THE EFFECT OFCORPORATE GOVERNANCE'SAPPLICATION ON BANK'S PERFORMANCE (Empirical Study on Bank Listed in Indonesia Stock Exchange)

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Abstract: *This study aimed to examine the effect of corporate governance indicators such as the board of directors, audit committee and audit quality on bank performance which is proxied by Camel Ratio such asCAR, NPL, LDR, BOPO, andROE. This study used30 banks listed in the Indonesia Stock Exchange as samples and Structural Equation Modelling (SEM) was used to examine the influence of corporate governance indicators on bank's performance. The test results reveal that the board of directors as one of the corporate governance indicator sh as a significantly positive correlation to bank's performance, which means the higherthe level of supervision by the commissioners, the better the performance of the bank. As for theaudit committee indicator, the result reveal positive effect on the bank's performance butinsignificant. Meanwhile, a corporate governance indicator of audit quality hasa significant positive relationshipto the performance ofthe bank, meaning the higher the auditquality ofabank, the higher the bank's performance. This is consistent withthe previous studies. It is concluded thatthe higherorbetterfunctioningthe board of directors, audit committee andaudit qualityin the bank, the better the performance ofthe bank.*

Keywords*: Corporate Governance, Bank Performance, Camel Ratio, the Board of Directors, the Audit Committee, Audit Quality*

INTRODUCTION

The banking industry has always been an object of interest for study since it has two characteristics that distinguish it from other industries. First, it'sa highly regulated industry.Every activity must be monitored and regulated by agency standard, which is carried out by Central Bank of Indonesia.The number of regulations governing the banking business aims to protect the interests of the community.It is a consequence caused by the second characteristics of the bank i.e the banking industry is an industry that is based on trust, particularly the trust of its customers.

As bank customer, people put their money in the bank without full guarantee from the bank, even with a rate of return which is determined by the bank. Based on its role as an intermediary andeconomic-driven, the bank will channel back the money collected from public in other form of investment. In carrying out its activities the bank faces a variety of risks such as credit risk, market risk, operational risk and legal risk. Thus, the bank needs to be managed with good corporate governance by professional management with high integrity. Without good corporate governance, the banking industry will be collapse, as happened in 1997.

The financial crisis which hits many countries in 1997-1998 was preceded by the financial crisis in Thailand in 1997 and followed by crisis in Japan, Korea, Indonesia, Malaysia, Hong Kong and Singaporewhich eventually turned into the Asian financial crisis. These considered as a result of weak practice of Good Corporate Governance (GCG) such as the close relationship between government and business people, conglomeration and monopoly, protection, and market intervention which makes these countries unprepared to enter the era of globalization and free market(Tjager et al, 2003).

The 1997 crisis in Indonesia begins with the issuance of Banking Deregulation policy package 1988 (Pakto 88) where the government and the Central Bank of Indonesia tried to go further in banking deregulation which became the turning point of the various banking curbing in 1971-1972. The issuance of new bank licensing that has been discontinued since 1971 was reopened by Pakto 88. Similarly, the permit of the opening of a branch office or establishment of the People's Credit Bank (BPR) was easier with lower capital requirement. Afacility that never been given to the banking sector. One of the fundamental clauses in Pakto 88 is permission for foreign exchange banks that require the bank'slevel of health and assets for only at least Rp.100 million.This resulted in an increase in the number of banks in Indonesia from around 111 banks in 1988 to as many as 240 banks in 1995.The increase of number of banks has encouraged the increase of credit distributed to the real sector. Thus it gives contribution to the improvement of moderate economic growth in the early 90's.

Nevertheless, this condition has a negative effect and triggers an increase in the number of banks and banking expansions aggressively. Besides that, there are also issues of cross ownership and cross management in Indonesia's financial industry. These two aspects are the cause of the increasing number of ownership concentration in banking industry, which will increase the likelihood of violation of legal lending limit to the company's group. These are the underlying causes of economic crisis and also impacting the banking sector severely.

