# The Impact of Profitability and Monitoring Function of

*by* Hisar Pangaribuan

# The Impact of Profitability and Monitoring Function of the Board and Audit Committee on CSR Disclosures

Hisar Pangaribuan[1*] Agus Sriyanto[2]

[1] *Universitas Advent Indonesia, Bandung, West Java, Indonesia*
[2] *Universitas Mpu Tantular, Jakarta, Indonesia*
[*] *Corresponding author. Email: pangabhsr@gmail.com*

**ABSTRACT**
The purpose of this study is to determine whether profitability, as measured by ROA and NPM, and the presence of an independent board of commissioners and an independent audit committee in carrying out their supervisory functions can have a significant impact on CSR disclosure in Indonesian banking companies. The descriptive confirmatory research approach was utilized, including secondary data from annual reports of banking companies listed on IDX. Using SPSS as a data processing tool, hypotheses are formulated and tested using a covariance technique. The findings proposed that profitability, as measured by ROA and NPM, has a significant and positive impact on CSR disclosure, implying that organizations with high levels of profitability are more conscious of the importance of establishing CSR programs and disclosures. Other findings from this study show that the supervisory function performed by an independent audit committee can contribute considerably and favourably to increased CSR disclosure. This conclusion is critical for senior management and business owners to increase CSR implementation and disclosure.

***Keywords:*** *behaviour, oversight function, independency, management annual report, environment*

## 1. INTRODUCTION

Companies compete to present a good image to the community. They are thought to generate extra value for the firm, which is utilized as a competitive strategy and sends a positive signal about the company and its sustainability (Guo et al., 2015) [1]. Companies are beginning to recognize the need of paying attention to the environment and implement Corporate Social Responsibility (CSR). Simultaneously, the academic and practical development of CSR themes is becoming increasingly enormous; a Google search yielded almost 722 million sites that describe and debate CSR.

CSR is a topic that can be explored in economic and business circles. This advancement is one of the components that must be indicated in the budget as evidence that the organization has an activity plan and commitment (Subramaniam et al., 2017) [2], and a corporate budget increase is necessary (Bello et al., 2019) [3]. This demands good action monitoring and reporting (Garas & El Massah, 2018) [4]. Nevertheless, Evans et al. (2020) [5] found out that the level of CSR exposure was still unsatisfying, and even still low (Moslemany & Etab, 2017) [6].

Implementing a thorough and proactive CSR strategy will benefit the firm in the long run (Sachs & Maurer 2009) [7]. CSR benefits not only marketing and public relations but also employees and trade unions (Bernardino, 2021) [8], and has a close relationship with global business principles (Büchner, 2012) [9], supporting the implementation of effective corporate governance (Garas & El Massah, 2018) [4], and bringing the corporation a good reputation (Usha & Gundavajhala, 2016) [10]. Studies also show firms that use CSR effectively enhance employee and company motivation and performance (Evans et al., 2020) [5].

Stakeholders must understand and acknowledge that the company has effectively implemented CSR programs, which must be presented to the public via CSR disclosures provided by the company (Pomering & Johnson, 2009) [11]. CSR communication is crucial, and El-Bassiouny (2018) [12] demonstrates that CSR communication strategies to stakeholders must be part of the business plan, as they will influence whether or not the company can compete in its industry.

The board is the highest supervisory body elected by shareholders at a general meeting to achieve the company's medium and long-term objectives (Riyadh et al., 2019) [13]. Meanwhile, the board's audit committee assists the board in carrying out its responsibilities as its highest supervisor. The audit committee, in particular, is in charge of ensuring that financial statements, internal controls, risk management, and information disclosure (including CSR disclosure) are provided to stakeholders (Djaddang et al., 2017) [14]. It should be mentioned that the term "board" in this study refers to the "company's board of commissioners" (in the sense of being the highest supervisor) because the tiered supervision employed in Indonesia differs from the system used in other countries such as America.

Companies that have adequate supervision, specifically the effective functioning of the board (Hanh & Hien, 2019) [15] and the audit committee Djaddang et al., (2017) [14], will carry out and disclose CSR programs better, with the hope that it will have a positive impact on both performances financial and corporate image, as well as long-term growth of the company.

