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# THE ROLE OF AUDIT COMMITTEE IN CORPORATE SUSTAINABILITY DISCLOSURE

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**ABSTRAK**

Penelitian ini bertujuan untuk menguji pengaruh karakteristik komite audit terhadap pengungkapan Corporate Social Responsibility (CSR) berkaitan dengan isu keberlanjutan. Karakteristik komite audit diproksikan dengan ukuran, jumlah anggota yang memiliki keahlian keuangan dan jumlah pertemuan komite audit. Penelitian ini menggunakan data sekunder laporan tahunan dan laporan keberlanjutan perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia periode 2014-2018. Jumlah sampel yang digunakan adalah 77 perusahaan. Data dianalisis menggunakan *Ordinary Least Square*. Berdasarkan hasil penelitian, ukuran komite audit memiliki efek positif yang signifikan terhadap pengungkapan CSR. Sebaliknya, keahlian keuangan dan jumlah pertemuan memiliki efek negatif yang signifikan terhadap pengungkapan CSR. Penelitian ini dapat memberikan rekomendasi untuk mempertimbangkan jumlah komite audit dalam membentuk komite audit untuk mendorong pengungkapan CSR yang lebih luas.

Kata Kunci: Pengungkapan, Corporate Social Responsibility, komite audit, keberlanjutan

**ABSTRACT**

This study aims to determine the influence of the characteristics of the audit committee on corporate social responsibility (CSR) disclosures related to sustainability issue. The audit committee characteristics are proxied by size, the number of members with financial expertise, and the number of audit committee meetings. This study used secondary data from the annual report and sustainability report of manufacturing companies listed on the Indonesia Stock Exchange for the period 2014-2018. The number of samples used is 77 companies. Data were analyzed using Ordinary Least Square. Based on the research findings, the size of the audit committee has a significant positive effect on CSR disclosures. In contrast, financial expertise and the number of meetings significantly negatively affect CSR disclosures. This research can provide recommendations to consider the size of the audit committee in establishing an audit committee to encourage broader CSR.

*Keywords: Disclosure, Corporate Social Responsibility, audit committee, sustainability*

## 1. Introduction

European Commission (2006) defines Corporate Social Responsibility *(CSR)* as corporate integration in their business operations' social and environmental fields by involving *stakeholders* voluntarily. Furthermore, Bose et al. (2021) explained that companies had shifted their focus from internal and external stakeholders to the public. However, there is no approved definition of the CSR concept. However, people tend to buy products or services that follow the ethical principles that apply in the community (Shamil et al., 2014). Thus, companies that care about CSR will get more attention from consumers.

Along with the increasing attention of stakeholders to CSR activities. Companies are required to carry out CSR activities and disclose them. So far, CSR disclosures are still voluntary. Although CSR is voluntary, according to a KPMG survey (2020) conducted at 5.200 companies globally, companies consider CSR disclosure necessary. This is evidenced by 80% of companies worldwide that have disclosed CSR. This shows that companies worldwide are increasingly concerned about social and environmental and not just focus on profit. Meanwhile, CSR disclosure in Indonesia has also increased, as evidenced by Indonesia getting the highest rating related to information disclosure in sustainability reports, according to the GRI survey in 2020 (mediaindonesia.com, 2020).

CSR disclosure in Indonesia originated from Law No. 40 of 2007, which requires companies to carry out CSR activities and disclosures but is still voluntary. Furthermore, the Financial Services Authority issued POJK number 51 of 2017 concerning sustainable finance that must be applied by public companies, especially financial services companies. After that, the Financial Services Authority again issued OJK SE Number 16 of 2021 concerning the Form and Content of the Annual Report of Issuers or Public Companies which requires public companies to report CSR activities which include economic, social, and environmental activities. These disclosures may be made separately from the annual report or be part of the annual report. Thus, this CSR disclosure becomes mandatory for public companies in Indonesia.

CSR disclosure relates to the theory of legitimacy. Based on the theory of legitimacy, the company operates in a community environment that requires the company to comply with the values and norms in society. One of them is CSR activities and disclosures. That way, the company gets permission from the community to operate in the community. In CSR disclosure managers may make CSR disclosures to cover up their opportunistic behaviour. Therefore, the disclosure needs supervision, one of which is through the audit committee (Mohammadi, 2020). Furthermore, Karamanou & Vafeas (2005) explained that the audit committee plays a role in overseeing information submitted to the public. Such information includes financial and nonfinancial information so that shareholders have confidence in companies that have a good effect on the performance of the board of commissioners and audit committees.

