

CHAPTER I

INTRODUCTION

A. Background

The annual report is one of the information that is published with a formal obligation, where the information published must be able to reveal the actual financial condition so that the report can be useful for the general public. Useful information is information that can be used in decision making and is relevant. According to Said et al. (2009), a possible indicator showing whether the accounting information is relevant is the reaction of investors when the information is announced which can also be observed through stock price movements and can be used as a basis for investors and potential investors, as well as creditors.

CSR itself is the delivery of information on the social and environmental impacts of a company's economic activities aimed at interested parties and the community as a whole. According to Herman and Saleh (2018), over time, CSR disclosure activities are increasing due to pressure from the global community's attention to national and multinational progress. Companies-related environmental damage issues that occur in Indonesia and Malaysia are air pollution, water pollution, and deforestation. In addition, the consequences of climate change that still often occur among companies are manufacturing companies.

There are so many forms of CSR carried out by various fields of companies, such as in the economic field, providing capital funds for the businesses of the surrounding community and can also form savings and loans cooperatives and community business programs and employees to develop their MSMEs. Another example in the field of infrastructure is providing places of worship and repairing damaged public road.

Although many regulations and standards have been set by the government, in the implementation process, many companies in Indonesia are still hesitant to carry out CSR. This is due to the perception that CSR can harm businesses and increase operating expenses. In fact, CSR disclosure itself is an activity that can have a positive impact on social, economic and environmental aspects (Kristi, A. A. 2013). From a financial perspective, by conducting a CSR program, a company will gain increased legitimacy which is reflected in lower social costs or an increase in company revenue or an increase in overall profits. This system view then the impact will be felt again by the company (Said et al., 2009).

The countries of Indonesia and Malaysia are countries with a Muslim population that dominate the country, so the industrial activities of companies operating in the utilization of natural resources, especially in the manufacturing sector, should have a reciprocal impact on the environment and society by prioritizing social values in life. Those are the factors that motivate the researcher to conduct research on CSR disclosure activities in these two countries and find out how far the countries of Indonesia and Malaysia implement the Islamic teachings in protecting the nature and environment in accordance to the Islamic guidance and verses of the Quran written in verse 177 of surah Al Baqarah.

❁ لَيْسَ الْبِرَّ أَنْ تُوَلُّوا وُجُوهَكُمْ قِبَلَ الْمَشْرِقِ وَالْمَغْرِبِ
 وَلَكِنَّ الْبِرَّ مَنْ آمَنَ بِاللَّهِ وَالْيَوْمِ الْآخِرِ وَالْمَلَائِكَةِ وَالْكِتَابِ
 وَالنَّبِيِّينَ وَآتَى الْمَالَ عَلَى حُبِّهِ ذَوِي الْقُرْبَىٰ وَالْيَتَامَىٰ وَالْمَسْكِينِ
 وَابْنَ السَّبِيلِ وَالسَّائِلِينَ وَفِي الرِّقَابِ وَأَقَامَ الصَّلَاةَ وَآتَى الزَّكَاةَ
 وَالْمُوفُونَ بِعَهْدِهِمْ إِذَا عَاهَدُوا وَالصَّابِرِينَ فِي الْبَأْسَاءِ وَالضَّرَّاءِ
 وَحِينَ الْبَأْسِ أُولَئِكَ الَّذِينَ صَدَقُوا وَأُولَئِكَ هُمُ الْمُتَّقُونَ ﴿١٧٧﴾

Meaning: "It is not a virtue to turn your face towards the east and west, but verily, virtue is believing in Allah, the Last Day, angels, books, prophets and giving the treasures that he loves to his relatives, children orphans, the poor, travelers (who need help) and those who beg; and (liberating) slaves, establishing prayers, and paying zakat; and those who keep their promises when they promise, and those who are patient in adversity, suffering and in war. Those are the righteous (their faith); and they are the righteous." (QS al-Baqarah: 177).

From the verse above, it can be concluded that Islam is a religion that prioritizes social values that are more valuable than praying. Without compromising the virtue of prayer, the Quran integrates the meaning and purpose of prayer with social values by emphasizing that the value of faith in the form of faith in Allah, Almighty, His Book, and the Day of Judgment will be imperfect if it is not accompanied by social practices such as caring and service to relatives, orphans, the poor, travelers and ensure the welfare of people in need. In this context, the meaning of CSR activities in Islamic perspective is a business activity or practice that has an Islamic ethical responsibility value that contains Islamic religious values and norms with a commitment to the company's sincerity in maintaining the social contract in its operations.

