

# ANALYSIS ON ACCOUNTING CONSERVATISM AND CSR DISCLOSURES OF INDONESIAN BANKS LISTED ON IDX FROM 2004 TO 2007

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## ABSTRACT

Disclosing corporate social responsibility (CSR) activities is mandatory in Indonesia as regulated by the government. This research investigates whether Indonesian companies are internally motivated to voluntarily conduct their social responsibility agenda. First, this research examines the conservatism in financial reporting practices of Indonesian banks. It also analyzes the relationship between conservatism and CSR disclosure. Using 21 Indonesian banks that went public in 2003-2007 as sample, this research conducts a content analysis on their financial reports to measure the conservatism and the CSR disclosure index.

The findings of this research reveal that Indonesian banks are, on average, conservative in their financial reporting. This research also provides the ranking of the banks under study in terms of conservatism. Further analysis shows that there is no clear evidence to support the relationship between conservatism and the Indonesian banks' CSR reporting. Overall, this research concludes that CSR disclosure practices in Indonesian banks are driven by government regulation. This research does not find any internal motive of the sample banks in disclosing their CSR activities voluntarily.

**Keywords:** conservatism, discretionary accruals, corporate social responsibility, rankings, banks, Indonesia

## INTRODUCTION

The Indonesian government requires all listed companies to include CSR disclosure in their annual report. Moreover, the society's pressure upon companies to conduct business responsibly is also a significant factor for companies to report their CSR programs. Using discretionary accruals as the measurement of conservatism, this research investigates whether there is internal motive, such as regulated accounting

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policy or management decision from companies to voluntarily conduct their social responsibility agenda.

In recent years, conducting socially ethical and responsible business has been an important issue in the business environment. Corporate social responsibility can be described as corporate awareness toward society's issues arising from business activities. The natural bond between the corporate and the society underlies the modern concept of corporate social responsibility (Shahin and Zairi, 2007). While social reporting is voluntarily disclosed by some companies in other parts of the world, others are mandatory regulated by their governments to comply with a standardized minimum level of reporting CSR activities. As many of society groups and other environmental communities force companies to run their business ethically, there is a moral obligation for companies to include social reporting as part of their financial reporting practices. Despite social forces from community elements and regulators, companies should see the inclusion of social reporting in their annual report as one way to show their shareholders and stakeholders that they value accountability, transparency, and integrity (Valle, 2009).

Unlike extractive or consumer goods industries, banks and other financial or insurance companies have little direct impact to the society that they are excluded from the analysis of components of corporate social responsibility disclosure studies (Archel, 2003). Banks as financial providers have an indirect impact to the society as they have no involvement in actions taken by companies they lend to. However, as the concept of the traditional view of social responsibility has shifted in recent years, the society has realized the effects of bank lending policies and investment to commercial activities in the society, thus, the demand for banks to report their social actions. At the same time, banks are aware of their obligations and start to feel the pressure to go beyond conventional business management.

This research paper conducts a content analysis of the financial reports of the listed banks during the 2003-2007 periods. To detect conservatism, discretionary accruals are calculated from 2004-2007. Further analysis is conducted to analyze the relationship between conservatism and their CSR disclosure. CSR disclosure is measured by a specific disclosure index. This study finds out that there is insignificant correlation between conservatism and the level of companies' disclosure score and can be said that Indonesian listed banks disclose CSR activities because it is mandatory and regulated by the government. The result implies that Indonesian banks do not have any internal motive in disclosing their CSR activities. It appears that the disclosure is only to fulfill the regulation set by the government.

## **THEORETICAL FOUNDATION**

In simple accounting sense, the common implication of conservatism is illustrated as book values are understated. Watts and Zimmerman (1986) define conservatism as the circumstance where the accountant should report the lowest value among possible

alternatives for assets and highest value for liabilities, and revenues should be recognized later rather than sooner and vice versa for expense. Rajan et al (2008) described conservative accounting as follows:

*The accounting is conservative if investments are written off faster, in a cumulative sense, than they would have been under neutral (unbiased) accounting. Conversely, liberal accounting requires new investments to be amortized more slowly in comparison to neutral accounting. This stronger form of conservatism is met, for instance, if straight-line depreciation is applied to projects with uniform cash flows, or if a share of new investments is directly expensed. Given neoconservatism, it can be shown that higher growth in any past period of the relevant time horizon will ceteris paribus lower current ROI. Partial expensing of new investments, like those for R&D and other intangible assets under GAAP, is arguably an extreme form of conservatism. More conservative accounting can then be represented by a higher share of directly expensed investments.*

