CHAPTER I

INTRODUCTION

1.1 Background of Research

United Nations Industrial Development Organization defines Corporate Social Responsibility (CSR) as a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with stakeholders. Based on Act No. 40 of 2007 about Corporation, Social and Environmental Responsibility is the commitment of the Company to participate in the sustainable economic development to improve the quality of life and environmental beneficial for the Company itself, the local community and society in general. Implementation of CSR in Indonesia is mandatory by government on Act No. 40 of 2007 about Corporation, Government Regulation No. 47 of 2012 concerning Social and Environmental Responsibility of Corporation, and the latest is on Decision of the Chairman of Capital Market and Financial Institution Supervisory Body (BAPEPAM-LK) No.KEP-431/BL/2012 concerning the Submission of Annual Report by Listed Company.

Some issues arise about the implementation of CSR in Indonesia. One of it is the issue of transparency on CSR's disclosure. It is proved by news on *RiauSatu.com* on April 2015 which stated that *"Ketua Pansus CSR berharap Pemerintah dan Perusahaan Transparan."* The news talked about the transparency of CSR's budget and the company's CSR activities. This issue in line with Kim et al., (2012) statement that CSR is an issue of growing interest, and the reporting of socially responsible activity is becoming more prevalent as investors, customers, and other stakeholders demand greater transparency about all aspects of business. When company becomes not transparent in their report, it will cause information asymmetry between company and the users of their report.

Company generally has responsibility to fulfill not only their shareholders' interest but also stakeholders'. Corplaw (2013) define stakeholders as any person or group which can affect or be affected by the actions of a business and it is including employees, customers, suppliers, creditors and even the wider community and competitors. Ekawati (2012) stated that CSR is an activity that shows the company's concern to their stakeholders and as a form of responsibility to the activities of the company in term of social, economic environmental. All information of CSR is reported and disclosed by company in their annual report as already regulated by government. The information provided is hoped may provide consideration for stakeholders in making decisions. CSR disclosure considered increasingly taking a role in the present due to the shift in the concept of profit which began to lead to the concept of the triple bottom line (profit, planet, people) initiated by John Elkington and increasingly into the mainstream of business ethics (Palguna Putra, 2013).

As already said before, implementation of CSR in Indonesia regulated by government, so the disclosure of CSR also mandatory for all listed company. Unfortunately, the regulations did not clearly explain about what are social and environmental responsibility's items that should be disclosed by a company. Even, the latest regulation in Decision of the Chairman of Capital Market and Financial Institution Supervisory Body (BAPEPAM-LK) No.KEP-431/BL/2012 only requiring companies to disclose its CSR activities that cover policies, types of program and cost incurred in four aspects such as environmental; employment practices, health, and work safety; social and community development; and product responsibility, still, the items are not too specifics. Thus, the activity and the disclosure of CSR in Indonesia is still based on company's decision (voluntary disclosures). Voluntary disclosures also mean that company disclose beyond what is mandatory.

Company should balance in fulfilling the interest of shareholders' and also stakeholders'. It is a good choice for a company to shift their concept from profit concept to triple bottom line concept. But there is one thing that should be realize by company that Act No. 40 of 2007 chapter 74 clause 2 mentioned that CSR is the obligation of the company which are budgeted and calculated as expenses of the company. When expense increase it will affect company's profit. Meanwhile, Milton Friedman (1970) in his shareholders theory said that the sole responsibility of business is to increase profits. Corplaw (2013) also adding that based on the premise that managements are hired as the agent of the shareholders to run the company for their benefit, and therefore they are legally and morally obligated to serve their interest. This is contradicting with the stakeholder theory which state that the company is not the only entity operates for his own benefit, and to gain support from stakeholders companies must provide benefits to its stakeholders. Stakeholder theory suggests the purpose of the firm is to serve broader societal interests beyond economic value creation for shareholders alone. So company should handle this problem and must ensure that the fulfillment of the interest not running unilaterally.

Both CSR and profit (earnings) information are represented in annual report and financial statements of the company. Investor, creditor and stakeholders use this information as based information for their decision-making process. Therefore, the quality of the company's annual report and financial statement plays an important role in the communication process for the transfer of information from the company to users of annual report and financial statement because it will affect their decision-making process.

