Regulation to Enhance Accountable Corporate Social Responsibility Reporting

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Abstract

The purpose of the essay is to a. discuss the role of regulator in promoting Corporate Social Responsibility (CSR) and b. identify and evaluate the infrastructures necessary for accountantable CSR reporting using the case of Indonesia. The essay suggests that regulator can promote CSR by creating condusive infrastructures for CSR. For CSR reporting these include a. the existence of globally accepted reporting standard/guidance on CSR reporting, b. the existence of globally assurance standard for CSR reports, c. the practice of good corporate governance, d. supportive regulatoin on CSR, and e. Public pressure on CSR. These infrastructures are applied to the condition in Indonesia.

Keywords: Corporate Social Responsibility, Social Accounting, Social Reporting, Indonesia, Regulation

General Topic: Social and environmental issues – Corporate Social Responsibility

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Regulation to Enhance the Quality of Corporate Social Responsibility Reporting

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I. Background

The topic related to Corporate Social Responsibility (CSR) recently has been widely covered in the World. More intense discussion on CSR issues is a logical consequence of the Good Corporate Governance (GCG) principles that among others state the need of a company to concern with the interest of its stakeholders according to the prevailing rules, and to actively cooperate with stakeholders for the company sustainability (OECD, 2004).

Many companies nowadays publish their CSR activities in annual reports or in special CSR reports. These reports reflect the need for corporate accountability in implementing CSR in order to enable its stakeholders to evaluate the implementation thereof. With transparency and accountability, it is hoped that companies voluntarily implement CSR. However, Haigh and Jones (2006) stipulate that most reports are only public relation tools and are not a form of accountability of the companies to the public. Information reported and disclosed varies and thus is difficult to evaluate. Furthermore, Cooper and Owen (2007) state that to fulfill accountability, a report should be supported by infrastructure that encourages a company to implement and report CSR objectively.

Based on abovementioned explanation, the purpose of this paper is to a. discuss the role of regulator in promoting CSR and b. develop a framework that identifies that can be utilized by regulator to enhance accountable CSR reporting. As illustration, the framework then is employed to evaluate whether the determinants are conducive to achieve accountable CSR reporting, especially in Indonesia. Then, the essay recommends efforts by regulator to achieve accountable CSR reporting in Indonesia. Indonesia is chosen since in recent years there have been serious environmental damages in the country, such as deforestation, air and water pollution, and climate change. This phenomenon cause the government of Indonesia to realize that natural resources are limited and therefore economic development should assure sustainability. Accordingly, last year the government issued a new company law (Law No. 40/2007 regarding Limited Liability Company) that obliges a company with business related to natural resources to implement social and environmental responsibility. The law also stipulates that all corporations should report CSR implementation in the annual report.

The following section discusses the rationale for implementing CSR and the role of government in CSR implementation. Afterward, section III explains the need for accountable CSR reporting and section IV discussess a framework of infrastructures condusive for accountable CSR reporting. Section V evaluates CSR reporting in Indonesia using the framework while the last section provides conclusion and recommendation.

II. Rationale for CSR and the Role of Government[1]

A company in doing its business has impact on its external environment whether negative or positive. A company does not have any incentive to reduce its negative external impact, because the company has to bear the cost to reduce the impact (e.g. installing dirty air screening device to reduce pollution) while the benefit (e.g., clean air for the people surrounding the factory) is received by other parties other than the company. The role of government is to introduce regulation that obliges firms to reduce the negative externalities or impose tax on firms with the revenue utilized to reduce the negative impact.

[1] Literatures discussing this topic widely vary; therefore, this paper limits the discussion only on literature in economics field and related to stakeholder theory.

In such condition, government plays its role and as long as the companies comply with government regulation, such negative externalities can be reduced. Based on this argument, Friedman (1970) argues that company shall focus only on making profit and comply to the prevailing regulation while it is government responsibility to produce public service/goods, including issuing regulation to reduce/eliminate any negative externalities. Therefore, Friedman basically states that a company does not need to implement CSR.

The basic assumption of the abovementioned condition is that the government in performing its duties is solely for the sake of public interest (according to the public interest theory); however, various empirical studies find that government officials take action not only for public interest, but also for personal or group interest (according to the interest group theory). The existence of this personal or group interest may result in the failure of government role to provide public service, including in reducing negative externalities of company'activities[2]. In this matter, CSR plays its role to substitute government failure in performing its duties (Besley and Ghatak, 2007). Without being required by the government, a company implementing CSR strives to reduce its negative externalities and increase its positive externalities.

The term CSR is relatively new and there are various definitions of CSR (Robin, 2005). As stated by Robin, the definition of CSR used by European Union is:

*CSR is a concept whereby companies integrate social and environmental concerns in their business operations and stakeholder relations on a voluntary basis; it is about managing companies in a socially responsible manner (*Holand, 2003*).*

Another definition of CSR as follow:

The obligation of the firm to use its resources in ways to benefit society, through commited participation as a member of society, taking into account the society at large, and improving welfare of society at large independently of direct gains of the company (Kok et al, 2001, p. 287).

