MANAGEMENT & ACCOUNTING REVIEW

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C O N T E N T S

The Effect of Corporate Social Responsibility Disclosure and Corporate Governance Mechanisms on Earnings Management and Stock Risk: Evidence from Public Banks in Indonesia

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ABSTRACT

This research aimed to examine the effect of corporate social responsibility disclosure (CSRD) and corporate governance mechanisms (CGM) on earnings management (EM) and stock risk (SRISK). The examination was conducted from the context of mandatory adoption of IAS-PSAK 50&55 (Revised 2006) and macroprudential policy in 2010. This study used the data of 36 banks, with 131 bank-years samples that were listed on IDX for the years 2008-2013. The results concluded that: (1a) CSRD has weak negative effect on SRIS; (1b) CGM has partial negative effect on SRISK, whereby BCM has no significant effect on SRISK, while ACM has significant negative effect on SRISK; (2a) CSRD has significant negative effect on E; (2b) CGM has partially negative effect on EM, whereby BCM has no significant effect on EM, while ACM has significant negative effect on EM; and (3) EM has positive significant effect on SRISK. Results 2 and 3 leads to the conclusion that direct effect of CSRD on SRISK was explained by indirect effect through EM. The overall result showed CSRD and CGM have negative effect on EM, though there are no significant decrease of EM at post period mandatory adoption of PSAK 50 and 55, yet the evidence found significant lower SRISK at post period of mandatory adoption of PSAK 50&55 (Revised 2006) and macroprudential policy.

Keywords*: corporate social responsibility, corporate social responsibility disclosure, earnings management, corporate governance mechanisms, stock risk.*

INTRODUCTION

Corporate Social Responsibility (CSR) is defined as a business' commitment to contribute to sustainable economic development, through collaboration with stakeholders, employees, customers, local communities and the public to improve quality of life, in ways that benefit both its own business and development (Kiroyan 2006; in Istianingsih and Zulni 2013). The companies face increasing demand of stakeholders to achieve a balance of economic, environment and social imperatives in accordance to the triple bottom line; people, profit and planet (Elkington 1998). CSR disclosure is viewed as a communication tool that influences the perceptions of stakeholders, analyst and institutional investor, regarding future profitability, financial prospect and sustainability (Linblom 1993; Handajani, Sutrisno and Chandrarin, 2009). The companies listed on Indonesia Stock Exchange (IDX) have to disclose CSR as regulated by law, *Undang Undang No. 40 tahun 2007, and Peraturan Pemerintah. No. 47 tahun 2012.* To date, majority of public banks in IDX have disclosed CSR in their annual reports, while several provide such disclosure in the integrated reporting sustainability report based on the Global Reporting Initiative (GRI).

Prior researches on economics consequences of voluntary disclosure (Botosan 1997; Leuz and Verrecchia 2000) have motivated several studies regarding CSR disclosure. Several findings showed that CSR disclosure has a positive effect on companies' performance, reflected through indicators such as abnormal returns, cumulative abnormal return, trading volume activity, and earnings per share (Cochran & Wood 1984; Andersen & Frankie 1980; in Sayekti 2011). CSR disclosure does have an effect on earnings response coefficient (ERC), and it increases earnings informativeness (Bae and Sami 2005; Sayekti &Wondabio 2007; Istianingsih & Zulni 2013). CSR disclosure is perceived as a signal of good performance and management accountability to gain stakeholders' legitimacy (Gray et al. 1996; Sayekti&Wondabio 2007; Sayekti 2011).

Bebbington, Larinaga and Moneva, (2008) stated that CSR disclosure could be viewed as part of reputational risk management. Reputation is conceptualised from the economic and strategic management perspective to sociologically-informed perspective that views reputation as the outcome of shared socially constructed impression of the firm (Scott and Walsham, 2005;

in Bebbington et al., 2008). Reputation is viewed as a strategic intangible asset that is expected to produce tangible benefits such as lower cost of capital, increased loyalty of employee and customer as well as increased quality of decision-making process (Roberts and Dowling 2002).

Hong and Andersen (2011) stated that the effect of CSR disclosure on risk could not be separated from the credibility of earnings information. Francis et al. (2005) found that the company with poor accrual quality has higher costs of capital than those with good better accrual quality. Botoson (1997) found that voluntary disclosure to reduce transaction costs is reflected through adverse selection component of bid-ask spread. These findings show the evidences that there are related information risk regarding CSR disclosure and companies' earnings information. Information risk is defined as the likelihood that firm specific information is of poor quality (Easley and O'Hara, 2004; Leuz and Verrecchia, 2004 in Francis et al., 2005)

Previous research studying the effect of CSR disclosure on earnings management found contradictory findings. CSR disclosure is found to be positively associated with aggressive earnings reporting, and increasing management opportunistic behaviour (Chih, Shen and Kang, 2008; Handajani et al.2009), while Hong and Andersen (2011) found negative association among the aforementioned variables. Bae, Doowon and Youngkyu (2013) found evidence that the effect of CSR on earnings management is more influenced by the specific context of the companies' environment, where CSR disclosure is found to be positively affecting earnings management in high-profile industry, but negatively effecting those in low-profile industry. Other research findings found that corporate governance (CG) mechanisms (eg. board of commissioners, audit committee, ownership structure) play an important role on the effect of CSR disclosure to earnings management (Chih et al. 2008; Handajani et al. 2009; Bae et al. 2013).

This research aimed to examine the effect of CSR disclosure and CG mechanisms on earnings management and stock risk. The first proposed model hypothesised that (1) CSR disclosure and CG mechanisms have negative effect on stock risk directly. This research also examined whether CSR disclosure and CG mechanism have negative effect on stock return indirectly through earnings management, by examining hypothesis (2) CSR disclosure and CG mechanisms have negative effect on earnings

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management, and (3) Earnings management has positive effect on stock risk. The CG mechanism comprised of board commissioner mechanism (BCM) and audit committee mechanism (ACM).

