

Corporate Governance Mechanisms and Value Relevance of Fair Value Assets under IFRS 13

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Abstract: This study sheds light on whether all fair values in three levels hierarchy are value relevant to investors post adoption of IFRS 13. Specifically, this study examines the influence of family ownership, board effectiveness and audit committee effectiveness as corporate governance mechanism on the value relevance of fair value hierarchy. This study uses Indonesia and Malaysia cross-country sampling data for pre and post-adoption IFRS 13. The result shows that value relevance of fair value assets increase from level 1 to level 3 in the fair value hierarchy. The result also shows that audit committee effectiveness, board effectiveness and family ownership also strengthen the value relevance of fair value estimates, but it is only for the value relevance of fair value assets on the level 2 and 3.

Key words: IFRS 13 • Value relevance • Fair value • Corporate governance

INTRODUCTION

International Accounting Standard Board (IASB) continuously develops an sustainable International Financial Reporting Standards (IFRS) in order to actualize the harmonization of global financial reporting. One of the most crucial issues is fair value accounting since the unavailability of fixed guidance in measuring of the fair value assets and liabilities that leads to inconsistency in practice. Eventually, this situation not only reaps pros but also reaps cons at the same time. However, IASB provides positive response to answer these issues by issuing IFRS 13 Fair Value Measurement as a global fixed guidance to measure fair value assets and liabilities.

Fair value concept causes assets and liabilities more volatile that gives impact on financial statements and then lead to stock price volatility [1]. The principal basis brought by IFRS allows the management to act opportunistically through fair value estimation [2]. Although fair value measurement standard has been set, the inconsistency in enforcement of the standard will result in different levels of compliance and influences the reliability and relevance of fair value estimation.

The corporate governance mechanism will reduce management opportunistic behavior and increases the value relevance of fair value [2,3,4]. The weak corporate

governance mechanism will encourage the incentives of management opportunism and discretion. In contrast, the strong corporate governance mechanism and supported by efficient monitoring performed by board and audit committee monitoring can reduce management incentive to act opportunistically. It also generates investor's higher trust and creates higher value relevance against fair value estimation [2].

Siekkinen [5] urged that fair value on the three levels is relevant to investors. The implementation of IFRS 13 has obscured the fair value relevance differentiation on all three levels then it has reduced the subjectivity on the level 3 of fair value estimation. In relation to corporate governance, Siekkinen [5] urged that board's characteristic influence the value relevance of fair value assets post- implementation IFRS 13. The investor's biased against fair value estimation on all three levels will decrease.

This study used Indonesia and Malaysia as South East Asia's representatives in order to expand previous studies regarding the value relevance of fair value estimation under IFRS 13. This study also seeks to deeper analyze the corporate governance by considering board effectiveness, audit committee effectiveness and family ownership as the corporate governance mechanism.

Literature Review: A capital market is called efficient if the stock price reflects all information related to the firm's management and activities. Stock price will continue to change spontaneously when there is new information [6]. Suwardjono [7] urged that value relevance and the purpose of financial reports are related to information's capability to influence the investor's investment decision.

IFRS 13 as the new standard directly influences financial statement and stock price. IFRS 13 not only defines fair value but also requires to disclose fair value based on three input levels hierarchy. Besides that, IFRS 13 requires additional disclosure to reduce biased information such as methodology, the reason for using that method and any information about changes in fair value estimation [8]. Therefore, IFRS 13 is expected to improve the value relevance of fair value especially on the third level of fair value hierarchy. Eventually, IFRS 13 is expected to protect investors.

Hypothesis Development: The fair value will have a value relevance if fair value's increase is in line with the stock price's increase and vice versa. Li dan Kyu [9] urged that fair value asset upon China's securities is related to the stock price. Khurana and Kim [10] analyzed banking in the US and they found that fair value assets will be more relevant if it is measured based on market's information. Song *et al.* [4] has urged found that the fair value assets have higher value relevance on the level 1 than level 2 and level 3 of fair value hierarchy.

