



## The Effect of Corporate Governance Mechanisms, Capital Structure and Firm Size on Risk Management Disclosure

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### ARTICLE INFO

#### Article History:

Received January 24<sup>th</sup>, 2018

Accepted March 3<sup>th</sup>, 2020

Available March 31<sup>th</sup>, 2020

#### Keywords:

capital structure;  
firm size;  
corporate governance  
mechanism;  
risk management disclosure  
(RMD)

### ABSTRACT

The study aims to analyze the influence of the duties and responsibilities of directors, institutional ownership, managerial ownership, capital structure and firm size by risk management disclosure at the Islamic banks in 2010-2014. The study used purposive sampling method where 35 analysis units from 60 population of Islamic banks in Indonesia. Analysis technique which used to examine the hypotheses was multiple linear regression analysis using SPSS 21 tool. The result of the study shows that firm size has a significant positive effect on risk management disclosure. Meanwhile, the other variables which are the duties and responsibilities of directors, institutional ownership, managerial ownership and capital structure do not affect on risk management disclosure. The conclusions of the study are that there is no significant positive effect of corporate governance mechanism and capital structure on risk management disclosure. Firm size has a significant positive effect on risk management disclosure. The bigger company will do a better risk management disclosure.

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### INTRODUCTION

The rapid development of sharia banking has enlivened the world of national banking business which had previously experienced a quite devastating crisis. The crisis era in 1997-1998 can be said to be a stepping-stone for the rapid development of sharia today. The passing of Law No. 21 of 2008 concerning Islamic Banking indicates that Islamic banking has showed its existence in the banking business.

The growth of national sharia banking far exceeds conventional banking in recent years. Based on the data from the financial services authority (FSA), the number of conventional commercial banks in general decreased from 130 banks in 2007 to 119 banks in 2014. As for the development of the number of Islamic commercial banks (BUS) significantly increased from 3 BUS in 2007 to 12 BUS in 2014.

The rapid growth of Islamic banks is certainly followed by all risks that must be faced. Despite the quite rapid growth, it is feared that Islamic banks are very vulnerable to facing risks which could one day suddenly confront and even destroy the banking sector as the

banking crisis in the previous years. This growth is also very vulnerable to fraud or unhealthy practices due to increasingly fierce competition.

The growth of Islamic commercial banks is increasing well. Unfortunately, the risk of bank financing is also increasing. The increase in non-performing financing has been experienced by the Islamic banking industry. Based on the data from the Financial Services Authority (FSA), the ratio of non-performing financing (NPF) of sharia banking increased from 2.22% in 2012, 2.62% in 2013, 4.33% in 2014 and 4.73% in October 2015. Even though the NPF percentage is still below the maximum limit of BI regulation, which is below 5%, the NPF always increases every year and is approaching the maximum limit so it is worth to be noticed.

Non-performing financing for Islamic banking is one of the real examples of risks that must be faced. Banks must solve the problems regarding this risk and improve the quality of financing because of course the non-performing financing will affect the profitability of the bank's business concerned and will cause bank performance to decline. Risks faced by banks must be managed properly so banks need risk management. Risk management can analyze the occurrence of risks so that control will be obtained for the risks that will or are being faced.

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Indonesia has experienced many cases of troubled banks due to unhealthy banking practices. This not only occurs in conventional banks but also occurs in Islamic banks that always carry sharia values in each of their operations. Example of cases that occurs in sharia banking is case of fraud that afflicted Bank Pembangunan Daerah (BPD) sharia unit of Central Java in 2011. It is known that there was fictitious Work Order Letter (SPK) from various Central Java provincial government projects carried out by sharia unit employees of BPD Central Java. The SPK is used to disburse credit funds using the name of another company.

In addition to the fictitious credit cases in the Central Java BPD sharia unit, there are also other cases that occur in Sharia banking, namely fictitious credit at Bank Mandiri Syari'ah, where the case began since the disbursement of credit in 2011, and the case of a gold pawning Bank Mega Syariah in 2013. Based on the case experienced by the Islamic banking, the stakeholders in the Islamic banking industry should realize that the application of risk management is important. Bank Indonesia as the banking authority has issued a risk management regulation specifically for Islamic banks.