After going through a period of economic crisis, the number of commercial banks in Indonesia has decreased (from 237 banks in 1997 to only as many as 130 banks in 2006 or a decrease of 45.2%), resulting from the freezing of 67 banks, as well as merger and acquisitions.The decrease number is a result of the strict standards that must be met for the establishment of a bank, such as capital structure, merger, acquisition and bank closures due to financial problems.

Considering those background and conditions, then one of the main causes of the banking industry experienced a collapse during the crisis was relating to the poor management of the bank.
Valuable lessons can be learned from the financial crisis experienced by Indonesia whereas the crisis caused by the weak implementation of Good Corporate Governance (GCG) in the banking industry. The implementation of GCG in the bank aims to strengthen the internal condition of the national banking system in dealing with increasingly complex risks, protecting the interest of stakeholders and improving compliance toward legislation and regulations and ethical values that generally accepted in the banking industry.

Organization of Economic Cooperation and Development(OECD) has developed a set ofcorporate governanceprinciples,or better known asThe OECD Principles of Corporate Governance.The basic principles ofgood corporate governanceinclude the principles of transparency, accountability, responsibility, independence, and equality or fairness, which aims to ensure the survival and growth of the company in a sustainable manner.These basic principles are certainly very necessary in the bank's management where the public trust is its main components.

One of the factors needed to create effectivecorporate governance,especially after the financial crisis in Asia is the role of the board of commissioners. Macey and O'Hara (2003) states that the commissioners' role is very important in a bank because the difference in the governance between bank and non-bank. The main reason of this difference is the existence of banks' other stakeholders such as creditor and regulators.Bank directors should be responsible not only to shareholders, but also to depositors, customers, and regulators.

Skully (2002) also states the critical role of the commissioners in the implementation ofcorporate governancesince supervision will reduce the risk of using the taxpayers' funds as mitigation or to resolve a crisis.The application of goodcorporate governancecan also play a role in controlling lending practices toward party that still has a relationship with the bank.

In the previous studies regarding the effect of the application of corporate governance, the outcome show vary result on the relationship between the composition of the company's board of management with the company's performance. Most studies find no effect or a significant correlation between the presence of the management board in the company with the company's performance, such as in Bhagat and Black's (1999) and Hermalin and Weisbach's (1991). Even research by Eisenberg, Sundgren, and Wells (1998) found a negative relationship between board size with the performance of the company or bank.

Meanwhile Rosentein and Wyatt (1990) found a positive and significant relationship between stock prices and the proportion of independent board.It is also supported by research conducted by Abeysekera (2008) toward companies in Kenya whereas the number of commissioners are considered effective in the range more of five and less than 14 people.Large board size is more effective than the small board size (Dalton et al, 1999; Nasution and Setiawan, 2007; and Abeysekera, 2008).And according to Andres, Azofra and Lopez (2005) the number of commissioners greatly affect the activity of control and supervision.The larger the board size is expected to supervise the management better, so it can improve the performance of banks or companies.

Moreover, the previous studies conducted by Xie, Davidson and DaDalt (2003) regarding the effect of the audit committee on the performance of the bankfound that the audit committee is an important factor in the oversight of management.In that study, the average audit committee which is owned by the company is 5 members in a range of 2 to 12 members.The number of audit committee members affect the level of influence that can be given to the company, the size of the larger audit committee is expected to maintain the bank's good performance.

Another study that examines the effect of the independency of audit committee members toward company's performance was conducted by Nasution and Setiawan (2007) and Li et al (2008).The results of their study revealed that audit committee members who are independent has a positive effect on company performance.Thus the independent audit committee is expected to improve the performance of the company.

On the other hand, Alijoyo (2003) states that the audit committee should be transparent, starting with the necessity of audit charter and annual work programs written agenda of the audit committee which is further supported by the regularity audit committee meeting.In carrying out the obligations and responsibilities concerning the financial reporting system, the audit committee should hold meetings three to four times a year (FCGI, 2001).The more often the audit committee meetings were conducted the better the audit committee's performance.With the regular meetings of the audit committee it is expected to improve the bank's performance.

