

# Audit Committee Characteristics and Sustainability Reporting in Indonesia

Siska Aprianti<sup>1,\*</sup>, Didik Susetyo<sup>2</sup>, Inten Meutia<sup>3</sup>, Luk Luk Fuadah<sup>4</sup>

<sup>1</sup> Doctoral Student of Universitas Sriwijaya

<sup>2,3,4</sup> Universitas Sriwijaya

\*Corresponding author. Email: [Siskaaprianti@polsri.ac.id](mailto:Siskaaprianti@polsri.ac.id)

## ABSTRACT

The purpose of this study is to determine the effect of audit committee characteristics such as size, independence, committee meetings, and audit committee expertise on the sustainability report by using secondary data from annual reports of the Indonesia Stock Exchange in 2020. The sample consists of 47 energy subsector companies that are actively listed on the Indonesian Stock Exchange and were chosen based on specified criteria. A multiple regression model was employed to conduct the analysis, which was conducted using SPSS version 25 software. The results of hypothesis testing show that the audit committee's characteristics, such as size, meeting frequency, and audit committee expertise, have an effect on the sustainability report. Meanwhile, the independence of the audit committee has no effect on the sustainability report.

**Keywords:** *Size, Independency, Meeting, Expertise, Sustainability Reporting*

## 1. INTRODUCTION

At the moment, social and environmental issues are critical, as a company's performance is judged not only in terms of tangible asset ownership but also in terms of intangible asset ownership [1]. Investors are not just concerned with short-term profits, but also with the company's long-term sustainability and profitability in order to satisfy all stakeholders. Until investors incorporate sustainability reports as a source of value-added information when making investment decisions [2]. The information contained in the sustainability report enables internal and external stakeholders to make informed decisions about the company's sustainable development goals [3].

Sustainability reporting (SR) is the practice of companies transparently reporting their economic, environmental, and social impacts, as well as their positive or negative contributions to sustainable development goals [3]. Financial Services Institutions, Issuers, and Public Companies are required to implement Sustainable Finance. The Regulation of Otoritas Jasa Keuangan (OJK) No.51/POJK.03/2017 states the Sustainability Report can be presented in the annual report separately, or as an integral part of the annual

report. It must be submitted to OJK before the deadline for submitting the annual report every year. This means the company can choose to report the sustainability report on a stand-alone basis or include it in the annual report.

Several studies link corporate governance factors with SR [4]–[8]. However, research that focuses on examining audit committee characteristics with SR is still limited. Independent commissioners can form committees to support Good Corporate Governance (GCG) implementation, which is the audit committee. The Audit Committee (AC) is expected to be able to control and monitor the decisions made by managers. It means that the decisions do not favor one party but bind all interested parties in the company. The audit committee is required to act independently because the audit committee is the party that acts as a bridge between the external auditor and the company and also acts as a bridge between the supervisory function of the independent commissioner and the internal auditor. The audit committee is an effective tool for conducting oversight mechanisms so as to reduce agency costs and improve the quality of corporate disclosure [9]. There is a significant effect among shareholders, business managers, and regulators on the quality and quantity of environmental social reporting and corporate

governance, especially for environmentally sensitive industries [10]. The establishment and active involvement of an independent audit committee in company supervision can help companies protect against the opportunistic behaviour of managers by using economic, social, and governance reporting as a self-improvement tool.

## 2. LITERATURE REVIEW

This study uses agency theory as the main theory that encourages companies to submit sustainability report. In the context of the interaction between management and shareholders, agency theory can provide an explanation for the interaction between principals and agents. According to [11], the agency relationship is likened to a contract between the agent as the implementing party and the principal as the party who has the capital. Agents have an obligation to work on behalf of the principal. The principal as the owner of capital does not have full information on the running of the company, limited to reports disclosed by agents in the financial statements. The audit committee's composition is an important corporate governance element, as according agency theory. Because the audit committee in the company to ensure that there is control and supervision of every manager's actions in the company, so that the interests of stakeholders can be protected. Agency theory proposes that in agent-principal relationships, there may be moral conflicts that result in agency costs [11]. As a consequence of the audit committee's existence, the asymmetry of information gained by the principal as the owner of capital will be minimized, against all opportunistic actions of agents when running the company.