The presence of inherent uncertainty in the real world makes conservatism a desirable feature of performance measurement, and under uncertain conditions, economic forces generated by the fact that various stakeholders will act in their own economic interests create a demand for conservative accounting (Kung et al, 2008). Ball and Shivakumar (2005) argue that conservatism in accounting is an important element of financial reporting quality as it enhances relevance and represents faithfulness. Additionally, as conservatism represents a more relevant and faithful financial reporting, conservatism also improves contracting efficiency because it increases decision usefulness for stakeholders who are believed to be interested in timely information.

Discretionary accrual is accounting policies related to accruals made by company management to reduce reported earnings. In conjunction with the concept of conservatism, discretionary accrual is usually used to measure conservatism.

In Indonesia, according to “Undang Undang No. 40 Tahun 2007 tentang Perseroan Terbatas Pasal 47”, CSR reporting is mandatory for all Indonesian listed companies. This regulation has caused society is unclear of the motive of Indonesian listed companies to report their CSR activities. Many companies claim that they are genuinely committed to the society, thus they perform social activities. However, it is a very subjective opinion. Public and government policies are believed to be the trigger of companies reporting CSR activities.

It is important that CSR activities are fully integrated into the company’s strategy to acquire competitive edge to be the basis for business development and efficiency (Rahendrawan, 2006). In addition, CSR programs also have to be congruent with company goals and objectives, which create an added pressure for a company to be socially responsible. Integration of its goals, objectives, and strategies reflected in the CSR activities ensures company sustainability between economy and environment.

CSR disclosure used in this research replicates the categories used by Branco and Rodrigues (2006) in Portuguese banks. Disclosure is divided into four major

categories; namely, environmental (environmental policies or company concern for the environment, environmental management, systems and audit, lending and investment policies, conservation of natural resources and recycling activities, sustainability, conservation of energy in the conduct of business operations); human resources (Employee health and safety, Employment of minorities or women, Employee training, Employee assistance/benefits, Employee remuneration, Employee profiles, Employee share purchase schemes, Employee morale, Industrial relations); products and services (Product quality, Customer complaints/satisfaction, Provision for disabled, aged, and difficult-to-reach customers), and community involvement (Charitable donations and activities, Support for education, Support for the arts and culture, Support for public health, Sponsoring sporting or recreational projects).

## RESEARCH METHODOLOGY

The research was conducted in Jakarta, Indonesia from February 2009 to June 2009 in Jakarta, Indonesia. The data were collected from the 2004-2007 annual reports of the banks under study.

Twenty one out of 29 banks listed in the Indonesian Stock Exchange were considered as study sample. Others were excluded for some reasons. For instance, Bank Artha Niaga Kencana was excluded as it had been delisted from the stock exchange due to acquisition by Bank Commonwealth. Bank Artha Graha was excluded from the sample as it was merged with Inter Pacific Bank in 2004.

The discretionary accrual was used to measure the conservatism of the research sample. The accruals were calculated using the Jones model (1991) as follows,

### 1. Determine Total Accruals

Determining a firm's total accrual is calculated as the difference between earnings and cash flows from operation. Earning is defined as net income before extraordinary items. However, considering the income tax expense included in cash flow from operation in Statement of Cash Flow, income tax expense should be deducted from the earnings. Eventually, Total Accrual is calculated Operational Income minus Income Tax Expense minus Cash Flow from Operating Activities.

### 2. Calculate value of firm specific parameter $\alpha_1, \alpha_2, \alpha_3$ of the regression model

The regression model used during the research required the author to determine parameter  $\alpha_1, \alpha_2, \alpha_3$  of the sample data which contained  $1/A_{t-1}, \Delta REV_t, PPE_t$  as the independent variables and Total Accruals as the dependent variable. In determining NDA (non-discretionary accruals) the author used the original Jones Model introduced by Jones (1991). The Jones Model (1991) regression used is as follows:

$$NDA_t = \alpha_1 (1/A_{t-1}) + \alpha_2 (\Delta REV_t) + \alpha_3 (PPE_t) \quad (1)$$

where:

$\Delta\text{REV}$  = revenues in year t less revenue in year t-1, scaled by lagged total assets at t-1

$\text{PPE}_t$  = gross property plant and equipment in year t, scaled by lagged total assets at t-1

$A_{t-1}$  = total assets at t-1

$\alpha_1, \alpha_2, \alpha_3$  = firm-specific parameter

To estimate a firm-specific parameter,  $\alpha_1, \alpha_2, \alpha_3$  are generated by using the following model in the estimation period :

$$\text{TA}_t = \alpha_1 (1/A_{t-1}) + \alpha_2 (\Delta\text{REV}) + \alpha_3 (\text{PPE}_t) + v_t, \quad (2)$$

where total accruals is scaled by lagged total assets in year t-1.

