existing regulations of the Indonesian Capital Market and Financial Institutions Supervisory Agency ("BAPEPAM-LK"), since 1st August 2012 which requires every company to report its annual reports through its website. Therefore, since the enactment of rule X.K.6 since 1st August 2012, makes Internet Financial Reporting (IFR), a mandatory disclosure for every company listed in the stock exchange.

d. Voluntary Disclosure

Information that can be provided by management but are not required to be disclosed will depend on the flexibility of the management in terms of disclosure. This type of disclosure is called voluntary disclosure or discretionary disclosure. Voluntary disclosure can be disclosed in the form of financial or nonfinancial information (Suwardjono, 2008:577-578). Voluntary disclosure is the disclosure done by the company beyond what is required by the accounting standards or rules of the regulatory bodies.

Gray and Roberts (in Craven and Marston 1999: 323) considered the costs and benefits of voluntary disclosure and investigated perceptions of costs and benefits empirically. In their theoretical discussion they noted that disclosure choices will be determined by managerial assessments of the costs and benefits of proposed alternative disclosures. Agency theory predicts that voluntary disclosures are likely to be influenced by managerial expectations of positive share price effects. They found that the most important perceived benefits of voluntary information disclosure were:

(1) improved image/reputation of the company;

(2) better investment decisions by investors;

(3) improved accountability to shareholders;

(4) more accurate risk assessment by investors;

(5) fairer share prices.

The most important cost factors constraining voluntary information disclosure were:

(1) cost of competitive disadvantage;

(2) cost of data collection and processing.

One incentive for voluntary disclosure is the need to raise capital at the lowest possible cost. Companies might increase their voluntary disclosure in order to raise capital more cheaply on the markets. This will increase transparency and reduce information asymmetries between the company management and market participants. Additional disclosures may help the listed companies to attract new shareholders, thus enabling companies to maintain a healthy demand for shares with a liquid market. Use of the Internet to disseminate financial information might be beneficial in this context. Because the public use of the Internet is in its infancy, the future demand for voluntarily disclosed corporate information is still somewhat conjectural. It is presumed that as use of the internet increases so will voluntary corporate disclosures. (Craven and Marston, 1999: 323-324)

5. Internet Financial Reporting

a. Definition of Internet Financial Reporting

Internet Financial Reporting (IFR) refers to the reporting of financial statements conducted by an entity over the internet presented within the company's website (Prasetya and Irwandi, 2012:152).

At early stages, companies had web pages to improve their corporate image. Now, firms can use the Internet to obtain some competitive advantages as well. The growth in the number of users, improvements in the speed and security of communications and the low costs of technology are allowing the Internet to become an important media for monetary and information resources. The relations between firms and investors are changing to use the many opportunities that new information and communication technologies offer. Digital reporting on the Internet is a new way for external decision-makers to access relevant accounting information. Some years ago, companies started to voluntary disclose all kind of financial and non-financial information to satisfy information demands of external users. (Bonsón and Escobar, 2002: 28)

In accordance with the existing regulations of the Indonesian Capital Market and Financial Institutions Supervisory Agency ("BAPEPAM-LK"), since 1st August 2012 which requires every company to report its annual reports through its website. Therefore, since the enactment of rule X.K.6 since 1st August 2012, makes Internet Financial Reporting (IFR) as a mandatory disclosure for every company.

According to Oyelere *et al.* (2003: 38), internet reporting improves users' access to information by providing information that meets their specific needs, allowing non-sequential access to information through the use of hyperlinks, interactive and search facilities, and allowing the opportunity for providing more information than available in annual reports. This improved accessibility of information results in more equitable information dissemination among stakeholders.

b. Benefits of Internet Financial Reporting

According to Khan and Ismail (2013: 45), implementation of Internet Financial Reporting can provide the following benefits: attract foreign investors, promoting the company to a wider range of the public, provide wider coverage, attract local investors, attract potential customers, promote transparency, enhance managerial efficiency, and improve financial performance. Meanwhile, IFR implementation benefit the users because it increases timeliness and efficiency in obtaining financial information, users can makes investment decision process easier and faster, provides information for companies inexpensively, provides accessibility to the users and provides another medium of disclosure. A few disadvantages of IFR include, security problems cost and expertise, developed and developing country digital divide, poor website design and advertising, authentication, attestation and information overload.

