

Environmental Expenditure Disclosure, Corporate Social Responsibility and Accounting Information Quality

ABSTRACT

This research examines the impact of environmental expenditure, environmental disclosure, and corporate social responsibility disclosure on the quality of accounting information. The quality of accounting information provided by companies has been highly doubtful in recent years, hence this research aims to connect it to non-financial information comprising of, environmental cost and corporate social responsibility disclosures. The population of this research consists of manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2020. This research uses purposive sampling to obtain 105 samples. The double regression analysis method was used. The result shows that both environmental and corporate social responsibility disclosures increase the quality of accounting information, while environmental expenditure disclosures do not affect the quality of the accounting information. An environmental expenditure disclosure is one of the voluntary disclosures which are part of management accounting, so the stakeholders, including the investors, tend not to consider that information in their investment decision-making, since management accounting is used mostly by the internal management.

Keywords: environmental disclosure, corporate social responsibility disclosure, environmental expenditure, accounting information quality

1. INTRODUCTION

Information quality is one of the most important elements in financial reporting. Stakeholders use the information in financial reports to evaluate the performance of company and to make decisions. Investors benefit from high-quality accounting information this helps them make better investment decisions. There are several criteria which define the quality of accounting information. The fundamental qualities include relevance and faithful representation (Kieso et al., 2018). Other characteristics which can improve the accounting information's quality are comparability, verifiability, timeliness and understandability (IFRS Foundation, 2016).

One of the most important criteria for information quality is relevance. The relevance of accounting information will influence the stakeholders' decision-making (Porter & Norton, 2007). A piece of information is relevant if it influence the users' economic decision-making. Information can have a predictive value if it can help users evaluate or assess past or future

21 events (Bukanya, 2014). The relevance of accounting information can be observed from the
22 fluctuation share prices following the announcement of that information (Harahap, 2016).

23 During their decision making, companies need to consider non-financial aspects
24 (Mbabazise et al., 2015), since financial information is not enough to assess future
25 performance and firm value (Orens & Lybaert, 2013). Financial information only conveys
26 short-term information; hence it becomes more important to consider non-financial
27 information. In this era of globalization, some non-financial information that is important for
28 the stakeholders includes companies' environmental activities and their expenditure to
29 prevent or treat any environmental damage caused by their operations (Suaryana et al.,
30 2011).

31 Nowadays, society's concerns toward economical and environmental sustainability
32 have sparked a trend which obliges companies to disclose their social responsibility activities
33 (Chen et al., 2018). Corporate social responsibility is a concept in which companies integrate
34 social and environmental matters into their business operations, as well as involving their
35 stakeholders (UN, 2019). The disclosure of corporate social responsibility is a form of
36 communication in which a company explains the impact of its business on the surrounding
37 social and environmental aspects and how the company treats the impact, which in turn
38 builds internal and external credibility (Oncioiu, I., et al., 2020).

39 Agusti & Rahman (2011) state that corporate social responsibility has a value
40 relevance. This value relevance decreases when the company engages in earnings
41 management (Kusuma., 2006). Earnings management is a policy, used by management to
42 attain certain objectives, and is usually to achieve the management's personal satisfaction
43 and increase the firm's market value (You et al., 2018). Brizolla & Klann (2019) state that
44 companies which spend more on environmental investment have lower levels of earnings
45 management.

46 Companies which are involved in environmental initiatives, marked by high
47 environmental expenditure and extensive CSR disclosures, are less likely to be involved in
48 earnings management practices (Kim, Park, & Wier, 2011). They also have less incentive to
49 undertake earnings manipulation (Litt, Sharma, & Sharma, 2014). This research aims to
50 develop the study of Brizolla & Klann (2019), which found that environmental expenditure
51 and disclosure increase the accounting information's quality.

52 **2. THEORY, CONCEPTUAL FRAMEWORK, HYPOTHESIS, AND RESEARCH**
53 **METHOD**

54 **2.1 Literature Review**

55 **Legitimacy and Stakeholder Theory**

56 Legitimacy theory states that society is considered whole regardless of separate
57 individuals (C. Deegan, 2002). This theory emphasizes that companies need to strive
58 continuously to ensure that companies operate in accordance with societal ties and norms
59 (Deegan, 2019).

60 The company's efforts to gain legitimacy from the community are generally carried
61 out in the form of social responsibility activities and disclosure of information related to the
62 impact of company operations on the environment (Berthelot & Robert, 2011).

