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Yang PAN, Xinguo MING, Siqi QIU

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Testing the Quality of Financial Reporting in Indonesia and Its Influence on Corporate Social Responsibility Investments

Lidya Agustina, Hanny, Meyliana

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This study aims to examine the quality of financial reporting in Indonesia not only by using accounting-based quantitative measurements, but also using qualitative measurements. In addition, this study also examines the impact of quality accounting ...

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Testing the Quality of Financial Reporting in Indonesia and Its Influence on Corporate Social Responsibility Investments

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ABSTRACT

This study aims to examine the quality of financial reporting in Indonesia not only by using accounting-based quantitative measurements, but also using qualitative measurements. In addition, this study also examines the impact of quality accounting information on the efficiency of CSR investment. This study uses data on financial statements of companies listed on the Indonesia Stock Exchange in 2015-2016 and Sustainability Reports taken from the companies' websites. Data analysis techniques used in this study were multiple regression and logistic regression tests. The results of this study indicate that the quality of quantitatively measured financial reporting has a significant positive relationship to CSR investment with the possibility of over investment, as well as having a significant negative relationship to CSR investment with the possibility of under investment. However, the quality of qualitatively measured financial reporting has a significant positive relationship to CSR investment with the possibility of over investment, and has a significant negative relationship to CSR investment with the possibility of under investment.

CCS CONCEPTS

• **General and reference**; • **Document types**; • **General conference proceedings**; • **Information systems**; • **Information systems applications**; • **Decision support systems**; • **Data analytics**;

KEYWORDS

Quality of financial reporting, quantitative measurement, qualitative measurement, CSR investment (over/under investment

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1 INTRODUCTION

The main purpose of financial reporting is to provide quality information about a company's financial position and performance that is useful for economic decision making. Related to this purpose of financial reporting, the financial statements should show high quality, because they can influence stakeholders in investing, making credit decisions, and in allocating resources that can improve the efficiency of the capital market as a whole [1, 2]. Investors and stakeholders can only rely on financial reporting as access to relevant information in decision making [3].

Testing of the quality of financial reporting can be done by two approaches—quantitative and qualitative. Testing the quality of financial reporting quantitatively has been performed by many previous studies, either by testing by an accounting-based or a market-based approach [3-7]. However, testing the quality of financial reporting qualitatively is still rarely done. [8] developed qualitative financial reporting quality assessment items based on the qualitative characteristics of the IASB. This study makes effort to accommodate both approaches, so this research tests the quality of financial reporting using two approaches—quantitative and qualitative.

Previous studies show that financial reporting can influence the company's financial performance in the future through the role of government, and quality financial reporting can also improve information efficiency [9]. In other words, quality financial reporting can reduce the problem of under and over investment [6, 10]. First, this explains that accounting information can help investment efficiency by reducing losses, liquidity risk, and information risk. Second, the disclosure of financial information can help control companies in preventing managers from taking over wealth from investors or creditors, so that it provides more certainty for external parties. Third, quality accounting information can improve managers' efficiency in making investment decisions [6].

High quality financial reporting might reduce hazardous bad moral problems by reducing information asymmetry and increasing the ability of shareholders to oversee managers in investing in CSR by using quality company information [7]. Quality financial reporting is predicted to influence the investment costs of Corporate Social Responsibility (CSR). The research findings in [7] document that the better the quality of financial reporting, it will reduce the cost of CSR investment, while there is a positive relationship between CSR investment and future earnings for companies that have quality financial reporting. Studies on CSR investment at this time is still not many, so further research is needed to obtain better results' generalization.