### 3. Calculate Non-Discretionary Accrual

The firm-specific parameter obtained in previous procedures, is then used to determine Non-Discretionary Accrual of 21 sample companies. Relevant regression model of the sample firms is as follows:

$$\text{NDA}_t = \alpha_1 (1/A_{t-1}) + \alpha_2 (\Delta\text{REV}) + \alpha_3 (\text{PPE}_t) + v_t \quad (3)$$

### 4. Determine Discretionary Accrual

Discretionary Accrual is estimated by subtracting non-discretionary accruals from total accruals (standardized by lagged total assets).

$$\text{DA}_{it} = \text{TA}_{it} - \text{NDA} \quad (4)$$

Using the average discretionary accruals, sample companies were sorted from the lowest discretionary accrual, denoting the highest conservatism to the highest discretionary accrual, indicating the lowest conservatism.

CSR disclosure scores from 2004 to 2006 were obtained from a previous study entitled "Ranking Indonesian Listed Banks on their Corporate Social Responsibility Disclosure" by Tandanu (2006). The CSR disclosure score in 2007 was obtained by conducting a content analysis.

For further analysis, this CSR disclosure score was used to analyze the correlation between conservatism and CSR disclosure. The measure used to analyze the relationship between the two variables is the nonparametric Spearman rank correlation coefficient.

## FINDINGS AND DISCUSSION

Firstly, the descriptive statistics of the research variables is presented in Table 1 below:

**Table 1.** Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
$A_{t-1}$	84	633093	267517192	47477862.32	66146739.97
$\Delta \text{Revenue}_t$	84	-6343613	5261881	396313.53	1362321.52
$\text{PPE}_t$	84	32532	8502644	1659485.22	2203912.16
$\text{TAC}_t$	84	-19372301	10063664	-697589.87	4501212.11
DA	84	-.44	.19	-.03	.09
CSR	84	5	15	9.30	3.01
Valid N (listwise)	84				

Notes:  $A_{t-1}$  is lagged total assets,  $\Delta \text{Revenue}_t$  is changes in revenue,  $\text{PPE}_t$  is property, plant, and equipment,  $\text{TAC}_t$  is total accruals, DA is discretionary accruals, CSR is corporate social responsibility ranks.

Table 1 show that all the research variables have positives means, except for discretionary accruals (DA) and total accruals (TA). The negative mean on total accruals indicates that a majority of the samples have greater cash flow from operation than operating income. Negative discretionary accrual is simply caused by negative total accruals.

### Conservatism of Indonesian Banks

As explained in the previous section, measuring the level of conservatism of the research sample entailed the use of discretionary accruals. The result of the regression analysis in equation 2 is presented in Table 2 below.

**Table 2.** Coefficient parameter

Parameter	Coefficient
(Constant)	-0.031
$1/\text{At-1}$	-55225.24
$\Delta \text{Revenue}_t/\text{At-1}$	0.297
$\text{PPE}_t/\text{At-1}$	0.75

Notes:  $A_{t-1}$  is lagged total assets,  $\Delta \text{Revenue}_t$  is changes in revenue,  $\text{PPE}_t$  is property, plant, and equipment.

Coefficients reported in Table 2 were used to determine the total accrual of each sample in each year. The result is presented in Appendix 1. Then, the non-discretionary accruals (NDA) were estimated and the result is presented in Appendix 2. The result shows there are some sample companies that have negative non-discretionary accruals. Under the condition where non-discretionary accrual is negative, it means that sample companies experienced a decrease in revenue that caused them to have negative changes in revenue or that they acquired a significant investment in property plant and equipment but without a significant increase in revenue.

The next procedure involved the calculation of the discretionary accrual (NDA) used to measure the conservatism.

Table 3 below presents the sorted discretionary accruals of each of the 21 sample companies from 2004 to 2007.