63 Freeman defines stakeholders as all parties, both groups and individuals who
64 influence and are affected by the achievement of company goals (Freeman et al., 2018).
65 Stakeholder theory assumes that the establishment of a company requires the support of
66 stakeholders, so companies need to consider the interests of stakeholders in all company
67 activities (Rokhlinasari, 2015).

68 The company has an obligation to convey information related to the company's
69 operations that have a direct or indirect impact on stakeholders and stakeholders have the
70 right to receive such information. Thus it can be legitimized by the stakeholders.

71 **2.2 Conceptual Framework**

72 This research is based on the stakeholder theory and signaling theory. The
73 stakeholder theory assumes that companies need support from their stakeholders to
74 maintain their existence, hence companies need to consider their stakeholders' interests in
75 all their activities (Rokhlinasari, 2015). The signaling theory stipulates that the purpose of
76 disclosure is to obtain legitimacy from the stakeholders and give positive signals to the
77 shareholders. Environmental expenditure disclosures and CSR disclosures can give positive
78 signals by improving the relevance of the accounting information.

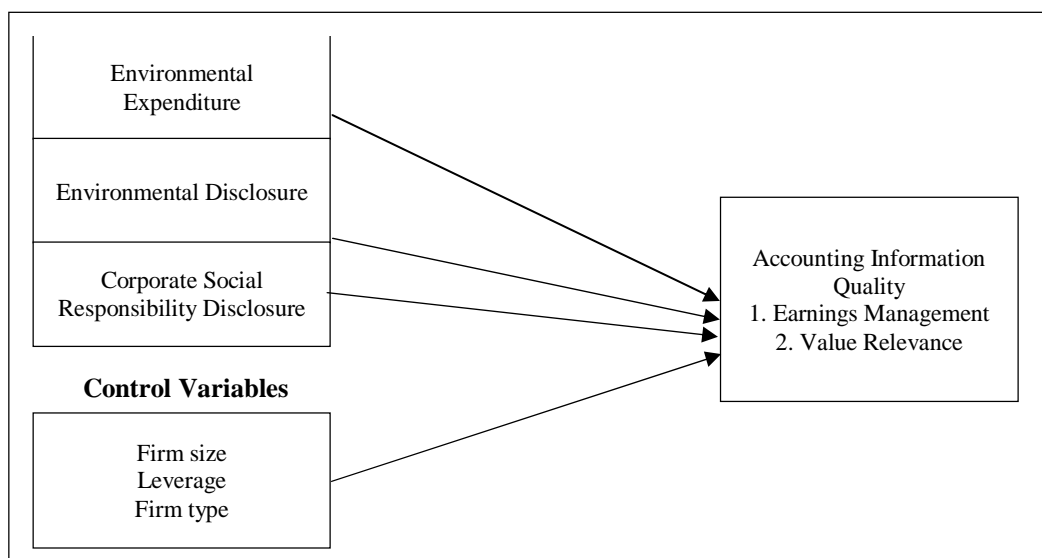
79 Companies allocate funds for environmental expenditure to fulfill their responsibility
80 to protect the environment from the impact of their operations (Hansen & Mowen, 2007;
81 Ojiakor & E-Obodoekwe, 2018). Information regarding environmental expenditure is used by
82 management in their decision making (Andayani, 2017). Environmental expenditure can be
83 calculated by comparing the costs incurred for environment-related CSR activities with after-
84 tax net income (Egbunike & Okoro, 2018). Companies may obtain economic gains from
85 environmental expenditure information by reducing their materials and waste, as well as

86 lower penalties relating to environmental damage (Mersi, 2016). Environmental disclosures
87 may also improve the company's image (Meilanawati, 2013).

88 Based on the stakeholder theory, companies are required to share information
89 regarding any of their operations which have a direct or indirect impact toward the
90 stakeholders. They do this to obtain support from the stakeholders. The legitimacy theory
91 explains that support from the stakeholders can influence the sustainability of the business.

92 Studies in Indonesia relating to environmental practices and accounting
93 information's quality have reported inconsistent findings. Some studies found that
94 environmental practices, such as environmental expenditure, environmental disclosure and
95 CSR disclosure increase the quality of the accounting information (Brizolla & Klann, 2019;
96 Pyo & Lee, 2013; Setyahuni & Handayani, 2020). On the other hand, another study finds
97 that environmental practices have no influence on the quality of the accounting information
98 (Schmelzer, 2013).