According to Dezoort and Salterio (2001) audit committee members who have knowledge of financial reporting and auditing provide support to external auditors whom in disputes with management. Dezoort (1998) also found that knowledge and expertise in the field of accounting/audit is required by the audit committee members in resolving disagreements between management and the external auditors.The dispute between the management with the external auditors may affect the performance of the company, therefore it is expected that the audit committee could resolve the dispute and eventually result in the company's good performance.

Moreover, another study that examine the effect of audit quality on the performance of banks conducted by Kell (2001), which proves that the audit is a systematic process to obtain and evaluate evidence objectively, relating to the assertion of the economic actions to measure the level of concordance between the assertion with the criteria that has been established then communicating the results to the parties concerned (Kell, 2001).Results of the audit process is the auditor's report (audit opinion),i.e the report contains the fairness of the financial statements in accordance with the generally acceptedaccounting principles.

The agency theory views the role of external auditors as a means of control that can be used to eliminate or at least provide a signal on opportunistic practices or fraud committed by management as earnings management (Jensen and Meckling, 1976; Watts and Zimmerman, 1986). Audit will reduce the information asymmetry that exists between management and stakeholders of the company by allowing outsiders to verify the validity of the financial statements. Kinney and Martin (1994) examined nine studies and found that the audit reduces the positive bias on net income and net assets before audited.

Good quality of audit should be able to detect fraud committed by management such as profit management and report the actual performance of the company so as not to deceive investors. The size of public accounting firm could be expected to affect the quality of the audit because big firm usually will not take risks in performing audit on the financial performance of its clients, and tend to report the actual performance of the company, thus could trigger the company to really improve the performance of its operations. The varied result from prior literature is caused by theendogenousrelationship, namely matters resulting from the company itself (Hermalin and Weisbach, 1991) and causality (Kole, 1997) between the composition of company's board and company's performance.

THEORETICAL STUDY AND HYPOTHESISDEVELOPMENT

Theories of Corporate Governance (GCG)

One of Corporate Governance theory was referring to agency theory (Syakhroza, 2003).Agency theory assumes that managers will act opportunistically to take personal advantage before it meets the interests of shareholders. The agency theory arises because of thedevelopment of modern management science that shifts the classical theory, i.e.the rule that separates the owner of the company (principal) with the company manager (agent).When companies grow big and shareholders increasingly dispersed, the agency cost is increasing and owners would to perform an effective control toward the managers who manage the company.

According to Jensen and Meckling (1976) potential conflicts of interest could occur between related parties such as between the shareholders and the company manager (agency cost of equity) or between the shareholders with the creditor (agency cost of debt).The agency costs include the monitoring costs, bonding cost and residual loss. Monitoring costs is an expense paidby the principal to measure, observe and control the behavior of the agent from deviating.These costs occur because of the imbalance information between principals and agents. In certain situations, agents allowed to expend company resources (bonding cost) to ensure that the agency will not act that may be detrimental to the principal or to ensure the principal will provide compensation for it.Nevertheless, there is still a difference between agent's decisions with the decisions that will maximize the agency's welfare. Value for money that equivalent to a reduction of welfare that experienced by principals is called residual loss.

Definitionof Good Corporate Governance

According to FCGI (2001), Good Corporate Governance is defined as a set of rules that govern the relationship between shareholders, management (managers) of the company, the creditors, government, employees and other internal and external stakeholders relating to their rights and obligations or in other words a system that regulates and controls the company. Meanwhile Cadbury Committee is a set of rules that define the relationship between shareholders, managers,creditors, government, employees, and those other interested parties both internal and external with respect to the their rights andresponsibilities.

Rahmawati et al (2006), defines Good Corporate Governance as a set of rules and principles that include fairness, transparency, accountability, and responsibility, which regulate the relationship between shareholders, management, the company (directors andcommissioners), creditors, employees and other stakeholders with regard to the rights and obligations of each party. Based on the definition of good corporate governance it can be concluded that, basically good corporate governance is about systems, processes, and a set of rules that govern the relationship between the various interested parties(stakeholders), namely the relationship between shareholders, board commissioners, and the board of directors for the achievement of company objectives.

