Evaluation on Supportive Infrastructures for Corporate Social Responsibility Reporting in Indonesia

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Abstract

The purpose of the essay is to evaluate the condition of infrastructure necessary for transparent and accountant Corporate Social Responsibility (CSR) reporting using the case of Indonesia. At present the level and quality of CSR reporting of companies in Indonesia is relatively low, which is due to the ineffective supporting infrastructures for CSR reporting. So far there has been no generally accepted CSR reporting standard which can be used as guidance for companies preparing their CSR report. 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 warranted, or the expansion of the function of available committee, such as audit committee, is 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.

Keywords: Corporate Social Responsibility, Social Accounting, Social Reporting

General Topic: Social and environmental issues – Corporate Social Responsibility
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Background

The topic related to Corporate Social Responsibility (CSR) recently has been widely covered in the World as well as in Indonesia. Many companies in the World and in Indonesia claim they have implemented CSR. 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\(^1\) according to the prevailing rules, and to actively cooperate with stakeholders for the company sustainability (OECD, 2004).

CSR concept states that corporate responsibility is not only to the owner or shareholder but also to its stakeholders. In determining and executing its business strategy, a company implementing CSR considers its impact to society and environment and strives for positive impact. The need for CSR is also a consequence of more environmental damage in the World, such as deforestation, air and water pollution, and climate change. This phenomenon cause people to realize that natural resources are limited and therefore economic development should assure sustainability (i.e. sustainable development), with the consequence that a company should run its business using efficient resources, ensuring that the resources are not depleted for the benefit of future generation.

In line with the trend, in Indonesia, Law No. 40/2007 regarding Limited Liability Company (or the Company Law) imposes an obligation for a company with business related to natural resources to implement social and environmental responsibility. The law also stipulates

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\(^1\) *Stakeholders* is any party receiving impact (positive or negative) of company existence and therefore have interest with the company. *Stakeholders* commonly including: employee, supplier, customer, creditor, government and public.
that all companies should report CSR implementation in the annual report. This report reflects the need for corporate accountability in implementing CSR in order to enable its stakeholders to evaluate the implementation thereof. Thus, with transparency and accountability, it is hoped that companies voluntarily implement CSR.

Currently many companies in Indonesia, especially large companies, report its CSR activities in the annual report; however, information reported and disclosed varies and thus is difficult to evaluate. Further, in general only positive information is disclosed (Hartanti, 2003), implying that the report is only a public relation tool and not a form of accountability of the company to the public (Haigh and Jones, 2006). Furthermore, Cooper and Owen (2007) state that reporting is not sufficient 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

1. To identify determinants/supporting infrastructure on CSR reporting.
2. To evaluate the extent that the determinants are conducive to achieve accountable CSR reporting in Indonesia and the World in general.
3. To recommend efforts to achieve accountable CSR reporting in Indonesia.

Related to the aforementioned purposes, this paper also discusses the extent of CSR reporting in Indonesia. The discussion focuses on corporations, public companies or companies using public fund. The reason is that in general the activities of these companies have significant impact on public welfare.

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2 Actually obligation to implement CSR is not only set out in Law No.40 but also in Law No.25/2007 regarding Capital Investment. The Law put an obligation to all companies doing investments, not only those doing business in natural resources.
CSR Reporting, Accountability and Organizational Learning Tools

Stakeholder theory and economics theories regarding CSR imply that stakeholders need to evaluate how far a company has performed its roles in accordance with the stakeholders’ need. 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 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 company’s accountability on CSR activities. The presence of accountability is becoming increasingly important as there is the presence of asymmetric information between stakeholders and company’s management. The stakeholders only has access to public information or the information conveyed to public, while the company management has complete information about the company.

The presence of asymmetric 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 asymmetric 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.

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Accountability can be met and asymmetric information may be reduced if companies report their CSR activities to the stakeholders. Based on the report, the stakeholders may evaluate the performance of CSR, and therefore, they can give 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 in accordance with the management performance.

In line with the above argument, the company’s reporting on its social and environmental activities may be defined as:

*The process of communicating the social and environmental effects of organizations’ economic actions to particular interest groups within society and to society at large. As such, it involves extending the accountability of organisations (particularly companies), beyond the traditional role of providing a financial account to owners of capital, in particular, shareholders. Such an extension is predicated upon the assumption that companies do have wider responsibilities than simply to make money for their shareholders* (Gray et al, 1996, p. 3 in Adams dan Zutshi (2004).