Image 1: Our conceptual framework is shown below:



100 2.2 Hypothesis

101 Several Indonesian companies have disclosed their environmental cost expenditure.
 102 Aside from the disclosures required by law, voluntary disclosures have been undertaken by
 103 companies to improve their images and attract public attention (Meilanawati, 2013). Brizolla
 104 & Klann (2019) and Pyo & Lee (2013) found that environmental disclosures improve the
 105 quality of the accounting information through lower earnings management and increased
 106 value relevance. This finding is consistent with Setyahuni & Handayani (2020) and Aureli et
 107 al., (2020). Companies which fulfill their environmental responsibilities produce higher quality
 108 reports. This will eventually benefit the stakeholders.

109 Based on the explanation above, we propose the following hypotheses:

110 **H1:** *Environmental costs negatively impact earnings management.*

111 **H2:** *Environmental information disclosures positively impact earnings value
 112 relevance and book value.*

113 Corporate social responsibility (CSR) disclosures provide information regarding
 114 corporate activities which have an impact on the community, environment, employees,
 115 consumers and energy usage of the company (Said et al., 2009). Companies perform and
 116 disclose their CSR activities to maintain their relationship with the stakeholders and obtain
 117 legitimacy from society.

118 Agusti & Rahman (2011) and Narullia et al., (2019) found that CSR disclosures have
 119 an impact on the quality of the accounting information through the fluctuation of share prices
 120 following the issuance of the disclosures. In contrast, Schmelzer (2013) found that CSR
 121 disclosures do not cause fluctuation in share prices.

122 Based on the above explanation, we propose the following hypothesis:

123 **H3:** Corporate social responsibility disclosures positively impact value relevance and
124 book value.

125 **2.3 Research Method**

126 This research examines the relationship between independent and dependent
127 variables using the quantitative method. Manufacturing companies listed on the Indonesia
128 Stock Exchange from 2016 to 2020 comprise the population in this research. GRI Standards
129 were initially applied in 2016. The manufacturing sector has been chosen due to the nature
130 of its operations, which produce waste and potentially harm the environment. The samples
131 were chosen by a purposive sampling method using several criteria.

132 Hypothesis testing using multiple regression, with the following equation:

133 **Model 1: $Y = \alpha + \beta_1ED + \beta_4Size + \beta_5LV + \beta_6Type + \epsilon$**

134 Description:

- 135 Y = Earnings Management
- 136 ED = Environmental Disclosure
- 137 FZ = Size
- 138 LV = Leverage
- 139 Type = Type of industries

140 **Model 2: $Y = \alpha + \beta_1ED_t + \beta_2EPS_t + \beta_3BVPS_t + \beta_4CSR_t + \beta_5Size + \beta_6LV + \beta_7Type +$**
141 **ϵ**

142 Description:

- 143 Y = Market Value for Equity
- 144 EPS_t = Earnings per Share t
- 145 $BVPS_t$ = Book Value of Equity
- 146 ED = Environmental Disclosure
- 147 CSR = CSR Disclosure

148 **2.3.1 Samples**

149 The sample selection process is shown in Table 1.

150 **Table 1. Sample Selection**

No.	Description	Number of Companies
1	Manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2020	181
2	Companies not issuing sustainability reports and/or annual reports during the research period	(3)

3	Companies with incomplete data related to environmental costs, environmental information disclosures, and CSR disclosures	(143)
4	Companies using foreign currency or operating at a loss	(14)
Number of samples		21
Number of observations during 2016-2020		105

151

152 **2.3.2 Operationalization and Measurement of Variables**

153 **Environmental Costs**

154 Environmental costs are measured by the amount disclosed in the CSR or
155 sustainability reports using the following formula:

156

$$157 \quad EC = \frac{\text{Environmental Costs}}{\text{Net income after tax}}$$

158 The index of environmental disclosure uses the following formula:

$$IED_j = \frac{\sum_{t=1}^{n_j} X_{ij}}{n_j}$$

159 **CSR Disclosures**

160 The CSR for each company is measured using the method developed by Amran
161 (2014). The study measures corporate social disclosures by giving a score of 1 for disclosing
162 companies and 0 for non-disclosing companies. The maximum score when a company
163 discloses all the information is 10. A company's total score is divided by the maximum score
164 to get the data ready to use for the research. This method is modified from the
165 environmental disclosure index by Clarkson et al., 2008 and Sutantoputra, 2009.

166

167 **Value relevance**

168 The value relevance of accounting information is calculated using a formula from
169 Ohlson (1995) as follows:

$$MVE = \alpha + \beta_1 EPS_t + \beta_2 BVPS_t + \beta_3 ED_t + \beta_4 CSR D_t + \beta_5 FZ + \beta_6 LV + \beta_7 TP + \varepsilon$$

170

171 **Earnings Management**

172 The measurement of earnings management used in this research is the regression
173 equation replicating the measurement of real earnings management through cash flows, by
174 Roychowdhury (2006).