All information in annual report or financial statements should be presented transparently to the users. Yeh et al., (2014) stated that managers usually have better or timelier information than investors. Thus, managers have incentives to withhold private information for their self-interest and to practice diversion of resources because of conflicts of interest principles and agents. This will lead to information asymmetry between company and the users of annual report or financial statement. When asymmetry is high, stakeholders do not have sufficient resources or access to relevant information to monitor manager's actions. It leads to creation of opportunities for earnings management practices (Richardson 1998 in Sanjaya and Young. 2012).

Information asymmetry is a condition describing that managers have access to information on the company's prospects which are not owned by outside parties (Sanjaya and Young, 2012). Lang and Lundholm (1996) in Yeh et al., (2014), find that companies are more likely to make voluntary disclosures when information asymmetry between the company and investors is severe. Yeh et al., (2014) adding that increased voluntary disclosure can effectively reduce information asymmetries among management and stakeholders. Sanjaya and

Young (2012) also stated that the increasing on presentation of voluntary disclosure, information asymmetry can be reduced so that earnings management can be prevented. When the practices of earnings management prevented it will affect to the increasing of earnings quality.

Ball and Shivakumar (2005) in Yeh et al., (2014) stated thar earnings quality refers to the level of faithful representation of the features of a firm's fundamental earnings processes that are relevant to specific decision making by investors, creditors, managers, and all other parties contracting with a firm. Quality of earnings is important because investors rely on earnings information to evaluate information risks related to a firm (Francis et al. 2004; Ng 2011 in Yeh at al., 2014). Higher quality of earnings indicating that information that use by users of annual report and financial statements are relevant and reliable as the based information in decision-making process.

Many researches already test about the influence of disclosure to earnings management or disclosure to earnings quality, and they have the same results which is disclosure negatively influence earnings management and positively influence earnings quality (Zhou and Lobo, 2001; Yeh et al., 2014; Sanjaya and Young, 2012; Blanco et al., 2014). Many researchers also research about the link between CSR and earnings quality or CSR and earnings management, and the results is mix (Kim et al., 2012; Ekawati, 2012; Isyanto, 2014; Hong and Andersen, 2011; Chih et al., 2008; Arief, 2014; Palguna Putra, 2013).

Based on those arguments, writer attracted to test the influence of level of CSR disclosure to earnings quality. This research will use discretionary accrual of earnings management as the proxy of earnings quality and also will use companies in mining sector that listed in Indonesia stock exchange year 2012-2014 as the sample of research.

1.2 Research Question

Based on background that explained above, thus, the research question can be formulated as follow:

Does the level of corporate social responsibility disclosures influence earnings quality?

1.3 Objective of Research

The objective of this research is to give empirical evidence the influence of level of corporate social responsibility disclosure to earnings quality on Indonesian mining companies that listed on IDX year 2012-2014

1.4 Contribution of Research

This research is expected to give contribution as follow:

1. As academic purpose, this research is to test the influence of level of corporate social responsibility disclosure on earnings quality in Indonesia especially in mining sector.
2. As managerial purposes, this research is expected to help users of financial statements to more thoroughly understand the performance of the company as a basis for making decisions and also is expected to provide input to the regulator, in here government, as a basis for the creation of a new policy relating to CSR and earnings management practices in Indonesia.

1.5 Systematic of Writing

Research was prepared by systematic as the following:

CHAPTER I: INTRODUCTION

Chapter I contain an introduction in the preparation of the research, which consist of background, formulation of the problem, research objectives, research contribution, and systematics of writing.

CHAPTER II: THEORETICAL BACKGROUND AND HYPOTHESIS DEVELOPMENT

Chapter II contains literature review outlines the theoretical basis and previous research to be used as a reference for data analysis study in this study. This chapter also includes a conceptual framework for hypothesis development that is being proposed in this research.

CHAPTER III: RESEARCH METHODOLOGY

Chapter III includes an operational definition of each variable and how measurement, data collection methods, population and sample used in this research, as well as the sampling techniques criteria used, and data method analysis.

CHAPTER IV: DATA ANALYSIS AND DISCUSSION

Chapter IV contains the results of processing and data analysis, whether the results is able to meet and prove the proposed hypothesis or not. Further discussion on the result of statistical analysis will be included as well.

CHAPTER V: CONCLUSION

Chapter V contains the final conclusion to answer research questions. Disclosing the limitations of the study as well as suggestions given for further research will be included also.