Simultaneously, companies with high levels of profitability will be more concerned with the environment and also for the purpose of sustainable growth, and in order to stay ahead of market competition, they will run and disclose CSR programs and disclose them better (Lee & Jung, 2016 [16]; Zieliński & Jonek, 2020) [17]. According to Varenova et al. (2013) [18], commercial and financial competitive advantages of enterprises will be used not only for the company's financial interests but also for the benefit of the local environment, including ecological, human, and social reasons.

Despite the fact that CSR disclosure provides numerous benefits to various stakeholders, a low level of CSR disclosure is still observed, as evidenced by the findings presented by Dura and Imola (2017) [19], who state that the availability of CSR communication is still low in Romania, Poland, and Hungary. Because of the company's financial factors, it was discovered that CSR on the wage scale for employees is still at a low level in practice (Grishnova et al., 2021) [20]. CSR disclosure became mandated in Indonesia on August 1, 2012, with the enactment of Bapepam and LK regulations no. Kep-431/BL/2012. Although the regulation on CSR disclosure was enacted in 2012, it has had an impact on increasing CSR disclosure in Indonesia (Ika et al., 2021) [21], Yunari et al. (2018) [22] believe that regulations are still being perfected in order to create more legal certainty at the normative level and its implementation in Indonesia.

According to Tarigan and Stacia (2019) [23], at the time of their study in 2019, Indonesia had not gotten attention from comprehensive norms and adequate literature on CSR. For it is still critical to focus on studies and proper rules in order to deliver benefits to diverse stakeholders and provide long-term added value.

Banking is a vital industry in any country, as the bank is the heart of the economy, powering the transaction engine and providing financial services to the general people. As a result, banks must be able to serve as models for other industries in the practice and disclosure of CSR as a kind of environmental responsibility (Mubarak et al., 2019) [24]. Based on this definition, the purpose of this research is to learn more about how the supervisory function of the board and profitability affect corporate social responsibility in Indonesian banks.

## 2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

The contract between the principal and management as an agent requires management to hold the principal accountable. Legitimacy is a psychological state in which one takes sides with individuals or groups of individuals who are very sensitive to the symptoms of their surroundings, both physical and non-physical. Legitimacy can be obtained if the existence of the company corresponds to the existence of the existing value system in society and the environment. A social contract is a notion that is used to convey people's expectations regarding how an organization should carry out its activities (Mubarak et al., 2019) [24].

Simultaneously, the company's survival is dependent on the support of stakeholders who impact and are affected by the company's actions. Management is responsible for generating shareholder value, and if the company engages in CSR activities that are not in the best interests of stakeholders, the company's major goals will be violated (Djaddang et al., 2017) [14]. The interests of these stakeholders must be met because ignoring them will result in the company losing its credibility with the stakeholders. According to Büchner (2012) [9], companies should maintain their reputation by shifting the orientation pattern that was previously measured solely by measurement that tends to shareholder orientation toward taking into account social factors as a form of concern and alignment with community social problems.

### *2.1 Profitability and CSR*

Lee and Jung (2016) [16] stated there is a positive association between profitability and CSR, which suggests that profitable organizations will aim to preserve and improve their product image by better implementing and disclosing CSR. It is hoped that they will be able to improve the company's financial performance in the future (Olufemi and Banjo, 2019) [25]. Furthermore, Zieliski and Jonek (2020) [17] assert that there is a significant and positive association between profitability and CSR disclosure, despite the fact that the majority of CSR activities and disclosures are focused on local community activities and the natural environment. When the credit rating is used as a moderator, Chang and Shen (2014) [26] discovered that the higher the company's credit rating, the weaker the association between profitability and CSR disclosure. Meanwhile, Xiao Juan Wu et al. (2021) [27] observed that in companies owned by families, there was a substantial effect on profitability on CSR; However, in companies not owned by families, there was no significant effect on profitability on CSR. Furthermore, Ika et al. (2021) [21] stated that profitability has no significant effect on boosting CSR disclosure in the Indonesian agricultural industry.