[2] See Stigler (1971) and Peltzman (1976) to discuss further on regulation theory..

The two definitions suggest that the implementation of CSR is integrated with the company's business, concerns with stakeholders' interest with the expectation of providing benefit for welfare of the society.

What is the motive for a company to implement CSR? Various company's CSR activities usually affect expenditures that reduce the company's profit. Since its purpose is to maximize shareholders wealth, i.e., profit maximization, CSR activities appear to be inconsistent with the purpose. As a result, the company is not motivated to implement CSR. There are two explanations that rationalize why a company has incentive to implement CSR. First, according to the Stakeholder Theory[3], a company existence is not only to maximize owner/shareholder wealth, but also to serve the company's stakeholders interest. Manager in making decision will consider its impact to its stakeholders and strive to maximize benefit and minimize loss on stakeholders in order to achieve balance of interest among various parties (Marcoux, 2000; Freeman and Phillip, 2002). Based on this view, a company will not pollute air for the sake of profit because the company will also consider the interest of people living in the area. The implication of the stakeholder theory is that a company will voluntarily implement CSR since it is part of its roles to its stakeholders.

The theory if applied indeed implies that a company voluntarily practices CSR; however, in practice it is not easy to apply the theory because a company often has to make decision that benefits one party but detriments other party (e.g., decision to achieve cost efficiency by reducing the number of employees) (Marcoux, 2003; Roberts and Mahoney, 2004). Moreover, if one company implements CSR consistent with the stakeholder theory while most other companies do not implement it, then CSR expenditures will make the company profit to be lower than other

[3] Robins (2005) states that this theory relates to Freeman (1984) view regarding corporate responsibility.

companies and this will reduce the company's competitiveness. Therefore, implementation of this theory will be effective only if most companies employ the stakeholder approach.

The second explanation is based on economics theory. The literature generally treats CSR activities as producing public goods/services. In the beginning, several literatures (i.e.Friedman, 1970; Baumol, 1991) suggest that companies should remain focus on making profit and government shall be responsible for producing public goods and resolving externalities problem. However, later on some economic studies demonstrate that a company action to generate profit and to implement CSR at the same time may not be contradictory (See Tsukamoto, 2007; Besley and Ghatak, 2007; Bagnoli and Watts, 2003; Kotchen, 2006; Baron, 2001).

Tsukamoto (2007) revises Friedman theory by showing that the existence of ethical capital enables moral behavior (e.g. conducting CSR activities) reflected in the market, which eventually will encourage companies to implement CSR. Consistent with Tsukamoto, Besley and Ghatak (2007) develop a model proving that CSR implementation is a response toward the preference of some customers who prefer a company to also produce public goods/services[4]. Thus, decision to implement CSR is in accordance with profit maximization strategy. Tsukamoto, Besley and Ghatak ideas are consistent with some business practitioners such as PricewaterhouseCoopers (2001) that suggests companies to create social and environment value in order to create optimal economic value in the long-term. In line with Besley and Ghatak (2007), Baron (2007) proves that manager will implement CSR if its compensation contract includes social performance. The preference to implement this social activity is not only from consumers' demand but also from investors, as reflected in higher stock price for companies implementing CSR.

For example a survey by MORI (http://www.mori.com/polls/2003/mori-csr.shtml) find that 70% consumer will pay higher price for product they thought ethically more superior. Sample of product that is ethically more superior is perfume that does not use *animal testing* in its production process..

The conclusion from the abovementioned description is that a company is motivated to practice CSR if the company's stakeholders (consumer, investor, and other stakeholders) provide *reward* (e.g., higher product and/or share price) for practicing CSR. Therefore CSR implementation is not contradictory with the objective of maximizing profit.

Robin (2005) also emphasizes that obtaining profit remains the primary objective of a company since without profit there will not be any resources for CSR activities. Robin and Hess (2001) further state that to encourage CSR it is better by moral suasion and market pressure rather than imposing regulation:

To raise business-relevant environmental standards for all through legislation is one thing and is acceptable, but any attempt to impose burdens which are not business-relevant, through regulation, is very risky indeed. Such action would be far more than just contentious; it would invite wholly negative social outcomes, including corruption and economic inefficiency (Robins, 2005, p. 112).

From the above discussion, the conclusion is that CSR may substitute the role of government in performing its public duty and thus should be encouraged. However, too much regulation on CSR may hamper business competitiveness. Therefore, government should create infrastructures that are condusive for CSR.

IV. CSR Reporting and Accountability

Stakeholder theory and cconomics theories regarding CSR imply that stakeholders need to evaluate how far a company has performed its roles in accordance with the stakeholders' need.[5] Consumers, for example, need to know whether the product sold by the company does not use woods from illegal logging or whether it uses production technology that causes pollution. Just

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[5] See Freeman and Philips (2002) and Marcoux (2000) for discussion on the relation between the stakeholder theory and CSR and Besley and Ghatak (2007), Tsukamoto (2007) and Kotchen (2006) for the discussion on CSR from the economics theory standpoint.

like the profitability of a company which varies according to the effectiveness of the management, the success of CSR activities also depends on the management. Therefore, the stakeholders require a company's accountability on CSR activities. The presence of accountability is becoming increasingly important as there is the presence of assymetric information between stakeholders and the management. The stakeholders only has access to public information or the information conveyed to public, while the management has complete information about the company.