The examination was conducted from the context of mandatory adoption of IAS-PSAK 50&55 (Revised 2006) and macroprudential policy in 2010. This study used pooled data of 36 banks (131 bank-years samples) listed on IDX for the years 2008-2013. PSAK 50&55 (Revised 2006) is the Statement of Financial Accounting Standard (SFAS) in Indonesia which regulates the measurement, recognition, and presentation of financial instrument. PSAK 50&55 had converged to IAS 32 and 39. Macroprudential policy is the approach of financial regulation aimed to mitigate systemic risk and maintain the stability of financial system by encouraging the bank and financial services companies to re-orient the business towards a macroprudential perspective (Ekaputri 2011).

This study was motivated by limited CSR disclosure research findings in the banking industry in Indonesia. Previous studies conducted were mostly in the non-financial industries and did not examine the effect of CSR disclosure on earnings management in the same context. The banking industries with high and specific regulation are predicted to have better CSR disclosure and have different effects on earnings management and stock risk, relative to other sectors and industries. Indonesia's banking sector survey by PricewaterhouseCoopers (2013) showed that high operational risk in the banking industry has attracted attention of management to focus on the quality of CSR disclosure to gain legitimacy of stakeholders.

The study contributes in several ways. Firstly, it contributes to the literature of CSR disclosure research as this study examines the direct and indirect effects of CSR disclosure as well as CG mechanisms on stock risk. The indirect effect will be explained by the effect of CSR disclosure and CG mechanisms through mediation on earnings management, as proxy of information risk. Secondly, this study provides input to regulators of the banking industry and the capital market about the regulatory effectiveness of CSR disclosure. Thirdly, this study provides input to investors, analysts and other related stakeholders for better decision-making.

The remainder of the paper is organised as follows: Section 2 explains the literature and hypotheses development. Section 3 explains the design of the research; sample and data, model development, and variable operationalisation. Empirical result and analysis are presented in Section 4, followed by conclusions, limitation and suggestion for future research in Section 5.

THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

Corporate Social Responsibility Disclosure and Stock Risk

It was argued that CSR disclosure should be a part of reputational risk management (Bebbington et al. 2008) as CSR disclosure conveys private information, signaling good performance of social responsibility to ensure that companies have taken desired action in accordance to social norms. The harmony in fullfiling the social contract will gain legitimacy of stakeholders and is expected to reduce risk (Dowling & Pfeffer 1975; in Sayekti 2011).

Prior research by Dufresne, Francois and Patrick (2004) found that CSR disclosure is associated with decreased business risk and increased risk-adjusted performance in the long term. Nguyen, Pascal and Anna (2015) found high CSR disclosures related to diversity and employee relations is positively associated on stock risk. Mishra and Modi (2002) categorised CSR disclosure into positive and negative, and found that positive CSR disclosure is associated with decreased stock risk and vice versa. Chakrabarty and Bass (2013) found that ethical value, and CSR in microfinance institution in developing countries related to decreasing operational risk.

Handajani et al (2009) found that effective CG mechanisms are integrated with corporate action and have important roles in the assurance of accountability strategy and implementation of CSR. The implementation of CSR initiatives and disclosure practice should be followed by regulation and policy in order to avoid opportunistic behaviour. The adoption of IAS-PSAK 50&55 as well as macroprudential policy in the banking industry are expected to be the direction in CSR initiatives and disclosure practice that will lead to decreased stock risk.

Based on the explanation above, the first hypothesis is derived as follows:

H1a	CSR disclosure has negative effect on stock risk.
H1b	The effectiveness of board commissioner mechanisms has negative effect on stock risk.
H1c	The effectiveness of audit committee mechanisms has negative effect on stock risk.
H1d	Stock riskwill be lower at post period of mandatory adoption of PSAK 50&55 and macroprudential policy.

CSR Disclosure, CG Mechanism and Earnings Management

Several reasons behind the companies' decision to undertake CSR initiatives have triggered negative or positive association to earnings management such as management compensation contract, increasing stock price, gaining social legitimacy and other management's interest (Baron 2007; Utama 2008; in Handajani et al. 2008). The negative association can be explained by *myopia avoidance hypothesis* in which management has long-term horizon in decision making, focusing not only on current profits but also on maintaining long-term stakeholders' relationships. The positive association can be explained by hypothesis of predictable earnings and multiple objective and interest (Chih et al. 2008). In this case, management tends to manage earnings opportunistically in order to maintain the predictability of future profits, after considering multiple objectives of the shareholders and stakeholders (Jensen 2001 in Chih et al. 2008; Handajani et al. 2009).

Shleifer (2004) stated that CSR disclosure is perceived as a tool to increase transparency and accountability and reduce number of opportunity to manage earnings. In this regard, findings showed that the companies with strong commitment to social responsibility do portray less earnings management. Other findings showed that more socially responsible firms have higher accrual quality and less earnings management, both of which have an impact on financial reporting quality (Shen and Chih 2005; Hong & Andersen 2011).

Other perspectives stated that CSR can exacerbate the agency problem that leads to increasing management incentive to undertake earnings management. Several findings showed that there are positive associations between CSR disclosure and earnings management (Chih et al. 2008; Prior et al. 2008; Handajani et al. 2009). Other findings showed that in order to gain the benefit of CSR in improving companies' values in the long term, firms need an integrated CG mechanism for CSR strategy and corporate action on CSR initiatives (Chih et al. 2008; Handajani et al., 2009; Lanis & Richardson 2011). Based on the explanation, the second hyphothesis is derived as follows:

H2a	CSR disclosure has negative effect on earnings management.
H2b	The effectiveness of the board of commissioners has strengthened the negative effect of CSR disclosure on earnings management.
H2c	The effectiveness of the audit committtee has strengthened the negative effect on CSR disclosure on earnings management.
H2d	Earnings management will be lower at post period of mandatory adoption of PSAK 50&55 and macroprudential policy

Earnings Management and Stock Risk

Previous research findings showed that earnings management has a positive relationship with risk. Francis, Ryan, Olsson and Schipper (2005) found that the companies with poor accrual quality have higher costs of capital than those with good accruals quality. Hong and Andersen (2011) stated that the effect of CSR disclosure cannot be separated from the credibility of earnings information. Poor accrual quality is a part of information risk.

