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CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE, OPPORTUNISTIC OR ETHICAL BEHAVIOR?

Eko Budi Santoso (Universitas Ciputra)

Email: ekobs3508@gmail.com

Abstract—This study is based on the paradox where companies that are active in carrying out social responsibility turn out to be involved in financial scandals. The aim of this study is to examine the association of corporate social responsibility (CSR) disclosure with earnings management. This study also investigates the role of assurance of CSR disclosure on those associations. This research was conducted at companies which have gone public in Indonesia which have issued CSR disclosures for the period of 2013-2017. The result of the study shows that there is positive association of CSR disclosure with earnings management and assurance of CSR disclosure strengthens the relationship. The findings of this study suggest stakeholders should not take for granted that CSR disclosure of the company automatically reflects their ethical behavior in financial areas.

Keywords—CSR Disclosure, Earnings Management, Assurance

I. INTRODUCTION

Corporate social responsibility is a growing issue in the business world along with increasing awareness that social responsibility is an integral part of business practice. Thornton (2008) stated that companies which adopt the principles of social responsibility believe in operating ethically and responsibly because this gives them a greater chance of success than companies which do not adopt this principle.

Research conducted by Orlitzky et al. (2003), Harjoto and Jo (2011), Blazovich and Smith (2010), and Lys et al. (2015) found that social responsibility activities influence company performance. Companies that are active in carrying out and reporting on their social responsibility activities experience sales growth and increases in stock prices and company value because the company is considered to be concerned with its social responsibility. These conditions motivate companies to compete actively to carry out and report on their social responsibility activities because they will increase company value in the eyes of stakeholders.

The problem arises when companies that actively engage in social responsibility are also involved in financial scandals, such as Enron and Xerox which, before their financial scandal was revealed, were known as active companies and had received awards in the field of social responsibility. The same paradox also occurs in developing countries such as in Indonesia, with PT. Asian Agri and PT. Kaltim Prima Coal which are active and were extended awards in disclosing social responsibility, but were involved in tax evasion scandals. The paradox shows that companies that actively carry out social responsibility disclosures are not necessarily companies that carry out ethical responsibilities in their business practices. Hemingway and Maclagan (2004) suggested that managers can use social responsibility activities as a tool to cover corporate financial fraud. The existence of companies that actively carry out social responsibility and at the same time carry out financial manipulation shows that motivation to do and report social responsibility activities is not always based on ethical considerations. The values contained in corporate social responsibility do not necessarily become ethical values that are integrated in the company, but can be an opportunistic behavior of managers to obtain personal benefits.

However, despite the same paradox, there are different conditions for disclosure of corporate social responsibility between developed and developing countries. Ali et al. (2017) found that, in developed countries, the concerns of certain stakeholders, such as regulators, shareholders, creditors, and environmentalists, as well as public pressure are important considerations in disclosing social responsibility, whereas in developing countries social responsibility disclosures are largely influenced by strong stakeholders, such as buyers and foreign investors. In addition, in developing countries, public pressure to disclose social responsibility is still low, which shows that there is still a lack of awareness of the importance of CSR. At the same time, opportunistic behavior of managers is difficult to control in developing countries which generally have a low level of investor protection (Chih et al., 2008; Richardson, 2008). This makes the association between social responsibility and ethical behavior in financial reporting interesting to study deeper, especially in the context of developing countries that have lower social responsibility awareness than developed countries. In developing countries, ethical responsibility occupies the last priority as a basis for companies in carrying out social responsibility activities (Alri & Tjiptono, 2014; Visser, 2008). Despite these conditions, there has been

a rapid increase in the number of CSR disclosures in developing countries over the past ten years. Thus, whether those changes indicate a move forward of ethical behavior or are simply a part of a manager's opportunistic behavior is an interesting topic to research about.