In addition to management supervision, the audit committee also plays a vital role in overseeing the company's compliance with applicable regulations. In this case, the audit committee works closely with the internal auditor to oversee the internal controls in the company. Also, evaluate the findings of external auditors. Thus, the audit committee has an essential role in overseeing management performance. The audit committee also plays an essential role in overseeing CSR practices and disclosures. CSR relates to the role of companies in society in the social and environmental fields. Therefore, companies should pay attention to business ethics in the local community (Mohammadi, 2020). Moreover, the company must also commit to conducting CSR practices. That way, the company can attract consumers and investors to make financial contributions to the company. In this case, the audit committee has a vital role in supervising CSR practices and disclosures conducted by the company to conduct CSR practices and disclosures on an ongoing basis (Karamanou & Vafeas, 2005; Qaderi & Alhmoud, 2020).

The audit committee's role in CSR disclosure has been widely done (Samaha et al., 2015) but gives mixed results (Buallay & Al-Ajmi, 2020). Bastina & Bernawati (2019) found that the size and number of meetings significantly positively impacted CSR disclosures to companies in Australia. Similarly, Buallay & Al-Ajmi (2020) found that the independence of audit committee members and the number of meetings significantly positively affected CSR disclosures in banking. Meanwhile, Dwekat & Carmona (2020) found that the size of the audit committee and the number of meetings negatively influenced CSR disclosure. Furthermore, Dwekat & Carmona (2020) explained that there are no standard attributes about the characteristics of the audit committee that affect CSR disclosure.

This research contributes to the growing body of literature on the relationship between corporate governance and corporate reporting in some ways. First, previous literature mostly focuses on the role of audit committees in financial information, while this research focuses on the role of audit committees in nonfinancial information. Based on previous research that produced mixed results, this study re-examines the influence of audit committee characteristics on CSR disclosures (Alotaibi, Aburuman, Hussien, 2019; Ismail & Ibrahim, 2008; Adegboye, 2019; Buallay & Aldhaen, 2018; Amosh & Khatib, 2021). Therefore, this study aims to examine the characteristics of audit committees that affect CSR disclosure in Indonesia. Indonesia is a developing country that encourages nonfinancial disclosures in public companies, so this study aims to see the role of audit committees in CSR disclosures in Indonesia.

This research was conducted on companies listed on the Indonesia Stock Exchange (IDX) from 2014 to 2018. This research is expected to be literature related to the audit committee and CSR review and provide an overview of CSR disclosure in Indonesia. This research is expected to provide recommendations to consider the size of the audit committee in establishing an audit committee to encourage broader CSR disclosures. In addition, this study also provides an overview of the level of CSR disclosure in Indonesia so that companies can increase CSR disclosures based on the criteria used by Global Reporting Initiatives (GRI) as an indicator to measure sustainability performance.

## 2. Literature Review and Hypotheses Development

Legitimacy theory explains that companies contract with society (Reverte, 2008). Thus, the company needs to operate according to the values and norms prevailing in society. If there is inappropriate behavior, the company will be punished by the community. One form of norms and values that apply in society is CSR activities.

Companies must be responsible for their operational processes through social and environmental concerns.

The audit committee is part of corporate governance, which aims to create good corporate governance. The audit committee is established by the board of commissioners, carries out the duties and functions of the board of commissioners, and is responsible to the board of commissioners. Among the duties of the board of commissioners is to review financial information and other reports related to the financial information of public companies. Among these other reports is the company's CSR report. The audit committee is also tasked with ensuring that the company complies with applicable regulations and carries out risk management properly.

The provisions of the audit committee in public companies in Indonesia are regulated by POJK Number 55 of 2015 concerning the implementation of the work of the audit committee. This regulation also stipulates the provisions of members and meetings of the audit committee. In its implementation, the audit committee is expected to help increase the company's transparency regarding financial and nonfinancial statements.

Global Reporting Initiatives (GRI) is an international organization that helps companies to disclose CSR activities that have been carried out. Since its establishment, GRI has issued several reporting standards, including GRI G4. GRI G4 presents economic, social, and environmental category information related to sustainability issues. Economic information includes the income generated and the distribution of that income. Social information is responsible for products, employees, human rights, and the surrounding community. Meanwhile, environmental information includes water use, energy, waste management, and biodiversity protection.

