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Corporate Governance and the Impact on Sustainability Report Disclosures

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Abstract

The realisation that financial performance alone is not sufficient to preserve and support a company's long-term development has made its non-financial performance an extraordinary concern for stakeholders. At long last, companies are starting to rely on the Triple Bottom Line (TBL) concept which focuses on profit, people, and planet (3Ps). According to sustainable business strategies, companies and organisations with promising ESG metrics tend to create superior financial returns, thus increasingly investors are focusing more on ESG metrics when making decisions about their investments. For this reason, a study is conducted to examine the impact of Good Corporate Governance on sustainability report disclosures, through analysing size of the Board of Commissioners (BoC), president of BoC's education level, size of the Audit Committee (AC), and financial expertise of AC members. This study found that president of BoC's education level positively impacts sustainability report disclosures, while financial expertise of AC members has a negative effect on sustainability report disclosures. The size of the BoC and size of the AC do not affect sustainability report disclosures.

Keywords: Good Corporate Governance, Sustainability Report, Board of Commissioners, Audit Committee, Agency Theory

1. Introduction

It is increasingly recognised that profit is no longer the only focus of companies nowadays. Corporate executives are increasingly recognising that a sustainable business strategy has the ability to not only address difficult challenges, but also lead to corporate success. Companies and organisations must play a part in contributing to the welfare of society (people) and environmental (planet) sustainability, thus they start to rely on the Triple Bottom Line (TBL) concept which focuses on the profit, people, and planet (Miller, 2020). This concept is regularly utilised by companies internally, whilst environmental, social, and governance (ESG) metrics are third party measurements of the procedure which makes companies have a public responsibility to focus on financial profits, as well as sustainable practices (Miller, 2020). Information regarding company's activities related to the TBL and ESG metrics is presented separately from the financial report, which usually can be seen in the company's sustainability report. In this era of sustainable development, companies are required to increase their awareness in managing and running companies, especially in dealing with environmental and social problems.

Companies demonstrate their efforts in maintaining environmental and social responsibilities through their sustainability reports. Furthermore, following the COVID-19 pandemic, consumers' perspectives on sustainability have shifted. They are beginning to search for sustainable brands and retailers to assist them in shopping sustainably. Consumers who are purpose-driven prioritise brands that align with their values and lifestyle. Currently, they are the biggest group of consumers in all product categories, making them highly attractive for retailers and companies to collaborate with (Haller *et al.*, 2022). The public can observe these sustainability values through companies' sustainability reports.

A sustainability report provides details on the economic, environmental, and social effects of a company's activities or operations. This report serves as a crucial tool for showcasing transparency and efficient governance, specifically targeting stakeholders (Sethi, Martell, and Demir, 2017). Growing attention from numerous stakeholder groups on how businesses handle sustainability matters is putting additional pressure on companies to implement sustainability reporting practices (El-Bassiouny and El-Bassiouny, 2019; Khan, Yu, and Umar, 2021).

Through research conducted by Erin, Adegboye, and Bamigboye (2022), it is known that board governance and audit committee attributes were significantly related to the quality of sustainability reporting in Nigeria. Buallay and Al-Ajmi (2020) also stated that the audit committee's financial background had a negative effect on the sustainability report, and the independence and frequency of audit committee meetings had a positive influence on the banks' sustainability reports in the Gulf Cooperation Council. On the other hand, Kumar *et al.* (2022) found no considerable influence of board size on sustainability reporting practices in India.

Indonesia currently has millions of companies operating in various segments and areas. As of January 2024, there are 910 companies whose shares are listed on the Indonesia Stock Exchange (Nurahmad, 2023). The total number of companies listed has increased by 10.3% from 2022, when there were 825 companies. This proves that the industrial climate in Indonesia proceeds to grow from year to year. Currently, the Indonesia Stock Exchange has 44 stock indexes, with one being the IDX30 index. This index is made up of 30 company shares that have been selected based on their high liquidity, large market capitalisation, and strong fundamentals (Indonesia Stock Exchange, 2021). Therefore, companies included within the IDX30 index will be studied.
Disclosures in sustainability reports are influenced by several factors, one of which is Good Corporate Governance (GCG). According to Bank Indonesia Regulation Number 8/4/PBI/2006, GCG is governance that implements the principles of transparency, accountability, responsibility, independence, and fairness. Companies need to improve and strengthen the implementation of GCG to reduce agency problems that may arise within the company (Schäuble, 2019). The success and maintainability of GCG implementation in a company is the functioning of the company's primary organs, that are the General Meeting of Shareholders (GMS), the Board of Commissioners (BoC), and the Board of Directors (*UU RI No. 40 Tahun 2007*, 2007). Additionally, the effective functioning of the company's supporting organs will also improve the

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implementation of the company's GCG. One of the company's supporting organs intended to assist the Board of Commissioners (BoC) in supervising the company is Audit Committee (AC), where this committee is formed by and is responsible to BoC in helping to carry out the board's duties and functions (Badan Pengawas Pasar Modal dan Lembaga Keuangan, 2012). Therefore, the effect of Board of Commissioners (BoC) and Audit Committee (AC)'s characteristics on sustainability reports will be studied further in this research.