H1: Value relevance of fair value assets decrease on the three levels of fair value hierarchy from level 1 to level 3.

Theoretically, the efficient market will not be actualized if there is an information asymmetry and agency conflict between prepares and users. This situation will influence investor's decision-making and decrease value relevance of accounting information. Corporate governance mechanism can influence the value relevance of financial statement. Song *et al.* [4] found that strong corporate governance mechanism will reduce management's opportunistic behavior. Habib dan Azim [3] added that corporate governance mechanism will create accounting information becomes more reliable. The last study, Siekkinen [5] analyzed board's five characteristics and found that it is related to the value relevance of fair value. This finding supports that Board working effectively will strengthen the value relevance of fair value assets estimation.

H2a: Board effectiveness strengthens the value relevance of fair value assets on the 3 level post-implementation IFRS 13.

The audit committee as responsible for assisting Board performance has a role equally in corporate governance. Eventhough, Siekkinen [5] did not find a relation between the audit committee and value relevance of fair value. But, most of the previous studies stated that the active audit committee can minimize misstatement in the financial statement [11]. Xie *et al.* [12] also found that audit committee is an important factor in preventing management discretion.

H2b: Audit committee effectiveness strengthens the value relevance of fair value assets on the level 3 post-implementation IFRS 13.

Ownership concentration is a factor that is also essential for good corporate governance. Based on agency theory, Shleifer and Vishny [13], Agrawal and Mandelker [14] and Agrawal and Knoeber [15] found that concentrated ownership will increase the monitoring of management. Most of ownership in emerging markets including Indonesia and Malaysia is concentrated in family ownership [16]. In this case, family ownership is expected to limit the management discretion in estimating fair value.

H2c: Family ownership strengthens the value relevance of fair value assets on the level 3 post-implementation IFRS 13.

MATERIALS AND METHODS

Sample Selection and Description: This study uses Indonesia and Malaysia cross-country data. The sample used in this study consist of listed firms in two countries' stock exchanges. This study uses non-financial firms sample and it was different from most of previous studies which used financial firms in US and UK countries as sampling data [4,5,17,18].

Indonesia has adopted IFRS 13 in 2015 while Malaysia previously has adopted IFRS 13 in 2013. Thus, the observation period is adjusted to the adoption in both countries. There were 1.169 listed firms on both countries' Stock Exchange. Total 287 financial firms are excluded from sample. An abnormal fiscal year-end (non-December) firms did not disclose fair value hierarchy of financial assets and liabilities and also data unavailability are excluded from the sample. Finally, the final sampel of this

study for 2 years observation period are 300 firm-year observations.

Data Collection: Data are collected for pre and post-implementation of IFRS 13 observation periods. The fair value of financial assets and liabilities data at each level of fair value hierarchy are derived from each firm's financial statements. The data of board, audit committee and family ownership are collected from the annual report of each firms. While firms-specific data included share price, earnings per share and shares outstanding are obtained from Thomson Reuters Database and Eikon that stated in US Dollars.

The Board effectiveness's assessment is obtained by calculating the total score of value gain accumulation based on *checklist* refers to Hermawan's research [19] including board's independence, activity, size and competence (17 question items). Meanwhile, audit committee's assessment includes activity, size and competence of audit committee (11 question items). The total score is converted into *dummy* variable (1,0) to avoid multicollinearity in data processing.

The family ownership is defined as more than 5% shareholding firm that is not owned by government, financial institution or society [20]. Subsequently, firm's sample is separated into two groups that are the high family ownership firms (family ownership proportion >50%) and low family ownership firms (family ownership proportion =50%). Then these two groups separation above are converted into *dummy* variable (1,0) [21].