Prior reseach on market reaction showed that investors tend to misprice the quality of accruals (Sloan 1996; Xie 2001; Richardson et al. 2005). In line with these findings, research in the banking industry by Beaver & Engel (1996) has found positive association between component of accrual descreationary of loan loss provision and market value of common equity. Yasuda (2004) found that bank risk is negatively associated with discretionary accrual in the banking industry of Japan. This finding indicated that investors misperceive high earnings quality as favourable information about bank financial health. The negative relationship was very strong in years of crisis in the late 1997, and decreased thereafter.

Assuming banking companies being in a highly regulated industry, regulation of CSR disclosure, mandatory adoption of IAS-PSAK 50&55 as well as macroprudential policy are expected to contribute in improving the quality of accruals and providing true understanding for investors.

The third hypothesis is derived as follows:

H3a	Earnings management has positive effect on stock risk.
H3b	Stock risk will be lower at post period of mandatory adoption of PSAK 50&55 and macroprudential policy, as consequences of lower earnings management.

RESEACH METHOD

Sample and Data

The population of the study comprised of all the banking companies listed on IDX during 2008-2013. The purposive sampling method was used for sample selection. The criteria for sample selection covers a) Banks with a minimum of 3 years of listing; b) Availability of the publication of the annual report containing CSR disclosure and Corporate Governance; and c) Availability of complete financial statements and other supporting financial data. The final samples of 131 observations (firm-years) are presented in Appendix Table 1.

Table 3.1: Sample Selection

		Population	Sample
Bank listed at IDX	2013	36	22
	2012	31	22
	2011	30	22
	2010	29	22
	2009	28	22
	2008	28	21
Total Selected Sample		182	131 firm-years

This study used secondary data from annual reports of the banking companies published in the IDX website. Annual reports are data sources for calculating the index of CSR and CG mechanisms. Financial statement and *Indonesia Capital Market Directory* are sources for financial data, while the stock price data were collected through *Yahoo Finance.* Review of literature was conducted through text book, scientific journals, and other related sources.

The data were analysed using balance panel approach and Ordinary Least Square/OLS multiple regression. Additional analysis was conducted using Two Stage Least Square/TSLS for endogenity problem in the model.

CONCEPTUAL FRAMEWORK AND RESEACH DESIGN

The research model was developed based on the following conceptual framework. Three models were developed to test the 3 hypotheses.
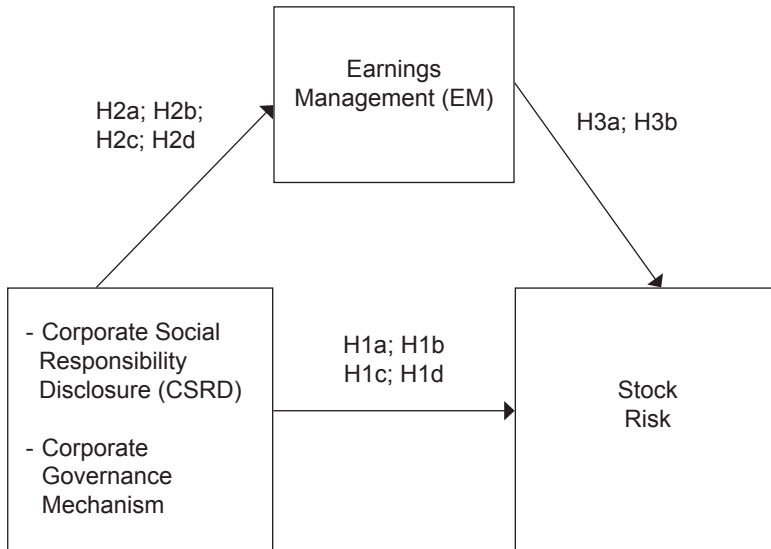
Figure 1: Conceptual Framework

Three models were developed to examine the hypotheses. Model 1 was used to test hypothesis 1, as follows:

$$
\begin{aligned}
SRISK_{it} = {}& \alpha_0 + \alpha_1 CSRD_{it} + \alpha_2\ BCM_{it} + \alpha_3\ ACM_{it} + \alpha_4 DGOV_{it} + \\
& \alpha_5 INST_{it} \\
& + \alpha_6 LN\_TA_{it} + \alpha_7\ PBV_{it} + \alpha_8 ROE_{it} + \alpha_9 DBIG4_{it} + \alpha_{10} \\
& DPOST_t \\
& + \varepsilon_{it}
\end{aligned}
\tag{1}
$$

It was expected that the coefficient of variables CSRD, BCM, ACM and DPOST (α_1; α_2; ; α_3 ;α_{10}) to be negative. This means that increasing level of CSR disclosure as well as increasing effectiveness of CG mechanism will contribute to decreasing stock risk. The negative coefficient for DPOST means that stock risk is predicted to be lower in the post period mandatory adoption of PSAK 50&55.

Model 2 was used to test hypothesis 2, as follows:

$$
\begin{aligned}
EM_{it} = {}& \beta_0 + \beta_1 CSRD_{it} + \beta_2 BCM + \beta_3 ACM_{it} + \beta_4 CSRD*BCM_{it} \\
& + \beta_5\ CSRD*ACM_{it} + \beta_6\ DGOV_{it} + \beta_7\ INST_{it} + \beta_8\ LN\_TA + \\
& \beta_9\ PBV_{it} + \beta_{10} ROE_{it} + \beta_{11} DBIG4_t + \beta_{12}\ DPOST_t + \varepsilon_{it}
\end{aligned}
\tag{2}
$$

It was expected that the coefficient of variables CSRD, BCM, ACM and DPOST (β_1; β_4; β_5 ;β_{12}) to be negative. This means that increasing level of CSR disclosure as well as increasing effectiveness of CG mechanism as moderating effect will contribute to lower earnings management. The negative coefficient for DPOST means that earnings management is predicted to be lower in the post period of mandatory adoption of PSAK 50&55.