The results of past research that associates social responsibility with earnings management provide inconclusive results. Research by Hong and Andersen (2011), Kim et al. (2012), Scholten and Kang (2012) and Choi et al. (2013), showed a negative association, whereas research by Prior et al. (2008), Bozzolan et al. (2015) and Muttakin et al. (2015) actually gave positive association results. Research conducted by Yip et al. (2011) shows that there are negative associations of social responsibility and earnings management in companies in the oil and gas industry, but the association is positive for companies in the food and beverage industry. This indicates that there are certain contexts that influence the association between social responsibility and earnings management. This study uses assurance of CSR disclosure as a contextual factor that can strengthen or weaken the association.

II. LITERATURE REVIEW

The concept of formal social responsibility was introduced by Howard Rothmann Bowen in 1953 in his book *Social Responsibilities of the Businessman*, which states that companies must pay attention to ethics in business so they can obtain superior long-term performance. In addition, Carroll (1997) stated that social responsibility of a business includes economic, legal, ethical, and public expectations aspects of the business at any given time. Based on these statements, it can be concluded that social responsibility is part of the ethical behavior in a company's ongoing commitment to operate and contribute to the economic development of the community. CSR is not only related to environmental and community issues, but is also related to all aspects of the company, including ethical business practices.

John Elkington (1994) put forward the Triple Bottom Line (TBL) concept, stating that businesses should not only focus on the single bottom line, namely profit (economy), but also must pay attention to people (labor) and the planet (environment). TBL is a corporate sustainability framework that tests the company's impact on social, environmental, and economic aspects. The workforce aspect refers to the company's business practices that support the workforce, such as protection of labor, provision of reasonable wages, and self-development of workers. In the environmental aspect, it focuses on managing the company against limited natural resources, reducing and managing the waste produced, and reducing the use of carbon emissions and energy use. The economic aspect, meanwhile, does not merely mean the profits obtained by the company, but the creation of fair and ethical trade. When looking for raw materials, the company not only focuses on the economic side by looking for the cheapest prices, but at a reasonable price instead. The implication of this concept is that companies must prioritize stakeholder interests over shareholder interests. After 25 years of the application of the concept, Elkington (2018) stated that companies still mainly focus on aspects of fulfilling profit targets compared to developing the other bottom lines. The measure of a manager's performance is still dominated by financial measures, namely the profits generated. This indicates that the activity and disclosure of environmental aspects are still intended to help achieve optimal benefits for the company.

The existence of social responsibility as a manifestation of the company's ethical behavior also evolved into a part of the company's business strategy. A view in Resource Based Theory (RBT) places social responsibility as part of the intangible resources that can contribute to the competitive advantage of a company compared to other companies. Furthermore, the existence of corporate social responsibility is one of the marketing strategies to achieve maximum financial performance. The shift of social responsibility from ethical behavior to marketing strategy can lead to disclosure of responsibility being no longer a reflection of ethical behavior of the company, but, instead, a tool for profit-seeking.

Researches in linking social responsibility with company performance have been carried out, but not many have tried to examine the company's motivation in carrying out social responsibility. Research conducted by Grougiou et al. (2015) found that companies that have negative stigma, such as companies in the alcohol, tobacco, gambling, nuclear energy, and weapons industries, report more social responsibility activities as a way to neutralize the negative impacts of their industries. Another study conducted by Ling and Sultana (2015) on companies on the Singapore Stock Exchange found that companies with high stock price volatility disclose more social responsibility activities in an effort to divert or change investor perceptions of the company. The results of these studies indicate that motivation in carrying out social responsibility disclosures is not always based on ethical considerations, but may be to neutralize or change stakeholder views on the company.

Research that seeks to link corporate social responsibility behavior in relation to corporate behavior in its finances in developing countries has inconclusive results. The research by Choi et al. (2013) on companies in Korea, which sought to link social responsibility, earnings management, and ownership structures, found that social responsibility was negatively related to earnings management, but the relationship weakened in family companies or companies with high ownership concentration. However, research by Muttakin et al. (2015) in companies in Bangladesh found that social responsibility was positively related to earnings management practices. It further found that companies that are export-oriented and dominated by strong

foreign buyers will make more disclosures and have less earnings management. This shows that ethical behavior is influenced by the pressure exerted by external parties and not based on values that are trusted by the company. Jordaan et al.'s (2018) study in South African companies found that companies with better social responsibility performance tended to make earnings management by increasing profits through discretionary accruals.