6. Firm Size

Larger firms have an increased need for external funds. Agency costs can arise because of the conflicting interests of shareholders, managers and debtholders. Increased disclosures will reduce agency costs and information asymmetries. Larger firms may have a greater incentive to signal their quality by means of improved disclosures. Large organizations are increasingly complex, so more disclosure may be needed to place the firm on the same footing as less complex organizations. Larger firms are more visible in society and political costs may be reduced by improved disclosures. The relative costs of collection and dissemination of information may be smaller for large firms, thus increasing the incentive to disclose. (Marston, 2003: 25)

As disclosure can reduce monitoring costs, a significant agency cost, one would expect to find greater disclosure among large firms relative to small firms (Oyelere *et al.*, 2003: 41). Small firms incur significantly higher costs than large ones in carrying out complex accounting standards or disclosure requirements (Wolk *et al.*, 2001: 315).

7. Audit Firm

The quality of audit services is defined to be the market-assessed joint probability that a given auditor will *both* (a) discover a breach in the client's accounting system, and (b) report the breach. Consumers incur costs of evaluating audit quality, i.e., of assessing the joint probability that a given auditor will both discover and report a breach on a given client's audit. (DeAngelo, 1981: 186)

Public companies are obliged to publish financial statements audited by a public accounting firm (CPA firm). Audits of financial statements are performed to provide assurance that the financial statements are free of material misstatement. Big Accounting firms such as the big four will maintain its reputation by maintaining its independence and present a complete audit report both to management and other stakeholders. (Kartika and Puspa, 2013: 184)

In Indonesia, the big four accounting firms that are recognized by companies and the government are as follows:

1) KAP Osman Bing Satrio & Eny affiliated with Deloitte Touche Tohmatsu
2) KAP Tanudiredja, Wibisana, Rintis & Rekan affiliated with Pricewaterhouse Coopers (PwC)
3) KAP Purwanto, Suherman & Surja affiliated with Ernst & Young
4) KAP Siddharta dan Widjaja affiliated with Klynveld, Peat, Marwick, Goerdeler (KPMG).

8. Leverage

Leverage is a tool to measure how much the company depends on the creditors to finance the company's assets. (Prasetya dan Irwandi, 2012: 153) Leverage refers to the use of the finance resources such as debt and borrowed funds to increase the return on equity. So, highly leverage companies will be responsible for satisfying the creditors' need by disseminating reliable information on their web sites to make these creditors more confident about the ability of the companies to pay their debts. (Ezat and El-Masry, 2008: 852)

The debt to total asset ratio measures the percentage of the total asset that creditors provide. The ratio can be computed by dividing total debt (both current and non-current liabilities) by total assets. This ratio indicates the company's degree of leverage. It also provides some indication of the company's ability to withstand losses without impairing the interests of creditors. The higher the percentage of debt to total asset, the greater the risk that the company may be unable to meet its maturing obligations. (Weygandt *et al.*, 2011: 676)

9. Profitability

Profitability measures the income or operating success of a company for a given period of time. Income, or the lack of it, affects the company's ability to obtain debt and equity financing. It also affects the company's liquidity position and the company's ability to grow. As a consequence, both creditors and investors are interested in evaluating earning power i.e. profitability. Analysts frequently use profitability as the ultimate test of management's operating effectiveness. (Weygandt *et al.*, 2011: 671)

Companies with poor performance try to avoid the use of techniques such as internet financial reporting because they are trying to hide bad news. In contrast to companies that have high profitability, they use the IFR to disseminate good news about their companies. (Prasetya and Irwandi, 2012: 153).

In this research, Return on Equity is used as the proxy of profitability. Return on Equity is computed by dividing net profit by total equity. (Aly *et al.*, 2010: 190)

10. Liquidity

Liquidity measures the short-term ability of the company to pay its maturing obligations and to meet unexpected needs for cash. Short-term creditors such as bankers and suppliers are particularly interested in assessing liquidity. The ratios that can be used to determine a company's short-term debt-paying ability are the current ratio, acid-test ratio, receivables turnover, and inventory turnover. (Weygandt *et al.*, 2011: 668)

The company's strength that is indicated by a high liquidity ratio will be associated with a complete and wide reporting of financial statements. Companies that have a high level of liquidity is likely to be motivated to inform its financial statements as complete and as widely as possible as compared with companies with low liquidity levels. (Kusumawardani, 2011: 29)

This research uses current ratio as the proxy for liquidity. According to Weygandt *et al.* (2011: 668), current ratio is a widely used measure for evaluating a company's liquidity and short-term debt-paying ability. The ratio is computed by dividing current assets by current liabilities.