The presence of assymetric information causes adverse selection or moral hazard which eventually results in a company not to perform CSR activities. If there is no objective report about a company's CSR activities, stakeholders will not be able to distinguish which company performs CSR and which company doesn't. As a result, it impossible for the stakeholders to give rewards or punishments for companies which perform or do not perform CSR. Without the reward-punishment mechanism, companies will not be motivated to perform CSR (adverse selection takes place). The presence of assymetric information also causes stakeholders not to be able to observe companies' efforts in performing CSR. As a consequence, companies will perform actions which will increase their profit while causing loss to the stakeholders (such as producing low quality foods). This phenomenon is called moral hazard.

Accountability can be met and assymetric information can be reduced if companies report their CSR activities to the stakeholders. Based on the report, the stakeholders may evaluate the perfomance of CSR, and therefore, they can provide rewards or punishment accordingly. Thus, as Cooper and Owen (2007) report, accountability does not only cover the power of the stakeholders to demand accountability from the company's management but it also covers the stakeholders' capability to give rewards/ punishment consistent with the management performance.

Since companies naturally tend to biasedly report their CSR activities only on positive aspects, the role of regulator is to establish infrastructures that support for accountable CSR reporting. The following section explains such infrastructures.

IV. Framework for Supporting Infrastructures for Accountable CSR Reporting

The following diagram identifies infrastructures for accountable CSR reporting.

[Insert Diagram of **Supporting Infrastructure for Accountable CSR Reporting** about here]

CSR report has to objectively describe CSR activities so that the stakeholders can reliabily use it to evaluate the company's CSR performance. To ensure the relevance and reliability of the CSR report, companies need to have a reporting standard which can be used as a guideline in making a CSR report. The absence of standard and guidance makes it difficult for stakeholders to evaluate the reports as companies may provide various types of reports. The quality of the report is also questionable as companies may make reports as their wish with the use of very limited resources. In order that the CSR report can be useful, the reporting standard has to include reporting and disclosure of the CSR activities as well as expenses and benefits obtained from the activities. Ramanathan (1976) and Global Reporting Initiative (2006) suggest that CSR reporting should not simply be qualitative report but it should also quantify the overall social and environmental effects of the company's activities. This statement suggests that the company's accounting system should not only record company's income and expenses but it should also estimate the social benefit and social cost of the various company's activities including those related to CSR.

The presence of a CSR reporting standard, however, does not guarantee the improvement in the quality of CSR reporting. Since a company wants to create a good self-image, it tends to report only positive aspects about the company's activities. As a result the report may not show the real picture, and thus it has losts its value as a report.

There are two mechanisms to ensure that the CSR report describes the real condition of a company. The first mechanism is the governance practice of the company, and the other is the presence of assurance service performed by an independent external party.

The governance of a company determines the direction of the company's policy, including CSR activities and their reporting. The implementation of CSR is closely related to the practice of Good Corporate Governance (GCG), as stated in the third principle of GCG of the OECD (2004). The third principle states that companies need to pay attention to the needs of stakeholders in line with the rules, and encourage cooperation between the companies and the stakeholders for the development of the companies. In line with the stakeholder theory, the principle also acknowledges that while the company does what it has to do for the benefit of the company it also has to take into consideration the need of its stakeholders for it has significant contribution for the long-term success of the company. In addition, the fourth GCG principle of the OECD requires transparent and adequate disclosure, suggesting that the CSR report be submitted to parties requiring it.

The presence of an independent external assurance service on CSR report may convince stakeholders that the report is made according to the reporting standard. As the report is audited by an independent external party, the report should state the reality (both positive and negative) of the company's CSR activities. To conduct the audit well, an auditor needs a CSR auditing standard. The standard is nothing like the auditing standard of financial report since CSR report covers wider aspects and the report is more qualitative than the financial report.

Although regulations on CSR reporting is important to encourage companies to prepare CSR report, up to now, even in developed countries there are still arguments on whether companies should be obliged to publish their CSR report (Tschopp, 2005). Theoretically, without making it obligatory, companies will publish reports to their stakeholders, otherwise they will punish them. For example, unless a company publishes its CSR report, investors will be unwilling to buy the shares of stocks of the company. This action may lead to the decreasing prices of the company's shares which in turn will cause loss to the company. Because of the direct impact to the company performance, the company will have incentive to produce the CSR report.

Yet, the voluntary CSR reporting may not happen because of its characteristic of public goods. Further, another justification for making companies obliged to make CSR report is that other stakeholders (such as consumers, employees, the society) do not have the power to make it obligatory for companies to make CSR report [6].