Model 3 was used to test hypothesis 3, as follows:

$$
\begin{aligned}
SRISK_{it} = {}& \lambda_0 + \lambda_1 CSRD_{it} + \lambda_2 EM\_EXP_{it} + \lambda_3 BCM_{it} + \lambda_4 ACM_{it} + \\
& \lambda_5 CSRD*BCM_{it} + \lambda_6 CSRD*ACM_{it} + \lambda_7 DGOV_{it} \\
& + \lambda_8 DINST_{it} + \lambda_9 LN\_TA_{it} + \lambda_{10} PBV_{it} + \lambda_{11} ROE_{it} t + \\
& \lambda_{12} DBIG4_{it} + \lambda_{13} DPOST_{it} + \varepsilon_{it}
\end{aligned}
\tag{3}
$$

It was expected that the coefficient variables of earnings management EM_EXP (λ_2) to be positive. This means that increasing level of earnings management will contribute to increasing stock risk. Meanwhile, the expectation of coefficient DPOST (λ_{13}) is predicted to be negative. It means that lower earnings management in the post period of mandatory adoption of PSAK 50&55 will contribute to lower stock risk. The variables are explained as follows:

Independent and/or Dependent Variable	
$CSRD_{it}$	CSR Disclosure index by Lanis & Richardson, (2011)
EM_{it}	Earnings management as absolute value of descreationary provision for loan losses for bank and financial services by Beaver dan Engel (1996),
$SRISK_{it}$	Variability in monthly stock price for 12 month since 1 January 2008.
BCM_{it}	Index of Board of Commisioners mechanism effectiveness by Hermawan (2009)
ACM_{it}	Index of Audit Committee mechanism effectiveness by Hermawan (2009)
EM_EXP_{it}	Natural Logarithm of expected earnings management (fitted value) by Beaver dan Engel (1996).
$DPOST_{it}$	Dummy variable 1 for post period adoption of PSAK 50&55 (2011-2013), 0 otherwise (2008-2010)
Control Variables	
$DGOV_{it}$	Dummy variable 1 for banking companies with government ownership, and 0 otherwise
$DINST_{it}$	Dummy variable 1 for banking companies with institutional ownership, and 0 otherwise
LN_TA_{it}	Proxy size of the companies measured as natural logarithm of total asset.
ROE_{it}	Proxy of profitability measured as ratio net income per book value equity
$DBIG4_{it}$	Proxy of external monitoring measured as dummy variable 1, if the banking companies using one of the Big4 auditors, and 0 otherwise.

Operationalisation of Variables

Corporate Social Responsibility Disclosure (CSRD)

CSR disclosure is measured as a checklist that consists of 52 items developed by Lanis and Richardson, (2011). The checklist consists of 6 groups of topics namely: 1) CSR and strategy items; 2) Staff strategy items; 3) Social investment items; 4) Environment items; 5) Customer and supplier items; and 6) Community and political involvement items. The checklist is then evaluated using content analysis with dichotomous approach, where if each CSR items disclosed is given the value 1, and 0 if it is not disclosed. Next, each item is summed to obtain the overall value to calculate the CSR disclosure index according to the formula as follows:

$$CSRD\ j = \Sigma\ Xij\ /\ nj$$

Where:

CSRD j: Corporate Social Responsibility Disclosure Index for company j

Nj: Total item for company j, nj <= 52

X ij :   Content analysis; 1=if item is disclosed; 0=if item I is not disclosed.

So that, 0 <= CSRD <= 1.

Additional tests are conducted on CSR disclosure using Sustainability Report (SR) based on GRI. In this regard, CSR disclosure is measured by dummy variable 1 for banking company that reports SR, and 0 otherwise. This testing is conducted as not all listed banking companies report on CSR in the Sustainability Report. The testing aims to find out whether it produces a consistent result with the proxy of CSR disclosure index.

Stock Risk (SRISK)

Stock risk is measured using the standard deviation of monthly stock price for 12 months from 1 January 2008. Standard deviation of monthly stock price can be used as a proxy to the absolute value of the stock price expectations (Hartono, 2013; Puspitarini, 2014). This study did not use beta from CAPM due to data availability. Standard deviation is calculated as follows

$$SD = \sqrt{\left\{\frac{(xi - x)^2}{n}\right\}}$$

Where:
Xi: Stock return monthi
X: Average value of stock at research period.
N: Number of observation

Earnings Management (EM)

Earnings management in this study is measured using descreationary accrual portion of loan losses for banking and financial services as used by Beaver and Engel, (1996) as follows:

$$N\_ALL_{it} = \alpha_0 + \alpha_1 CO_{itt} + \alpha_2 LOAN_{it} + \alpha_3 NPA_{it} + \alpha_4 {}_\gamma \Delta NPA_{it+1} + \varepsilon_{it}$$

$$ALL_{it} = N\_ALL_{it} + D\_ALL_{itt}$$

$$ALL_{it} = \alpha_0 + \alpha_1 CO_{itt} + \alpha_2 LOAN_{it} + \alpha_3 NPA_{it} + \alpha_4 {}_\gamma \Delta NPA_{it+1}^{itt} + z_{it}$$

$$z_{it} = {}_3 D\_ALL_{it} + {}_\gamma \mu_{it}$$

Where:

CO_{it}	Loan charge offs
$LOAN_{it}$	loans outstanding
NPA_{it}	non performing assets.
ΔNPA_{it+1}	One period ahead change in nonperforming assets
N_ALL_{it}	Estimated nondescreationary portion of the allowance for loan losses
ALL_{it}	Total allowance for loan losses.
z_{it}	Residual value as accrual descreationary

Corporate Governance Mechanism Effectiveness

This study measures CG mechanisms through content analysis to obtain an index CG mechanisms effectiveness. CG mechanisms effectiveness is measured through a proxy of board of commissioners (BCM) and audit committee (ACM) in accordance with CG mechanism checklist published by Hermawan, (2009). Scoring method for CG disclosure items are based on quality of disclosure, whereby the score 3 indicates (good), 2 for (fair) and 1 for (poor) disclosure.