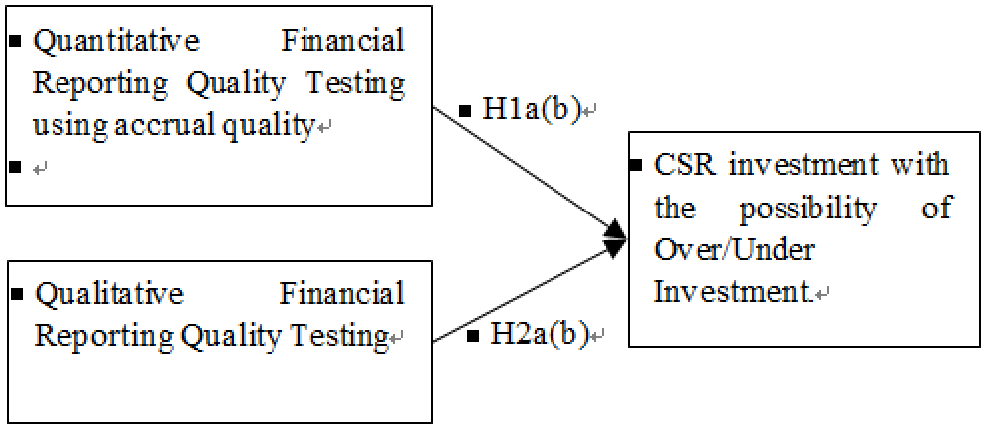

Figure 1: Conceptual Framework Model

2 RESEARCH FRAMEWORK & HYPOTHESIS DEVELOPMENT

In the world of business, shareholders as principals require accounting information contained in financial reports to help make investment decisions. They may rely solely on financial reporting as access to relevant information in decision making [3]. Therefore, the quality of financial reports is paramount. This is because quality financial reports can reduce agency problems between managers and investors. Moreover, quality financial reporting can reduce information asymmetry and increase investment efficiency by reducing the cost of external financing for companies [11].

Testing the quality of financial reporting that is often used in previous studies is a quantitative measurement method where this method tests financial reporting related to earnings quality [5, 6]. However, in fact, the main weakness of this quantitative testing method is the lack of validity, and it only provides partial and indirect proxies for decision making. In addition, it does not involve non-financial information which means it does not perform a comprehensive assessment. Therefore, qualitative measurement of financial reporting quality needs to be developed in order to have a comprehensive measure of financial reporting by involving financial and non-financial data [8].

According to [12], when companies perform their CSR, high quality financial reports can influence their CSR strategy. This is because when shareholders obtain high-quality financial reports, they receive more informative and more transparent data in monitoring the CSR strategy that will be performed by the management. Therefore, it is predicted that the manager will only use CSR funds for activities that benefit the funder [10]. Adequate supervision of the CSR fund manager can reduce the risk of moral hazard [13]. When moral hazard conditions can be reduced, the risk of over/under investment in CSR investment can be reduced. Research by [7] states that over/under investment in CSR investment can reduce the effectiveness of the CSR program. This is detrimental to shareholders/funders considering that CSR investment can have a positive impact on the entity's future profits.

Moral hazard conditions can occur in an organization when the manager's supervision is inadequate [13]. In implementing CSR, this moral hazard can lead to over investment in the personal interests of the organization's managers [7].

Financial statements can be one of the tools of supervision and control of the performance of the manager, including when running their CSR programs. This can be seen from the function of financial statements as a form of accountability of management to stakeholders [14]. Thus, the quality of financial reporting becomes an important requirement for its stakeholders. [10] state that good quality financial reporting can reduce the risk of occurring moral hazard in an organization when investing. Thus, the existence of quality financial reporting can improve investment efficiency. Other previous studies showing similar results to the study in [10] are the results of the studies of [6, 15]. The research results of [7] also revealed that there was a negative relationship between the quality of financial reporting and the risk of over investment in implementing CSR. This means that the high quality financial reporting of an organization can reduce the risk of over investment in the implementation of the organization's CSR. Based on the description above as could be seen on Figure 1, then the following hypotheses can be formulated as:

H1a(b) = Quality of financial reporting (quantitative) has an influence on CSR investment in companies with the possibility of over investment (under investment)

H2a(b) = Quality of financial reporting (qualitative) has an influence on CSR investment in companies with the possibility of over investment (under investment)

3 RESEARCH DESIGN

This research uses quantitative and qualitative methods in measuring the quality of financial reporting in Indonesia, and then sees the effect on CSR investment costs. According to [16], quantitative methods focus on measurement and the number (more and fewer, larger and smaller, often and rarely, same and different) of the characteristics of the objects studied by researchers. However, qualitative research includes case studies, personal experiences, introspective, life stories, interviews, observations, historical, interactions, and visual texts that describe the routines and problematic moments that exist in human life.