The above discussion emphasizes the importance of the role of the public in encouraging and forcing companies to conduct CSR and reporting it. In line with Besley and Ghatak (2007), if the society punish companies which do not conduct CSR so that the companies' profit decreases the company will be motivated to perform CSR. Haigh and Jones (2006) said that in facing competition, a company will conduct CSR strategy if it believes that not performing CSR may harm the company's market position. Empowerment of civil society also encourages company's accountability among stakeholders. Further, Cooper and Owen (2007) explain that the society can use force to indirectly give reward/punishment to companies performing or not performing CSR and this, in turn may substitute ineffective governance mechanism, which in the long run may create the accountability of companies' CSR.

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[6] See Adams (2004) who conducted a case study on CSR writing and suggested that a comprehensive CSR reporting is obligatory.

V. Evaluation on CSR Reporting in Indonesia

The Level of CSR Reporting and Disclosure in Indonesia

The following part discusses the level of CSR reporting and disclosure in Indonesia, followed by the discussion on the conditon of various supporting infrastructure mentioned earlier in Indonesia and in the world in general.

Various domestic and foreign studies suggest that the reporting and disclosure of CSR in Indonesia is relatively low. The following are findings of several studies.

Chapple and Moon (2005) compare reports of 50 biggest companies in seven Asian countries, including Indonesia, on CSR through the website. Since the sample companies are big companies, they have large number of stakeholders so that the pressure for conducting CSR and issuing the reports is greater. The findings of the study suggest that only 24% of companies in Indonesia report their CSR activities which, in the study, are classified into 3 categories: community involvement, production process and labor relations which are socially accountable. The proportion of this is the lowest among other countries. Furthermore, among the companies reporting their CSR activities, the majority (73%) report low coverage (1-2 pages), 9% medium (3-10 pages), and 18% extensive (more than 10 pages).

Hartanti (2003)[7] examines the social disclosure of annual report of companies in Indonesia during the period of 1999-2001. The researcher employs content analysis, that is comparing social disclosure in the annual report with a list of social disclosure as a reference. The findings show that the average rate of disclosure is relatively low. The majority of the disclosure is on the product, labor, and followed by community involvement, environment and the last one is energy.

[7] Hartanti, D. 2003. Pengungkapan sosial dalam laporan tahunan perusahaan-perusahaan di Bursa Efek Jakarta tahun 1999 & 2001. *Working Paper*. Departemen Akuntansi Fakultas Ekonomi Universitas Indonesia.

Hartanti also find that almost 100% of information disclosed are positive information. This suggests that the disclosure of CSR is still considered as a means of public relations not as an accountability measure of the company towards its stakeholders.

In a further study Hartanti (2007)[8] utilizes a list which is based on *Global Reporting Initiative* (GRI) Guideline. The disclosures are classified into the disclosure of environments information and the disclosure of environments management system. The samples are 81 government-owned manufacturing companies and corporations which have received PROPER Award from the Ministry of Environment[9]. Hartanti (2007) find that average disclosure of environments information is relatively low, i.e. 8.3 on a maximum score of 30; similarly the disclosure of environment management system is 2.6 on a maximum score of 7.

The following part shows that the low CSR reporting in Indonesia may be due to the inadequate condition of supporting infrastructure for the CSR reporting in Indonesia.

Governance Structure and Mechanism

In Indonesia the Company Law No. 40 of 2007 requires that both Board of Commissioners and Board of Directors to put the company's interest first (article 92 paragraphs 1 and 108)[10]. Since the priority is on the company's interest, the two bodies should take into consideration not only the shareholders but also the stakeholders. Hence, the Law is actually in line with the stakeholder theory. The Law also implies that the position of three bodies of a

[8] Hartanti, D. 2007. Pengaruh kinerja lingkungan hidup dan manajemen lingkungan hidup terhadap kinerja keuangan perusahaan. *Working Paper*. Departemen Akuntansi Fakultas Ekonomi Universitas Indonesia.

[9] The Department of Environment regularly checks the rate of companies' compliance in applying environment-friendly prduction process. The result of the checking is awarded to the companies (in the form of the PROPER certificate) from the worst (black-rated) to the best (gold-rated). No single company has ever achieved the gold-rated PROPER certificate so far.

[10] The governance structure in Indonesia adopts dual boards: the Board of Commissioners, which performs as a supervisory/oversight body and the Board of Directors, which performs as an executive body.

company, (the Shareholders, the Board of Commissioners and the Board of Directors) is at the same level. Article 92 paragraph (2) states: ”The Board of Directors has authority to manage the company [for the interest of the company], according to the policy considered to be appropriate and shall be in accordance with the provision as regulated under in this Law and/or the articles of association.” The term ‘authority’ implies that the Board of Directors may make a decision which is against that of the Board of Commissioners if the Board of Directors has strong reason that the decision is for the interest of the company. Since the main interest is the company’s interest, and the three governing bodies are in the same position, the Board of Directors should voluntarily perform CSR and publish the CSR report.