Design: Focus of this study is to analyze the value relevance of fair value of financial assets. Thus, it is in line with previous studies on value relevance [4,5,17,18], the regression of this study uses modified Ohlson's model [22] that has been developed to examine the hypothesis 1 as follow:

$$Price_{it} = \beta_0 + \beta_1 NFVA_{it} + \beta_2 FVA1_{it} + \beta_3 FVA2_{it} + \beta_4 FVA3_{it} + \beta_5 NFVL_{it} + \beta_6 FVL12_{it} + \beta_7 FVL3_{it} + \beta_8 EPS_{it} + \varepsilon_{it} \quad (1)$$

where $Price_{it}$ is firm's stock price in four months after fiscal-end year t (30 April). $FVA_{it}(FVL_{it})$ is the fair value assets (liabilities) in level 1, 2 and 3 hierarchy per outstanding share. $NFVA_{it}(NFVL_{it})$ is the non-fair value assets (liabilities) per outstanding share. Finally, EPS_{it} is the earnings per share. In examining of hypothesis 1, pre and pos-adoption IFRS 13 period observation data are combined into sample consisting of 300 firm-year observations.

Further, this study uses dummy-year variable and pools the observation into two groups for pre and pos-adoption IFRS 13 period to see the value relevance' difference by using this following equation:

$$Price_{it} = \beta_0 + \beta_1 NFVA_{it} + \beta_2 NFVA_{it} * YD + \beta_3 FVA1_{it} + \beta_4 FVA1_{it} * YD + \beta_5 FVA2_{it} + \beta_6 FVA2_{it} * YD + \beta_7 FVA3_{it} + \beta_8 FVA3_{it} * YD + \beta_9 NFVL_{it} + \beta_{10} NFVL_{it} * YD + \beta_{11} FVL12_{it} + \beta_{12} FVL12_{it} * YD + \beta_{13} FVL3_{it} + \beta_{14} FVL3_{it} * YD + \beta_{15} EPS_{it} + \beta_{16} EPS_{it} * YD + \beta_{17} YD + \varepsilon_{it} \quad (2)$$

Considering corporate governance mechanisms's role (*CGMech*) on the value relevance of fair value and stock price, this study uses separate regression from the three determinants that are Board effectiveness (*BD*), audit committee effectiveness (*AC*) and family ownership (*FO*) by using the equations as follows:

$$Price_{it} = \beta_0 + \beta_1 NFVA_{it} + \beta_2 FVA1_{it} + \beta_3 FVA1_{it} * CGMech + \beta_4 FVA2_{it} + \beta_5 FVA2_{it} * CGMech + \beta_6 FVA3_{it} + \beta_7 FVA3_{it} * CGMech + \beta_8 NFVL_{it} + \beta_9 FVL12_{it} + \beta_{10} FVL3_{it} + \beta_{11} EPS_{it} + \beta_{12} CGMech + \varepsilon_{it} \quad (3)$$

RESULTS

Descriptive Statistics: Based on the descriptive statistics presented in part A table 1 it shows that mean of FVA2 (0.0103) is higher than FVA1 (0.0097) and FVA3 (0.0077). This finding shows that non-financial firms have the amount of financial assets that are measured in level 2 fair value is higher than in level 1 and 3. While financial liability that is more frequently measured at level 3 found that FVL3 (0.0043) is higher than FVL12 (0.0016). While mean of share price and EPS are 0.6373 and 0.0906.

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
price	300	0.6373	1.4460	0.01	14.481
fva1	300	0.0097	0.0247	0	0.2397
fva2	300	0.0103	0.0780	0	1.2733
fva3	300	0.0077	0.0427	0	0.5003
nfva	300	0.1670	0.3833	0	3.1702
fv12	300	0.0016	0.0066	0	0.0603
fv13	300	0.0043	0.0466	0	0.7162
nfvl	300	0.1318	0.3203	0	2.5641
eps	300	0.0906	0.6667	-0.21	9.7762

Price: Stock price at 30 April; FVA1,FVA2,FVA3: Fair Value Asset per share for each level of the fair value hierarchy; NFVA: Non-Fair Value Asset per share; FVL12 dan FVL3: Fair Value Liabilities per share for each level of the fair value hierarchy; NFVL: Non-Fair Value Liabilities per share; EPS: Earnings per share.