Gond and Herrbach (2006) are of the opinion that CSR reporting is not only useful for external parties but also for the company. By making CSR report, the company will make a self-assessment so that it can identify its strengths and weaknesses related to the CSR activities of the company. Thus, the report may serve as an organizational learning tool which may cause dynamic changes of the individuals and the company which eventually encourage improvement of organizational performance. Hence, it can be concluded that transparent and accountable CSR reporting may encourage companies to perform CSR which eventually may improve not only the reputation of the company but also the welfare of the society.

**Supporting Infrastructure for Accountable CSR Reporting**

This part discusses the infrastructure required as presented in the following diagram.
CSR report has to describe the real CSR activities so that the stakeholders can reliably 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 ensure the availability of accounting, reporting and disclosure of the CSR activities as well as expenses and benefits obtained from the CSR 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.

However, the presence of a CSR reporting standard does not guarantee the improvement in the quality of CSR reporting. Since CSR reporting is made by a company, and the company wants to create a good self-image, the company 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 lost 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 structure and mechanism 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.

In Indonesia, a listed company or a company using public funds (such as company which issues bonds or banks) is currently required to have an independent commissioner. The independent commissioner is expected to have no personal interest, instead, he or she is expected to put the interest of the company as a whole, including the stakeholders of the company. The quality of CSR reporting is also determined by the audit committee and the accounting division of a company. To ensure the reliability of the CSR report, the audit committee should not only focus on the feasibility of the financial report but also on the CSR report. Or, the company may form a CSR committee, most of whose members are external parties having expertise in CSR. This committee is to provide advices to the company about efforts to increase the implementation and reporting of CSR in the company. The accounting division of the company
should also be involved in the preparation of the CSR report, including the reporting and disclosure of benefits and social cost of CSR.

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 or whether it is up to the companies to publish the report or not (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 report⁴.

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⁴ See Adams (2004) who conducted a case study on CSR writing and suggested that a comprehensive CSR reporting is obligatory.
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 with the current governance structure which stresses on the interest of the shareholders, it is difficult for the stakeholders to demand a company’s accountability through the governance mechanism. Therefore, the society can use force to indirectly give reward/punishment to companies performing or not performing CSR. This, in turn may substitute ineffective governance mechanism, which in the long run may create the accountability of companies’ CSR.

**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 condition of various supporting infrastructure mentioned earlier in Indonesia and in the world in general.

The term CSR has currently gained popularity among the business community in Indonesia, as shown in a research conducted by SWA magazine in 2005 that find that CSR is one of the most implemented concepts in strategic setting by companies in Indonesia (31.11%) (Hasibuan-Sedyono, 2006). However, 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) 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. 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) 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. Hartanti (2007) find that average disclosure of

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5 The Department of Environment regularly checks the rate of companies’ compliance in applying environment-friendly production process. The result of the checking is awarded to the companies (in the form of the PROPER
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 low disclosure of social and environmental information is also found by Darwin (2006): Indonesian Accountant Association (IAI) Management Accounting Compartment conducts an annual Indonesian Sustainability Reporting Awards (ISRA) and finds that only 10% of Indonesian public companies disclosed social and environmental information in their 2004 annual report. In fact, only very few companies make a special report on environmental and social information.

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). 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 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 certificate) from the worst (black-rated) to the best (gold-rated). No single company has ever achieved the gold-rated PROPER certificate so far.
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, article 97 paragraphs 3 to 5 and article 114 paragraph 5 of the Law state 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 both the Board of Directors and Board Commissioners to focus on making profit, which may lead to the company’s unwillingness to perform CSR. This situation makes it difficult for the Board of Directors and the Board of Commissioners to perform CSR, prepare the report and cater all the needs of the stakeholders.

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. To compensate the risk of the shareholders, they are entitled to control and direct the management of the company. 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. It is very important for companies doing business in the fields which are potential to cause negative externalities (such as in the field of forestry or mining) to have CSR Committee.

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\(^6\), so it is difficult for stakeholders to learn how much a company’s management compensation is based on CSR performance. Lack of transparency in the management compensation system may hinder the creation of reward/punishment mechanism by stakeholders to the company.

\(^6\) 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 of CSR Reporting and Disclosure

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).7

The development of CSR reporting and disclosure 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). Thus, this kind of reporting does not only focus on shareholders (who are entitled to the net profit), but also on other stakeholders (creditors, employees and the government). 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, measures the value of human resources in the company. This is triggered by a belief that a company’s main asset is the company’s human resources which, in the financial report, is not considered as assets. A number of researches propose various alternative human resources acknowledgement and measurement as asset (e.g., Glaütier and Underdown, 1973, Hekimian and Jones, 1967, Lev dan Schwartz, 1971 in Belkaoui, 2004), but

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7 Gray (2002) provided a comprehensive review on the development of social accounting in the past 25 years.
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. For example, value added reporting has a wider coverage compared to income statement because it also covers value added yielded for other stakeholders (e.g. employees and the government); however, it does not show the negative or positive externalities impact of the company’s activities.

