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# Earning management, corporate governance and corporate social responsibility disclosure: Evidence from Indonesia

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**Abstract**
This research aims to test the influence of earning management and Corporate Governance on Corporate Social Responsibility. The research was conducted on primary and secondary industrial companies listed on the Indonesia Stock Exchange (IDX) using data from 2014 to 2020. Data analysis will be done by quantitative data analysis with regression analysis using panel data. The results showed that earning management has a negative effect on corporate social responsibility. Corporate governance has a positive effect on corporate social responsibility. The results of the study have implications in an academic and practical manner. This research will provide additional literature that is useful for the development of accounting science, especially the topic of corporate social responsibility. In practical terms, the results of this study can be a consideration in making decisions for company managers and considerations in policy making to make a regulation by the government.
**Keywords:** Corporate social responsibility, Earning management, Corporate governance, Indonesia Stock Exchange.

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## 1. Introduction

In recent decades Corporate social responsibility (CSR) has become a critical issue and attracted the attention of practitioners and academics around the world (Zaid et al., 2020; Dwekat et al., 2020; Nejati et al., 2020). This is in line with increasing stakeholder awareness of sustainable development. The triggers include human rights violations, worker ecstasy, environmental destruction and other socioeconomic issues. The majority of them have a very strong argument that the company's performance should not only be judged on success in its economic and financial performance alone (Dwekat et al., 2020; Inekwe et al., 2021; Bahta et al., 2020; Devie et al., 2020; Lin et al., 2020). CSR is a form of corporate action in which their activities contribute to improving social conditions, morals, labor, the environment in which they operate. Furthermore, this action is also interpreted as the obligation or demand of the company to act in accordance with norms and contribute to economic development without ruling out social aspects such as employee rights, acts of exploitation and environmental destruction (Bahta et al., 2020; Inekwe et al., 2020).

Corporate concern in implementing CSR not only has a positive impact on the company's external parties such as addressing social, economic and environmental problems only (Devie et al., 2020). In addition, the company will basically get a positive impact such as building public perception of the company in a positive way, increasing the competitiveness of the company, improving sustainability (Bahta et al., 2020). This is in line with the theory of legitimacy, companies that run CSR well will get a reputation, positive image and legitimacy from the community (Nguyen & Trinh, 2020). Thus CSR plays an important role in achieving balance in business and sustainable development. For that, companies need to manage CSR practices well in order to achieve actual CSR goals and not just formalities. In addition, companies must also be able to control risks or deviations that may arise in their operating processes that can interfere with CSR practices, one of which is earning management.

Earning management often happens to companies. Earning management is a condition in which management takes deliberate steps to bring reported profits to the desired level for self-interest (Baskaran et al., 2020). Seeking profit or profit is the company's goal, profit information can be distorted when management has flexibility in choosing alternative transaction recording and in choosing options to determine accounting treatment policies using its superior knowledge and control over the company's financial reporting operations and systems (Suhadak et al., 2020). Investor focuses more on information about the company's profits and tends to ignore that management can manipulate the information and management does not give the actual power to the owner (Mahrani &Soewarno, 2018). As a result, the company will take action to overcome the impact of earning management such as focusing on the company's internal activities so that CSR practices can be disrupted.

Then, this CSR disclosure is very closely related to corporate governance (Al-Gamrh et al., 2020). Good corporate governance will solve this effectively and efficiently. Even before the problem occurs with good governance will be a preventive step for the company so that problems that may occur can be avoided or at least minimized. Furthermore, corporate governance will minimize the occurrence of *conflict interests* due to *asymmetric information,* as *agency theory* explains basically there is a difference in the amount of information between company managers and company owners.