Quantitative testing in this study uses an accounting base approach in measuring the quality of financial reporting in Indonesia. Then, the qualitative testing of the quality of financial reporting uses 33 items of measurement of financial reporting quality compiled based on CF [2] and developed by [8]. Of all the items, 13 items relate to value relevance, 7 items relate to faithful representation (a concept where LK can describe the company's actual business conditions), 6 measurement items relate to ease of understanding, 6 items relate to comparability, and one item illustrates the timeliness of reporting.

3.1 Population and Sample

The population in this study uses all companies listed on the Indonesia Stock Exchange that have published their 2015-2016 Financial Statements as secondary data sources. Based on the sample selection criteria, there are only 55 companies that have their complete financial data and published a sustainability report that lists the costs of CSR in it.

3.2 Operational Variables

3.2.1 Quality of Financial Reporting (Quantitative). Testing the quality of the financial reporting used the testing related to cash and profits which are proxied as accrual quality [7]. In line with [17], we performed accrual quality testing based on cross-sectional model data. Accrual quality testing was done by determining the TCA (Total Current Accrual) in equation 1)

$$TCAi,t = \alpha 0 + \alpha 1 CFOi, t-1 + \alpha 2 CFOi, t + \alpha 3 \Delta Revi, t + \alpha 4 PPEi, t + \varepsilon i, t \tag{1}$$

Where:
CFO = Net income before extraordinary items − TA
ΔRev = change in company i revenue in year t
PPE = Gross value of property, plant, and equipment of company i in year t

3.2.2 Quality of Financial Reporting (Qualitative). Qualitative measurement of financial reporting quality was done by using 33 measurement items of financial reporting quality developed by [8], which consist of 13 items related to relevance, 7 items related to faithful representation (a concept where FIs can describe the actual condition of a company's business), 6 items related to ease of being comprehended, 6 items related to their comparability, and one item that describes the timeliness of reporting. Furthermore, each measurement item was ranked using 5 Likert scale.

3.2.3 CSR Investment Costs (Over/Under Investment). To examine the relationship between the quality of financial reporting with CSR investment, a proxy for each under or over investment is needed. Proxies used in this study are the model developed by [10]. The proxies use specific characteristics that tend to influence the likelihood for the company to experience over investment. Based on this, according to [10], two proxies—cash balances and leverage—are established. Companies with large cash balances tend to face agency problems and over-invest (over-invest), while companies with high leverage tend to experience debt overhang problems, forcing companies to under-invest [10]. The proxy used to assess CSR investment was CSR costs incurred by the company. Testing CSR investment using the log value of total CSR costs was based on the writer's prediction that the total CSR costs can indicate the amount of CSR investment of a company with a tendency to experience over (under) investment.

Equations to test hypotheses:

$$\begin{aligned} HighCSR\_Change = \beta 0 + \beta 1 AQ\_ranki, t + \beta 2 AQ\_ranki, \\ t * HighOverii, t + \beta 3 HighOverii, t + \varepsilon i, t \end{aligned} \tag{2}$$

$$\begin{aligned} HighCSR\_Change = \beta 0 + \beta 1 FRQ\_ranki, t + \beta 2 FRQ\_ranki, \\ t * HighOverii, t + \beta 3 HighOverii, t + \varepsilon i, t \end{aligned} \tag{3}$$

$$\begin{aligned} LowCSR\_Change = \beta 0 + \beta 1 AQ\_ranki, t + \beta 2 AQ\_ranki, \\ t * LowOverii, t + \beta 3 LowOverii, t + \varepsilon i, t \end{aligned} \tag{4}$$

$$\begin{aligned} LowCSR\_Change = \beta 0 + \beta 1 FRQ\_ranki, t + \beta 2 FRQ\_ranki, t \\ t * LowOverii, t + \beta 3 LowOverii, t + \varepsilon i, t \end{aligned} \tag{5}$$

4 RESEARCH RESULT

4.1 Descriptive Statistics

Based on the sample data collected, only 112 companies provided complete and manageable data, while of the 112 companies only 55 companies presented the total CSR costs incurred by the company for 2015-2016. The average CSR costs incurred by the company in 2015 were 9 billion Rupiah with the lowest value of 23 million Rupiah and the highest value of 206 billion Rupiah. However, in 2016 the average CSR costs increased to 11 billion Rupiah, with the lowest value paid was 46 million Rupiah and the highest value of 322 billion Rupiah. The amount was only around 1.7% of the company's total Net Income in 2015, and around 1.1% of the company's total Net Income in 2016.