According to The Financial Services Authority (POJK) Regulation number 55 of 2015, the audit committee has at least three people from independent commissioners and outside parties. Determining this amount aims to improve the supervisory function of the audit committee. According to Bedard et al. (2004) in Qaderi & Alhmoud (2020), the larger the size of the audit committee, the more resources, expertise, and perspectives of each member also vary. This encourages more optimal than surveillance.

The larger the audit committee's size, the more members' duties and functions can appropriately delegate, including in CSR activities (Barakat, 2015). The more the number of audit committees, the greater the ability to solve problems in financial reporting and encourage the disclosure of nonfinancial information, including CSR disclosure (Buallay & Al-Ajmi, 2020). Research on the influence of the size of the audit committee on CSR disclosures has been conducted among others by (Barakat 2015; Buallay & Al-Ajmi, 2021; Mohammadi, Saeidi, & Naghshbandi, 2020), which shows the size of the audit committee positively affect CSR disclosures. Thus, the hypothesis is:

$H_1$: The size of the audit committee members positively affects CSR disclosure.

Based on POJK No. 50 of 2015, the audit committee must have at least one member who is an expert in accounting and finance. It aims to improve the audit committee's role in overseeing the company's financial affairs. Dhaliwal (2010) in, Qaderi, & Alhmoud (2020) explain the audit committee members with the financial expertise to understand financial reporting. Furthermore, Persons (2009) in Qaderi & Alhmoud (2020) describe audit committees that have expertise in finance can detect "peculiarities" in financial statements and unnatural transactions.

Audit committee members with finance expertise also have the awareness to encourage CSR disclosure (Shaukat et al., 2016; Chan et al., 2020). Members of audit committees who do not have expertise in finance tend not to want to pay attention to matters related to financial reporting (Dwekat et al., 2020). Research on the relationship between audit committee expertise in finance and CSR disclosure has been conducted. Qaderi & Alhmoud (2020) found a positive relationship between the expertise of audit committee members in finance and CSR disclosures. The same was also discovered by Dwekat et al. (2020), Chan et al. (2020), and Moalla, Salhi & Jarboui (2020). So, the hypothesis is:

$H_2$: Members of the audit committee who have expertise in finance positively influence CSR disclosure.

Based on POJK number 55 of 2015, the number of audit committee meetings at least one time in 3 months. Several professional audit companies, such as Price Waterhouse Cooper (1993) and KPMG (1999), recommended that audit committee meetings be held at least three or four meetings per year. A formal audit committee meeting is at the heart of his work, and sufficient should be given to allow the committee to conduct the necessary discussions and detect fraud (Chen, 2006). The more often the audit committee meets every year, the more likely it will be to make a difference and ensure the reliability of the CSR disclosure process. Frequent meetings also help AC members sit and decide on CSR plans and convince stakeholders (Fahad & Rahman, 2020). Li et al. (2012), using 100UK-registered companies, found a positive relationship between the frequency of audit committee meetings and the level of CSR disclosure. So, the hypothesis is:

$H_3$: The number of audit committee meetings positively affects CSR disclosures.

## 3. Research Methodology

This research uses a descriptive quantitative approach. The research instrument is documentation from annual reports, sustainability reports, and company websites. The data used in this study is secondary data obtained from literature studies. Table 1 describes the criteria and total observation in this study.

The population in this study is all companies listed on the Indonesia Stock Exchange (IDX) from 2014 to 2018, with a total sample of 77 manufacturing companies with 385 total observations. This research was conducted on manufacturing companies because manufacturing companies have a large impact on social and environmental, so stakeholder demands for CSR disclosures also increase. Meanwhile, the research sample was determined by using purposive sampling with the following criteria:

**Table 1. Sampling Calculation**

| No | Criteria | Sample |
|---|---|---|
| 1. | Companies registered in IDX from 2014 to 2018 | 185 |
| 2. | Companies belong to manufacturing industries | 81 |
| 3. | Companies that have complete data related to research variables | 77 |
| | Total Observation for 5 Years | 385 |

Source: Secondary data (processed)

The model used in this study are:

$$CSRD_{it} = \beta_0 + \beta_1 ACS_{it} + \beta_2 ACFE_{it} + \beta_3 ACM_i + \beta_4 FSIZE_{it} + \beta_5 FAGE_{it} + \beta_6 LISTAGE_{it} + \beta_7 LEV_{it} + \varepsilon$$