2. Theory & Hypotheses Development

Agency theory is a theory which provides an understanding of the concept of corporate governance. This theory was then expanded by the company's responsibility towards stakeholders beyond shareholders. The increase in global awareness of the destruction of our planet and social order was welcomed by the United Nations, eventually giving rise to the rules of Corporate Social Responsibility (CSR), Environmental Management Accounting (EMA), and sustainability reports (Hoesada, 2020). This agency theory arises when company activities are not necessarily controlled directly by principals or business owner, and generally management affairs are taken over by agents or managers. This theory explains that the separation between business owners (principals) and management or business managers (agents) can cause agency problems to arise (Jensen and Meckling, 1976). Agency problems may arise from disparities in information ownership between business owners and managers, as well as the potential for managers to act in ways that do not align with the desires of the business owner, and other related issues. Implementing Good Corporate Governance (GCG) is one way to ensure that agents act as desired by the principals. The main and supporting organs of the company play a significant role in the successful and efficient execution of governance, which is crucial. The importance of the Board of Commissioners (BoC) and the Audit Committee (AC) as company organs is significant in safeguarding the interests of the principals.

2.1 Board of Commissioners (BoC)

The Board of Commissioners (BoC) is an organ of the company which has the duty to carry out general and specific supervision in accordance with the articles of association and also provide input to the Board of Directors (*UU RI No. 40 Tahun 2007*, 2007). The BoC has a vital function for the company and a great power to manage all the resources of the company (Sukandar and Rahardja, 2014). Board size has been recognised as one of the most important elements of a company's board (Koufopoulos *et al.*, 2020). The president of BoC's education level is also an important factor that needs to be considered. A company's top executive position may require a specific business degree or a master's degree (Milano, 2022).

2.2 Audit Committee (AC)

The Audit Committee (AC) is a committee formed by and responsible to the BoC, which plays a role in assisting the implementation of the duties and functions of the BoC (Otoritas Jasa Keuangan, 2015). According to Peraturan Otoritas Jasa Keuangan Nomor 55/POJK.04/2015 concerning the establishment and implementation guidelines for the Audit Committee, the AC must consist of at least 3 members from Independent Commissioners and parties from outside the public company. On the other hand, financial expertise of AC members also has a significant effect on the quality of sustainability reports (Buallay and Al-Ajmi, 2020).

2.3 Sustainability Report (SR)

Sustainability report is a report published by company that presents data regarding the economic, environmental, and social impacts which arise as a result of their activities. This report is an important form of communication tool to demonstrate transparency and effective governance, specifically aimed at stakeholders (Sethi, Martell, and Demir, 2017). In a study conducted by Erin, Adegboye, and Bamigboye (2022), it was found that board governance and audit committee attributes were significantly related to the quality of sustainability reporting. Disclosures in sustainability reports are influenced by several factors, one of which is Good Corporate Governance (GCG). Good Corporate Governance certainly plays an important role in the sustainability of the company. With the implementation of GCG, stakeholders' trust in the company's sustainability performance will increase. How each company implements GCG is generally presented in its sustainability report.

2.4 Hypotheses

Board size is considered as one of the internal procedures to reduce agency problems (Jensen and Meckling, 1976). Thus, the size of BoC is one of the most important components in the implementation of GCG in order to achieve optimal corporate sustainability performance. In a research conducted by Shamil *et al.* (2014), it was found that a board size that was too large was ineffective. Therefore, a smaller board size was more efficient. Meanwhile, according to Hamidah and Sastra (2020), board size did not have a significant influence on companies' sustainability reports. Based on these inconsistent findings, we argue that the smaller the size of the BoC, the better and more efficient the board will work. Hence, the hypothesis is formulated as follows:

H1: Size of the BoC has a negative effect on the company's sustainability report.