B. Prior Researches

The tables below describe prior studies conducted by several researchers:

Table 2.1

Xiao *et al.* Research Details

Title	The Determinants and Characteristics of Voluntary Internet-based Disclosures by Listed Chinese Companies
Year	2004
Written by	Jason Zezhong Xiao, He Yang, and Chee W. Chow
Variables	Dependent: Disclosure Index Independent: Share ownership, independent directors, auditor type, foreign listing, industry, influence of the CSRC. Control Variables: Firm size, profitability, leverage, rights issues, fixed assets
Research Method	Univariate Analysis and Multivariate Hypothesis tests
Conclusion	Findings from the 300 largest Chinese listed companies support the proposition that these firms' internet-based disclosure choices are responsive to specific attributes of their environment. Results found were IT industry, size, legal person ownership, leverage, state share ownership were found to influence voluntary internet-based disclosures by listed Chinese companies.

Source: The determinants and characteristics of voluntary Internet-based disclosures by listed Chinese companies Journal

Table 2.2

Aly *et al.* Research Details

Title	Determinants of Corporate Internet Reporting: Evidence from Egypt
Year	2010
Written by	Doaa Aly, Jon Simon, and Khaled Hussainey
Variables	Dependent: Disclosure Index Independent: Firm's size, profitability, leverage, liquidity, industrial sector, auditor size, foreign listing
Research Method	Ordinary Least Square Multiple Regression Analysis
Conclusion	It was found that 56 percent of Egyptian companies report a significant portion of information on their websites. Some financial characteristics explain the variation in degree of internet reporting between Egyptian listed companies. In particular, profitability, foreign listing and industrial type (communications and financial services) are the determinants of the amount and presentation formatting of information disclosed on Egyptian companies' websites. However, other firm characteristics such as firm size, leverage, liquidity and auditor size, do not explain corporate internet reporting.

Source: Determinants of Corporate Internet Reporting: Evidence from Egypt Journal

Table 2.3

Yane Devi Anna Research Details

Title	Analisis Faktor-Faktor yang Mempengaruhi *Internet Corporate Reporting*
Year	2013
Written by	Yane Devi Anna
Variables	Dependent: Corporate Internet Reporting Index (Checklist) Independent: Firm size, profitability, leverage, growth, foreign listing, ownership structure
Research Method	Linear Regression and Classic Assumption tests
Conclusion	This research uses data obtained from corporate websites and annual corporate reports of Kompas 100 companies listed on Indonesia Stock Exchange in 2012. The results found that significant determinants of Corporate Internet Reporting (CIR) index were firm size and leverage, and results show that on average the level of CIR is medium.

Source: Analisis Faktor-Faktor yang Mempengaruhi Internet Corporate Reporting Journal

Table 2.4

Bonsón and Escobar Research Details

Title	Digital Reporting in Eastern Europe: An empirical study
Year	2006
Written by	Enrique Bonsón and Tomás Escobar
Variables	<u>Dependent</u>: Disclosure Index <u>Independent</u>: Activity sector, Region of origin of the company, firm size, auditor firm
Research Method	Multiple Regression
Conclusion	Data was collected from 13 Eastern European countries and results shows a statistically significant relationship between the extent of information disclosure on the internet and company size, company's activity being in the financial sector, and the fact of employing one of the world's big four accountancy firms for auditing the company's books.

Source: Digital Reporting in Eastern Europe: An empirical study Journal

Table 2.5

Luciana Spica Almilia Research Details

Title	Faktor-faktor yang Mempengaruhi Pengungkapan Sukarela 'Internet Financial and Sustainability Reporting'
Year	2008
Written by	Luciana Spica Almilia
Variables	Dependent: Internet Financial Sustainability Reporting Index Independent: Firm size, Profitability (ROE and ROA), Leverage, Outside Ownership
Research Method	Multiple Regression
Conclusion	The purpose of this research was to examine financial variables that affect Internet Financial and Sustainability Reporting (IFSR) in Indonesia Stock Exchange companies. The samples include 104 listed firms in ISE. The findings of this research found that firm size, profitability (return on asset) and majority holder are determinant factors of IFSR index.