This study measures profitability using return on assets (ROA) and net profit margin (NPM), just as Safaeianpoor and Shoorvarzy (2017) [28] do, and the results reveal that ROA has a substantial link with CSR. Moslemany and Etab (2017) [6] discovered a favorable and significant association between profitability and CSR by measuring profitability with NPM and ROA. Based on the findings of previous research, this study makes the following hypotheses:

**H1**: Profitability, as measured by ROA, has a significant effect on CSR disclosure

**H2**: Profitability, as measured by NPM, has a significant effect on CSR disclosure

### *2.2. Supervision by the Board and Audit Committee on CSR*

Independent boards are those who are not members of parties related to family or business with parties that could interfere with their objectivity in carrying out their supervisory tasks (Liao et al., 2018) [29]. Independent boards that are devoid of personal interests or specific groupings are required to strengthen the objectivity of the supervisory function (Hanh & Hien, 2019) [15]. Audit committee independent directors, according to agency theory, are more likely to influence the efficient monitoring function of management behaviors because they have no personal or economic ties with management and can thus act objectively and independently from management effect. As a result, audit committee independence has a higher possibility of monitoring, decreasing risk, and fewer chances for management to conceal facts for personal gain (Musallam, 2015) [30].

The existence of an independent audit committee has a substantial impact on CSR disclosure since it is not influenced by management (Mohammadi et al., 2020) [31]. The lesser the proportion of independent audit committees, the more limited their oversight authority. The presence of an independent audit committee can have a considerable positive impact on CSR disclosure since the audit committee objectively and effectively supervises CSR implementation and disclosure (Djaddang et al., 2017) [14]. Meanwhile, Liao et al. (2018) [29] found that the presence of an independent board did not have a substantial impact on CSR practices in China. Based on the findings of the research, this study makes the following hypotheses:

**H3**: The proportion of independent board has a significant effect on CSR disclosure

**H4**: The proportion of independent audit committees has a significant effect on CSR disclosure

## 3. RESEARCH METHOD

The descriptive confirmatory method is used in this study, and the topic of research is profitability, as well as the function of the board and the audit committee in the oversight and disclosure of CSR. It should be noted that in this study, the term board refers to the company's board of commissioners (in the sense of being the highest supervisor), which is due to the multiple layers of supervision carried out in Indonesia contrasted to the system used in numerous other countries such as America. Furthermore, profitability is measured using two indicators, namely ROA and NPM, while the supervisory function is measured using the proportion of independent board and the proportion of independent audit committees, and CSR disclosure is measured using the content analysis method based on the Global Reporting Initiatives (GRI) assessment, namely 79 items of disclosure. The quantity of CSR disclosure achievement is calculated by dividing the number of items revealed by the 79 GRI guidance items.

Profitability is measured by ROA and NPM. ROA is calculated by dividing net income by total assets, while NPM is calculated by dividing net income by total net sales.

Furthermore, the independence of their individual roles is used to assess the supervisory role of the board and the audit committee. It is measured for an independent board by the number of members of the independent board divided by the total members of the board in the relevant period, and for an independent audit committee by the number of members of the independent board divided by the total members of the respective board.

This study uses secondary data, namely the banking industry annual report data obtained from the Indonesia Stock Exchange website in 2018 and 2019. With the population of Indonesian banks listed on the IDX, 40 banks were selected as samples (because three of these banks did not have reporting data that complete) with 2018 and 2019 data, so each is 80 data samples. The hypothesis was developed to be tested with a covariance approach, and this study used SPSS to help test the intended hypothesis. Descriptive analysis, correlation coefficient testing, determination coefficient testing, and significance testing are some of the tests carried out.

## 4. RESULT AND DISCUSSION

This study found 80 observational data by using secondary data from 40 banking companies listed on the Indonesia Stock Exchange in 2018 and 2019. 1st Table Descriptive Statistics presents an overview of study data, the least value of CSR is 34%, with a high of 87.5% and an average of 56.5%; this demonstrates that despite Bapepam and LK regulations no. Kep-431/BL/2012, there are still some banks that declare fairly low CSR. Banking companies have an average rate of 0.56 percent and a maximum ROA value of 4 percent, with an average NPM of 9.42 percent and a maximum NPM of 46 percent. Descriptive data have also shown that numerous banking companies are found to have a negative level of profitability, implying that these companies lost money during the study's observation period.