The effectiveness of the board of commissioners (BCM) is measured by 17 items, namely a) independence - 6 items; b) Activities - 6 items; c) The size of commissioners - one item; and d) Skills and competencies - 4 items. The effectiveness of the audit committee (ACM) is measured by 11 items, namely a) Activity - 8 items; b) Size - 1 item; c) Skills; and d) Competencies - 2 items. Next, each item is summed to obtain the overall value for the CG mechanism effectiveness index.

Control Variables

This study uses several control variables. They are ownership structure, the financial characteristics of the company as well as audit quality as external monitoring mechanisms, all of which are found to have significant effects in prior research finding (Handajani et al. 2009; Hong and Andersen 2011, and Sayekti 2011).

Characteristics of ownership structure include: government ownership and institutional ownership. The financial characteristics of the company include: the size of the company, growth and profitability. Audit quality as a measure of external monitoring mechanism is proxied by auditor from Big 4 auditing firms. The adoption of SFAS 50&55 and macroprudential policy are controlled by dummy variable for post period of adoption from 2011-2013.

RESULT AND DISCUSSION

Descriptive Statistics

Descriptive statistic results are presented in Table 2 as follows:

Table 2: Descriptive Statistic

	Mean	Median	Maximum	Minimum	Std. Dev	Obs
SRISK	0.114	0.096	0.096	0.000	0.072	131
EM	0.616	0.379	4.817	0.007	0.754	131
EM_EXP	2.533	2.573	2.828	2.095	0.189	131
CSRD	0.498	0.444	0.822	2.095	0.189	131

BCM	0.786	0.444	0.822	0.267	0.141	131
ACM	0.786	0.765	0.980	0.471	0.099	131
LN_TA	15.685	17.049	20.413	10.301	5.384	131
PBV	3.205	1.670	18.452	-1.740	4.404	131
ROE	1.077	1.170	3.730	-9.460	1.652	131
DGOV	0.323	0.000	1.000	0.000	0.448	131
DINST	0.710	1.000	1.000	0.000	0.456	131
DPOST	0.520	0.275	1.000	0.000	0.483	131
DBIG4	0.710	1.000	1.000	0.000	0.524	131

Sources Eviews 8

Based on the maximum, minimum and average values, the CSR disclosure index (CSRD) ranges between 0.267-0.822, with the average of 0.498. The results show that CSR disclosure in the banking industry in Indonesia is quite low; it is below 60%. The range of Board of Commisioners effectiveness index (BCM) is 0.471-0.980, with an average of 0.786. Meanwhile, the range of Audit Committee effectiveness index (ACM) is 0.364-0.970 with an average of 0766. The results show that CG mechanism is adequate as the value is bigger than 75%.

Classical Test Assumption

Classical test assumption is performed to meet the normality assumption as stated in Table.3. Normality test shows that the distribution of the data is approximately normal as evidenced by the bell-shaped pattern of the histogram and coefficient of Jarque-Berra. The probability for all models is proven to be more than 0.05. This result shows that the data used in the models of the study is normally distributed. Pearson-Correlation test shows that there is no significant correlation among variables. Multicolinearity test shows that the Variance Inflation Factor/VIF has a value below 10 for all models. Therefore, it is concluded that there are no multicolinearity problems among the independent variables within the model. The models also pass the LM-test and White-test, for autocorrelation and heterokedasticity in the data.

Table 3: Classical Test Assumption

Model	Normality		Autocorrelation-LM Test			Heterokedastity - White		Multicolinearity
	Jarque-Berra	Prob	Durbin-Watson	F-Stat	Prob	F-Stat	Prob	VIF
Model 1 CG,CSR → SRISK	1.757	0,4154	1.9766	0.0545	0.9998	1.1286	0.3113	VIF <5
Model 2 CG,CSR→EM	1.1190	0.6102	1.9653	0.1845	0.9988	1.2966	0.1478	VIF < 10
Model 3 CG, CSR,EM_ EXP →S RISK	2.945	0.4563	2.0220	0.1059	0.9999	1.0175	0.423	VIF < 5

Sources: Eviews 8, SPSS

Correlation Test

The results of correlation test are presented in Tabel 4. The correlations among the variables are less than 0.8. It indicates that there is no potential multicollinearity problem with the data. The correlations between CSR disclosure and stock risk (SRISK), and CSR disclosure and earning management (EM) show negative values of (-0.132) and (-0.028), respectively; the sign is as predicted. The correlations between board of commissioner mechanism (BCM) and stock risk (SRISK), and BCM and earning management (EM) also show negative values of (-0.096) and (-0.019), respectively. The correlation between audit committee mechanism (ACM) and stock risk (SRISK) shows a positive value of (0.038), which contradicts with the prediction. Lastly, the correlation between ACM and earnings management (EM) shows a negative value of (-0.019).

Regression Result

The regression of the model is presented in Table 5 in the appendix. The F-Test results indicate the effect of independent variables on the dependent variable in each model. The adjusted R-squared for the models 18.7%, 31.4% and 11.9%, respectively, with the probability of F-stat is significant at 1% for all models. It can be deduced that the independent variables in all models can explain the dependent variable.