Although the Board of Commissioners and the Board of Directors should put the company’s interest first, in practice, however, there is a governance mechanism which forces them to put the interest of the shareholders first. The Company Law entitles the shareholders, through the General Meeting of Shareholders, to determine members of the Board of Commissioners and Board of Directors (Articles 94 and 109). It is almost certain that the shareholders will select members who will put the interest of the shareholders first. In addition, the performance of both the Board of Commissioners and the Board of Directors until now is evaluated on their economic performance which is reflected in the company’s profit. The company’s profit disregards the social effect of the company’s business activities. In line with the emphasis of obtaining profit, the Law states that both the Board of Directors and the Board of Commissioners are fully and personally responsible for the company’s loss which is due to their negligence in performing their duties. These regulations force them to focus on making profit, which may lead to the company’s unwillingness to perform CSR.

Indeed, it is natural for the Board of Directors and the Board of Commissioners to put the interest of the shareholders first as it is the shareholders who establish the company by using their capital and that the shareholders are the residual claimant, the last to get the result after all the liabilities to other parties are paid. Thus, what is required is an additional instrument in the governance structure which encourages the creation of CSR activities and reporting. Public companies and companies using public funds (such as banks and companies issuing bonds) are obliged to use independent commissioner and audit committee. Although the duties of an independent commissioner is similar with the duties of other commissioners, they are expected to pay more attention to the interest of the stakeholders. According to the Bapepam Decree No. 29/PM/2004, an audit committee is assigned to examine financial information including financial reports, in addition to other duties. The audit committee does not examine the annual report or other company's report related to CSR. Currently, there is no rule or regulation making it obligatory for companies to have a CSR Committee, and not many companies in Indonesia have CSR Committees.

To encourage the management to perform CSR, its compensation should also be based on a measurement which reflects the company's environmental and social performance in addition to the level of profit obtained. Information about management compensation system is hardly disclosed in a public company's annual report[11], so it is difficult for stakeholders to learn how much a company's management compensation is based on CSR performance. Lack of transparancy in the management compensation system may hinder the creation of reward/punishment mechanism by stakeholers to the company.

[11] A study conducted by *Indonesian Institute for Corporate Directorship* (2007) on all companies listed at the Jakarta Stock Exchange find that almost 91% of them do not disclose the bases of their remuneration for their management.

The Standard/Guideline of CSR Reporting

Efforts to develop accounting for CSR, also known as social accounting, have been conducted for more than 30 years; however, the discussion has so far been on the theoretical ground, tend to not observing the CSR reporting practice by companies, and it has not yet yielded social accounting in the reporting of CSR which can be used as a guide (Gray, 2002) [12].

The development of CSR reporting is related to the increased public demand for more company's disclosure in the fields of other than financial disclosure (Wallman, 1999). Belkaoui (2004) states that a number of reports related to company's social activities, i.e. value added reporting, employee reporting, and human resources accounting. Value added reporting shows increased wealth yielded from productive use of company's resources before allocating it to shareholders, creditors, employees and the government (Belkaoui, 2004). However, value added reporting has not been put into practice by many companies. Employee Reporting, according to Belkaoui (2004) is a special report prepared for employees and labor union. This report reveals various statistical data about the characteristics and demography of employees, including various facilities provided by the companies for the employees. Next, human resources accounting which started to develop in the 1970s (e.g., Glautier and Underdown, 1973, Hekimian and Jones, 1967, Lev dan Schwartz, 1971 in Belkaoui, 2004) measures the value of human resources in the company. However, because there are problems in defining and measuring the value of the asset, the effort to consider human resources as asset does not develop further.

The above discussion brings to the conclusion that there have been efforts to produce reports which do not only focus on the company's financial aspect, however, the reports tend to be partial i.e., focuses on certain aspect and does not reflect the effect of a company's activities on the environment and on the society.

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[12] Gray (2002) provides a comprehensive review on the development of social accounting in the past 25 years.

Other problems in social accounting which may explain why social and environmental reporting has not significantly progressed for the past 30 years are the emphasis in accounting field that information provided to external parties has to be reliably measured in monetary term. Basically, the field of accounting is divided into two main fields, namely, Management Accounting which is the delivery of information for internal needs of an entity; and Financial Accounting which is the delivery of information for external parties. Note that the term ‘Financial Accounting’ implicitly assumes that the delivery of information for external needs cover only financial information. This assumption causes information presented for external parties is limited to information in monetary value, while there is a lot of relevant information which is difficult or impossible to be presented in monetary value is not disclosed, such as the social impact of a company’s activities. With such rigid recognition criteria for financial report, Wallman (1995) expresses his worry that the relevance of financial report will decrease.

On the other hand, the increased need for non-financial information (including CSR) which cannot be met by the current format of financial report causes the emergence of various forms of non-financial reports, inclusing reports related to CSR. As a result, companies have to make various types of reports, which are financial reports and other types of reports.