### 2.1. AC Size

In the financial reporting process, the audit committee serves as a mediator between the board members, company management, internal auditors, and external auditors. The audit committee also plays an important role in supervising and monitoring responsibilities such as internal and external controls, meeting with the company's external auditors to discuss concerning accounting, auditing, internal controls, and other financial reporting issues [12]. The complexity of the tasks that must be carried out by the audit committee requires a large amount of resources. So with a larger number of audit committee members, it is expected that the supervisory, evaluation and control functions of all aspects of the company's performance will be better. Because according to [13], [14] an audit committee with more members will have a greater diversity of viewpoints and skills, allowing the committee to work more effectively. The size of the audit committee was found to be positively connected to the Corporate Biodiversity Disclosure in the study's findings [15]. In line with that

[16] found that the size of the audit committee is related to the quality of financial reports positively. And [17] found that audit committee size was positively related to Quality of Integrated Reports. The following are the study's hypotheses:

H1: AC Size and Sustainability Reporting have a positive association.

### 2.2. AC Independent

Audit committee members are said to be independent if they meet the following criteria: they do not work for the firm, do not have authority or responsibility for the company, do not own the company, and have no link or kinship with it. So according to [14], this independence to ensure that they can carry out their fiduciary duties and protect the interests of stakeholders. Because independence is the main quality that allows the company's management to make the right decisions both for the company and for stakeholders. Earlier studies reported that independent AC and sustainability reports have a positive association [18][19][20][21]. In line with [21] and [17] found the presence of an independent audit committee was linked to higher report quality. The following are the study's hypotheses:

H2: AC Independent and Sustainability Reporting have a positive association.

### 2.3. AC Meeting

The audit committee meeting is an important ritual where in the meeting all members of the audit committee can have discussions when they will take an important decision related to the results of the examination. As a consequence, it is essential that members of the audit committee attend regular meetings. As a result, if the company's failure to benefit when selecting independent audit committee members with knowledge in their industries might be reduced. The attendance of audit committee members at regular meetings demonstrates a commitment to fulfilling fiduciary responsibilities in accordance with stakeholder expectations [14]. External auditors feel that the presence of the AC, the number of meetings it holds, as well as the presence of an auditor at those meetings, will lower audit risk, and that the presence of the AC is a key factor in significantly reducing audit risk [21]. The results of the study [15] show that the meeting activities carried out by the audit committee have a positive relationship with Corporate Biodiversity Disclosure. [16] found the regularity with which members of the audit committee fulfill their tasks has an impact on the quality of financial reports. According to [17], the frequency of meetings has a positive impact on the Quality of Integrated. The following are the study's hypotheses:

H3: The AC Meeting and Sustainability Reporting have a positive association.

**2.4. AC Expertise**

The audit committee is in charge of assuring the quality of business reports, quality assurance engagements, both financial and non-financial, and internal audit and risk management assurance within the organization. As a result, in order to ensure that this task is completed successfully, it requires resources who have expertise in this field [14]. So that the lack of expertise possessed by the audit committee causes the board to only depend on the external auditor [18]. [17] and [21] found that AC expertise is positively related to report quality, where the more expert the audit committee is, the more quality the reports produced by the company will be. The following are the study's hypotheses:

H4: AC Expertise and Sustainability Reporting have a positive association.

**3. RESEARCH METHODS**

**3.1. Sample and Population**

This is quantitative research that uses secondary data from annual reports and firm sustainability reports for the year 2021. The data are obtained from the web addresses of each company and through the idx.co.id website. The subjects of this research include all 66 companies listed on the Indonesia Stock Exchange in the 2020 Energy Subsector. The sample selection was carried out using several criteria so that the final sample obtained was 47 companies. Table 1 shows the sample selection process based on the criteria carried out in this study.