Table 4: Pearson Correlation

Covariance / Correlation	SRISK	EM	EM_EXP	CSRD	BCM	ACM	LN_TA	PBV	ROE	DGOV	DINST	DPOST	DBIG4
SRISK	0.005 / 1												
EM	0.006 / 0.112	0.564 / 1											
EM_EXP	-0.001 / -0.111	-0.069 / -0.492	0.035 / 1										
CSRD	-0.001 / -0.132	-0.028 / -0.268	0.016 / 0.603	0.020 / 1									
BCM	-0.001 / -0.096	-0.019 / -0.252	0.005 / 0.244	0,008 / 0.229	0,010 / 1								
ACM	0.000 / 0.038	-0.009 / -0.093	0.003 / 0.128	0.042 / 0.454	0.008 / 0.469	0.017 / 1							
LN_TA	-0.014 / -0.117	-0.629 / -0.495	0.301 / 0.094	-0.027 / -0.063	0.042 / 0.254	0.022 / 0.101	2.866 / 1						
PBV	0.069 / 0.218	0.058 / 0.018	-0.060 / -0.073	0.032 / 0.196	-0.032 / 0.196	-0.414 / 0.508	-0.359 / -0.048	19.246 / 1					
ROE	-0.006 / -0.051	-0.422 / -0.342	0.121 / 0.391	0.005 / 0.106	0.005 / 0.106	0.013 / 0.063	1.414 / 0.508	0.774 / 0.107	2.709 / 1				
DGOV	-0.012 / -0.338	-0.049 / -0.149	0.031 / 0.370	-0.004 / -0.099	-0.004 / 0.099	0.003 / 0.049	0.281 / 0.373	0.614 / 0.314	0.215 / 0.293	0.199 / 1			
DINST	-0.006 / -0.189	-0.023 / 0.078	-0.023 / 0.275	-0.006 / -0.132	-0.006 / -0.132	-0.001 / -0.016	-0.221 / -0.228	-0.880 / 0.442	-0.215 / 0.288	-0.172 / -0.450	0.206 / 1		
DPOST	-0.012 / -0.338	-0.001 / -0.004	-0.001 / 0.116	0.026 / 0.386	-0.006 / -0.132	-0.023 / -0.367	0.117 / 0.143	-0.491 / -0.233	0.041 / 0.052	-0.021 / -0.097	0.024 / 0.108	0.231 / 1	
DBIG4	0.001 / 0.016	-0.182 / -0.464	0.050 / 0.059	0.009 / 0.176	0.028 / 0.381	0.008 / 0.111	0.499 / 0.564	0.072 / 0.032	0.255 / 0.297	0.043 / 0.183	-0.016 / -0.066	0.009 / 0.035	0.272 / 1

Sources: Eviews 8

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Table 5: Regression Result

	Exp Sign	Model 1 CG, CSR→SRISK			Model 2 CG, CSR→EM			Model 3 CSR,EM_ EXP→SRISK		
		Coeff	p-value		Coeff	p-value		Coeff	p-value	
Intercept		0.281	0.004	**	2.670	0.015	**	0.689	0.004	***
CSRD	-	-0.020	0.093	*	-0.403	0.084	**	-0.034	0.098	*
BCM	-	0.117	0.102	*	1,546	0.104	*	0.094	0.135	
ACM	-	-0.016	0.047	**	-0.751	0.032	**	-0.094	0.048	**
DPOST	-	-0.045	0.007	***	0.132	0.230		-0.041	0.001	***
CSRD*BCM	-				0.648	0.072	*	0.608	0.075	*
CSRD*ACM	-				-0.193	0.025	**	-0.198	0.284	
EM_EXP	+							0.014	0.046	**
DGOV	-	-0.025	0.173		-0.195	0.140		-0.024	0.180	
DINST	-	-0.049	0.045	**	-0.234	0.110		-0.045	0.053	**
DBIG4		0.014	0.194		-0.450	0.005	***	0.020	0.113	
LN_TA	+	-0.001	0.280		-0.034	0.097		-0.003	0.435	
PBV	-	-0.030	0.442		-0.032	0.156		0.002	0.451	
ROE	-	-0.002	0.303		-0.073	0.025	**	-0.001	0.356	
Adjusted R-squares		0.187			0.314			0.119		
F-Stat		2.66			5.503			2.363		
Prob (F-Stat)		0.006		***	0.000		***	0.007		***

*** Significant at 1%; ** Significant at 5%; * Significant at 10%

SRISK: Standard deviation or variability of monthly stock price. EM: Earnings Management - Absolute Discreationary Accrual for Loan loss provision (Beaver and Engel, 1996); EM_EXP: Fitted Value / Expected Earnings Management; CSRD: CSR disclosure index; BCM: The Effectiveness of Board of Commisioner (Hermawan, 2009); ACM: The effectiveness of Audit Committee (Hermawan, 2009); DGOV: Dummy 1 for Government Ownership, 0 otherwise; DINST; Dummy 1 for institutional Ownership, 0 otherwise; DBIG4; Dummy 1 for BIG4 auditors, and 0 otherwise; LN_TA: Natural logarithm of Total Assets; PBV: Price to Book Value (Growth); ROE: Return on Equity (Proxy for profitability; DPOST; Dummy 1 for the period after the regulation (2011-2013), and 0 for the period (2008-2011).

Sources: Eviews 8

Table 6: Additional Test

	Exp Sign	Additional Test CG,CSRD→EM			Exp Sign	Additional Test CG,CSRD,EM_Exp→Risk			Endogenity Test CG,CSRD,EM_Exp→Risk		
		Coeff	p-value			Coeff	p-value		Coeff	p-value	
Intercept		2.670	0.015	***		0.689	0.004	***	0.689	0.004	***
DUM_SR	-	-0.403	0.043	**	-	-0.034	0.098	*	-0.039	0.098	*
BCM	-	1,546	0.104	*	-	0.094	0.135		0.094	0.135	
BCM_ACTIV	-	0.507	0.104		-	0.098	0.102		0.813	0.085	
BCM_INDEP	-	-0.453	0.097	*	-	-0.172	0.083	*	-0.103	0.065	*
BCM_SIZE	+	0.354	0.101		+	0.056	0.354		0.365	0.323	
ACM	-	-0.751	0.032	**	-	-0.094	0.048	**	0.094	0.048	**
DPOST	-	0.049	0.364		-	-0.042	0.002	***	-0.045	0.006	***
EM_EXP	+				+	-0.018	0.445		-0.886	0.138	
DGOV	+	-0.195	0.140		+	-0.024	0.180		-0.024	0.180	
DINST	-	-0.234	0.110		-	-0.045	0.053	**	-0.045	0.053	**
DBIG4	-	-0.450	0.005***		-	0.020	0.113		0.020	0.113	
LN_TA	+	-0.034	0.097*		+	-0.003	0.435		-0.003	0.435	
PBV	-	-0.032	0.156		-	0.002	0.451		0.002	0.451	
ROE	-	-0.073	0.025**		-	-0.001	0.356		-0.001	0.356	
Adjusted R-squares		0.314				0.191			0.207		
F-Stat		5.503				2.122			2.365		
Prob (F-Stat)		0.000	***			0.017	***		0.000	***	