The objective of good corporate governance is to create added value for all interested parties (stakeholders).Theoretically, the implementation of good corporate governance can increase the company's value by improving their financial performance, reducing the risk of the board of commissioners with decisions that could benefit themselves and good corporate governance also can boost investor confidence (Tjager et al., 2003).

Darmawanti, Rahayu, and Khomsiyah (2004), stated that the issue of corporate governance arises because there is a separation between the ownership and the management of the company, or often referred as an agency problems. A problem of agency in relation between capital owners with the manager is the difficulty in ensuring that the funds will be invested in profitable projects that will bring return. Moeljono (2002) explains that corporate governance is necessary to reduce the agency problem between owners and managers.

Corporate Governance Principles

Organization of Economic Cooperation and Development (OECD) developed a set of corporate governance principles, or better known as The OECD Principles of Corporate Governance. The basic principles of good corporate governance include:

1. Transparency (Disclosure of information), that transparency in the decision making process and openness in exposing material and relevant information about the company.
2. Accountability (accountability), i.e. clarity of function, structure, systems; and accountability of the company so that the management of the company runs effective.
3. Responsibility (accountability), is a compliance in the management of the company to the right company principles as well as laws and regulations.
4. Independency (autonomy), is a state where company is professionally managed with no conflict of interest and influence or pressure from management that is not in accordance with the regulations and legislation and the company's principles.
5. Fairness (equality and fairness), is a fair and equal treatment in fulfilling stakeholder rights arising under the agreement and applicable laws and regulations (Kaihatu, 2006).

Mechanism of Corporate Governance

In order to apply the corporate governance's principles, the management of company is carrying out the following matters:

1. General Meeting of Shareholders
2. Openness and Transparency
3. The existence of Independent Commissioners
4. Size Board of Commissioners
5. The Audit Committee
6. Ownership Structure

Previous Research Study

1. The effect of Board of Commissioners on Bank's Performance

Supervision system in the company is divided into two types, namely two-tier and one-tier system. In a company that practice two-tier board system like in Indonesia, the supervisory role of the company in general carried out by the board of commissioners, while in a company with one-tier board system the supervisory function carried out by board of directors.

Previous studies regarding the importance of corporate governance's implementation, especially in other countries beside Indonesia, the term board of directors was used to describe its supervisory function. For instance, research by Pathan (2007), which examines the size and independency of the board of directors and its influence on the company's performance on several banks in Thailand. Thailand was chosen as a research area since Thailand also experienced severe financial crisis in 1997, just like Indonesia. The study was using fixed effect model of panel, and it found that there is a significant negative relationship between board size with bank's performance in Thailand. This is consistent with the hypothesis and show that smaller board size will be more effective in monitoring the bank manager, while the board with a larger size is more vulnerable experiencing agency problem between the owners of the company and those who run company's operational activities (manager).

The second result obtained from the research was finding the positive relation between bank's board independency with bank's performance in Thailand banks. The result revealed that independent directors showed a better performance in monitoring (especially in Thailand), because they have market reputation that need to be maintained. Findings in these studies suggest the bank can improve its performance by reducing the number or size of the board and add a few more independent commissioners.

Research by Eisenberg, Sundgren, and Wells (1998) also found a negative relationship between board size with the performance of the company or bank. Similarly, the research by Hermalin and Weisbach (2003) also revealed that the board with a smaller size would be more effective and can provide added value because it is easier for coordination.

However, research by Abeysekera (2008) found a significant positive relationship between board size and company's performance in Kenya. The number of commissioners are considered effective in the range of more than five and less than 14 people.Large board size is more effective than the small board size (Dalton et al, 1999; Nasution and Setiawan, 2007; and Abeysekera, 2008).And according to Andres, Azofra and Lopez (2005) the number of commissioners greatly affect the activity of controlling and supervising. A larger board size is expected to supervise the management better, so it can improve the performance of banks or companies.

In line with this, Adams and Mehran (2003) and Belkhir (2005) states that for US Bank Holding Companies, it was found that the size of the board and its performance has a positive relationship.This study suggests that the surveillance conducted by the board with a large number of members or more will have the advantage that would exceed the costs incurred.Positive relationship between the size of the board and the performance of the companies in the US can further be explained due to mergers and acquisitions in the banking industry in the United States.