Corporate Governance (CG) itself is very effective in ensuring that the interests of stakeholders are protected (Said et al., 2009). A number of experts consider the emergence of corporate governance because it is related to agency theory which views

that in a company there are two interacting parties, namely the management as the agent and the owner as the principal. Corporate governance is governed by the principle of separation between management and ownership to maintain reputation and transparency (Sarbah, A. and Xiao, W. 2015).

Corporate governance is a procedure to regulate the company's operations and protect the interests of the company and its shareholders. In addition, it can cope with the activities of managers in the management of the company. Disclosures related to the company's financial statements must contain information about the activities of all business units carried out by the company.

The company's goal in implementing good corporate governance (GCG) is to build a corporate image and fulfill responsibilities to shareholders, society and employee welfare (Natalylova, K. 2013) . Therefore, GCG is very necessary in the development of a company so that the company can increase its success both within the company itself and in the community.

The implementation of GCG really brings great benefits to the company. According to Harmanto in SWA magazine (2004), several benefits of implementing good corporate governance are, for example: being trusted by investors, business partners, or creditors; becoming more linear because of the clear division of tasks and authorities; balance of power between the company's internal structure, namely directors, commissioners, audit committees and so on; decision making becomes more careful for the sake of the company's sustainability.

GCG and CSR are two concepts that grew and developed at the same time in early 2000. The concept of GCG and CSR concerns the activities of the business world in relation to the community and has become a widespread concern among academics,

practitioners, and business actors at home and abroad. The financial crisis that hit several countries had an impact on society and the social environment, due to the low social awareness of companies (Buchholtz et al., 2015). As a result, the idea of implementing GCG and disclosure of CSR information is expected to increase economic growth along with better transparency in corporate management and will benefit many parties (Priantana & Yustian, 2011).

Currently CSR and GCG are an inseparable part of a long-term competitive strategy oriented to mentoring programs and public policies. CSR is no longer seen as a cost center but as a future profit generator. Murwaningsiri (2009) states that GCG is also closely related to CSR. This is because one of the main principles of GCG is responsibility.

According to Danuri (2008), CSR is a form of sustainability reporting that makes companies not only faced with responsibilities that are based on a single bottom line, namely disclosure in terms of financial condition only. However, it turned into a triple bottom line, namely disclosure in terms of the company's financial, social and environmental conditions. This is in line with Law No. 40 of 2007 article 66 paragraph 2 part C which explains that in addition to submitting responsibilities in the form of financial reports, companies are required to report on their social and environmental responsibility activities.

According to Kumar & Verma (n.d.), CSR is based on the concept of self-governance which is related to external legal and regulatory mechanisms, while corporate governance is the broadest control mechanism in which companies make management decisions. governance (CG) and CSR becomes very important and significant. In order to assess the current position of CSR and GCG, it would be useful

to examine the legal and regulatory framework relating to CSR and corporate governance (CG).

Seeing this, it can be said that GCG has a positive effect on corporate social responsibility. The Research conducted by Setyarini and Melvie (2011) found that the mechanism of good corporate governance affects the disclosure of corporate social responsibility. This research is supported by Ramdhaningsih and Utama (2013) who also get the same result. Research on the effect of the relationship between good corporate governance and the company's financial performance has also been carried out and the results also show that good corporate governance has an effect on the company's financial performance.

According to Monks (2003), GCG mechanism will be useful in regulating the company to create added value. To support this, the implementation of GCG must be supported by company organs that must carry out their functions in accordance with the provisions and carry out their duties, functions and responsibilities solely for the benefit of the company. The company's organs consist of the general meeting of shareholders (GMS), and the board of directors.

In carrying out its duties, the board of directors forms several committees, one of which is the audit committee. The quality of the audit committee is characterized by the expertise possessed by the members of the audit committee, with this expertise helping to improve company performance and reducing the moral hazard carried out by managers (Indira and Syafruddin, 2022). Furthermore, the expertise of the audit committee is expected to help increase awareness of corporate social responsibility. In this case, it is also included in the annual report as the research of Foker (1992) as cited in Said et al. (2009) that the existence of an audit committee can reduce agency costs,

and improve internal control and improve the quality of disclosure. In this study, the internal research mechanism focuses on the board of directors and the audit committee.