With the increased awareness of both society and companies on the importance of performing CSR, the need for CSR reporting standard which can be used as a guidance for report writing also increases. For the past ten years, there have been efforts to propose standards for reporting and disclosing CSR[13]; but there has so far not been an agreement on which format can be

[13] See Szekely and Knirsch (2005) who did a comprehensive review on various alternative measurements of sustainable performance.

used as the global reporting standard [14]. This lack of agreement has led to the differences in CSR reporting which in turn leads to low comparability among CSR reports of companies.

Regulators around the world can play a key role by reaching a consensus on which CSR reporting standard/guideline that they recommend companies around the world to use as the benchmark to prepare their CSR reports. The agreement may be initiated by the Capital Market Supervisory Bodies around the world that encourage publicly listed firms to report their CSR using a certain standard/guideline.

Assurance Services

Assurance services or attestation on CSR report by an independent party is required to ensure that the report reflects a company's CSR activities and the impact of the company's activities on the surrounding environment and society. By using this service, the company can increase the credibility of the CSR report. However, the survey conducted by KPMG (2002) in Dando and Swift (2003) found that among 100 large companies in 11 countries only 27% of their reports are audited by external parties.

Even with reports which have been verified by external parties, according to Dando and Swift (2003), the reliability, consistence and robustness of these kinds of reports are questionable. This is due to the lack of a generally accepted assurance standard related to CSR reporting (Adams, 2002); Owen et al., 2000), so that assurance services in general use financial assurance standards, which are not appropriate for CSR reports as CSR reports are very broad and usually qualitative (D'Dwyer, 2001).

[14] This situation is different from the standard financial reporting, with the agreement of most countries in the world to adopt *International Financial Reporting Standard* (IFRS), which is developed by *International Accounting Standard Board* (IASB) as a standard reference in making financial report.

Hence, a common standard of assurance is required so that it can be used as a reference by an external auditor verifying the CSR report. Presently, efforts have been made to develop such assurance standards, as stated by Dando and Swift (2003) where the Institute of Social and Ethical Accountability developed AA1000 Assurance Standard, an assurance standard for social, environmental and economic reporting.

Balou et al (2006) further state the efforts of a number of accounting professions (such as AICPA in the US, CICA in Canada, and an accounting profession in the Netherlands) in developing assurance standard for CSR reporting. In January 2005, the International Auditing and Assurances Standards Board (IAASB) approved an international standard for CSR report. This standard may also be used as a guideline for the data collection procedures by auditors in making their conclusion. A Sustainability Advisory Expert Panel has been established by IAASB to examine the possibility of issuing assurance standard for CSR report.

One main obstacle in auditing CSR report is that some of the information in the report is more qualitative than quantitative, and when the information is quantitative, its reliability is low. As a result, CSR report is difficult to audit or verify so that the aspects or coverage of the report audited is limited to those which can be audited or verified (Balou et al, 2006). Other alternative assurance which can be used is limited assurance or at the review level. The decreased coverage of the audited report and the lower level of assurance will certainly decrease the credibility of CSR report.

Regulation[15]

[15] In this part, the discussion on the regulation is restricted to the Law No. 40 about Limited Companies and to a number of Bapepam regulations.

In the US and EU, the CSR reporting has so far been a voluntary activity (Tschopp, 2005), however, some member countries of EU (such as France in 2001 and Spain in 2005) have made it mandatory for public companies to issue CSR reports.

With the issuance of the Corporation Law No. 40 of 2007, the government has explicitly made it mandatory for companies dealing with natural resources to perform their social and environmental responsibility (Article 74 paragraph 1), in addition, all companies are required to submit their annual environmental and social activities report (article 66 paragraph 2). Compared to other countries, Indonesian government is quite bold in issuing this regulation. The discussion of the two regulations is presented below. The concept of sustainable development is reflected in the Law since the definition of Environmental and Social Responsibility (Article 1 Paragraph 3) emphasizes the commitment of a company to participate in the sustainable economic development.

Article 74 especially paragraph 1 requires further regulation which details the coverage of companies obliged to perform social and environmental responsibility for the following reasons. Although not all companies are obliged to perform social and environmental responsibility, the coverage of the companies affected by the regulation is very wide. The Law states that corporations that do not directly deal with natural resources but their activities affect the function or capability of the natural resources are required to perform CSR. Since there might be different interpretation for this regulation, a more detailed types of activities having impact on the natural resources is required. Further, as the Law does not regulate how a company may be classified as having performed the social and environmental responsibility; a further rule (such as Government's Decree) has to explicitly make the classification.

The detailed regulation should also take into consideration how prepared are Indonesian companies in performing the social and environmental responsibility. It will be almost impossible to expect that all Indonesian companies are ready to perform the responsibility to meet the GRI standards. If the demand for social responsibility is too high while companies not meeting the requirements are punished then what worries Robins (2005) will happen: an economic inefficiency will take place where companies are reluctant to invest in businesses dealing with natural resources which will eventually have very bad impact on the country's economy. Unclear regulation is potential in causing corruption as people may take advantage of the confusion of the regulation.