Risk disclosure by banks in Indonesia is one of the mandatory disclosures regulated in PSAK 50 (revised 2010). The purpose of the disclosure is to provide information to improve understanding of the significance of financial instruments on the financial position, performance, and cash flow of the entity and help assess the amount of time and certainty of future cash flows. In addition, there is also on the regulation of Bapepam-LK 2009 regarding the implementation of risk management with the aim of being able to anticipate and manage risks effectively and efficiently. Bank Indonesia also regulates risk management based on Bank Indonesia Regulation Number: 13/23 / PBI / 2011 concerning the implementation of risk management for Islamic banks and sharia business units.

Research on risk disclosure has been carried out in various countries, including Gründl, Wandt, & Schluetter (2011) in Europe, Ismail & Rahman (2013) ; Mohd Ali & Taylor (2014) ; Nordin & Abdul Hamid (2013) in Malaysia, Tankiso (2014) in Africa, M. Linsley & J. Shrivs (2005) in UK. Research on risk disclosure is also carried out by Zulbahridr & Azhar (2014), Mubarok (2013), Rahman (2013), Anisa (2010), Saidah, (2014), Utomo (2014), Wardhana (2013), and much more research on risk disclosure.

Amran *et al* (2009) found a positive relationship between firm size and risk disclosure. Mubarok (2013) found that firm size has no effect on risk disclosure in interim financial statements. Mubarok (2013) showed that institutional ownership has no effect on risk management disclosure. While Saidah's research (2014) found that ownership structure has a significant effect on risk management disclosure.

According to Kumalasari, Subowo, & Anisykur-lillah (2014), extensive risk management disclosures can show the effectiveness of company uncertainty management related to risks and opportunities with the aim of enhancing firm value. Adamu (2013) revealed that risk

disclosure increases company transparency; facilitate effective risk management; minimize the problem of over / under stock valuation; and helps analysts make earnings estimates with reasonable accuracy. As a result, entities registered in Nigeria are urged to report risk-related information because they obtain all these benefits.

Disclosure of risk management is important to do since it can be used as a decision-making tool for users of financial statements. The company's ability to manage risk through risk management is expected to reduce the impact of risks or even eliminate them. Saufanny & Khomsatun (2017), Islamic banking is faced with more risks than conventional banking. For this reason, it is needed research on the disclosure of risk management in Islamic banking in Indonesia by taking all types of risk, not just finance.

Based on the importance of risk management, the existence of gap phenomena, and the research gap from the results of the previous studies, the researchers are interested in further examining about risk management disclosure. The researchers choose the object of research in Islamic banks because it is still rarely done. From the previous research searches that have examined risk management disclosure, it is mostly done on conventional banks or companies. The purpose of this study is to find out the variables affecting the risk management disclosure at Islamic commercial banks in Indonesia.

Sharia Enterprise Theory is a theory that puts God at the center of everything (Triyuwono, 2011). The implementation of sharia enterprise theory principles generally in Islamic commercial banks will make management more comply with established principles, including in making risk management disclosures. Risk management disclosure conducted by Islamic banks is a mandate and fulfilment of obligations as the caliph of God in managing companies that cannot be separated from the teachings of Islam in fulfilling social obligations to corporate stakeholders. Islamic commercial banks carry out risk management disclosure, which is to provide complete and comprehensive company information as a responsibility to stakeholders.

Stakeholder theory states that companies operate not only for the progress of the company, but also provide benefits for stakeholders (Ghozali & Chairiri, 2007). The implementation of stakeholder theory in Islamic commercial banks will encourage Islamic commercial banks to carry out their responsibilities in meeting the interests of corporate stakeholders. This theory explains the company in conducting risk management disclosure (RMD) to provide information and meet the interests of corporate stakeholders. Through the existence of RMD, it is expected that the wishes of stakeholders can be accommodated so that it will produce a harmonious relationship between the company and its stakeholders. A harmonious relationship will result in the company achieving its corporate sustainability.

Agency theory according to (Jensen & Meckling, 1976) is the relationship between agents and principals in running a company. Agency theory can be used as a basis for understanding the practice of risk disclosure. The agent has more information about the whole con-

dition of the company. Users of financial information such as creditors, shareholders and other stakeholders need this information as a basis for decision making. If information asymmetry occurs between the agent and the principal, then it will have an impact on the decisions taken and disadvantage many parties. Managers should ensure the availability of relevant and complete information about the risks the company will face. This can be done by managers by using a disclosure mechanism. The existence of risk management disclosures can reduce the occurrence of information asymmetry between agents and principals.