Where,

CSRD : CSR disclosure level
ACS : number of members of the audit committee
ACFE : percentage of members who have expertise in finance
ACM : number of audit committee meetings
SIZE : company size (ln total assets)
FAGE : company age
LIST AGE : age of listing
LEV : leverage
$\beta_0$ : constant
$\beta_1$ - $\beta_7$ : regression coefficient
$\varepsilon$ : error

Furthermore, the data were analyzed with ordinary least squares using STATA. The analysis included selecting panel models using the Chow, Hausman, and LM tests. Then, after the model was obtained, a classic assumption test had a multicollinearity test, heteroscedasticity test, and autocorrelation test. While variables operationalization is explained in Table 2 as follows:

**Table 2. Variables Operationalization**

| Variable | Measurement | References |
|---|---|---|
| CSR disclosure level | Firm's CSR disclosure | Global Reporting Inititives (GRI) G4 |
| Audit committee member | Total members of the audit committee | Bastina & Bernawati (2019) |
| Audit committee member with finance expertise | Percentage of audit committee members who have financial expertise | Bicer & Feneir (2019) |
| Audit committee meetings | Total number of audit committee meetings | Dhaliwal (2010) in Qaderi & Alhmoud (2020) |

## 4. Results and Discussion

This section discusses the research results and discussions related to the research results as follows.

**Table 3. Descriptive Statistics**

| Var. | Obs. | Average | Median | Std. Dev | Min | Max |
|---|---|---|---|---|---|---|
| CSR | 385 | 28,7 | 29 | 14,96 | 2 | 108 |
| ACS | 385 | 3,3 | 3 | 0,66 | 2 | 6 |
| ACE | 385 | 0,69 | 0,66 | 0,21 | 0,25 | 1 |
| ACM | 385 | 7,69 | 6 | 7,6 | 2 | 96 |
| FAGE | 385 | 43,05 | 40 | 21,6 | 7 | 118 |
| SIZE | 385 | 19,61 | 20,65 | 3,91 | 10,8 | 26,5 |
| LIST_AGE | 385 | 18,43 | 20 | 9,30 | 1 | 39 |
| LEV | 385 | 0,41 | 0,41 | 0,19 | 0,07 | 0,84 |

Table 3 describes the descriptive statistics of the reversed variables. Based on Table 3, the average CSR disclosure is 28.7, with a maximum value of 108. This value is only 5% of the maximum value if all items are disclosed, 582. The audit committee size has an average value of 3, with a minimum number of members of the audit committee of as many as two people and a maximum value of 6 people. This is by POJK Number 55 of 2015, namely the number of members of the audit committee of at least three people.

The variable proportion of audit committee members with financial expertise has an average value of 0.69, with a minimum value of 0.25 and a maximum of 1. While the meeting count variable has an average value of 7.69, a minimum value of 2, and a maximum of 96. This follows POJK Number 55 of 2015, where the audit committee must hold a meeting at least once every three months.

Based on Figure 1, CSR disclosures from 2014 to 2018 continue to develop. This is driven by the disclosure of company information that all parties can access. Thus, the more transparent the information presented, the easier the investor gets the information, and if the company's performance is good, then the investor will be interested in investing. In addition, the information needed for investor decision-making is not only financial information but nonfinancial information, one of which is CSR information.

This data also shows that the need for corporate CSR information is increasing. Stakeholders want to know the CSR activities carried out and how the company is responsible for its operations to society and the environment. Thus, companies are required to be more transparent to stakeholders.

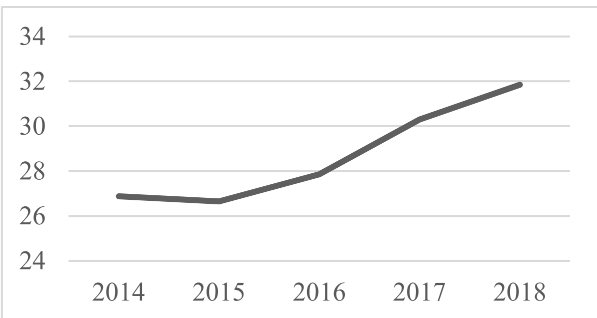


**Figure 1. CSR Disclosure Developments from 2014-2018**

This is also in line with the survey conducted by KPMG. From a survey of 5,200 companies worldwide, the level of CSR disclosure increased from 2002 to 2020. In 2020, 80% of companies in the world conducted CSR reporting, an increase of 5% from the previous survey conducted in 2017. Those companies also use the GRI as a reporting standard.