The Company Law obliges all companies to make report on the implementation of Social and Environmental Responsibility in their annual report. The availability of this report is one form of the company's accountability in social and environmental activities; however, as Cooper and Owen (2005) state, a mere writing of the report is not enough to achieve accountability, as it is also important that stakeholders are able to access it and evaluate it for them to determine appropriate actions based on their evaluation. For public companies, the general public are able to access the report, otherwise, the report is accessible only for the shareholders. Therefore, to comply with the spirit of the Article 74 of the Law, the general public should be able to access the report on Social and Environmental Responsibility of a company dealing with natural resources.

To assure the report is not used as a public relations only and to make it easier for the general public to evaluate the company, the coverage of the information to be reported has to be regulated by taking into consideration the principles of cost-benefit in determining the coverage of the information. In addition, to ensure that the report is objective and credible, the company should have an independent external assurance to audit the social and environmental report.

Since generally the business activities of large companies have significant impacts on the condition of the society and environment, the proposed regulations should be mainly applied to the large companies. Thus, only large companies are required to submit social and environmental responsibility report to the public. Coverage of the information may differ depending on the size of the company; the bigger the company the more the coverage of the report. Similarly, only the reports of the large companies need to be audited by an external auditor.

Bapepam LK has recently issued a decree No. 134/BL/2006 about the Obligation to Submit Annual Report for listed firms and public companies. The regulation makes it obligatory for companies to detail the activities and the cost for the activities related to the environment and society. Similar with the the Company Law, the content and format of the report is determined by the company, which may make it difficult for the general public to evaluate and compare the CSR activities across companies. Therefore, a further regulation is warranted to clarify how companies disclose their CSR activities and the expenses they spend for these activities.

Public Pressure

Various researches in developed countries have found that consumers' social and environmental awareness have significantly increased (Mastny 2004, Vagasi 2000 in Malovics et al 2007). The same trend goes with NGOs advocating CSR and social and environmental awareness (such as Green Peace, Indonesia Business Links which deals with the promotion of CSAR idea in Indonesia) for the past years.

In reality, the percentage of companies implementing the principle of sustainability is less than 1% and the general public is still focusisng their attention on the growth of GDP (which ignores the impact of production on the environment) and income in evaluating economic development (Doane, 2005). This shows that consumers are not environmentally aware in their activities and consumption pattern, so that their pressure to companies to report their CSR activities is not strong enough (Doane 2005). When relatively more educated consumers in developed countries with better understanding of sustainable development have low environmental awareness, let alone Indonesian consumers who have relatively lower education and lower understanding of sustainable development.

This indicates that companies' awareness model proposed by Besley and Gathak (2007) has not been effectively performed. Companies making effort to perform CSR (with the consequences of higher cost and therefore higher price) cannot compete with companies not performing CSR. As a result, in order to be able to compete, companies may decide not to perform CSR (Malovics et al, 2007).

In addition to the lack of people's awareness on the importance of CSR, the weak public pressure to companies to perform CSR may be due to their lack of information about the social and environmental impacts of companies' activities which is caused by their limited access to the CSR report. Thus, public pressure will be effective only when the CSR reports are transparent.

VI. Conclusion and Recommendation

CSR can play its role to substitute government in performing its duties. A company implementing CSR strives to reduce its negative externalities and increase its positive externalities. Therefore, governement should encourage CSR. However, too much regulation on CSR may hamper business competitiveness. Accordingly, government should create infrastructures that are condusive for CSR. Further, since companies tend to report CSR only for public relation purpose and not for accountability purpose, the role of regulator is to establish infrastructures that support for accountable CSR reporting which include: a. the existence of globally accepted reporting standard/guidance on CSR reporting, b. the existence of globally assurance standard for CSR reports, c. the practice of good corporate governance, d. supportive regulatoin on CSR, and e. the existence of public pressure on CSR.

Currently the level and quality of CSR reporting of companies in Inodnesia is relatively low, which is due to the ineffective supporting infrastructure for CSR reporting. Currently there is no generally accepted CSR reporting standard which can be used as guidance for companies writing their CSR report. Social and environmental accounting has not well developed yet because a) there are restrictions on the aspect of information to be reported to external parties, and b) disclosure criteria stresses on the reliability and measurability of an item. An assurance service for the report is required to ensure the credibility of CSR reporting, yet, the assurance standard for CSR reports are still at early stage of being developed. To support the implementation of company's CSR, a CSR committee may be necessary or the expansion of the function of audit committee to also oversee CSR report may also be required. The Corporation Law makes it obligatory for all companies to report their social and environmental responsibility in their annual report, but as there is not any subsequent regulation to operationalize the obligation, there will be variety of reports submitted by companies making it difficult to evaluate. Finally, there has been an increase in the public awareness on the importance of CSR, yet they do not have adequate power to force companies to perform and report CSR.