Sharia enterprise theory reveals that there are three stakeholders namely God, humans and nature. For this reason, the company is not only responsible for humans and nature but is primarily responsible for God. Therefore, corporate governance that is built must also be in accordance with the provisions of God or in accordance with sharia. Stakeholder theory according to Ghozali and Chariri (2007) that companies are not entities that only operate for their own interests, but also must provide benefits to all stakeholders. This stakeholder group is a consideration for the company in disclosing whether or not the information in the financial statements. Thus, a corporate governance mechanism is built so that the company runs according to its objectives and still protects the interests of stakeholders.

The duties and responsibilities of directors are one of the right choices to be used as indicators of sharia corporate governance mechanisms. Duties and responsibilities of directors play an important role in the implementation of operational activities of Islamic banks. Directors are not only responsible for the company's operations but also required to accounting for the implementation of their duties to shareholders through a general meeting of shareholders (GMS). Therefore, the duties and responsibilities of directors can influence the disclosure of risk management. Based on the description, the following hypothesis is obtained:

**H<sub>1</sub> : The duties and responsibilities of directors have a positive effect on risk management disclosure.**

According to stakeholder theory, by disclosing risk information in more depth and breadth shows that the company is trying to satisfy the needs for information needed by stakeholders (Anisa, 2012). Stakeholders will always make broader disclosure requests, demand companies to disclose information specifically information about risk management in a transparent and complete manner. Through the existence of RMD, it is expected that the wishes of stakeholders can be accommodated so that it will produce a harmonious relationship between the company and its stakeholders. RMD which is part of corporate responsibility to stakeholders can be influenced by corporate governance mechanisms, for example institutional ownership and managerial ownership.

Institutional ownership is usually a means of monitoring management actions. Institutional ownership is important in monitoring management because ownership by institutions will encourage increased op-

timal monitoring. Institutional ownership can play an important role in disclosing higher risks because institutional ownership holders can be used as monitoring agents (management). Saidah's research (2014) finds that ownership structure has a significant effect on risk management disclosure.

**H<sub>2</sub> : Institutional ownership has a positive effect on risk management disclosure.**

The implementation of stakeholder theory in Islamic commercial banks will encourage Islamic commercial banks to carry out their responsibilities in meeting the interests of corporate stakeholders. Through the existence of RMD, it is expected that the wishes of stakeholders can be accommodated so that it will produce a harmonious relationship between the company and its stakeholders. A harmonious relationship will result in the company achieving its corporate sustainability. Risk management disclosure which is part of corporate responsibility to stakeholders can be influenced by corporate governance mechanisms, one of which is managerial ownership.

Managerial ownership can be interpreted as share ownership by the company management. These parties are those who sit on the company's board of commissioners and board of directors. Management does not only act as a manager of the company but also as a shareholder. Management will be responsible for what is done by making disclosures in the company's financial statements.

**H<sub>3</sub> : Managerial ownership has a positive effect on risk management disclosure.**

According to the agency theory approach, capital structure is structured to reduce conflicts between various interest groups. The conflict between shareholders and managers is information asymmetry. Managers know more information than information held by shareholders. Debt can be considered as a way to reduce agency conflict. If the company uses debt, then the manager will be forced by shareholders to make disclosure more widely.

Capital structure is a permanent or long-term fund that consists of own capital and loan capital (debt). Company is expected to be able to provide risk management disclosures in order to provide justification and explanation for what happened to the company. When the company has a higher level of debt risk in the capital structure, creditors can force the company to disclose more information. Companies with high debt to capital ratio will provide comprehensive information of risk management disclosure to meet the demands of long-term creditors compared to companies with low ratio. Therefore, capital structure can influence risk management disclosure. Based on the description, the following hypothesis is obtained:

**H<sub>4</sub> : Capital structure has a positive effect on risk management disclosure.**

Based on agency theory, large companies have greater agency costs when compared to small compa-

nies. Large companies will disclose more information than small companies. This is since large companies have greater resource capabilities to finance the provision of information for internal company parties. The information is used to provide information to external parties of the company, so it does not require a greater cost to make a comprehensive disclosure. Small companies do not have the ability as large companies so it requires more money to have information that will be disclosed as complete as large companies.

Research conducted by Amran et al (2008) finds a positive relationship between firm size and risk disclosure. Also the research by Anisa (2012) and Zulbahridr & Azhar (2014) which find that firm size has a significant positive effect on risk disclosure. The hypothesis that can be drawn based on the description is as follows:

**H<sub>5</sub> : Firm size has a positive effect on risk management disclosure.**

Based on the description that has been explained, the framework of this research is illustrated in Figure 1.