Hypotesis Test

Hypothesis 1: The result of first equation estimation that is used to test hypothesis 1 is presented in table 2. The results shows that fair value at each level of hierarchy is significantly relevant. Fair value assets provide positive influence on stock price otherwise liabilities provide negative effect. In line to Siekkinen's finding (2016), fair value assets FVA2 has greater coefficient (0.702) from FVA1 (0.444) and FVA 3 (0.504) coefficient. It indicates that FVA2 more relevant than FVA1 and FVA3. However, EPS's coefficient (0.703) is higher than fair value assets. This finding shows that market value reflected from stock price is controlled by earnings rather than assets and liabilities. Thus, the result shows that hypothesis 1 is rejected.

Table 2: Value Relevance of Fair Values

price	Coeff.	t	p-value
fva1	0.444	2.70	0.000***
fva2	0.702	2.74	0.000***
fva3	0.504	5.38	0.000***
nfva	0.611	1.76	0.089*
fv112	-0.605	-2.24	0.039**
fv13	-0.734	-3.10	0.050**
nfvl	-0.835	-7.48	0.000***
eps	0.703	7.48	0.000***
cons	0.687	6.25	0.000***

Obs = 300

R-squared = 0.1841

Prob > F = 0.0000

*, **, *** Statistical significance at the 0.10, 0.05 and 0.01 levels; FVA1, FVA2, FVA3: Fair Value Asset per share for each level of the fair value hierarchy; NFVA: Non-Fair Value Asset per share; FVL12 dan FVL3: Fair Value Liabilities per share for each level of the fair value hierarchy; NFVL: Non-Fair Value Liabilities per share; EPS: Earnings per share.

Furthermore, to find the difference of value relevance before and after IFRS 13 adoption, regression is conducted by using year-interaction as in equation two. The equation's estimation result is presented in table 3. The result shows that in 2014 before IFRS 13 adoption, FVA2 coefficient value (0.6856) was higher than FVA1 (0.4289) and FVA3 (0.6366). While after IFRS 13 adoption in 2015, FVA3 coefficient value (0.9643) was higher than FVA1 (0.5300) and FVA3 (0.8974). This means that the increase of value relevance of fair value asset level 3 (0.3277) is highest than fair value asset level 2 (0.2118) and level 3 (0.1011) after adoption of IFRS 13.

It indicates that IFRS 13 most influence the value relevance of fair value asset level 3 which is considered less relevant on the previous studies. IFRS 13

successfully has been able to obscure the bias in fair value asset specifically for FVA level 3. In contrast to Siekkinen's finding (2016), IFRS 13 Fair Value Measurement provide significant influence on value relevance shifting among the fair value assets hierarchy.

Table 3: Value Relevance of Fair Values (year-interaction)

price	coef.	t	p-value
fva1	0.4289	1.96	0.043**
fva1d	0.5300	8.56	0.006***
fva2	0.6856	1.90	0.032**
fva2d	0.8974	7.44	0.000***
fva3	0.6366	2.41	0.009***
fva3d	0.9643	5.81	0.000***
nfva	0.5193	5.54	0.000***
nfvad	0.8213	6.31	0.000***
fv112	-0.5217	-7.22	0.000***
fv112d	-0.7464	-2.52	0.016**
fv13	-0.7181	-2.46	0.029**
fv13d	-0.9581	-2.53	0.044**
nfvl	-0.7027	-3.88	0.000***
nfvld	-0.8010	-5.91	0.000***
eps	0.8227	7.06	0.000***
epsd	0.9612	4.01	0.000***
dy	0.2025	9.45	0.005***
cons	0.7702	5.53	0.000***

Obs = 300

R-squared = 0.2230

Prob>F = 0.0000

*, **, *** Statistical significance at the 0.10, 0.05 and 0.01 levels; FVA1, FVA2, FVA3: Fair Value Asset per share for each level of the fair value hierarchy; NFVA: Non-Fair Value Asset per share; FVL12 dan FVL3: Fair Value Liabilities per share for each level of the fair value hierarchy; NFVL: Non-Fair Value Liabilities per share; EPS: Earnings per share; dy: Dummy-Year Variable (1=post-IFRS 13, 0 = pre-IFRS 13).