With this information, managers who have demands to manage a company with good performance will tend to take advantage of its advantages for the purpose of personal interests and override the interests of shareholders or owners (Imamah et al., 2019). Because of this tendency, it will affect all company activities including CSR. Thus corporate governance

mechanisms, involving the system of rules, practices, and processes by which companies are directed and controlled, play an important role in CSR disclosure.
Previous literature has discussed the link between CG and CSR disclosure. There is a significant positive relationship between the two (Ong & Djajadikerta, 2020; Bose et al., 2021; Purbawangsa et al., 2020; Stuebs & Sun, 2015). Conversely, there was also a negative relationship between CG and CSR (Dwekat et al., 2020; Zeng, 2020; Worokinasih & Zaini, 2020). In addition, (Colakoglu et al., 2021) found no relationship between the two variables. With inconsistencies between previous studies, this research was conducted to fill the gaps in between. This research is different from previous research, namely by including earnings management as a variable that contributes to the disclosure of CSR by the company.
Thus, the purpose of this study is to test the influence of CG and earning management on CSR disclosure. The uniqueness of this research is to be done in Indonesia which is one of the developing countries. Indonesia has a unique setting and is considered to still have problems in implementing effective and efficient CSR practices, in addition to having an idea that earning management is not always bad. This research contributes to the development of accounting science, especially csr topics. In addition, this study has practical implications, namely as a matter of consideration in making decisions as well as for regulators in making appropriate regulations.

## 2. Literature Review and Hypotheses Development

Legitimacy theory is a theory that has been generally accepted and closely related in explaining the social reporting practices of a company (Khan, 2010) Legitimacy emphasizes that company management will react to community expectations and human resource management. Nguyen & Trinh (2020) explains that organizational legitimacy is a concept that can be used to obtain information regarding the drive that companies have to disclose CSR information voluntarily. legitimacy is one of the factors that motivate management to adopt and report social practices. Then, agency theory explains, agency conflicts can occur between society and management, where company management must operate as effectively and efficiently as possible to get maximum sales with minimal expenditure. Thus, corporate management should avoid the cost of social issues such as air and water pollution and minority and female employment issues. On the other hand, society wants companies to use their profits to solve some of society's social problems, many of which have been created or donated to or by companies such as air and water pollution, sewage, and so on. Thus, companies should use CSR to show the community and stakeholders that the company cares about the community and the surrounding environment (Said et al., 2017).
Based on the above explanation, a mechanism is needed that can overcome it, the *Good Corporatae Governance* (GCG). GCG as a system that controls the management of the company and minimizes conflicts of interest in the company, so as to maximize the interests of the company owner. GCG is also a process and structure that will be used to direct and manage corporate and business accountability. In the process GCG is indicated by the existence of an audit committee, Risk management, The main purpose of the implementation of GCG is to optimize the value of the company while taking into account the interests of stakeholders (Musallam, 2018; Aldhamari et al., 2020; Worokinasih & Zaini, 2020).

### 2.1. Earning management and CSR Disclosure

Earning management is one form of fraud that occurs in the company. Earning management arises due to the behavior of company managers who use the advantages of information for their personal interests. Usually this action is done by changing the amount of profit in the

financial statements to the amount he wants (Baskaran et al., 2020). Thus, the rights of other stakeholders will tend to be sidelined and even harmed. Furthermore, this action will have an effect on the company's activities and company performance (Mahrani & Soewarno, 2018). Thus, if there is earning management by lowering the company's profit, it will also interfere with other company activities including CSR.

H1. Earning management negatively affects CSR disclosure

## 2.2. Corporate governance and CSR Disclosure

As explained by the agency theory where the occurrence of conflicts of interest between managers (agents) and principals (owners) is starting from the *existence of a data gap* between the two. With this, of course, the advantages of information owned by agents can be used for the benefit of the agent. This causes irregularities and adversely affects the program that must be implemented by the company (Rodriguez-Fernandez, 2016; Lin et al., 2020). That requires the right approach to the company. Good corporate governance (GCG) is an important factor in encouraging companies to operate effectively and efficiently by suppressing information asymmetry that causes conflicts of interest in the company. In addition, good governance will be the check and balances of the parties involved can be the company so as to create balance (Said et al., 2017 ). One of the demands for the company at this time is csr practices. Where the company no longer maintains profit alone, but also pay attention to social welfare and environmental welfare around it. CSR generally refers to a company's voluntary actions to integrate environmental and social concerns into the business and towards stakeholders to achieve sustainability in addition to its business interests ( Jain et al., 2016; Devie et al., 2020). Currently CSR becomes an important thing for the company to continue to exist and get legitimacy so that the company's performance can achieve the targets that have been set.