Source: Faktor-faktor yang Mempengaruhi Pengungkapan Sukarela 'Internet Financial and Sustainability Reporting' Journal

C. Conceptual Framework

1. Influence of *Firm Size* to the disclosure of Financial Information through the Internet

Larger companies have higher information asymmetry between managers and shareholders and, therefore, higher agency costs arising from such asymmetry. To reduce these agency costs, larger firms disclose more information than smaller companies. Given the need for greater disclosure by large firms, it is expected that large firms will be inclined to adopt various disclosure methods including IFR, which allows large amounts of disclosures at low incremental costs and in user friendly ways. Large corporations also have more shareholders and greater shareholder dispersion. IFR will be particularly effective in these circumstances as information can be efficiently disseminated to a large dispersed audience. (Debrency *et al.*, 2002: 377-378)

According to Singhvi and Desai (1971: 131), a positive relationship between firm size and the extent of disclosure include the following factors:

(1) The cost of accumulating detailed information is relatively high for smaller corporations. In larger corporations, such information is accumulated for internal reporting to top executives and, therefore, disclosure of such information is not a costly affair for them.

(2) The management of larger corporations is likely to realize the possible benefits of better disclosure, such as easier marketability of securities and greater ease in financing. Smaller corporations usually do not raise funds

in the securities market and, therefore, cannot realize the possible benefits of better disclosure.

(3) Smaller corporations are likely to feel more threatened than larger corporations that full disclosure of information could endanger their competitive position.

IFR is largely unregulated, and as such, individual firm disclosure will likely reflect the tradeoff between the relevant perceived costs and benefits of supplementing traditional financial reporting with IFR. Among other things, costs could include preparation and dissemination costs, litigation costs, or loss of competitive position; while benefits may include factors such as reductions in agency costs, and avoidance of political or legal costs. (Oyelere *et al.*, 2000: 18)

Marston and Polei (2004: 293) add that larger firms are also more complex and more information disclosure is necessary to allow existing and potential investors to make efficient investment decisions. Furthermore, it can be said that large firms are more visible in the capital market and in society in general, which is likely to put pressure on the enterprises to disclose more information.

2. Influence of *Audit Firm* to the disclosure of Financial Information through the Internet

It is suggested that audit quality is an important factor in improving firms' overall reporting practices. International audit firms such as the big four audit firms, are more likely to facilitate the diffusion of innovative practices, such as the internet financial reporting (Hail, 2002; Xiao *et al.*, 2004). The relationship existing between the auditor firm and the extent of information disclosure on the internet can be explained by several different reasons. From agency theory perspective, the key purpose of auditing is to reduce the conflicts between managers and owners (i.e. the shareholders) of a company (Bonsón and Escobar, 2006: 307). Agency theory suggests that auditing helps mitigate agency costs due to the interest conflicts between manager and shareholders. Big four auditors are likely to be independent and could constrain managers to maintain more stringent disclosure standards (DeAngelo, 1981: 185).

Large international audit firms such as the big four audit firms, are more likely to demand high-quality disclosure. This could be explained by the signaling theory because managers that hire large auditing firms signal to the market that they are willing to provide quality disclosures (Healy and Palepu, 2001).

3. Influence of *Leverage* to the disclosure of Financial Information through the Internet

Leverage is one that can be viewed from many angles. Users of financial information must not only see leverage as a negative condition. Loans are taken into consideration and analyzed by creditors or debtholders. Signaling theory is used to explain that if the creditor is a bank, this shows that the company can obtain the trust of banks and obtain loans from them. It signals the reliability of a company and the trusts of external party creditors towards the firm in providing them with loans and paying off their obligations at a later date. Usually when firms are provided loans by other companies within the same group as the company, it shows that these companies can only obtain trusts of other companies within their own group.

With an increase in leverage, managers can use the IFR to help disseminate positive information about the company in order to "obscure" the attention of creditors and shareholders to not really focus only on its high leverage. This is due to financial reporting via the Internet may contain information that is more than the company through paper-based reporting. (Lestari and Chariri, 2007)

4. Influence of *Profitability* to the disclosure of Financial Information through the Internet

According to Prabowo and Angkoso (2006: 94), profitability is good news for investors. It is also a signal of managers' skills. They have the incentive to disassociate their firms from the less profitable firms. Managers with more profitable firms are willing to disclose more to signal the good news to market in the form of more extensive disclosure or using technology (IFR).