The educational background of company leaders had a positive effect on environmental protection behaviour carried out by the company (Wang, Gou, and Li, 2022). However, this finding was not in line with the study conducted by Tjahjadi, Soewarno, and Mustikaningtiyas (2021). In this study, it was known that the educational background of the President of BoC had a negative effect on economic and environmental sustainability performance. The results in previous studies that have not been consistent lead the authors to argue that the higher the President of BoC's education level will enhance the quality of the company's sustainability report. Thus, the hypothesis is formulated as follows:

H2: President of BoC's education level has a positive effect on the company's sustainability report.

The structure of the Audit Committee consists of at least three members from Independent Commissioners and parties from outside the issuer or company (Badan Pengawas Pasar Modal dan Lembaga Keuangan, 2012). According to Lendengtariang and Bimo (2022), the number of AC members had a negative effect on corporate sustainability disclosure. However, in research

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conducted by Sultana and Mitchell Van der Zahn (2015), it was found that as the size of the AC increased, the more diverse the experience of AC members so they could generate a better sustainability report. These various and inconsistent research results lead the authors to argue that the smaller the size of the AC, the better the quality of the company's sustainability report because the AC can work more effectively and efficiently. Therefore, the hypothesis is formulated as follows:

H3: Size of the AC has a negative effect on the company's sustainability report.
Based on agency theory, AC members who have financial expertise can improve the AC's ability to review and evaluate the auditor's assessment. There was a positive relationship between the financial expertise of AC members and the quality of corporate reporting (Mangena and Tauringana, 2007). On the other hand, Buallay and Al-Ajmi (2020) found a significant negative relationship between the financial expertise of AC members and the company's sustainability report. Based on the inconsistent research results, the authors argue that the financial expertise of AC members negatively affects the company's sustainability report because the financial expertise of AC members tends to be more relevant to financial-related issues than to the issue of sustainability reports (Li, Mangena, and Pike, 2012). For that reason, the hypothesis is formulated as follows:

H4: Financial expertise of AC members has a negative effect on the company's sustainability report.

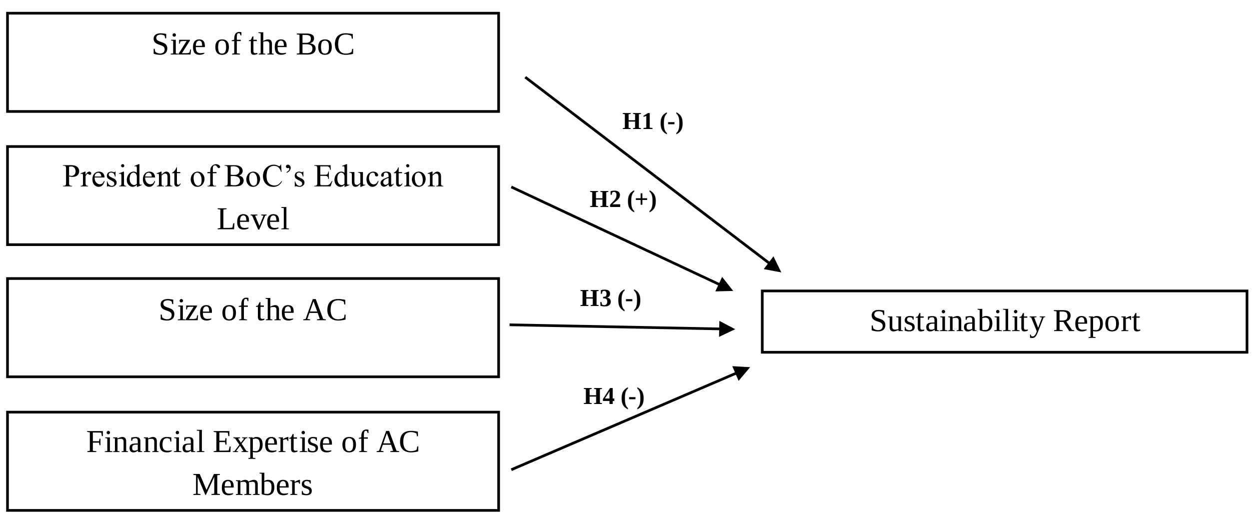

Figure 1. Research Framework

3. Method

This study is a quantitative research which aims to describe and analyse the relationship between GCG and sustainability report. The data used in this study are obtained from the sustainability reports and annual reports of IDX30 companies listed on the Indonesia Stock Exchange (IDX). These reports are obtained through the official websites of each company.