H2. Corporate Governance has a positive effect on Corporate Social Responsibility (CSRD) Disclosure

## 3. Methodology

The population in this study is primary and secondary industry companies listed on the Indonesia Stock Exchange from 2014-2020. Using pusposive sampling, the final sample used was as many as 130 companies with a total of 910 observations. The type of data in this study is quantitative data obtained from each company's unnual report. Here are the models used in this study:

$$CSRD_{it} = \beta 0 + \beta 1EM + \beta 2CG + \beta 3LEVit + \beta 4SIZEit + \beta 5AGEit + \beta 6YEARit + \beta 7INDUSTRYit + \varepsilon$$

Where CSRD is CSR Disclosure, EM is earning management, CG is corporate governance, LEV is Debt to Equity ratio, SIZE is The Company's size of the number of company asset logs, AGE is the age of the company from the number of years since the company was founded, YEAR is Year of data used, INDUSTRY: Corporate industry, ε is Error term, error rate of presumption in research.

**Dependent Variable**

This study *uses corporate social responsibility* as a dependent variable. *Corporate social responsibility* is assessed based on indicators in the Global Reporting Initiatives G4 Guidelines

Scoring. The assessment guidelines are gri g4 guidelines, the criteria for giving the score are as follows:
0 = if the item is not disclosed
1 = if the item is disclosed but not comprehensive
2 = if the item is comprehensively disclosed but does not conform to the GRI G4 Guidelines criteria
3 = if the item is comprehensively disclosed and in accordance with the GRI G4 Guidelines criteria

**Independent Variable**
In this study the independent variables are earning management and corporate governance.
*Earning management*
Profit management is measured using the modified Jones model (1995). In this model it uses total accrual as its size.

$$TACC = \Delta_{CAt} - \Delta Cash - \Delta CLt + \Delta DCLt - DPt$$

TACCt: Total accrual in year t divided by total assets in year t-1
ΔCAt : Change in current assets in year *t*
Δcash : Change in cash and cash equivalents in years t
ΔCLt : Change in current liabilities in year t
ΔDCLt: Change in short term debt included in current liabilities in year t
DEPt : Depreciation and amortization expense in year t

*Corporate Governance*
CG measurements are conducted based on ASEAN CG, which divides measurements into 2 levels, including

Level 1
The level 1 assessment contains five main aspects that refer to OECD principles and each aspect has 179 items used as guidelines. These five aspects, namely:
a) Protection of the rights of shareholders;
b) Equal treatment of shareholders (the equitable treatment of shareholders);
c) Stakeholder role (the role of stakeholders in corporate governance);
d) Disclosure and transparency;
e) Responsibilities of the Board of Commissioners and Board.
How to calculate a level 1 score as follows:

$$\boldsymbol{Score = \frac{No.of\ Item\ scored\ by\ PLC}{Total\ no.of\ question}}\ \text{x}\ \boldsymbol{Maximum\ Attainable\ score\ of\ part\ (in\ points)}$$

Level 2
Level 2 contains bonuses and penalty with a composition of 11 bonus items and 21 penalty items. The total level 2 score is calculated by adding a bonus score and penalty score.

**Table 1. Structure and Composition of Level 2 ASC**

| Level 2 | Number of Questions | Maximum Score (point) |
|---|---|---|
| Bonus | 11 | 28 |
| Pinalty | 21 | (50) |

Source: ASEAN CG Scorecard Assessment (2014)

Determining the number of scores is:

TOTAL SCORE = Total level score 1 + Total level 2 score

**Control variable**

This study used control variables including leverage, size, age, year and type of company industry.

## 4. Results and Discussion

### 4.1. Descriptive statistics

Table 2 provides an overview of the variables used in this study through mean values, standard deviations, minimums and maximums.