Instrumen Variabel for Endogenity Test :
CSRD, BCM, ACM, CSR*BCM, CSR*ACM, DGOV, DINST, DBIG4, LN_TA, PBV, ROE, ,DPOST

*** Significant at 1%; ** Significant at 5%; * Significant at 10.

SRISK: Standard deviation or variability of monthly stock price. EM: Earnings Management - Absolute Descreationary Accrual for Loan loss provision (Beaver and Engel, 1996); EM_EXP: Fitted Value / Expected Earnings Management; DUM_SR: CSR disclosure in Dummy 1 if using Sustainability Report, 0 otherwise; BCM: The Effectiveness of Board of Commisioner (Hermawan, 2009); ACM: The effectiveness of Audit Committee (Hermawan, 2009); DGOV: Dummy 1 for Government Ownership, 0 otherwise; DINST; Dummy 1 for institutional Ownership, 0 otherwise; DBIG4; Dummy 1 for BIG4 auditors, and 0 otherwise; LN_TA: Natural logarithm of Total Assets; PBV: Price to Book Value (Growth); ROE: Return on Equity (Proxy for profitability; DPOST; Dummy 1 for the period after the regulation (2011-2013), and 0 for the period (2008-2011).

Model 1 is used to examine hypothesis 1, which stated that CSR disclosure and CG mechanism have negative effects on stock risk. The T-Test result shows that CSR disclosure negatively affects stock risk, significant at 10%. This finding is in line with the prediction, thus, H1a is accepted. The board of commissioner mechanism positively affects stock risk, significant at 10%, but the sign is opposite to the prediction. Hence, H1b is rejected.

The audit committee mechanism negatively affects stock risk, significant at 5%. This finding is in line with the prediction, hence, H1c is accepted. The results show negative coefficient for post period (DPOST), significant at 1%. This implies that the stock risk is lower at post period of mandatory adoption of PSAK 50&55. This finding is in line with prediction, thus H1d is accepted.

The evidences show weak effect of CSR disclosure in reducing stock risk (significant at 10%). This weak effect occurs in situations where the CG mechanisms show partial effect on stock risk, with the role of board of commissioner mechanism is less effective. Nevertheless, the evidence shows the stock risk is lower in post period of mandatory adoption of PSAK 50&55 (Revised 2006) and related macroprudential policy.

Model 2 is used to examine hyphothesis 2 that states that CSR disclosure and CG mechanisms are affecting earnings management negatively. The T-test result for model 2 shows that CSR disclosure negatively affects earnings management, significant at 10%. This finding is in line with the prediction, thus H2a is accepted. The interaction between CSR disclosure and board of commissioner mechanisms (CSRD*BCM) positively affects earnings management, significant at 10 %, but the sign is opposite to the initial prediction. Thus, H2b is rejected. The interaction between CSR disclosure and audit committee mechanisms (CSRD*ACM) has negatively affected earnings management, significant at 5%. This finding is in line to the prediction, thus, H2c is accepted. The results show that there is no significant difference in earnings management in the prior period compared to the post period of mandatory adoption of PSAK 50&55, as predicted. Therefore, H1d is rejected.

The evidences show that the effect of CSR disclosure in reducing earnings management is quite weak. There are partial effects of corporate governance mechanism in reducing earnings management. The insignificant moderating effect of board of commissioner seems to be compensated by strong effect of audit committee mechanisms. However, the existence of partial role of corporate governance is supposed to cause no significant decrease in earnings management, hence, there is no significant differences in earnings management in periods prior to and post mandatory adoption of PSAK 50&55 and related macroprudential policy.

Model 3 is used to examine hyphothesis 3 that states that earnings management positively affects stock risk. The T-Test result for model 3 shows consistent result for the effects of CSR disclosure and CG mechanisms on stock risk. CSR disclosure is affecting stock risk, and the effect of interaction between CG mechanisms and stock risk is found to be partial. The evidence shows that earnings management (fitted value of EM) is found to be positively affecting stock risk, significant at 5%.Thus, H3a is accepted. Overall, it can be concluded that showstock risk is lower in post period of mandatory adoption of PSAK 50&55 as predicted.

The evidence suggests that earnings management reflects accrual quality; higher earnings management reflects poor accrual quality and related to information risk. This study supports those studies by Leuz and Verrecchia, 2004 and Francis et al. 2005. The evidence of lower risk post period of PSAK 50&55, reflects that the market responds to the information of accrual properly; this finding is in line with Francis, (2005) but dissimilar to those of Beaver and Engel, (1996) as well as Sloan, (1996), Xie, (2001); Richardson et al. (200) and Subramanyam, 2007).

The T-Test Result for Control Variables for all models can be concluded for the effect of ownership structure (DGOV and DINST), financial characteristic (Size, Profitability and Growth) and audit quality (DBIG4). The evidences show insignificant lower earnings management and stock risk at banks with goverment ownership, but significantly lower stock risk for banks with institutional ownership. The size and growth of companies have no significant effect on earnings management and stock risk. Profitability has a negative effect on earnings management, but does not affect stock risk.The banks that are audited by Big4 auditors are found to have lower earnings management, although it has no effect on stock risk.

Additional Test

Additional testing is done with consideration of several things; 1) To use dummy variable for banks that disclosed CSR using Global Reporting Initiative/GRI in Sustainability Reporting, 2) To explore the findings of the ineffective role of board of commissioner mechanisms (BCM), by decomposing board of commissioner mechanism into activity, independence and size of BCM; and 3) To address the issue of endogenity in the model of the study, using Two Stage Least Square/TSLS.