175 **Source:** Brizolla & Klann (2019)

$$\frac{CFO_t}{A_{t-1}} = \alpha + \beta_1\left(\frac{1}{A_{t-1}}\right) + \beta_2\left(\frac{S_t}{A_{t-1}}\right) + \beta_3\left(\frac{\Delta S_t}{A_{t-1}}\right) + \varepsilon$$

176 **Control Variables**

177 This study uses three control variables, namely firm size, leverage and industry type.
 178 The size of the company can determine the level of ease of the company in obtaining funds
 179 from the capital market. Therefore, it can increase the market value.

$$\text{Company Size} = \text{Total Asset}$$

181 Leverage is an important component in measuring the effectiveness of the use of
 182 corporate debt (Prasetyorini, 2013). The higher the leverage value of a company, the
 183 higher the company's financial risk caused by high debt to finance company activities.

$$\text{Debt to Total Assets (DTA)} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

185 The types of companies used in this study were identified in the study as follows:

186 1 = Consumer Goods Industry; 2 = Basic and Chemical Industry; and 3 = Various
 187 Industries.

188 **3. RESULT AND DISCUSSION**

189 The result of this research is explained using descriptive statistics, the regression result, and
 190 a discussion.

191 **3.1 Descriptive Statistics**

192 **Table 2. Descriptive Statistics Result**

	N	Minimum	Maximum	Mean	Std.Deviation
Environmental Disclosure	105	0.06	0.62	0.190	0.123
Market Value for Equity	105	19.15	32.43	28.019	2.404
EPS	105	-2	38,596	610	3,769
Book Value per Share	105	-159.78	244,558	5,261	29,698
Firm Size	105	25.32	32.01	28.495	1.325
Leverage	105	0.00	16.95	0.949	1.990
Company Type	105	1	3	2.29	0.769
CSR Disclosure	105	0.20	1.00	0.716	0.163
Real Earnings Management	105	-0.62	0.28	0.047	0.103
Environmental Cost	105	0.00	1.15	0.027	0.121
Valid N (listwise)	105				

193
 194 The result of the descriptive statistics showed no significant deviation in the data.
 195 The data consisted of 105 observations. The classical assumption tests include a normality
 196 test which resulted in a significance of less than 0.05; model 1 had a significance of 0.059

197 while model 2 had 0.2. The multicollinearity test resulted in a tolerance value and variance
 198 inflation factor (VIF) of less than 0.10 or a VIF value less than 10, hence the data were free
 199 from multicollinearity.

200 The heteroscedasticity test in this research was conducted using the Glejser test;
 201 this regressed all the independent variables toward an absolute residual value of the model.
 202 The model could be considered free from heteroscedasticity if the significance of the F test
 203 was greater than 0.05. The testing resulted in the significance of model 1 and model 2 of
 204 0.768 and 0.983, respectively. The autocorrelation test results in Asymp. Sig (2-tailed) of
 205 0.817 for model 1 and 0.324 for model 2. These values were above the significance limit of
 206 0.05, hence it was concluded that the residual values of both models were free from
 207 autocorrelation.

208 3.2 Hypothesis Testing

209 The hypothesis testing consisted of two models. Model 1 was used to examine the
 210 independent variables toward earnings management, while model 2 examined the
 211 independent variables toward value relevance. The results of the double regression testing
 212 are shown in Table 3.

213 **Table 3. Double Regression Testing**

Model		Coefficient	Std. Error	t	Sig.
1	(Constant)	-0.397	0.227	-1.749	0.083
	Environmental Expenditure (X1)	-0.046	0.081	0.570	0.570
	Firm Size (FS)	-0.013	0.008	1,650	0.102
	Leverage (L)	-0.001	0.005	-0.242	0.809
	Company Type (TP)	0.027	0.013	2.008	*)0.047
<hr/>					
2	(Constant)	21,126	1,282	16,483	0.000
	Environmental Disclosure (ED)	13,069	1,464	8,929	****)0.000
	EPS	0.001	0.000	-2,717	***)0.008
	BVPS	2,679	0.000	-14,520	****)0.000
	Firm Size	0.032	0.043	0.743	0.459
	Leverage	0.049	0.061	0.801	0.425
	Company Type	-0.139	0.068	-2,026	***)0.046
	CSR	5,980	0.746	8,013	****)0.000
Notes:					

Model	Coefficient	Std. Error	t	Sig.
****) Significant at 1% Adjusted R2 of 0.057% and 0.52%				
**) Significant at 5% F test 0.042 and 0.00				
*) Significant at 10%				

214

215 The results showed that the book value was one of the important aspects that
216 investors consider in their decision making. Higher book value and earnings per share lead
217 to a higher firm value. Book value is considered to be a benchmark for a safe plan for
218 investing, where it could be a predictor of the lowest tolerable price of a stock (Puspita &
219 Samin, 2014).