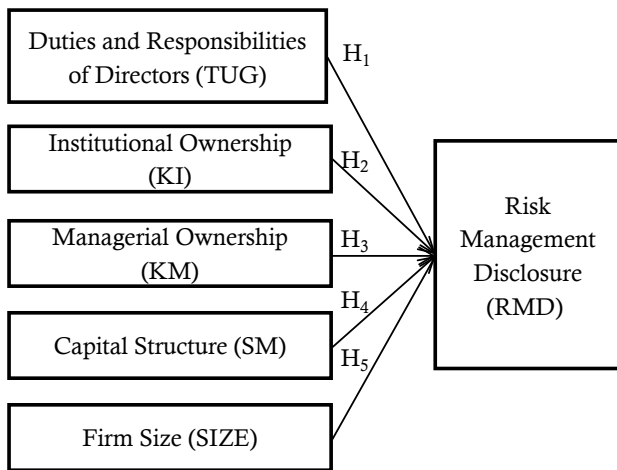


Figure 1. Theoretical Framework

**RESEACH METHODS**

The type of research used was quantitative research. The data used in this study was secondary data in the form of annual reports of Islamic banks in Indonesia in 2010-2014. The population in this study was Islamic commercial banks in 2010-2014, amounting to 12 banks. The technique used in the selection of samples of this study was purposive sampling. The results of purposive sampling are shown in Table 1.

Table 1. Sampling Criteria

No	Sampling Criteria	Beyond Criteria	Total
1	Total Islamic Commercial Banks registered on the IDX during 2010-2014 (Population)		12
2	Islamic Commercial Bank which has annual report for 2010-2014	(4)	8
3	Islamic Commercial Bank that has a report on the implementation of Good Corporate Governance in 2010-2014	(0)	8
4	Islamic Commercial Bank in 2010-2014 that meets the required research variables	(1)	7
5	Duration of study (year)		5
Total analysis units			35

Source: Data processed, 2016

The variables used in this study consisted of dependent variable and independent variable. The dependent variable in this study was Risk Management Disclosure (RMD). Meanwhile, the independent variables in this study are the Duties and Responsibilities of Directors, Institutional Ownership, Managerial Ownership, Capital Structure and Firm Size. For the research variables, the description of variables and the variables

Table 2. Operational Definition of Variable

No	Variables	Definition	Indicators
1	Risk Management Disclosure (RMD)	The measurement of the dependent variable in this study is by using the amount of risk disclosure presented in the annual report.	$\frac{\text{Total Risk Disclosed}}{\text{Total Risk Types}}$
2	Duties and Responsibilities of Directors (TUG)	The results of the self assessment rank of the implementation of the duties and responsibilities of directors that can be seen in the GCG BUS implementation report	Rating 1 = very good = 5 Rating 2 = good = 4 Rating 3 = good enough = 3 Rating 4 = less good = 2 Rating 5 = not good = 1
3	Institutional Ownership (KI)	Percentage of total shares owned by institutional parties from all of the company's total shares	$\frac{\text{Total institutional shares}}{\text{Total outstanding shares}}$
4	Managerial Ownership (KM)	Total percentage of shares owned by management	$\frac{\text{Total managerial shares}}{\text{Total outstanding shares}}$
5	Capital Structure (SM)	The comparison between debt and own capital which is reflected in the company's financial statements at the end of the year	$\frac{\text{Total Debt}}{\text{Own Capital}}$
6	Firm Size (SIZE)	Is the level of the company in which there is labor capacity, production capacity and capital capacity (total financing)	$\log \sum \text{financing}$

Source: Writers' Summary, 2016

indicator can be seen in the operational definition of variables in Table 2.

Data collection techniques in this study used documentation technique in the form of financial statements of Islamic banks in Indonesia in 2010-2014. The data analysis technique used in this study was multiple linear regression analysis technique with SPSS 21 with a significance level of 5% (0.05). This research consisted of descriptive statistical analysis technique and inferential analysis techniques. Hypothesis testing uses multiple linear regression analysis by containing multiplication interaction elements of two or more independent variables (Ghozali, 2013).

The regression equation is as follows:

$$RMD = \alpha + \beta_1TUG + \beta_2KI + \beta_3KM + \beta_4SM + \beta_5SIZE + e(1)$$

Multiple regression equation (1) has the description of RMD as risk management disclosure, TUG as the duty and responsibility of directors variable, IC as institutional ownership variable, KM as managerial ownership variable, SM as capital structure variable, SIZE as firm size variable,  $\alpha$  (alpha) as a constant, and  $e$  as an error.