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, including 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\(^8\); but there has so far not been an agreement on which format can be used as the global reporting standard \(^9\). This lack of agreement has led to the differences in CSR reporting which in turn leads to low comparability among CSR reports of companies.

One of the proposed standard is Sustainability Reporting developed by the Global Reporting Initiative (GRI). GRI focuses on the disclosure standards of various economic, social, and business environments with the aim to improve quality, rigor and utilization of sustainability reporting\(^10\). Companies can use GRI guidelines on three levels (GRI, 2006). The lowest level, level C, reports only part of the whole GRI disclosure standards, while the highest level, level A reports the whole GRI disclosure standards. GRI encourages that report be audited by independent external parties. Performance indicators are divided into 3 components, namely economics, environmental and social indicators which include human rights, labor and business environment practices, product accountability, and the society. Disclosure wise, these indicators are composed of core indicators and additional indicators. For example, in the 9 economic performance indicators, 7 of them are core indicators and the others are additional indicators. Of

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\(^8\) See Szekely and Knirsch (2005) who did a comprehensive review on various alternative measurements of sustainable performance.

\(^9\) 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 was developed by *International Accounting Standard Board* (IASB) as a standard reference in making financial report.

\(^10\) Since 2000, a larger number of companies have used GRI, and by October 2006, the number of companies using GRI reached 1000 spreading in 60 countries. (Ballou et al, 2006).
the 79 total performance indicators, 9 are economic indicators, 30 environmental indicators and 40 social indicators.

The structure of GRI version of sustainability report is different from that of the financial report. Financial statements consist of several reports (Balance Sheet, Income statement, Cash Flow Statement and Statement of Changes in Owner’s Equity) which are supported by notes to financial statements. Readers of the financial statements may focus on the main reports while referring to the notes to the financial statements for more detailed information. For shareholders, the information in the Income Statements, especially the net profit of the company may serve as the main indicator for evaluating the company’s performance, while the Balance Sheet provides the shareholders with the information on the company’s assets and liabilities. The sustainability report does not have summarized reports like the financial statements, instead there are a number of indicators as explained earlier. The great number of indicators suggests that CSR report is comprehensive and will help readers in evaluating the company’s performance related to economic, environmental and social matters. However, the absence of summarized report makes it difficult for the CSR report readers to get a whole summarized picture of the company’s performance in terms of environmental and social factors.

Refering back to the discussion on financial statements, Wallman(1996) criticises the recognition criteria which are too focused on the criteria of measurement reliability so that more relevant information is not reflected in the financial report as it does not meet the criteria. To ensure that the report readers get the relevant information though less reliable, Wallman suggested that a multilayered reporting be used with each layer using different disclosure and measurement criteria. Wallman’s suggestions (1996) basically widen the accounting coverage for external parties in that they do not only cover financially-related items, but they also report non-financial items or items which has no monetary value. Therefore, the information related to
CSR may be reported using more than just the first layer, depending on the criteria it meets. In addition, the company does not have to prepare a number of different reports for external parties since a single report will serve the purpose.

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).

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**

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. Generally, companies in EU countries are more advanced in their CSR reporting compared to those in the US as the US government does not fully encourage companies to do that.

With the issuance of the Corporation Law No. 40 of 2007 to replace Law No. 1 of 1995, 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

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11 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.
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. Furthermore, the reason for implementing Article 74 Paragraph 1 is also related to the sustainability concept which is to ensure that natural resources are not depleted or damaged so that they cannot be used by the future generations of the nation. Therefore, only companies dealing with natural resources are obliged to perform environmental and social responsibility.

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 explanation to the regulation states that although the corporations do not directly deal with natural resources but their activities affect the function or capability of the natural resources then these types of corporations are also included in the types of companies having to comply with the regulation. Since there might be different interpretation for this regulation, a more detailed types of activities having impact on the natural resources is required.

In the discussion on sustainability reporting in GRI, it has been stated that companies could choose the layer of reporting appropriate to their implementation of the concept of sustainability in their business activities. The implementation of the sustainability concept in the company’s activities range from the lowest to the highest. As the Law on Corporation does not regulate how a company may be classified as having performed the social and environmental
responsibility; therefore, a further rule (such as Government’s Decree) has to explicitly make the classification.

The detailed regulation should 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.