Companies that have a high level of profitability tend to reveal more because they wants to show to the public and stakeholders that the company has a high level of profitability in compared with other companies in the same industry. (Almilia, 2008)

It is suggested that firm profitability can be regarded as an indicator to good management, as management tends to disclose more information when the rate of return is high. Hence, profitable companies have extra financial resources to disseminate financial information and have more incentives to disclose to both the stakeholders and public that they are more profitable than their counterparts in the same industry. (Basuony and Mohamed, 2014: 74)

5. Influence of *Liquidity* to the disclosure of Financial Information through the Internet

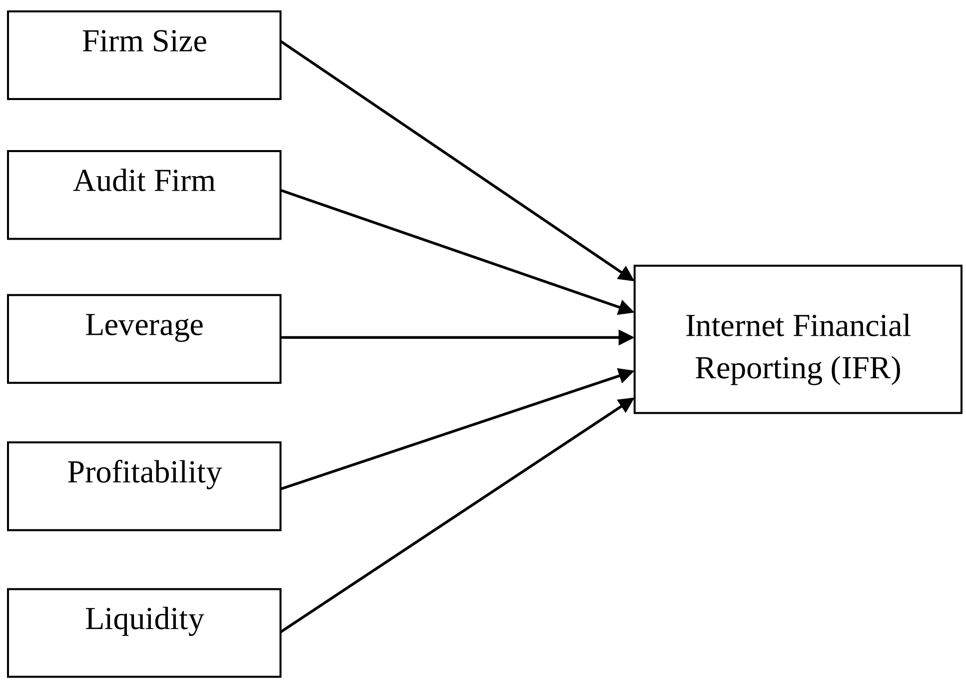
According to Wallace and Naser (1995: 320), the ability of a firm to meet its short-term financial obligations without having to liquidate its long-term assets or cease operations is an important factor in the evaluation of the firm by interested parties such as investors, lenders and regulatory authorities. The inability of the firm to meet its current obligations may mean a deferment of the payment of interest and principal on loans to the detriment of the lender, and it may mean, in the extreme case, bankruptcy. Belkaoui and Kahl (in Wallace and Naser, 1995: 320), suggest that firms with a high liquidity ratio will present more disclosure. This is expected because of the idea that a highly liquid firm is most likely to provide greater information.

Liquidity can be defined as a company's ability to repay short-term obligations. The higher the company's ability to repay short-term debt, the more liquid the company is. Wherein, the level of liquidity of the company will influence investors in making decisions regarding their investments. Investors will not invest in companies that are less liquid because they would assume that companies which are less liquid have a tendency to undergo a bankruptcy. (Kusumawardani, 2011: 28-29)

According to Oyelere *et al.* (2003: 42), the use of internet for providing financial information may be an expression of management's confidence in a company's solvency and future prospects.

Figure 2.1

Conceptual Framework



D. Research Hypothesis

H$_1$: *Firm Size* has a positive influence towards Internet Financial Reporting.

H$_2$: *Audit firm* has a positive influence towards Internet Financial Reporting.

H$_3$: *Leverage* has a positive influence towards Internet Financial Reporting.

H$_4$: *Profitability* has a positive influence towards Internet Financial Reporting.

H$_5$: *Liquidity* has a positive influence towards Internet Financial Reporting.