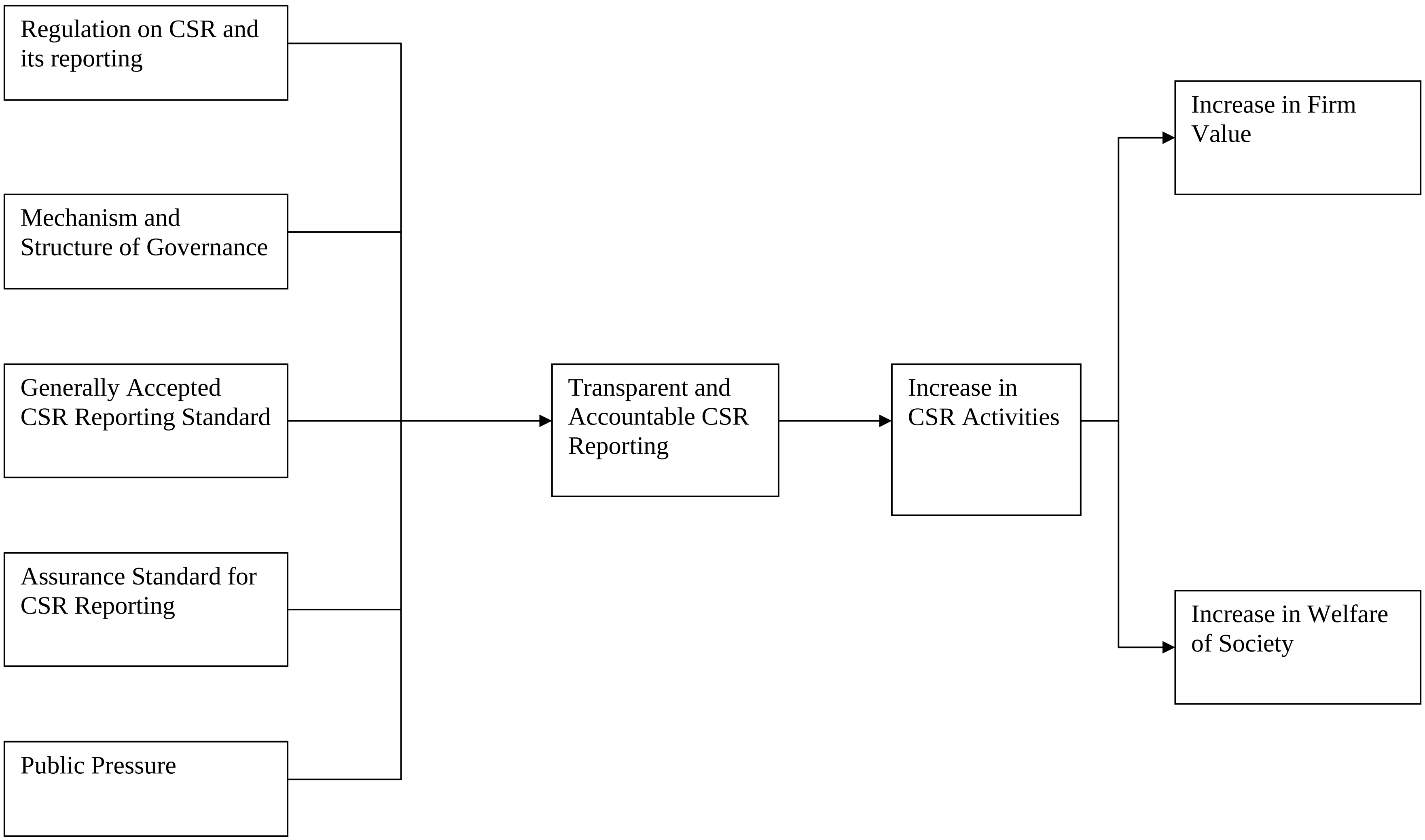
Some recommendations to increase the level and quality of CSR reporting are proposed below. First, since the Corporation Law has taken effect, the government need to issue further regulation which will explicitly state :

- Business sectors which are obliged to perform social and environmental responsibility,
- When a company can be verified as having performed their responsibility,
- The coverage of the CSR report which has to be submitted.

Further, CSR reports of large companies whose business is related to natural resources need to be accessible by the public and are desirably to be audited by independent external parties.

Secondly, regulators around the world should agree on a global CSR reporting standard so that companies in different countries have one standard to refer in preparing their CSR report. Third, regulators around the world should also promote the development of a generally accepted assurance standard for CSR reporting by taking into consideration the different characteristics of CSR report from financial reports. Fourth, regulators should establish rules that encourage companies to change their governance system to a more accomodative system for the performance and reporting of a company's CSR activities. For example, the compensation system for the Board needs to be revised to also be based on the company's CSR performance indicators. Fifth, governemnt should continuously put effort to increase the public awareness on the importance of sustainable development and on the fact that social welfare and environmental preservation is the responsibility of all members of the society. Therefore, education curriculum from the elementary level to the university level needs to be designed to develop this awareness and responsibility.

Diagram 1: Supportive Infrastructure for Transparent and Accountable CSR Reporting



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