Law No. 40 of 2007 makes it obliged for all companies to make report on the implementation of Social and Environmental Responsibility in their annual report submitted by the Board of Directors, examined by the Board of Commissioners and approved by the General Meeting of the Shareholders. 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 people who have interest in the report to be able to access it and evaluate it for them to determine appropriate actions to take for the company based on their evaluation. In addition to the shareholders, other people interested in the implementation of the social and environmental responsibility of the company are the stakeholders, thus the report is to be written not just for the shareholders but also for the stakeholders. For public companies, the general public are able to access the report, otherwise, the report is written only for the shareholders so that it is difficult to measure the accountability of the company. 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.

In order that 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. The coverage may refer to the relevant local or national standard or to the international standard. 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. Compared to the previous decree (SK Bapepam No. 38/PM/1996) the amount of information that should be disclosed, especially the one related to the corporate governance, is much higher. 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 Law on Corporation, 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 among several companies. Therefore, like Law No. 40, 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 western 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%, the general public is still focusing 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. In terms of forcing companies to implement and report CSR activities, what can you expect from Indonesian people who are used to damaging their environment.

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 was caused by their limited access to the CSR report. Companies writing CSR report will only put good information in their report as there is currently no CSR reporting standard nor is there an assurance standard on CSR report. This in turn makes it difficult for the general public not only to distinguish which companies perform CSR and which don’t but also to give rewards and punishment appropriately. Thus, public pressure will be effective only when the CSR reports are transparent.

**Conclusion**

Currently the level and quality of CSR reporting of companies in Indonesia is relatively low, which is due to the ineffective supporting infrastructure for CSR reporting. There has currently been no agreement on the CSR reporting standard which can be used as guidance for companies writing their CSR report. The available standard coverage of CSR (such as Sustainability Reporting from GRI) is quite comprehensive, however, the absence of a summarized report which can describe the impact of companies activities on the society and environment will make it difficult for stakeholder to evaluate the effectiveness of the company’s CSR activities. 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. As the governance system in Indonesia states that the Board of Directors and the Board of Commissioners have to put the company’s interests first, it implies that they take into consideration the shareholders’ interests but also that of tother
stakeholders. But, as these two elements of the company are elected by the shareholders, another element to support the implementation of company’s CSR, such as CSR committee or the expansion of the function of available committee, such as audit committee, is 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 read. 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 so that there is no need to punish them,
- The coverage of the report of social responsibility which have to be submitted.

Besides, it is advisable that the report of large companies whose business is related to natural resources may be accessed by the public. These companies should be encouraged to hire independent external parties to audit their report. Secondly, a further research is required to develop CSR reporting standard which can describe the effectiveness of a company’s CSR activities. Hence a global CSR reporting standard needs to be developed so that companies in different countries have one standard to refer in preparing their CSR report. The accounting profession should reconsider the coverage of the information presented for external parties: whether it still needs to be presented in monetary value or not. Third, a generally accepted assurance standard for CSR reporting should immediately be prepared by taking into
consideration the different characteristics of CSR report from financial reports. Fourth, companies need to be encouraged to change their governance system to a more accommodative system for the performance and reporting of a company’s CSR activities. Therefore, the compensation system for the Board of Commissioners and the Board of Directors need to be revised to also be based on the company’s CSR performance indicators. Fifth, there should be continuous 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.

In relation to the field of accounting, if the accounting profession wants to have the report for external parties to have high relevance, it should change the mindset that the report has to have the financial characteristics. The word ‘accountant’ is derived from the word ‘accountability’ which suggests that this profession has a very important role in presenting the company’s accountability to the owners of the company or to the other stakeholders, and that accountability also covers non-financial information.

This change may also have implication on the accounting education, especially in Indonesia. The skills to develop CSR report requires more than just business and accounting knowledge but it also needs other knowledge, such as economics (public and natural resources), sociology, and social welfare. Thus, the accounting education should yield knowledgeable accountants who masters not only financial accounting. The proportion of accounting subjects in the curriculum in Indonesia is currently very high. Thus, the curriculum for accounting education needs to be reviewed by considering the possibility of increasing the number of subjects related to humanities and economics, and by offering non-financial accounting subjects, such as social and environmental accounting, human resources accounting, etc.
Diagram 1: Supportive Infrastructure for Transparent and Accountable CSR Reporting

- Regulation on CSR and its reporting
- Mechanism and Structure of Governance
- Generally Accepted CSR Reporting Standard
- Assurance Standard for CSR Reporting
- Public Pressure
  
  Transparent and Accountable CSR Reporting
  
  Increase in CSR Activities
  
  Increase in Firm Value
  
  Increase in Welfare of Society
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Undang-Undang No. 40 tentang Perseroan Terbatas.