2. The effect on Audit Committee on Bank's Performance

Another important component that supports the implementation of good corporate governance is the audit committee (FCGI, 2001). In accordance with the Decree of Chairman of Bapepam Number: Kep.29/PM/2004, the audit committee is a committee established by the board of directors to carry out the task of supervision and management of the company.

Research conducted by Xie, Davidson and DaDalt (2003) found that the audit committee is an important factor in supervising the management. In that study, the average audit committee which is owned by the company are 5 members in a range of 2 to 12 members.The number of audit committee members affect the level of influence that can be given to the company, a larger size of audit committee is expected to maintain bank's better performance.

Meanwhile the study that examines the effect of independent audit committee members on company or bank's performance performed by Nasution and Setiawan (2007) and Li et al (2008). The results of their study revealed that an independent audit committee member has a positive effect on company performance. Thus the independent audit committee is expected to improve the company's performance.

On the other hand, Alijoyo (2003) states that the audit committee should be transparent, starting with the necessity of audit charter and annual work programs written agenda of the audit committee which is further supported by the regularity audit committee meeting. In carrying out the obligations and responsibilities concerning the financial reporting system, the audit committee should hold meetings three to four times a year (FCGI, 2001). The more often the audit committee meetings were conducted the better the performance of the audit committee. A regular meeting of the audit committee is expected to improve the bank's performance.

According Dezoort and Salterio (2001) audit committee members who have knowledge of financial reporting and auditing provide support to external auditors whom in disputes with management. Dezoort (1998) also found that knowledge and expertise in the field of accounting and auditing is required by the audit committee members in resolving disagreements between management and the external auditors. A dispute between management with external auditors may affect the performance of the company, therefore it is expected that the existence of audit committee has a positive effect on resolving the dispute which eventually will improve the company's performance.

3. The effect of Audit Quality on Bank's Performance

Audit is a systematic process to obtain and evaluate evidence objectively, relating to the assertion of the economic actions to measure the level of concordance between these assertions with the criteria then communicating the results to the parties concerned (Kell, 2001). Result of the audit process is the auditor's report (audit opinion), i.e. the report contains the fairness of the financial statements in accordance with generally accepted accounting principles.

From the agency theory perspective, the role of external auditors is viewed as a means of control that can be used to eliminate or at least provide a signal on opportunistic practices or fraud committed by management such as earnings management (Jensen and Meckling, 1976; Watts and Zimmerman, 1986). Audit will reduce the information asymmetry that exists between management and stakeholders of the company by allowing outsiders to verify the validity of the financial statements. Kinney and Martin (1994) examined nine studies and found that the audit reduces the positive bias on net income and net assets before audited.

Good audit of quality should be able to detect fraud committed by management such as profit management and report the actual performance of the company so as not to deceive investors. The size of public accounting firm could be expected to affect the quality of the audit because big firm usually will not take risks in performing audit on the financial performance of its clients, and tend to report the actual performance of the company, thus could trigger the company to really improve the performance of its operations.

Research Hypothesis

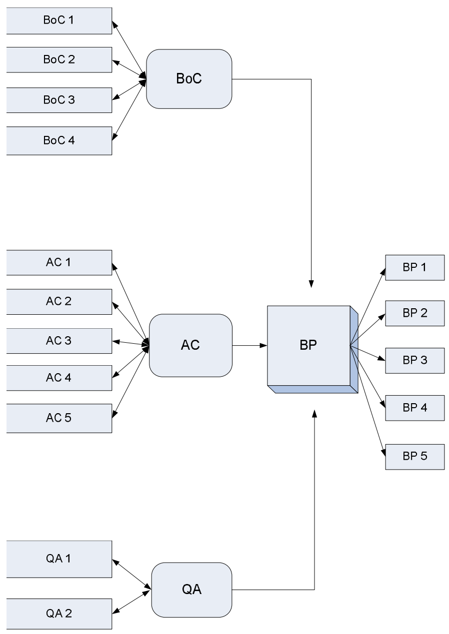
Based on the analysis and previous studies, the hypothesis is stated as follows:

H1: The board of commissioners has an influence on bank's performance.
H2: The audit committee has an influence on bank's performance.
H3: Audit quality has an influence on bank's performance.