3.1 Population, Sample, and Sampling Method

The population of this study are all companies that listed on Indonesia Stock Exchange (IDX) since 2019. Purposive sampling, which involves selecting samples based on specific criteria, is the sampling method utilised in this study. The criteria for determining the samples in this study are companies in the IDX30 index listed on the IDX since 2019 and companies in the IDX30 index that publish sustainability reports and annual reports in 2019, 2020, and 2021.

3.2 The Study Variables

3.2.1 Independent Variables

The size of the BoC is the total number of all members of the BoC in a company. Size of the BoC is measured using the following formula, adopted from the study of Chams and García-Blandón (2019).

$$Size\ of\ the\ BoC = \sum number\ of\ all\ members\ of\ the\ BoC\ in\ the\ company$$

President of BoC’s education level is the highest level of education that has been completed by the President of BoC of the company. It can be measured using a scale range of 1 to 5, which was adopted from Wang, Gou, and Li's (2022) research. The education level is divided into the following levels: 1 = senior high school or below, 2 = junior college or associate’s degree, 3 = bachelor’s degree, 4 = master’s degree, and 5 = doctoral degree or above.

$$President\ of\ BoC's\ Education\ Level = 1\ /\ 2\ /\ 3\ /\ 4\ /\ 5$$

Size of the AC is the total number of AC members in a company. Size of the AC is measured using the following formula, adopted from the study of Chams and García-Blandón (2019).

$$Size\ of\ the\ AC = \sum number\ of\ all\ members\ of\ the\ AC\ in\ the\ company$$

Financial expertise of AC members is the proportion of AC members of a company with financial expertise background. AC members who have work experiences as an AC member for more than 5 years is assumed to have financial expertise (Buallay and Al-Ajmi, 2020). Each member of the AC who has financial expertise is given a score of 1, and 0 if they do not have such expertise. Financial expertise of AC members can be measured using the following formula, which was adopted from the study of Lendengtariang and Bimo (2022).

$$Financial\ Expertise\ of\ AC\ Members = \frac{\sum AC\ members\ with\ financial\ expertise}{\sum Number\ of\ all\ members\ of\ the\ AC}$$

3.2.2 Dependent Variable

Sustainability report disclosures are based on GRI Standards indicators with a total of 94 disclosure items, consisting of 17 economic indicator items, 37 environmental indicator items, and 40 social indicator items. For every item disclosed in the sustainability report, this metric gives a score of 1, and a score of 0 to items that are not disclosed. Sustainability report disclosures can be measured using the following formula, which was adopted from the study of Haniffa and Cooke (2005).

$$Sustainability\ Report\ Disclosures = \frac{\sum Items\ disclosed\ in\ the\ sustainability\ report}{\sum Disclosure\ items\ in\ GRI\ Standards\ (94)}$$

3.3 Research Model

This study uses multiple linear regression analysis to measure the impact of corporate governance on sustainability report disclosures. The research model is formulated as follows:

$$SRInd_{it} = \alpha + \beta_1 SB_{it} + \beta_2 PE_{it} + \beta_3 SA_{it} + \beta_4 FE_{it} + \varepsilon$$

where,

$SRInd_{it}$ = Sustainability report disclosures of company *i* in period *t*
$\beta_1 SB_{it}$ = Size of the BoC of company *i* in period *t*
$\beta_2 PE_{it}$ = President of BoC's education level of company *i* in period *t*
$\beta_3 SA_{it}$ = Size of the AC of company *i* in period *t*
$\beta_4 FE_{it}$ = Financial expertise of AC members of company *i* in period *t*
ε = Error term

Multiple tests are conducted in order to prevent issues related to heteroscedasticity, multicollinearity, autocorrelation, and normality. Errors are rectified and the data values are considered to be accurate and reliable. Breusch-Pagan test shows that there is no heteroscedasticity problem in the model. Every independent variable has a VIF value less than 10, signifying no issue of multicollinearity in the model being studied. The Durbin-Watson test is employed to examine the issue of autocorrelation in the research model. The model's Durbin-Watson value falls within the 1.5-2.5 range, measuring at 1.824. This shows that there is no autocorrelation present in the research model. The study data are found to be normally distributed according to the result of the Kolmogorov-Smirnov test.

4. Results & Discussions

Table 1 presents the research's descriptive statistics. The table displays the minimum, maximum, mean, and standard deviation values for both the independent and dependent variables in this study.