**Table 1.** Sample Selection Criteria

Energy subsector companies listed on the IDX	66
Data not available	(19)
Research sample	47

Source: Processed secondary data, (2021)

**3.2. Variable Measurement**

Following previous research [12], [22]–[24], the audit committee's characteristics, which include the size of the audit committee, independence, the frequency of meetings held by the audit committee, and the competence held by the audit committee, are the independent variables used in this study. The number of members on the audit committee refers to the size of the audit committee. The number of independent audit committee members who are not directors, commissioners, have shares in the company or have financial links with the company is used to determine the audit committee's independence. The number of audit

committee meetings held in 2020 is used to calculate the audit committee meeting variable. The number of audit committee members who have competence in the subject of accounting, either through education or job experience, is used to determine the audit committee's expertise. The Sustainability Report, which is measured by a value of 1 if the company presents a stand-alone Sustainability Report and a value of 0 otherwise, is the dependent variable in this study. This type of measurement has been utilized by [25]. The research model or equation was tested using multiple regression analysis with the SPSS 25 program.

**4. RESULTS AND DISCUSSION**

**4.1. Descriptive Statistics**

Table 2 presents descriptive statistics for both the audit committee's characteristic variables in this study. The audit committee's size ranges from three to five members. The independent audit committee has a score of between 2 and 5 on a scale of 1 to 5. The number of audit committee meetings ranges between 0 and 32. The audit committee's financial skill ranges from 1 to 4. According to the descriptive statistical analysis table, energy sub-sector organizations listed on the Indonesia Stock Exchange in 2020 have met the requirements provided forth by OJK No. 55/POJK.04/2015 regarding the Establishment and Work Implementation of the Audit Committee. At least three members of the audit committee, chaired by an independent commissioner and two other members from outside parties with no relationships to the corporation, and at least one member of the audit committee with accounting and finance experience. As well as attending at least one audit committee meeting every three months (four times a year).

**Table 2.** Descriptive Statistics Results

	N	Min	Max	Mean	Std. Deviation
Y SR	47	0.00	1.00	.3191	.47119
X1 Size	47	3.00	5.00	3.2128	.58741
X2 Indp	47	2.00	5.00	3.1489	.65868
X3 Meet	47	0.00	32.00	6.2128	4.82717
X4 Expt	47	1.00	4.00	1.8511	.77960

Source: SPSS result

**4.2. t test (Partial)**

The findings of the t statistical test are shown in Table 3:

**Table 3.** Partial Test Results

	<b>t</b>	<b>Sig</b>	<b>Result</b>
Constant	-3.626	.001	
Size	1.987	.053*	Accepted
Indp	-1.047	.301	Rejected
Meet	3.961	.000***	Accepted
Expt	2.145	.038**	Accepted

Source: SPSS result (significant at 10%\*, 5%\*\* , 1%\*\*\*)

Table 3 presents the results of the t statistic test as well as the significant value of each independent variable (Size, Ind, Meet, and Expt), which indicates whether the hypothesis is accepted or rejected. The following can be concluded as from the results of the t statistical test (partial test):

1. The t-count value of variable size is 1.987, with a significance value of 0.053. This indicates that the t-count value is less than the t-table value ( $1.987 < 2.018$ ), indicating that the SR variable is not significant. However, when adopting a 10% level of significance, the significance value of variable AC Size is less than 0.10 ( $0.053 < 0.10$ ), indicating that the Size variable has an impact and is significant on the SR variable.
2. The t-count value of the Ind variable is -1.047, and the significance value is 0.301. Because of t-count value is less than the t-table value ( $-1.047 < 2.018$ ) and the significance value is greater than 0.05 ( $0.301 > 0.05$ ), the Ind variable has no effect on the SR variable.
3. The t-count value of the Meet variable is 3.961, with a significance value of 0.000. Because of t-count value is more than the t-table value ( $3.961 > 2.018$ ) and the significance value is less than 0.05 ( $0.000 < 0.05$ ), the Meet variable can be declared to have a significant and significant effect on the SR variable..
4. The Expt variable has a significance value of 0.038 and a t-count value of 2.145. Because the t-count value is greater than the t-table value ( $2.145 > 2.018$ ) and the significance value is less than 0.05 ( $0.038 < 0.05$ ), the Expt variable can be said to have a significant and significant effect on the SR variable.

**4.3. F test (Simultaneous)**

The following are the findings of the F statistical test:

**Table 4. F Statistical Test Results**

	<b>F</b>	<b>Sig</b>
Regression	10,901	0,000b
Residual		

Source: SPSS result

The F-count value is 10.901 and the significance value is 0.000, as seen in Table 4. So the F-count value of 10.901 is more than the F-table value of 2.59 ( $10,901 > 2.59$ ) and the significance value of 0.000 is less than the significance value of 0.05 ( $0.000 < 0.05$ ). The variables Size, Ind, Meet, and Expt have a simultaneous and significant effect on SR.