**RESEARCH RESULTS AND DISCUSSIONS**

Descriptive statistics can provide a description of a data that is seen from the average value (mean), standard deviation, variance, maximum, minimum, sum, range, kurtosis, and skewness (slope distribution). Based on the results of descriptive statistical tests using SPSS 21, the results shown in table 3 are obtained.

The result of descriptive analysis based on table 3 shows that the average of each variable is greater than the standard deviation value. This means that the tendency of variables is at an average because the average value is greater than the standard deviation value. There-

fore, the data can be used for research.

The classical assumption test is a statistical requirement that must be met in multiple linear regression analysis. The classical assumption tests used in this research are multicollinearity test, heteroscedasticity test, and autocorrelation test. This study fulfils the requirements of all classical assumption tests as shown in Table 4.

Based on table 4, the normality test of research data has a normal data distribution. The independent variables in the regression model do not have multicollinearity and autocorrelation does not occur so that it can be used to measure the degree of effect of the independent variable on the dependent variable. The heteroscedasticity testing using glejser test shows that the variance from one observation residual to another observation remains or does not occur heteroscedasticity. That is, the research data meets the classical assumption criteria and the data can be used for research.

Multiple regression model is used to test the effect of independent variables on the dependent variable. According to Ghozali (2013: 98) the t statistical test shows how far the influence of one independent variable individually in explaining the variation of the dependent variable. The results of hypothesis testing with multiple linear regression using SPSS 21 in this study can be seen in Table 5. Based on the test results in Table 5, the regression equation model is obtained as follows:

$$RMD = -2.485+0.396 TUG - 1.427 KI - 4.943KM - 0.049 SM + 64.435 SIZE \dots\dots\dots(2)$$

Hypothesis assessment can be done by looking at the results of the significance and coefficient values in beta. If the significance value is lower than (0.05), and the result of the coefficient direction in the beta column

**Table 3.** Descriptive Statistical Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
RMD	35	0.40	0.80	0.6371	0.17335
TUG	35	0.53	0.88	0.7950	0.09811
KI	35	0.76	1.00	0.9737	0.05936
KM	35	0.00	0.07	0.0089	0.02233
SM	35	0.06	4.18	1.8452	1.09591
SIZE	35	11.09	13.65	12.7593	0.65466

Source: Data processed, 2018

**Table 4.** Results of the Classical Assumption Test

Variables	Classical Assumption Test					
	Normality Test		Multicollinearity Test		Autocorrelation Test	Heteroscedasticity Test
	Kolmogorof Smirnov	Sig ( $\geq 0.05$ )	Tolerance ( $\geq 0.10$ )	VIF ( $\leq 10$ )	Test (DW)	Glejser Test ( $\geq 0.05$ )
RMD						
TUG			0.870	1.149		0.352
KI			0.969	1.032		0.064
KM	0.593	0.873	0.784	1.276	2.836	0.051
SM			0.682	1.467		0.607
SIZE			0.616	1.624		0.901

Source: Data processed, 2018

is in accordance with the hypothesis statement then the hypothesis is accepted. Recapitulation of the results of hypothesis research can be seen in table 6.

**Table 5.** Result of t-Statistical Test

	Model	<i>Unstandardized Coefficients B</i>	Sig.
1	(Constant)	-2.485	0.063
	TUG	0.396	0.208
	KI	-1.427	0.000
	KM	-4.943	0.060
	SM	-0.049	0.033
	SIZE	64.435	0.000

Source: Data processed, 2018

**Table 6.** Recapitulation of the hypothesis results

No	Hypothesis	Information	Results
1	H <sub>1</sub>	The duties and responsibilities of directors have a positive effect on risk management disclosure	Rejected
2	H <sub>2</sub>	Institutional ownership has a positive effect on risk management disclosure	Rejected
3	H <sub>3</sub>	Managerial ownership has a positive effect on risk management disclosure	Rejected
4	H <sub>4</sub>	Capital structure has a positive effect on risk management disclosure	Rejected
5	H <sub>5</sub>	Firm size has a positive effect on risk management disclosure	Accepted

Source: Writer's documentation, 2018

### **The Effect of the Duties and Responsibilities of Directors on risk management disclosure**

The first hypothesis which states that the duties and responsibilities of the director have a positive effect on the risk management disclosure is rejected. Based on the descriptive statistical data, the ranking of the duties and responsibilities of directors' implementation in 2010 to 2014 has the highest rating of 1 and the lowest rating of 3. As examples, BNI Syariah in 2012 and 2013 revealed a number of 4 risk management and the self-assessment ranking of BNI Syariah board of directors in the same year got a ranking with a very appropriate category. Bank Syariah Mandiri in 2012 disclosed a number of eight risk management and the self-assessment ranking of Bank Syariah Mandiri board of directors in 2012 received the ranking by category is quite appropriate. The data proves that the increase in self-assessment ranking of board of directors is not followed by an increase in risk management disclosure.