The result of additional test is presented in Table.6. It shows a consistent result in terms of the negative effect CSR disclosure (CSRD) has on earnings management and stock risk. The evidence shows there are significant lower earnings management as well as lower stock risk for banks that disclosed CSR in Sustainability Report (DUM_SR). The evidences show that the ineffective board of commissioners' mechanism is caused by ineffectiveness in the activity and size of BCM. The result shows only the independence of the board has a significant effect on earnings management and stock risk. This result suggests that the ineffective size of the board contributes to communication problem among members in directing the banks' activities and executing their monitoring function. The endogenity test of the model is done using two stage least square /TSLS, with related instrument variable: CSRD, BCM, ACM, CSR*BCM, CSR*ACM, DGOV, DINST, DBIG4, LN_TA, PBV, ROE, DPOST. The result shows consistent and significant explanation of independent to dependent variable in the model of the study (Adjusted R-square 20.7% significant at 1%).

CONCLUSION, IMPLICATION AND SUGGESTION

This study aimed to investigate the effects of CSR disclosure and CG mechanisms on earnings management and stock risk in the banking industry of Indonesia. The study also aimed to explain whether the effect of CSR disclosure on stock risk is mediated by the effect on earnings management. The study is conducted from the context of mandatory adoption of PSAK 50&55 (Revised 2006) and macroprudential policy in 2010, and performed on 131 bank-years samples companies listed on IDX during the period from 2008 to 2013.The result of this study has added empirical evidence regarding the effect of CSR disclosure on stock risk in the banking industry in Indonesia.

The result of the study shows there is a weak, direct and negative effect of CSR disclosure on stock risk (significant at 10%). The evidence shows partial effect of CG mechanisms on stock risk. The role of board of commissioner mechanisms as proxy of CG mechanisms is found to be less effective, while the audit committee mechanisms are found to be negatively affecting stock risk. However, overall, the evidence shows that stock risk is lower in post period of mandatory adoption of PSAK 50&55

(Revised 2006) and related macroprudential policy. This findings support prior research by Mendelson (1986) and Diamond and Verrecchia, (1991), which similarly concluded that voluntary disclosure has negative effect on bid ask spread as proxy of risk.

The effect of CSR disclosure on stock risk is significantly explained by mediation of earnings management. The result shows that CSR disclosure has a significant negative effect on earnings management, which is consistent with (Hong and Andersen 2011), and earnings management has a significant positive effect on stock risk, which is consistent with Bebbington et al. (2008) and Shen and Chih (2008). This result supports the argument that accrual quality reflects information risk (Easley and O'Hara, 2004; Leuz and Verrecchia, 2004 and Francis et al., 2005). CSR disclosure is proved to be negatively affecting earnings management and stock risk, hence, it can be concluded that the result also supports the argument of Bebbington et al. (2008), in which it stated that companies undertake CSR disclosure as part of their reputational risk management.

It is also found that the effectiveness of CG mechanisms plays an important role in determining the effect of CSR disclosure on earnings management and stock risk. This result supports prior reseach (Chih et al 2008; Handajani et al. 2009). The result suggests that ineffective activity and size of board of commissioner contribute to ineffective communication among the members of the board in directing and monitoring the banks. The result of the study supports the claim that the effect of CSR disclosure on earnings management should be supported by related regulation and policy. The mandatory adoption of PSAK 50&55 (Revised 2016) and related macroprudential policy is proven to complement the CSR disclosure practice in the banking industry in Indonesia.

This study has several implications for regulators. The low level of CSR disclosure in the banking industry, especially for the banks listed on IDX needs to be a concern for regulators in assessing the effectiveness of related standard, regulation and policies in banking industries. A strong impetus is needed to encourage the effective CG mechanisms in CSR disclosure practice.

This study has several limitations that can be used as consideration for future research such as a) potential bias in calculating the index of CSR disclosure and CG mechanisms index, due to the subjective nature of content analysis; and b) this study is using relatively short time period of data. It is suggested that future research focuses on measuring CSR disclosure using the Sustainability Report based on the checklist of Global Reporting Initiative/GRI and extends the observation period.

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APPENDIX

Checklist Item CSR Disclosure (Lanis & Richardson, 2011)	
Item	**Category of CSR disclosure item**
	1. Corporate and CSR strategy items
1	Corporate mission
2	Code of ethics/business conduct
3	CSR strategy statement
4	Record of complaints
5	Relationship with clients
6	Impact on work practice
7	Impact on suppliers
8	Corporate governance statement
	Total for category
	2. Staff strategy items
9	Staff training
10	Staff career development
11	Staff diversity
12	Staff protection (EEO, safety and security)
13	Compliance with labor standards
14	Employees' ownership
15	Staff communication
16	General staff appointment policy
17	Executive appointment policy
18	Major appointment for the year
19	Breakdown of employees by geographical
20	Breakdown of employees by line of business
21	Breakdown of employees by level of qualifications
22	Breakdown of employees by ethnic origin
23	Discussion of employees' welfare
24	Information on accidents at workplace
25	Monitoring of staff and employees work relation policy
26	Implement of employees mission statement
	Total for category
	3. Social investment items
27	Social commitment statement
28	Value of social investment and charitable work
29	Assistance to charities and NGOs
30	Community sponsorship (financial support)
31	Staff volunteering
	Total for category

	4. Environment items
32	Environmental protection statement
33	Does the firm recognize environmental protection objectives?
34	Do they measure their performance against the objectives?
35	Greenhouse gas emissions policy
36	Energy consumption
37	Water consumption
38	Paper recycling
39	Ink recycling
	Total for category
	5. Customer and supplier items
40	Statement of internal control
41	Value added statement
42	Product safety statement
43	Improvement in product quality
44	Improvement in customer service
45	Distribution of marketing network for finished products
46	Customer award /ratings received
	Total for category
	6. Community and political involvement items
47	Participation in government social campaign
48	Community programs (health and education)
49	KPIs linked to CSR (social, community, and environment)
50	Assigned specific responsibility
51	Policies on lobbying and political donations
52	Charity/pro-bono work
	Total for category
	Grand Total for the 52 items