RESEARCH METHODS

Model Research

To determine the influence of the independent variables of: Board of Commissioners, Audit Committee and Audit Quality on the dependent variable of Bank Performance (CAR, NPL, LDR, BOPO, and ROE) a model of Structural Equation Model (SEM) was used. Meanwhile, for the measurement model, a Confirmatory Factor Analysis (CFA) was used to indicate a latent variable which was measured by one or more variables observed. In this case the latent variable is bank's performance while the observed variables used to measure bank performance variable is the variable of the Board of commissioners, audit committee, and audit quality. So the research model using the CFA is as follows:



Variable operationalization

Latent Variables

Latent variables in this study are Board of Commissionaires, Audit Committee, Audit Quality and Bank's Performance.

Board of Commissioners (BoC) was measured using 4 variables i.e. BoC 1, BoC 2, BoC 3, and BoC 4. **Audit Committee (AC)** was measured using 5 variables: AC 1, AC 2, AC 3, AC 4, and AC 5. **Quality Audit (QA)** was measured using two variables: QA 1 and QA 2. **Bank Performance (BP)** was measured using 5 variables: BP 1, BP 2, BP 3, BP 4, and BP 5.

Variable Observed

Variables observed in this study consisted of 16 variables comprising:

1. Four variables of Board of Commissionaires (BoC). BoC 1 was measured using a board size, BoC 2 measured using the proportion of independent directors, BoC 3 was measured using a number of board meetings, and BoC 4 measured using the educational background of the commissioner.
2. Five variables of AC. AC 1 was measured using a number of audit committee, AC 2 was measured using a proportion of the audit committee independent, AC 3 was measured using a number of audit committee meetings, AC 4 was measured using the work experience of the audit committee members as an auditor, and AC 5 was measured using educational background of the audit committee.
3. Two variables of QA. QA 1 was measured using dummy of the size of Public Accounting Firm which conducts an audit of banks sampled in this study. If the company or bank was audited by

the Big 4 of Public Accounting Firm then the audit quality was considered high and on the other hand if it was audited by non-Big 4 Public Accounting Firm, the quantity of audit was lower. QA 2 was measured using a dummy of the audit opinion given by an external auditor. A value of 1 used if the audit opinion obtained is unqualified, and if the audit opinion obtained other than "unqualified" the value is 0.

Method of Collecting Data

Data used in this research is secondary data, such as annual reports and financial statements of the banks listed on the Indonesia Stock Exchange (IDX) in the year of 2009-2010. Data is taken from official site of IDX (www. idx.co.id), and the official website of each company. Data of the board of commissionaires and audit committees derived from bank's annual reports. Meanwhile data of CAMEL ratio for measuring bank performance derived from the bank's financial statements.

Sample Selection Method

The unit of analysis in this study is banking company. And the population of this research is all banks listed in the Indonesia Stock Exchange (IDX) in 2009-2010.

Hypothesis Testing

In testing the hypothesis, the method of Maximum Likelihood Estimation (MLE) in SEM was applied.

According to Hair et. Al. (1998), evaluation of the degree of data fitness by using SEM model is done through several stages, namely:

- ❖ Overall model fit
- ❖ Measurement model fit
- ❖ Structural model fit

RESULTS AND DISCUSSION

Based on data on Table 1, the descriptive statistics for each variable in this study are as follows:

1. The average value of BoC 1 which is measured with the board size is as much as 4 people, with a minimum of 3 people and a maximum of 8 people.
2. The average value of BoC 2 which is measured with the proportion of independent directors is 0.5. It means the number of independent board members compared to the number of commissioners has the same proportions. Meanwhile the minimum number is 0667, and the maximum value is 0.75.
3. The average value of BoC 3 which is measured by the number of board meetings is 10 meetings a year. This is the same as the number of meetings required by the government, while the minimum value is 4 which means the meeting is only conducted 4 times a year. And the maximum value is 43 which is in excess of that required by the government.
4. BoC 4 which is measured using commissioner educational background found an average value of 0.33. It means that the average member of the commissioner who has a background in accounting is 1/3 of the total number of commissioners. While the minimum commissioners who have an educational background in accounting is 0 meaning no commissioners in the bank that has the educational background of accounting or economics. While the maximum value of BoC 4 is 1.00 means that each member of the board of commissioners in a bank has a background in accounting education.