4.2 Testing the Quality of Financial Statements

Testing the quality of financial statements quantitatively and qualitatively is shown in Table 1, Table 2.

Simultaneous test results in Table 1 show the sig value. of 0,000 <0.05 (alpha), which means that simultaneously there are influences of the PPE, Rev, CFO 2015, CFO 2016 variables on TCA simultaneously, while the PPE, Rev, CFO 2015, CFO 2016 variables can explain the TCA variable of 67.1% (Table 2), while the remainder is explained by other variables.

4.3 Hypothesis testing

4.3.1 Quantitative quality testing of financial reporting on CSR investment in companies with the possibility of over investment (under investment). The first hypothesis (a) in this study predicts that the quality of financial statements (quantitatively tested) can reduce over investment in CSR investment.

Table 3 shows the significant values of hypotheses 1(a) and 1(b) of 1.000>0.05, which means that the model of logistic regression is worthy of further analysis or in other words the models of hypotheses 1(a) and 1(b) were declared fit.

Based on Table 4, the following is the equation:

HighCSR_Change=-3.456+22.302AQ_ranki - 20.024AQ_ranki, t*HighOverii+0 HighOverii + ϵ

The equation shows that the quality of the quantitatively assessed financial statements (AQ) has a positive influence of 14.8% (Table 5) on the cost of CSR investment with the possibility of

Table 1: Simultaneous Test Results

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	.076	4	.019	7.567	.000[b]
Residual	.125	50	.003		
Total	.201	54			

a. Dependent Variable: TCA
b. Predictors: (Constant), PPE, REV, CFO2016, CFO2015

Table 2: Determination Coefficient Simultaneous Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.834	.696	.671	2.715500694

Table 3: Hosmer and Lemeshow Test

	Chi-square	df	Sig.
hypothesis 1a	.000	1	1.000
hypothesis 1b	.000	1	1.000

Table 4: Logistic Regression Test of the first hypothesis (a)

	B	S.E.	Wald	df	Sig.	Exp(B)
Aq_ranking_2016	22.302	40192.876	.000	1	.000	4846422635
High_overii_2016	.000	49226.007	.000	1	.000	1.000
Aqranking_highoverii	-20.024	40192.876	.000	1	.000	.000
Constant	-3.456	49226.007	.000	1	.000	.032

higher over investment. However, the marginal effect of the quality of financial statements with HighOverii is negative and significant.

Furthermore, the first hypothesis (b) predicts that the quality of financial statements (tested quantitatively) can reduce divestment in CSR investment.

Based on Table 6, the following is the equation:

Low CSR_Change = 48.294 − 34.749 AQ_ranki + 17.374 AQ_ranki,t*Low Overii − 34.749 Low Overii,t+ ϵ

The equation shows that the quality of the quantitatively assessed financial statements (AQ) has a negative influence of 4.6% (Table 5) on the cost of CSR investment with a higher possibility of under investment. This shows that companies with better financial statements will be less likely to divest their CSR investment.

4.3.2 *Qualitative quality testing of financial reporting on CSR investment in companies with the possibility of over investment (under investment).*

The second hypothesis (a) in this study predicts that the quality of financial statements (tested qualitatively) can reduce over investment in CSR investment.

Table 7 shows the significant value of hypothesis 2(a) of 0.512> 0.05 and hypothesis 2 (b) 0.779> 0.05. These values mean that the logistic regression models of hypotheses 2(a) and 2(b) deserve further analysis.

Based on Table 8, the following is the equation:

HighCSR_Change=18.819+ 0.343FRQ_ranki − 20.526HighOverii+ 0 FRQ_ranki, t*HighOverii +ϵ

The equation can show that the quality of qualitatively assessed financial statements (FRQ) has a positive influence of 4.7% (Table 9) on the cost of CSR investment with the possibility of higher over investment. However, the marginal effect of the quality of financial statements with HighOverii is negative and significant.