**Table 2. Descriptive Statistics**

| Variable | Obs | Mean | Std. Dev. | Min | Max |
|---|---|---|---|---|---|
| CSR | 910 | .302 | .145 | 0 | 1 |
| ABSDA | 910 | .119 | .212 | 0 | 2.379 |
| GCG | 910 | 38.922 | 12.917 | 4.286 | 82.113 |
| LEV | 910 | 8.343 | 34.648 | -244.22 | 357.4 |
| ROA | 910 | 3.009 | 8.946 | -56.73 | 71.6 |
| SIZE | 910 | 21.963 | 1.584 | 17.134 | 26.587 |
| AGE | 910 | 37.395 | 20.15 | 5 | 119 |

Based on the table above, CSR disclosure has a fairly high average disclosure, but still needs to be considered again because there are still companies that do not have awareness. For the implementation of good corporate governance, the company has shown good enough practices. As for earnings management, the company has a relatively low fraud rate, which means it's good for the company.

### 4.2. Results of Hypothesis Testing and Discussion

The test results of each hypothesis can be seen in table 3 below.

**Table 3. Regression Analysis Results**

| CSRD | Coef. | St.Err. | t-value | p-value | [95% Conf | Interval] | Sig |
|---|---|---|---|---|---|---|---|
| ABSDA | -.044 | .022 | -2.03 | .042 | -.087 | -.002 | ** |
| GCG | .002 | 0 | 5.10 | 0 | .001 | .003 | *** |
| LEV | 0 | 0 | 0.60 | .551 | 0 | 0 | |
| ROA | 0 | .001 | 0.36 | .722 | -.001 | .001 | |
| SIZE | .016 | .003 | 5.35 | 0 | .01 | .022 | *** |
| AGE | 0 | 0 | 2.12 | .034 | 0 | .001 | ** |

| | | | |
|---|---|---|---|
| R-squared | 0.135 | SD dependent var | 0.145 |
| Number of obs | 910 | Prob > F | 0.000 |
| Prob > chi2 | 1.000 | Industry effect Control | Yes |

p<.01, **p<.05, *p<.1

Based on the table above it is known that earning management has a significant negative effect on CSR disclosure, *H1 is accepted*. This means that, when the company succeeds in suppressing the opportunist actions of corporate manager who attaches importance to personal interests will increase the level of CSR disclosure. This is in line with the agency theory which sees the potential for fraud committed by managers as a consequence of power sharing and information asymmetry. Company managers have superior control that is supported by excess information that they have. This finding confirms that companies that successfully control the behavior appropriately will have a positive impact on the company such as increasing CSR disclosures. In addition, the results of regression analysis also showed that good corporate governance had a significant positive effect on CSR disclosure, *H2 was received*. When companies implement good corporate governance, which is characterized by the principles of accountability, responsibility, transparency, transparency and fairness owned by companies in operating will increase their CSR disclosure. A good CG technology will make the company operate effectively and efficiently which affects every line of corporate activity including CSR. This finding confirms the argument in the previous literature that corporate governance will increase CSR disclosures.

## 5. Conclusion

Along with increasing stakeholder concern for the development of sustainability, there are demands that companies implement CSR practices and disclose them. This research examined the influence of earning management and corporate governance on CSR disclosure. The results of this study found that earning management had a significant negative effect on CSR disclosure. While corporate governance has a significant positive influence on CSR disclosure. This research contributes to the development of accounting science especially in the discussion of CSR topics. In addition, in practice, the results of this study can be a consideration for companies and governments in making decisions and policies.

The limitations of this study lie in the scope of the sample region used. This study presents samples to primary and secondary industry companies listed on the Indonesia stock exchange that have different cultures and regulations from other countries, so when distributed to other developing countries need further consideration. In addition, the study still uses direct influence research models, not yet considering the indirect effects of other variables. For future research it is recommended that it can increase the number and area of the sample area and include variables that might mediate the relationship between the variables used in this study.

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