The inconsistent results of the study indicate the existence of contingent variables in the association. In the context of contingency theory research, the relationship between two variables is contingent with the third variable. This study uses assurance of CSR disclosure as a contingent variable that moderates the association of social responsibility disclosures with earnings management.

Information that contains disclosure of sustainability reports is important because it is the basis for decision-making. Therefore, the information must be reliable. The credibility of information is obtained from the provision carried out by independent parties (Simnett et al., 2009). Assurance will provide confidence that information on disclosure of social responsibility presented can be trusted. In addition, the existence of collateral also shows that the company has a high seriousness in carrying out its social responsibility activities such that it is willing to be verified by an independent party. Assurance will limit the opportunistic behavior of managers who try to use social responsibility disclosures only as a tool to hide corporate fraud.

III. HYPOTHESIS

H_1 : There is an association of CSR disclosure with earnings management

H_2 : Assurance of CSR disclosure moderates the association of CSR disclosures with earnings management

IV. RESEARCH FRAMEWORK

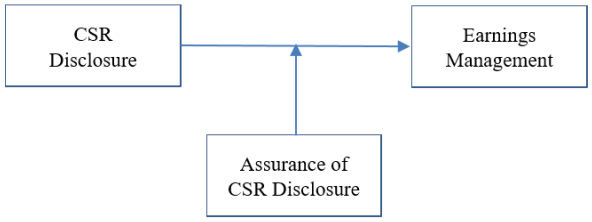

Figure 1. Research Framework

V. METHODS

This research is a quantitative study using secondary data on non-financial industrial companies that went public and are listed on the Indonesia Stock Exchange in the period of 2013-2017. This sample period was chosen because since 2013, GRI-G4 guidelines have been applied for reporting CSR.

A. Definition of Operational Variables and Measurement

1) Corporate Social Responsibility Disclosures

The disclosure of corporate social responsibility in this study is defined as the disclosure of the company's social responsibility, which is carried out by publishing the GRI-G4 version of the sustainability report. Disclosure of social responsibility is calculated by summing the items disclosed by the company in its sustainability. Score of 1 is given if the company makes a disclosure and 0 if it does not disclose. The total score will then be compared with the total number of disclosure items in the G4 version of GRI, resulting in the CSR disclosure index for each company.

2) Earnings Management

Earnings management is a company's action to manipulate profit figures intended for certain purposes. Earnings management is measured by the discretionary accrual earnings management approach using the modified Jones Model (Dechow et al., 1995).

3) Assurance of CSR disclosure

The assurance of CSR disclosure is that the information presented has a quality that can lead to confidence in the information. Assurance of CSR disclosure in this study is measured using a dummy variable, namely, 1 if the company has a report on the sustainability report that has been issued and 0 if not.

B. Control Variables

The control variables used in this study are company size (SIZE) (Prior et al., 2008), debt level (LEV) (Mahadeo et al., 2011), and company growth (PBV) (Kim et al., 2012).

C. Data Analysis Techniques

Hypothesis testing uses multiple linear regression with the following research models:

1) Model for testing H1

$$DA_{it} = \alpha_0 + \alpha_1 CSR_{it} + \alpha_2 SIZE_{it} + \alpha_3 LEV_{it} + \alpha_4 PBV_{it} + \alpha_5 IND\_Dummy_{it} + \alpha_5 YEAR\_Dummy_{it} + \varepsilon_{it} \quad (1)$$

2) Model for testing H2

$$DA_{it} = \alpha_0 + \alpha_1 CSR_{it} + \alpha_2 ASR_{it} + \alpha_3 CSR * ASR_{it} + \alpha_4 SIZE_{it} + \alpha_5 LEV_{it} + \alpha_6 PBV_{it} + \alpha_5 IND\_Dummy_{it} + \alpha_5 YEAR\_Dummy_{it} + \varepsilon_{it} \quad (2)$$

Where:

DA = Discretionary accruals, computed through the cross-sectional Modified Jones model

CSR = Index CSR disclosure based on GRI G4 guidelines

ASR = Assurance of CSR disclosure

SIZE = Natural logarithm of total asset

LEV = Total debt scaled by total equity

PBV = Price scaled by book value per share

VI. RESULTS AND DISCUSSION

The following are descriptive statistics of the variables used in the study.