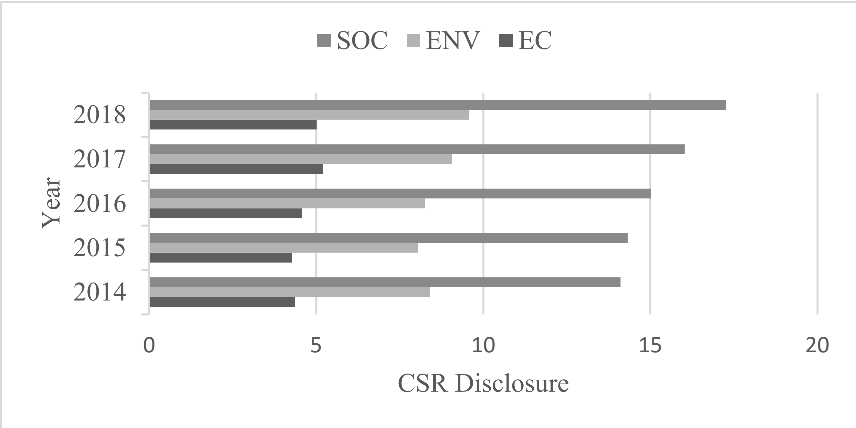


**Figure 2. Development of Social, Environmental, and Economic Category Disclosure from 2014 to 2018**

The Global Reporting Initiatives (GRI) G4 Guideline divides disclosures into economic, social, and environmental categories. The social category includes how the company generates income and its distribution. Environmental categories include disclosure of water use, energy, waste management, and responsibility for biodiversity. Meanwhile, the social category includes human rights policies, responsibility for products, and treatment of employees and the surrounding community.

Based on Figure 2, CSR disclosure of manufacturing companies in Indonesia in the social, environmental, and economic categories increased from 2014 to 2018. Meanwhile, social categories have the most significant proportion expressed, followed by environmental and economic categories, and a large proportion in social category, followed by the environment and economy.

Three data processing methods can be used in the data processing panel: pooled leased square, fixed effect, and random effect. Tests conducted to determine the most appropriate model used are Chow Test, LM Test, and Hausman Test. Based on the test results in Table 4, the most appropriate regression model used is *the fixed effect.*

**Table 4. Regression Model Determination**

| **Dependent variable** | ***P-value*** |
|---|---|
| Fixed effect estimator estimator | 6.0323e-081 |
| Result | fixed |
| Brush–Pagan statistic test | 5.86231e-091 |
| Result | random |
| Hausman test statistic result | 2.13222e-009 |
| Result | fixed |

Table 5 explains the results of the hypothesis test, and the discussion of each hypothesis is as follows:

**Table 5. Hypothesis Test Results**

| Variables | Coefficient | Std. Error | t-ratio | p-value | |
|---|---|---|---|---|---|
| CONST | 85.1873 | 7.75638 | 10.98 | <0.0001 | *** |
| ACS | 3.89002 | 1.28485 | 3.028 | 0.0026 | *** |
| ACFE | −18.5388 | 4.56923 | −4,057 | <0.0001 | *** |
| ACM | −0.26419 | 0.111310 | −2,373 | 0.0181 | ** |
| FAGE | −0.00444 | 0.026764 | −0.166 | 0.8681 | |
| FSIZE | −0.24713 | 0.126368 | −1,956 | 0.0512 | * |
| LIST_AGE | 0.34639 | 0.082730 | 4.187 | <0.0001 | *** |
| LEV | 27.6595 | 3.50170 | 7.899 | <0.0001 | *** |
| F test | 36,29 | | | | |
| Sig. F test | 0,0000 | | | | |
| R Square | 0,4025 | | | | |
| Adj. R Square | 0,3914 | | | | |

***),**),*) significant at $\alpha$ = 1%; 5%; 10%

Based on the hypothetical test results in Table 5, the size of the audit committee has a significance value of 0.00025<0.05, which means that the size of the audit committee has a significant positive effect on CSR disclosure. These results are by the research of Barakat et al. (2015) but different from the study results by Dwekat & Carmona (2020). The audit committee is tasked with reviewing financial and nonfinancial information. Based on POJK Number 55 of 2015, the minimum number of audit committee members is three people, which means that there is a minimum limit so that they can effectively supervise the company.