Tabel 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
BoC1	30	3.000	8.000	4.000	2.5000
BoC 2	30	.667	.750	. 500	.6552
BoC 3	30	4.000	43.000	10.000	1.3607
BoC 4	30	.000	1.000	0.330	.48918
AC 1	30	3.000	6.000	4.000	.38824
AC 2	30	.000	.750	.500	.6801
AC 3	30	2.000	16.000	13.000	7.8925
AC 4	30	.000	.667	.330	.3423
AC 5	30	.000	.667	.330	.2197
QA 1	30	.000	1.000	.700	.50855
QA 2	30	.000	1.000	.600	.49827
Valid N (listwise)	30				

5. AC 1 which is measured using the number of audit committee found an average value of 4. It means on average most banks have a total audit committee (external and internal) of 4 people, and the minimum value of is at 3 which means that there is a number of bank that has 3 members of the audit committee. Meanwhile the maximum is 6 meaning that there is a number of bank that has a number of audit committee members as much as 6 people.
6. AC 2 which is measured using the proportion of independent audit committee found an average value of 0.5. It means the number of independent audit compared to the number of audit committee members as a whole have the same proportion. Meanwhile the minimum value of 0.667 means the number of independent audit committee members has a smaller or less proportion compared with the number of members of the audit committee as a whole. While the maximum value of 0.75 means the number of independent audit committee members has nearly the same proportion as the number of audit committee members as a whole.
7. The average value of AC 3 which is measured with the number of audit committee meetings found as many as 13 meetings in a year, while the minimum meeting is twice a year. And the maximum value of 16 times is in excess of that required by the government.
8. The average value of 0.33 was found on AC 4, which is measured with the experience of the audit committee members worked as an auditor. It means 1/3 of the total number of members of the audit committee has an experience working as an auditor. The minimum values of 0.00 meaning no member of the audit committee in the bank that has an experience working as an auditor. While the maximum value is 0.667 means that the number of audit committee members who has an experience working as an auditor reach 70% of the total number of members of the audit committee as a whole.
9. AC 5 which is measured with the educational background of the audit committee also found an average value of 0.33 and the minimum value of 0.00. The maximum value of 0.667 means that almost 70% of the total number of members of the audit committee that has educational background of accounting.
10. On average QA 1 as measured using the dummy of the size of the Public Accounting Firm which conduct an audit to the sampled banks found a value of 0.70. It means that most of the banks in this study are audited by the Big Four accounting firm.
11. Using the dummy of audit opinion, the average value for QA 2 is 0.60. It means that most of the banks in this study obtain audit opinion of "unqualified" from the external auditor.

Structural Equation Model:
The structural equation model in testing the hypothesis is as follows

KNJ = 0.56*BoC + 0.033*AC + 0.44*QA, Error var.= 0.066 , R^2 = 0.93
(0.13) (0.100) (0.10) (0.057)
4.40 0.33 4.26 1.17

From the structural model above it shows that the hypothesis of H1 and H3 showed a significant result, while H2 proved insignificant result.