**Table 1** Descriptive Statistics

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| CSR (%) | 80 | 34.00 | 87.00 | 56.05 | 10.948 |
| ROA (%) | 80 | -9.00 | 4.00 | .56 | 0.563 |
| NPM (%) | 80 | -20.00 | 46.00 | 9.42 | 13.556 |
| Board | 80 | 2.00 | 6.00 | 2.75 | 1.096 |
| Board_Ind (%) | 80 | 43.00 | 100.00 | 59.71 | 12.342 |
| AC | 80 | 3.00 | 7.00 | 3.68 | .935 |
| AC_Ind (%) | 80 | 50.00 | 100.00 | 98.50 | 7.088 |
| Valid N (listwise) | 80 | | | | |

The study's findings indicated that the profitability variables represented by ROA and NPM, as well as the supervision variables represented by the independent board and independent audit committee, each contributed positively to the increase in CSR disclosure with a constant value of 0.784, indicating that each increase in the predictor variable will contribute to an increase in CSR disclosure. The regression equation shown below can indicate the outcomes of various statistical tests (as shown in Table 2).

$$CSR = 0.784 + 0.334\ ROA + 0.\ 093\ NPM + 0.026\ Board\_Ind + 0.239\ AC\_Ind + \varepsilon$$

The hypothesis testing findings show the amount of each predictor variable's influence on CSR disclosure (at $\alpha = 5\%$), and it is discovered that ROA has a substantial effect on CSR disclosure (with a significance value of 0.049 0.05, we supported H1). Similarly, NPM This result was consistent with Zieliński and Jonek-(2020) [17] Kowalska's findings, which state that organizations with high levels of profitability will tend to operate the program CSR is better and expresses it, thereby generating a better image for the company (Mubarak et al., 2019) [24].

Other findings from this study shown that the independent board has no significant effect on the increase in CSR disclosure, as evidenced by the significant result of 0.125 (> 0.05) (we did not support H3), whereas the independent audit committee has a significant effect on CSR disclosure in banking companies in Indonesia, with a significance value of 0.019 0. (we supported H4). These findings suggest that the audit committee's (particularly the independent audit committee's) supervision may be more effective than the board's supervisory role because the audit committee (particularly the independent audit committee) is closer to management in terms of interaction and supervision than the board members.

**Table 2** Regression Test Results

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. | Decision |
|---|---|---|---|---|---|---|
| | B | Std. Error | Beta | | | |
| (Constant) | .784 | 1.197 | | 4.297 | .000 | |
| ROA | .334 | 1.006 | .182 | 2.143 | .049 | $H_1$ => S |
| NPM | .093 | .158 | .103 | 1.726 | .047 | $H_2$ => S |
| Board_Ind | .026 | .105 | .030 | .997 | .125 | $H_3$ => NS |
| AC_Ind | .239 | .281 | .155 | 2.320 | .019 | $H_4$ => S |

a. Dependent Variable: CSR
b. S = supported; NS = not supported

According to Djaddang et al. (2017) [14], members of independent audit committees can effectively control the financial reporting process and CSR disclosure.

**Table 3** The Coefficient of Determination

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| | .397[a] | .158 | .153 | .173517 |

a. Predictors: (Constant), ROA, NPM, Board_Ind, AC_Ind

The test results have shown that the value of r is 0.397, with a R square value of 0.158 and an adjusted R Square of 0.153, indicating that about 15% of CSR disclosure can be explained by ROA, NPM, independent board, and independent audit committee, with the rest explained by factors outside the research model. These include company culture, social growth and sustainability (Bergman, 2015) [32], employee engagement (Bernardino, 2021) [8], and others.

## 5. CONCLUSION

CSR disclosure is seen as advantageous to both internal and external enterprises and to the overall business and environmental sustainability. Profitability as assessed by ROA and NPM, as well as the supervisory function provided by an independent audit committee, have a significant impact on increasing CSR disclosure, according to the findings of this study. As a result, to maximize CSR implementation and disclosure, business owners should pay closer attention to the oversight function performed by the general meeting of shareholders. Since profitability has a positive and significant impact on CSR disclosure, increased monitoring efforts are essential to guarantee that bank profitability remains good/satisfactory, supporting the implementation and disclosure of banking CSR.

### *5.1. Limitation and Suggestion*

This research is limited to banking data in Indonesia for two years of research data; further research needs to be done by expanding the sample and the data period so that it is better to digest the generalization of conclusions.

### *5.2. Managerial Implication*

The role of management in carrying out its functions is vital to produce optimal profitability. In addition, the audit committee's role in carrying out the supervisory process is crucial in supporting more optimal CSR disclosures. For all of these reasons, the board of commissioners, as the highest supervisory body, must carry out its supervision so that management and the audit committee can optimally carry out their functions. It will increase CSR disclosure, which impacts making positive contributions to the company's internal and other stakeholders.

## NOTE

This research study is entirely self-contained.

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