The research conducted by Badjuri (2011) states that there is a significant positive influence between the board of directors and the disclosure of corporate social responsibility for the annual reports of banking companies in Indonesia. Responsibility in the annual reports of banking companies in Indonesia. According to Suryono and Prastiwi (2011), the audit committee has a positive effect on corporate social responsibility. Companies that have an audit committee will better disclose financial statements and be responsible to the public. However, this study contradicts the research conducted by Muharsyahbana (2012) which states that the audit committee has a negative influence on the extent of CSR disclosure.

This study is a replication of the previous research by H Manurung et al. (2017) with the title "The Influence of Corporate Governance, Financial Performance and Environmental Performance on Corporate Social Responsibility Disclosures". The sample used in this study is a manufacturing company listed on the Indonesia Stock Exchange, with the variables of the board of commissioners, board of directors, audit committee and financial performance on corporate social responsibility.

The contribution of this study is the development of samples and variables. The difference between this research and the previous research is eliminating 1 variable and eliminating one variable in it and extending the research period for 5 years, namely from 2017 to 2021. For the variables, the board of directors is used. The board of commissioners is not used because it is not used by most foreign companies. Then the samples used in this study are the companies listed on the Indonesia Stock Exchange and the Malaysia Stock Exchange. Malaysia was chosen as a comparison in this study

because it is a member of ASEAN like Indonesia. Malaysia has several similarities with Indonesia, such as in culture and geographical location. Thus, Malaysia is truly comparable to Indonesia.

Based on the description of the background above, the researcher formulate the research title as follows: **"THE EFFECT OF CORPORATE GOVERNANCE MECHANISM ON CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE (A CASE STUDY OF INDONESIAN AND MALAYSIAN COMPANIES)."**

B. Research Question

Based on the above background, the problem formulation in this research is as follows:

1. Does the size of the board director have a positive effect on CSR disclosure in Sharia compliance in Indonesia and Malaysia ?
2. Does the board of director meeting have a positive effect on CSR disclosure in Sharia compliance in Indonesia and Malaysia ?
3. Does the board of director diversity have a positive effect on CSR disclosure in Sharia compliance in Indonesia and Malaysia ?
4. Does AC size have a positive effect on CSR disclosure in Sharia compliance in Indonesia and Malaysia ?
5. Does AC meeting have a positive effect on CSR disclosure in Sharia compliance in Indonesia and Malaysia ?

C. Research Purpose

Based on the research question above, the objectives of this research are to examine and find empirical evidence of :

- 1) The positive effect of the board of director size on the CSR disclosure in Sharia compliance companies in Indonesia and Malaysia.
- 2) The positive effect of the board of director meeting on the CSR disclosure in Shariah compliance companies in Indonesia and Malaysia.
- 3) The positive effect of the board of director diversity on the CSR disclosure in Sharia compliance companies in Indonesia and Malaysia.
- 4) The positive effect of AC size on the CSR Disclosure in Sharia compliance companies in Indonesia and Malaysia.

- 5) The positive effect of AC meeting on the CSR disclosure in Sharia compliance companies in Indonesia and Malaysia.

D. Research Benefits

Based on the research objectives, it is hoped that this research can provide theoretical and practical benefits for various parties. The benefits of this research are as follows:

1. Benefits of theory

Theoretically, the results of this study are expected to contribute to the development of financial accounting studies regarding agency theory so that the quality of good corporate governance and its impact on company characteristics can be determined. The results of this study are also expected to enrich the repertoire of knowledge in the field of accounting and as input or reference for further researchers who use the same research variables.

2. Practical Benefits

- a. Academic

This research is expected to provide new insights, broaden knowledge, and be considered for further research for those who will research similar topics.

- b. Company

The results of the study are expected to provide benefits to the company, especially regarding the influence of the quality of good corporate governance on improving the quality of the company. With the various company ratings based on good corporate governance applied, this research is expected to provide additional confidence in the usefulness of the ranking results to be used as input in decision-making.

c. Society

It is expected to provide important information about CSR activities carried out by companies to obtain social rights from a company.

d. Government

It is hoped that this can be used as an illustration of the effectiveness of the implementation of GCG and CSR in the company so that further developments in GCG and CSR regulations can be discussed.