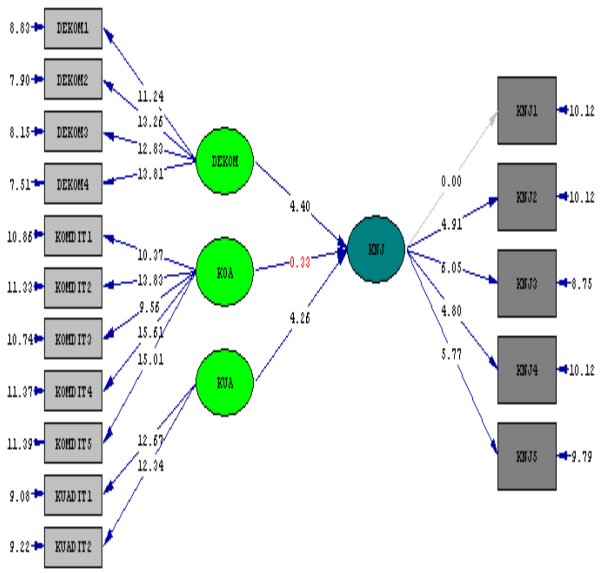
The insignificant result of H2 can be proven from the descriptive statistic of audit committee meeting variable that reached an maximum value of 16 times which exceed the government requirement. The result also shows that the accounting education background and experience as an auditor does not have a significant effect on the performance of the audit committee on bank performance.

To determine the coefficient of determination of structural equation, the value of R^2 should be calculated (Wijanto, 2006). Lisrel test results that can be seen in Equation Reduced Form obtained the value of R^2 for structural equation in this study. The value of R^2 in this research model is 0.93, which means the model is able to explain 93% of the change in the latent variable of Bank's performance. Overall t value results of the three hypotheses proposed in this study can be summarized as follows:

Table 2. t-value result for each hypothesis

Hypothesis	Path	Estimates	t-value	Conclusion
1	BoC → BP	0.56	4.40	Significant
2	AC → BP	0.033	0.33	Insignificant
3	QA → BP	0.44	4.26	Significant

Results of path diagram below, shows the structural model generated from the lisrel:



Analysis of Test Results

Based on structural equation model, it confirms that the commissioner has a positive influence on bank performance significantly. It means that the greater supervision by the board of commissioners on banking operations, the higher the performance generated by banks. The results of this study reinforce the results of the previous studies by Rosentein and Wyatt (1990), Dalton et al (1999), Nasution and Setiawan (2007), and Abeysekera (2008).

The second hypothesis which examines the effect of the audit committee on bank performance also finds a positive result but insignificant. These results reinforce the results of previous studies of Herwidayatmo (2000), Xie, Davidson and DaDalt (2003), and Abeysekera (2008).

This can be explained from the bank that has a large number of audit committee members and exceeds the requirement set by Bank of Indonesia and Capital Market Supervisory Agency and Financial Institution. There are also banks that held audit committee meetings up to 16 times in one year which exceeds that required by the government.

The third hypothesis that evaluated the effects of audit quality on bank's performance shows a positive and significant result. It means that the greater the quality of the audit of a bank, the better the performance generated by the bank. These results reinforce the results of previous studies such as research by Jensen and Meckling (1976), and Watts and Zimmerman (1986).

CONCLUSION

1. This research is based on the previous studies related to the effect of the corporate governance's application on the bank's performance. The purpose of this study is to see to which extend the application of corporate governance can affect the bank performance. This model uses 30 data of banking company.
2. Hypothesis 1 used to test whether the board of directors as one of the indicators in the corporate governance affects the banks' performance significantly. The structural equation shows a positive result which means commissioners has a positive effect on the bank performance. The better the performance of the board of commissioners, the better the performance of the banking system.
3. Hypothesis 2 that tests whether the audit committee as one of the indicators in the corporate governance affects the banks' performance proved to have no influence. It shows in the output of structural equations that reveal positive result. It means the audit committee has a positive effect on bank's performance. Whereas the better the performance of the board of commissioners, the better the performance of the banking system.
4. Hypothesis 3 which test whether audit quality as one of the indicators in the corporate governance affects the banks' performance proved a significant effect. The structural equation result shows a positive value which means the positive effect of the audit committee on the bank's performance. The better the performance of the board of commissioners, the better the performance of the banking system.

Suggestion

Based on these results it is expected that in future studies to increase the number of samples and widens the years of observation (firm years) and add a variable in corporate governance that might could influence the bank's performance.

Limitations Research

Limitation of this study is the small number of respondents therefore it cannot be tested with weighted least square (WLS) method which is likely will give different results.

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