Other reasons why the duties and responsibilities of directors have no effect on the risk management disclosure, it is possible that the effectiveness of the duties and responsibilities of directors' assessment on the

implementation of good corporate governance is less compatible or inappropriate because it is carried out by the company's internal parties. The results of the assessment will be more appropriate if the assessment of the implementation of good corporate governance of Islamic banks is carried out by external bodies that are more professional and independent.

### **The Effect of Institutional Ownership on Risk Management Disclosure**

Institutional ownership has no significant effect on the risk management disclosure. The research data shows that there are several companies with high institutional ownership but low risk management disclosure. As examples, Bank Panin Syariah in 2010 with an institutional ownership of 1.00 disclosed risk management of 0.4 or only revealed 4 of 10 risk management that should have been disclosed according to Bank Indonesia regulations. Whereas institutional ownership at Bank Muamalat Indonesia sample in 2012 with an institutional ownership of 0.846 the company revealed 8 risk management or revealed almost all of the overall risk management.

Institutional ownership can be used as agent or management monitor in managing the company, but it cannot influence management in the risk management disclosure process. The result of this study is consistent with the research conducted by Zulbahridr & Azhar (2014) which shows that institutional ownership has no significant effect on risk management disclosure.

### **The Effect of Managerial Ownership on Risk Management Disclosure**

Managerial ownership has no effect on the risk management disclosure which is caused by the low ownership of shares by the management. There are a number of companies that have relatively small managerial ownership, so that the manager may not have the full authority to influence the discussion of risk management disclosure in the annual report. Low management ownership can result in management will not attach much importance the welfare of the owner and the possibility if responsibility in managing the company will also be reduced. The lack of management responsibility in managing the company results in the lack of good management so that disclosure is not done sufficiently.

The result of this study is consistent with the previous studies conducted by Zulbahridr & Azhar (2014) and Saidah (2014). Zulbahridr & Azhar (2014) conclude that institutional ownership has no effect on risk management disclosure and Saidah (2014) stated that managerial ownership has no effect on risk management disclosure.

### **The Effect of Capital Structure on risk management disclosure**

The capital structure does not affect the RMD because the company already has special posts in the company budget Zulbahridr & Azhar(2014). It can be inter-

puted that the company has had a specified budget for the payment of its debts, which funds have indeed been budgeted to pay debts and not used for other costs. So, the creditor is not worried about borrowing the funds to the company so that the capital structure has no effect on the risk management disclosure. This research is consistent with the result of research conducted by Zulbahridr & Azhar (2014) that capital structure has no significant effect on risk management disclosure.

### The Effect of Firm Size on risk management disclosure

The hypothesis which states firm size has a significant positive effect on risk management disclosure is accepted. The result of this study is consistent with the previous studies of Amran et al (2008), Anisa (2012), Rahman (2013), Zulbahridr & Azhar (2014) which state that firm size has a significant positive effect on risk management disclosure. The result of this study also supports the study of Wardhana (2013) that firm size affects the level of risk disclosure.

The result of this study is in accordance with stakeholder theory, that many parties concerned with information about the company and the company's responsibility for that information are getting bigger, so that large companies will disclose more extensive information compared to smaller companies. Large companies are entities that are much considered by the public, by disclosing more company information is part of the company's efforts to realize public accountability. The bigger the company, the higher the risk management disclosure of the company.

### CONCLUSIONS

Based on the hypothesis test, the conclusion in this study is that there is no significant positive effect of the duties and responsibilities of the directors, institutional ownership variables managerial ownership variable, and capital structure variable on risk management disclosure. Meanwhile, firm size variable has a significant positive effect on risk management disclosure.

Research suggestions can expand the sample to be used. For example, by adding years of research or adding other research objects such as sharia business units. Future studies can also analyze other factors that can affect risk management disclosure in Islamic commercial banks such as the duties and responsibilities of the board of commissioners.

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