This research contributes to legitimacy theory, where the audit committee must ensure that the company complies with regulations and stakeholder expectations to gain operating licenses in society. The larger the number of members of the audit committee, the greater the ability to solve problems. Also, encourage the disclosure of nonfinancial information, including CSR disclosures (Buallay & Al-Ajmi, 2020). The larger the size of the audit committee, the more expertise each member has, making it more effective in overseeing financial and nonfinancial reporting (Mohammadi, 2020). In addition, audit committee oversight of management performance is also increasing.

One of the duties of the audit committee is to supervise the disclosure of financial information and nonfinancial information. The higher the supervision carried out by the audit committee, the higher the attention to social and environmental impacts and the encouraged companies to be responsible to the community in overcoming social and environmental problems.

Based on the hypothesis test results in Table 5, the financial expertise of the audit committee has a significance value of -0.0001<0.05, which means that the financial expertise of the audit committee has a significant negative effect on CSR disclosure. This is in line with the results of research by Bicer & Feneir (2019) and Li et al. (2012) but inconsistent with the results of the study Mohammadi (2020). Based on POJK Number 55 of 2015, the audit committee must have a minimum of 1 person with an accounting and financial background. The greater the number of members with financial expertise, the better the supervision carried out, including in supervising disclosures.

The information disclosed in the CSR report includes financial and financial information. Thus, financial expertise negatively affects CSR disclosure because the audit committee focuses on financial information (Uyar et al., 2022). In addition, the final decision to determine the extent of disclosure of information that is not required is the obligation of the board of commissioners so that the audit committee cannot fully determine the information (Buallay & Al-Ajmi, 2020). Furthermore, the disclosure of CSR information also requires expertise in nonfinancial fields, such as environmental experts. Thus, financial expertise does not entirely affect CSR disclosure. This is because CSR information relates not only to financial information but also to nonfinancial information such as the amount of waste, the number of emissions, biodiversity, and other information. Thus, financial expertise is the irrelevant company that needs to look for other nonfinancial expertise.

According to Table 5, the number of meetings of the audit committee has a significance value of -0.0181<0.05. This indicates that the number of audit committee meetings significantly negatively affects CSR disclosures. This is in line with the research of Dwekat & Carmona (2020). The number of audit committee meetings has been determined through POJK number 55 of 2015, at least once in 3 months. The issues discussed at the audit committee meeting included financial and nonfinancial issues. However, the audit committee was only involved in decision-making and was not directly involved in CSR practices, so the meeting did not encourage CSR disclosure. In addition, the large number of meetings does not reflect the accomplishment of work, so it is necessary to look at the effectiveness of such meetings (Menon & Williams, 1994; Othman et al., 2014).

The disclosure of CSR has become an essential issue for companies worldwide. This is indicated by the increased number of companies making CSR disclosures over the past 30 years. Companies in Indonesia also do this. The greater the company's attention to social and environmental issues, the greater the interest of investors and consumers. Research on the characteristics of the audit committee on CSR disclosures has been conducted, but the variation of characteristics that affect CSR disclosure has not been concluded. This study provides evidence about the effect of audit committee characteristics on CSR disclosure as part of managing corporate sustainability issues.

The theoretical and practical implications of this research are as follows. This research supports the theory of legitimacy, where the audit committee must be able to supervise whether the company has complied with applicable regulations related to social and environmental activities and be transparent in disclosure. This is done, so the company gets a license to operate in the community. In addition, companies must also pay attention to the characteristics of the audit committee to be effective in supporting CSR disclosures. In addition, this research is expected to provide an overview of CSR disclosure in Indonesia and aspects that must be improved, thus considering the government to set standards for CSR disclosure.

## 5. Conclusion, Implication, and Limitations

Based on the analysis results, CSR disclosure is still low, while the company focuses on environmental information rather than economic and social information. For hypothesis testing, the audit committee size significantly positively affects CSR disclosure. In contrast, financial expertise and the number of meetings significantly negatively affect CSR disclosure. The larger the number of members of the audit committee, the more expertise each member has and the greater the ability to solve problems, including encouraging the CSR disclosure in encouraging corporate sustainability.

There are several limitations in this research. This research is only conducted on manufacturing companies because the company belongs to the industry sensitive to social and environmental, so the disclosures made are expected to be broader. In addition, the characteristics of the audit committee used in this study are the size, financial expertise, and the number of meetings. Further research is expected to expand the scope of the industry and the characteristics of the audit committee being reviewed, such as the audit committee's independence and the audit committee member's age. And also the measurement of disclosure variables can be increased again to the quality of CSR disclosure.

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