220 Net income is another important piece of information that the investors consider. An
221 increase in the net income of a company reflects the favorable performance of the company,
222 which attracts the investors' attention. A high level of investment may increase the stock
223 price and market value of the company. This result is consistent with Agusti & Rahman
224 (2011) and Brizolla & Klann (2019) who all argue that book value and earnings per share
225 have value relevance.

226 The control variables firm size, leverage, and company type did not affect the level
227 of earnings management. This finding showed that the level of environmental expenditure
228 did not reduce earnings management. This implied that environmental cost disclosures did
229 not increase information quality.

230 Environmental expenditures incurred by a company tended not to have economic
231 consequences, as they did not an effect on firm value. Companies tend to consider
232 environmental costs to be a burden on them that lowers their income. A lower net income
233 may negatively affect investors' intentions to invest in the companies, which in turn reduces
234 their market value. Furthermore, environmental expenditures are part of the management
235 accounting for internal users. This result contradicted the result of Brizolla and Klann (2019),
236 who found that environmental costs affect the level of earnings management.

237 The result also showed that firm size, leverage and company type had a positive
238 impact on value relevance and book value. This showed that environmental disclosures
239 increase the value relevance of net income and book value (quality of accounting
240 information). This result indicated that environmentally responsible companies, which
241 voluntarily disclose environmental information, provide valuable information to the market.

242 The result of this research supports the findings of Brizolla and Klann (2019) and
243 Setyahuni and Handayani (2020), who all found that environmental expenditure has a
244 significant effect on value relevance. This result contradicted Qiu (2016) who found that

245 environmental expenditure has no effect on value relevance. Qiu (2016) states that
246 environmentally-sensitive sectors tend to have lower disclosure levels, to avoid potential
247 problems with the stakeholders.

248 Firm size, leverage, and the type of company had a positive impact on value
249 relevance and book value. This showed that CSR disclosures increased the relevance of
250 income and book value. CSR disclosures may increase transparency and reduce information
251 asymmetry, which in turn would increase the credibility of the company in the market.

252 This result was consistent with Agusti & Rahman, (2011), Lako, (2019) and Narullia
253 et al., (2019) who all found that corporate social responsibility disclosures had a significant
254 impact on the value relevance of both net income and book value. A high level of CSR
255 disclosure showed that a company was concerned about the impact of its operations on the
256 surrounding economic, social, or environmental conditions.

257 This result contradicted Schmelzer (2013), who found that CSR disclosures had no
258 impact on value relevance. CSR disclosures are voluntary, but CSR activities are required
259 under Law number 40 of 2007. This could lead to investors not considering CSR in their
260 decision making, since all companies are equally required to perform CSR.

261 **4. CONCLUSION**

262 This research examines the impact of environmental expenditure, environmental
263 disclosures, and CSR disclosures on the quality of the accounting information of
264 manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2020. The
265 result shows that environmental expenditure disclosures do not decrease earnings
266 management. Companies disclose this information to earn legitimacy from society and
267 support from their stakeholders.

268 The level of disclosure increases the quality of the accounting information. This
269 indicates that investors consider environmental information in their decision making. Hence,
270 we conclude that environmental disclosures improve the quality of the accounting
271 information.

272 Corporate social responsibility disclosures are found to increase the value relevance
273 and book value. This indicates that investors take into account information regarding CSR
274 activities in their decision making. Information regarding CSR activities reflects the
275 responsibility and goodwill of a company toward its economic, social, and environmental
276 surroundings.

277 The control variables firm size and leverage do not affect the quality of accounting
278 information. However, the type of company increases the value relevance and the level of
279 earnings management.

280 This research uses environmental expenditure as an independent variable.
281 However, there are only a small number of companies which disclose their environmental
282 expenditure explicitly. Hence, we consider CSR expenditure as environmental expenditure.
283 There is an element of subjectivity in measuring the corporate social responsibility index. We
284 recommend future studies to reduce the level of subjectivity by discussing this with other
285 researchers who have previously studied corporate social responsibility disclosures.

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