Hypotesis 2: Hypothesis 2 test is conducted by separate regression for each determinants of corporate governance mechanism which stand for Board effectiveness, audit committee effectiveness and family ownership. Table 4 presents the regression with Board effectiveness as moderation variable to test hypothesis 2a. The results shows that board's effectiveness does not strengthen fair value assets on the level 1. It can be described as the nature of FVA1 which are observable inputs that almost no possibility for management discretion.

As the results on the Table 4, board effectiveness only strengthens the value relevance of fair value assets level 2 and 3. However, Board effectiveness strongly strengthens FVA3 value relevance on stock price compared to FVA1 dan FVA2. This implies that the more effective firm's Board the better monitoring on the

management will be. So that, it will reduce bias or management's discretion in estimating fair value asset on the level 3. Therefore, fair value assets level 3 became more relevant. The investors will pay assets level 3 of the firms with higher Board effectiveness. Thus, hypothesis 2a is accepted.

Table 4: Board Effectiveness

price	coef.	t	p-value
fva1	0.4347	0.86	0.037**
fva2	0.7531	2.85	0.021**
fva3	0.6574	2.34	0.011**
nfva	0.6075	6.03	0.000***
fva1*BDS	0.5821	0.59	0.721
fva2*BDS	0.7200	2.00	0.000***
fva3*BDS	0.8171	4.57	0.000***
fv112	-0.2089	-2.73	0.000***
fv13	-0.4002	-2.07	0.034**
nfvl	-0.7202	-2.11	0.017**
eps	0.6659	5.96	0.000***
BDS	0.2551	1.94	0.054*
const	0.1137	1.17	0.242

Obs = 150

R-squared = 0.1711

Prob > F = 0.0000

*, **, *** Statistical significance at the 0.10, 0.05 and 0.01 levels; FVA1, FVA2, FVA3: Fair Value Asset per share for each level of the fair value hierarchy; NFVA: Non-Fair Value Asset per share; FVL12 dan FVL3: Fair Value Liabilities per share for each level of the fair value hierarchy; NFVL: Non-Fair Value Liabilities per share; EPS: Earnings per share; BDScore: Dummy Variable for Board Effectiveness (1= score is greater than median score; 0= otherwise).

Then, table 5 presents audit committee effectiveness regression's result to test hypothesis 2b. In line with the board effectiveness moderation influence, the result shows that audit committee effectiveness significantly strengthens fair value assets at level 2 and level 3.

Therefore, audit committee effectiveness is significantly the strongest in strengthening FVA2 on stock price than FVA1 and FVA3. This indicates that firm's audit committee effectiveness will influence the accounting information quality specifically in fair value estimation (Siekkinen, 2016). IFRS 13 provides basic reference to reduce bias on management discretion on the level 2 and level 3 fair value estimation. The more effective audit committee, the more focus on IFRS 13 application will be, so that value relevance of level 2 asset fair value (0.7017 becomes 0.9386) has increased and followed by the increase in level 3 (0.6482 becomes 0.8793). Thus, hypothesis 2b cannot be rejected.

Table 5: Audit Committee Effectiveness

price	coef.	t	p-value
fva1	0.4131	2.00	0.050**
fva2	0.7017	8.98	0.000***
fva3	0.6482	3.11	0.000***
nfva	0.5857	5.12	0.001***
fva1*ACS	0.6240	1.02	0.612
fva2*ACS	0.9386	3.42	0.000***
fva3*ACS	0.8793	2.80	0.007***
fv112	-0.4032	-4.95	0.000***
fv13	-0.5408	-2.60	0.006***
nfvl	0.6396	-3.00	0.000***
eps	0.6051	5.50	0.000***
ACS	0.2130	1.79	0.075*
_cons	0.1661	2.53	0.013**

Obs = 150

R-squared = 0.1852

Prob > F = 0.0000

*, **, *** Statistical significance at the 0.10, 0.05 and 0.01 levels; FVA1, FVA2, FVA3: Fair Value Asset per share for each level of the fair value hierarchy; NFVA: Non-Fair Value Asset per share; FVL12 dan FVL3: Fair Value Liabilities per share for each level of the fair value hierarchy; NFVL: Non-Fair Value Liabilities per share; EPS: Earnings per share; BDScore: Dummy Variable for Audit Committee Effectiveness (1= score is greater than median score; 0 = otherwise).