**4.4. Discussion**

The audit committee size variable (Size) had a significant effect on the stand-alone sustainability report, with a significance value of 0.053 at a significance level of 10%, according to findings. As a result, hypothesis 1 is accepted, namely, that the size of the audit committee (Size) has a positive relationship towards sustainability reporting. This means that the larger the audit committee, the more corporations will be encouraged to publish stand-alone sustainability reports. In line with the agency's anchovies, a larger number of audit committee members will encourage management to disclose more information about environmental, social and corporate governance performance more openly by submitting stand a-lone sustainability separate from the annual report, not only financial reporting. Because the greater the number of audit committee members, the better oversight function performed by the audit committee, so that the evaluation and control functions of all aspects of performance will be better as well. The findings of this study agree with those of [18] and [19], who found that the number of audit committee members had an impact on the company's sustainability report.

The results showed that the audit committee independence variable (Indp) had a negative sign and had no effect on the stand-alone sustainability report, rejecting hypothesis 2. The data test revealed the opposite result: there was a negative association between audit committee independence and sustainability reporting. This means that the presence of an independent audit committee will not be able to persuade corporations to submit a stand-alone sustainability report from their annual report in order to disclose information on the social environment and corporate governance. The findings of this study agree with those of a study [26] that indicated a negative association between the audit committee and the quality and quantity of financial statement disclosures, as well as a study [27] that revealed a negative correlation between the independent audit committee independent and CSR.

The audit committee meeting variable (Meet) was shown to have a substantial effect on the stand-alone sustainability report, with a significance value of 0.000. Therefore, hypothesis 3 is accepted, indicating that there is a positive correlation between the frequency/intensity of audit committee meetings (Meet) and Sustainability Reporting. This means that the more frequently the audit committee meets, the more likely the company will submit a sustainability report. According to agency theory, the more intensive the audit committee's meetings with the board of commissioners, the greater the possibility to assess the company's strategic plans, thereby minimizing information asymmetry.[10], [18]–[21], [28].

The results indicated that with a significance value of 0.038, the audit committee expertise variable (Expt) had a significant effect on the stand-alone sustainability report. Thus, hypothesis 4 is accepted, indicating that there is a positive correlation between audit committee expertise and sustainability reporting. This means that the more financial professionals on the audit committee, the more corporations will disclose their sustainability reports. According to agency theory, when audit committee members possess competence, particularly in the field of finance, this assists them in completing their assigned obligations as members of the audit committee more quickly. Thus, the duty of monitoring and managing financial and non-financial reporting will be simplified in this instance. As a result, the distance between the agent and the principal will be narrowed. The findings of this study corroborate those of previous studies conducted by [15]–[17], [27], [29] that the audit committee's knowledge in the financial industry has a beneficial effect on the quality of reporting.

## 5. CONCLUSION AND LIMITATION

The purpose of this study is to evaluate the audit committee's characteristics in relation to sustainability reports for listed companies on the Indonesian Stock Exchange, primarily in the energy sub-sector. The audit committee's characteristics are examined from four perspectives: the size, as measured by the total number of audit committee members; independence, as measured by the number of independent audit committee members; audit committee meetings, as measured by the number of audit committee meetings held each year; and the audit committee's expertise, as measured by the number of members who have earned competence in accounting and finance through education, training, or experience. Meanwhile, the variable referring to sustainability reports is proxied by presenting a self-contained sustainability report. The research showed that the characteristics of audit committee size, audit committee meetings, and audit committee expertise had a significant impact on the filing of a stand-alone sustainability report. While the independent audit committee has no bearing on the sustainability report.

This study has limitations, including that this research only focuses on energy sub-sector companies as research samples, so the research results are not necessarily the same if the samples are different. Future research should use all sectors so that research results can be generalized. The audit committee independence variable was quantified in this study using a proxy for the number of independent audit committees, and the findings indicated that there was no effect. The measurement of variables is carried out only based on independent statements issued by the audit committee without further tracing whether the committee really has no affiliation, financial, with the

company to verify that perhaps the audit committee fulfils its independence.

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