Table 1. Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std Deviation
Independent Variables				
Size of the BoC	2.000	10.000	6.107	2.246
President of BoC's Education Level	1.000	5.000	3.518	1.062
Size of the AC	2.000	8.000	3.804	1.420
Financial Expertise of AC Members	0.250	1.000	0.769	0.196
Dependent Variable				
Sustainability Report Disclosures	0.000	0.640	0.312	0.132

Table 2 displays the outcomes of the multiple linear regression. The *p*-value of the *F*-test is below 0.050. This implies that sustainability report disclosures, as the dependent variable, is influenced by all independent variables simultaneously. As shown in Table 2, the adjusted R^2 value is 0.330 (33%). This indicates that the independent variables in this research can impact the dependent variable by 33%. While the remaining 67% is accounted for by factors other than the independent variables in this study.

Table 2. Results of the Multiple Linear Regression

Variables	Coefficient	Sig.
Independent Variables		
Size of the BoC	-0.004	0.667
President of BoC's Education Level	0.038	0.012
Size of the AC	0.000	0.989
Financial Expertise of AC Members	-0.344	0.000
R^2	0.379	
Adj. R^2	0.330	
F-statistic	7.775	
p-value	0.000	

We discover that the size of the BoC does not have a significant impact on sustainability report disclosures (Sig>0.050). This goes against previous assumption that the BoC's size would be negatively correlated with the sustainability report disclosures. Nonetheless, the outcome of this study aligns with the findings of research done by Hamidah and Sastra (2020) and Ganesan *et al.* (2017). They discovered that sustainability disclosure was not influenced by board size. This finding indicates that the size of the BoC, whether big or small, does not impact company's sustainability report disclosures. This could be due to the fact that the BoC does not currently place importance on sustainability issue, leading to consistent sustainability report disclosures regardless of the size of the BoC. Therefore, **H1 is not accepted**. The results of this study suggest that there is a significant and positive association between president of BoC's education level and sustainability report disclosures (Sig<0.050; Coefficient: 0.038). This finding is consistent with a research done by Wang, Gou, and Li (2022) who identified a positive significant correlation between CEO education and corporate environmental protection investment. This outcome suggests that the greater the educational attainment of president of BoC, the greater the level of sustainability reporting performed by the company. This may be attributed to the fact that the president of BoC, who is highly educated, is connected to increased environmental awareness, leading to enhanced sustainability in corporate practices (Amore *et al.*, 2019). A more educated president of BoC will bring enhanced capabilities, skills, and strategic thinking to supervise the company, ultimately leading to improved sustainability report disclosures. Thus, **H2 is supported**. We find that the size of the AC does not significantly impact sustainability report disclosures (Sig>0.050). This contradicts the previous assumption that the size of the AC would have a negative relationship with sustainability report disclosures. However, the result of this study is consistent with the conclusions of a study conducted by Mangena and Pike (2005). They disclosed that they did not discover any notable correlation between the size of the Audit Committee and the level of disclosure in interim reports. This discovery suggests that the sustainability report disclosures of a company are not affected by the size of the AC, regardless of whether it is large or small. The lack of emphasis on sustainability in audit objectives by AC may be the reason why the size of the AC does not affect a company's sustainability disclosures. Hence, **H3 is unsupported**. The research findings also show that financial expertise of AC members has a significant and negative impact on sustainability report disclosures (Sig<0.050; Coefficient: -0.344). This result aligns with a research conducted by Buallay and Al-Ajmi (2020) which found a significant negative relationship between financial expertise of AC members and sustainability disclosure. This result implies that companies with fewer financial experts in the AC tend to have higher levels of sustainability reporting. This is likely due to the fact that the financial expertise of AC members is typically more applicable to financial matters rather than sustainability reporting (Li, Mangena, and Pike, 2012). For that reason, having fewer financial experts on the AC can enhance the quality of sustainability report disclosures as they will be more attuned to sustainability issues. Therefore, **H4 is accepted**.

5. Conclusion and Recommendation

This research examines how corporate governance, represented by board of commissioners (BoC) and audit committee (AC), affects companies' sustainability report disclosures. Samples for the study are taken from companies in the IDX30 index that have been listed on the IDX since 2019 and have released sustainability reports as well as annual reports for the years 2019, 2020, and 2021.

The results indicate that president of BoC's education level positively influences sustainability report disclosures, whereas financial expertise of AC members has a negative impact on sustainability report disclosures. Nonetheless, size of the BoC and size of the AC do not impact sustainability report disclosures significantly.

There are numerous opportunities available for future research. Future research is anticipated to have a longer duration in order to align the results more closely with potential future changes. Additionally, a wider range of companies from different industries is suggested to be analysed to gain a deeper understanding of the extent to which Indonesian companies are contributing to sustainability. Furthermore, exploring additional variables could lead to a more comprehensive outcomes.

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