Table 6: Family Ownership

price	Coeff.	t	p-value
fva1	0.4238	2.05	0.050**
fva2	0.6987	3.73	0.001***
fva3	0.5073	1.94	0.046**
nfva	0.6094	2.70	0.000***
fva1*FO	0.4921	0.64	0.823
fva2*FO	0.8995	1.84	0.087*
fva3*FO	0.7270	3.29	0.000***
fv112	-0.4512	-2.25	0.032**
fv13	-0.5080	-2.76	0.000***
nfvl	-0.7529	-5.02	0.000***
eps	0.0719	7.98	0.000***
FO	0.3414	7.89	0.000***
cons	0.3823	2.88	0.005***

Obs = 150

R-squared = 0.3036

Prob > F = 0.0000

*, **, *** Statistical significance at the 0.10, 0.05 and 0.01 levels; FVA1, FVA2, FVA3: Fair Value Asset per share for each level of the fair value hierarchy; NFVA: Non-Fair Value Asset per share; FVL12 dan FVL3: Fair Value Liabilities per share for each level of the fair value hierarchy; NFVL: Non-Fair Value Liabilities per share; EPS: Earnings per share; FO: Dummy Variable for Family Ownership (1=proportion more than 50%; 0 = otherwise).

Finally, the regression result for ownership variable is presented in table 6. Surprisingly it shows that family ownership strongly significantly strengthens fair value assets on the level 3. But the coefficient value (0.7270) is smaller than fair value asset on the level 2 (0.8995). It indicates that family ownership has the big impact on monitoring management specifically on estimation of fair value assets on the level 3. Eventhough, it seems that investors consider that fair value assets level 2 more relevant than assets level 3 which is need more subjectivities. Thus, hypothesis 2c is accepted.

In fact, IFRS 13 application has successfully influence in improving the value relevance of fair value assets of Indonesia and Malaysia's listed firms that have similarity in firms ownership structure that tends to concentrate on family ownership.

CONCLUSION

This study aims to analyze value relevance of fair value assets estimation based on three input levels hierarchy after implementation of IFRS 13. By using Indonesia and Malaysia cross-country data with total 300 observations of non-financial firms-year, this study also contributes by analyzing the role of corporate governance mechanism in strengthening the value relevance of fair value assets estimation.

The empirical result shows that fair value in each level of fair value hierarchy is significantly relevant and it is increasing in line with fair value hierarchy from level 1 to level 3. Therefore, the implementation of IFRS 13 gives a significant influence on value relevance shifting among the three levels of fair value hierarchy pre and post-implementation of IFRS 13. This finding is different from Siekkinen's finding [5] that value relevance of assets on the level 1 and 3 are similar post-implementation IFRS 13.

In addition, the result of the study proves that not only board and audit committee 's effectiveness but also family ownership significantly strengthen only asset's fair value on the levels 2 and 3 whereas it does not happen in level 1. Hence, corporate governance mechanisms and IFRS 13 provide significant influence upon the value relevance of fair value assets.

Limitations of the Study: This study has analyzed the influence of IFRS 13 implementation on value relevance of fair value assets. Therefore, according to the finding's result, there are some difference with the previous study. Hence, this results cannot be generalized. The other

limitation of this study is the amount of the observations. IFRS 13 is a standard that is newly effective enacted so that there are many firms that have not disclose the fair value hierarchy of financial assets. In addition, non-financial firms did not have substantial financial asset as in financial sector. Finally, regarding cross-country data usage, although there are some similar aspect in Indonesia and Malaysia, yet there was unavoidable factors in both countries that could affect the result of this study.

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