Table 5: Coefficient of Determination

	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
hypothesis 1a	60.149	0.101	0.148
hypothesis 1b	9.679	0.007	0.046

Table 6: Logistic Regression Test of the First Hypothesis (b)

	B	S.E.	Wald	df	Sig.	Exp(B)
Aq_ranking_2016	-34.749	63247.294	.000	1	.000	.000
Aq_lowoverii	17.374	48833.868	.000	1	.000	35119037.42
Low_overii	-34.749	55471.549	.000	1	.000	.000
Constant	48.294	68502.308	.000	1	.000	9.41607E+20

Table 7: Hosmer and Lemeshow Test

	Chi-square	df	Sig.
hypothesis 2a	1.339	2	.512
hypothesis 2b	1.092	2	.779

Table 8: Logistic Regression Test: the Second Hypothesis (a)

	B	S.E.	Wald	df	Sig.	Exp(B)
High_overii 2016	-20.53	28420.66	.000	1	.009	.000
Frq_ranking	0.343	0.419	0.673	1	.012	1.41
Constant	18.82	28420.66	.000	1	.009	1.5E+08

Table 9: Coefficient of Determination

	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
hypothesis 2a	64.402	.032	.047
hypothesis 2b	9.791	.005	.034

The second hypothesis (b) predicts that the quality of financial statements (which are tested qualitatively) can reduce divestment in CSR investment.

Based on Table 10, the following is the equation:

LowCSR_Change = 14.065 − 0.317 FRQ_ranki+ 0.158 FRQ_ranki,t*LowOverii − 17.634 LowOverii+ ϵ

The equation can show that the quality of qualitatively assessed financial statements (FRQ) has a negative influence of 3.4% (Table 9) on the cost of CSR investment with the possibility of higher under investment.

4.4 Discussion

Based on the research results above, it is known that hypotheses 1(a) and 2(a) show a significant positive relationship between the quality of financial reporting on CSR investment with the possibility of over investment. The results of this study are not in line with the research results of [14] which show a negative relationship between the quality of financial reporting on CSR investment and the possibility of over investment. Thus, companies that have high quality financial reporting and want to invest more will tend to increase CSR investment. Then hypotheses 1(b) and 2(b) show a significant negative relationship between the quality of financial reporting on CSR investment and the possibility of under investment. The results of this study indicate that companies with high quality financial reporting tend to be less likely to divest CSR investment. The results of this study are also not in line with the results of [14] which state there is no significant relationship. Based on the results of our research, we can conclude that testing the quality of financial statements quantitatively has a greater effect than testing financial statements qualitatively.

5 CONCLUSIONS

Our conclusions found that quantitatively measured financial report quality has a significant positive relation on CSR investment with over investment probability and about 14.8% leverage. However, the marginal effect of financial reporting quality has negative and significant relation to CSR investment with over investment probability. This means that the better financial report quality is, the lower over investment is found in CSR investment. On the contrary, quality financial report has a significant negative relation on CSR investment with under investment probability and about 4.6% leverage. A qualitatively measured quality financial report has a significant positive relation to CSR investment with over investment probability and about 4.7% leverage, while the marginal effect of financial report quality shows negative and significant relation to CSR investment with over investment probability. This

Table 10: Logistic Regression Test: the Second Hypothesis(b)

	B	S.E.	Wald	df	Sig.	Exp(B)
Frq_ranking	-0.317	17138.34	.000	1	.000	0.729
Frq_lowoverii	0.158	17138.34	.000	1	.000	1.171
Low_overii	-17.63	33188.25	.000	1	.000	.000
Constant	14.07	33188.26	.000	1	.000	1283745

means that the better financial report quality is, the lower over investment is found in CSR investment. On the contrary, financial report quality has a significant negative relation on CSR investment with under investment probability and has 3.4% leverage. Comparing the influences between quality financial report which uses quantitative measurement and quality financial report which uses qualitative measurement, it can be said that quality financial report using quantitative measurement has a bigger influence than quality financial report using qualitative measurement. Our study provides evidence from Indonesia where there is an influence of quality financial report on CSR investment. The better financial report quality, the lower the tendency of a company to divest in CSR investment. Seeing that the results of this study are different from previous studies, then future studies can consider factors of organizational culture, political climate, and economic climate as a unit of research analysis and as factors that influence the relationship of those variables and the quality financial reporting on Corporate Social Responsibility investment in Indonesia.

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