TABLE 1. DESCRIPTIVE STATISTIC

Variables	N	Mean	Median	St.dev.
DA	134	0.028	0.021	0.558
CSR	134	0.438	0.430	0.184
ASR	134	0.276	0.000	0.449
SIZE	134	16.803	16.837	1.152
LEV	134	1.179	0.940	1.322
PBV	134	4.664	1.840	11.891

Based on the results of descriptive statistics, it can be seen that the average disclosure of corporate social responsibility in Indonesia is 43.8% of the total items in the GRI G4 index. This is because companies use the GRI G4 Core option disclosures that provide flexibility for companies to choose CSR items to be disclosed in accordance with company conditions.

TABLE 2. HYPOTHESIS TESTING

Variable	DA				
	Coeff.			Coeff.	
	(t-stat)			*(t-stat)*	
	(1)			(2)	
CSR	0.518			0.028	
	(1.750)	*		*(0.080)*	
ASR				-0.876	
				(-3.090)	***
CSR*ASR				1.716	
				-3.020	***
Control					
SIZE	0.004			0.035	
	(0.100)			*(0.790)*	
LEV	-0.007			-0.014	
	(-0.190)			*(-0.380)*	
PBV	0.004			0.006	
	(0.940)			*(-1340)*	
Industry Dummy	included			included	
Year Dummy	included			included	
R^2	0.032			0.102	
Notes: * sig 10%	** sig 5%			*** sig 1%	

The results of hypothesis testing are presented in Table 2. Based on the regression output, it can be seen that CSR disclosures are positively significantly (β = 0,518, p <0.10) associated with earnings management. So, Hypothesis 1, which states that there is an association between CSR disclosures with earnings management, can be accepted. A positive sign indicates that a higher CSR disclosure index associates with more discretionary accruals, resulting in lower earnings quality. This indicates that companies use CSR disclosure to divert stakeholder attention on managerial opportunism activities, i.e. earnings management. Managers utilize a naturalistic fallacy on CSR whereby people perceive companies active in social responsibility are companies who hold ethical values in their business. They believe CSR disclosure reflects a company's ethical behavior and generalize it to all areas of its operation. On the other hand, managers could continue to do earnings management activities and use CSR disclosure as a compensation for such actions.

The test results for Hypothesis 2 indicate that the assurance on CSR disclosure moderates the association of CSR disclosure with corporate earnings management (β = 1.716, P < 0.01). Therefore, Hypothesis 2 is accepted. Positive sign on the interaction variable indicates that assurance of CSR disclosure turns out to strengthen the association of CSR disclosure with earnings management. Managers use stand-alone CSR reports to convince stakeholders of the company's seriousness to disclose CSR activities in order to gain their appraisement. Assurance is provided to make the CSR report more convincing as it follows certain guidelines, i.e. GRI-G4, and is verified by external parties. Managers expect to convince stakeholders to tag the company as an ethical one and make decisions without further analyzing other areas, such as financial. Together, these conditions will make managers more unimpeded to exercise earnings management activities.

VII. CONCLUSION

The results of the study show that CSR disclosures are positively associated with the company's earnings management and the association is strengthened by the existence of assurance from external parties. CSR disclosure in developing countries is still utilized by opportunistic manager for their self-interest. The contribution of this study is in suggesting stakeholders analyze comprehensively when assessing a company's ethical behavior and not to solely rely on CSR disclosure. Companies' ethical behavior should be inclusive in all aspects, including the financial area. Thus, CSR disclosure acts as complementary to rather than a substitution of financial analysis in assessing a company's ethical values. Further research could examine the association of CSR disclosures against other fraudulent practices in accounting, such as tax avoidance. Other than that, analysis of CSR can be done across countries to examine whether legal systems affect manager behavior towards CSR disclosures.

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