**Table 3.** Discretionary Accrual of research sample

No	Company code	Average DA
1	MEGA	-0.21
2	BBNP	-0.08
3	BBCA	-0.06
4	BMRI	-0.06
5	BEKS	-0.06
6	BBRI	-0.06
7	BABP	-0.05
8	BCIC	-0.04
9	BBNI	-0.04
10	PNBN	-0.02
11	LPBN	-0.02
12	BSDW	-0.02
13	NISP	-0.02
14	BNLI	-0.02
15	BVIC	-0.001
16	MAYA	0.0004
17	BNGA	0.004
18	BKSW	0.01
19	BNII	0.03
20	BDMN	0.03
21	BBIA	0.05

The table shows that Bank Mega is the most conservative bank as it has the lowest DA ratio of -0.2142. This condition is caused by its relatively low average total accrual and high average non-discretionary accrual. Bank Nusantara Parahyangan and Bank BCA followed with -0.0751 and -0.0602 respectively. On the contrary, Bank Buana Indonesia is the least conservative bank with a DA ratio of 0.04666 followed by Bank Danamon and Bank International Indonesia with 0.03095 and 0.02954 respectively.

### **CSR disclosure of Indonesian Banks**

Tandanu (2006) evaluated the CSR disclosure of Indonesian listed banks and ranked them based on the disclosure score. The method used in this research was in-depth

content analysis of the sample annual reports, as content analysis is commonly used to examine CSR disclosure. The analysis was done by classifying the information disclosed into categories of items which captured four elements of social responsibility. The category used during the study was the replicating disclosure framework used by Branco and Rodrigues (2006) who studied Portuguese banks as mentioned earlier. . In this study Bank BRI got the highest average total points of 14.67. Moreover, it was found out that the four banks with the highest disclosure scores are state owned banks with higher total assets and net income. Overall, Indonesian listed banks had reported their CSR activities. However, none of 21 sample banks disclosed conservation of natural resources and recycling activities, as well as provision for the disabled, aged, and difficult to reach customers. Aside from Tandanu's study (2008), this research also performed similar procedures to calculate the CSR disclosure of the research sample in 2007. The result is shown in Table 4 below.

**Table 4.** Average CSR Disclosure Score of Indonesian Listed Banks from 2004 to 2007

Company code	Average CSR disclosure score
BABP	8.75
BBCA	9
BCIC	5
BDMN	13
BEKS	5.5
BNII	11.25
BKSW	6.75
LPBN	10
BMRI	14.25
MAYA	7
MEGA	9
BBNI	11.75
BNGA	11.25
NISP	10.25
BBNP	5.25
PNBN	7.25
BNLI	9
BBRI	14.75
BSDW	8.25
BBIA	12.25
BVIC	5.75

#### Testing on Correlation of the Two Variables

Before analyzing the correlation between the conservatism and the CSR disclosure scores, the normality of the data needed to be examined. Using the one sample

Kolmogorov-Smirnoff test, the result had shown that the data were not normally distributed (table 5)

**Table 5.** One-Sample Kolmogorov-Smirnoff Test

	Average DA	Average CSR
N	21	21
Kolmogorov-Smirnov Z	0.9	0.51
Asymp. Sig. (2-tailed)	0.39	0.96

Notes: Average DA is average discretionary accruals, average CSR is average corporate social responsibility disclosure score.

Given the result from the one- sample Kolmogorov-Smirnoff statistical test, Spearman rho test was used to test Non- parametric data distribution. Table 6 below shows the result of the Spearman’s Rho test.

**Table 6.** Spearman’s Rho Non-Parametric Test

		Average DA	Average CSR
Spearman's rho	Correlation Coefficient	1	0.21
	Sig. (2-tailed)		0.37
	N	21	21
	Correlation Coefficient	0.21	1
	Sig. (2-tailed)	0.37	.
	N	21	21

From Table 6 above, the Spearman Rho’s coefficient is 0.207. However it appears to be insignificant statistically.

### **Discussion on the Findings**

The findings reveal that the financial reporting practice in the banks, which measures the conservatism, does not have a significant relationship with CSR disclosure. This implies that CSR disclosure by Indonesian banks is seemingly not voluntary.

Freedman and Stagliano (1995) suggested that the increase in CSR disclosures over the period under study may be the result of regulatory effects. In Indonesia, disclosing CSR activities is mandatory for all Indonesian Listed companies as it is regulated in “Undang Undang No. 40 Tahun 2007 tentang Perseroan Terbatas Pasal 47”. The research result could imply that the company motive of disclosing its CSR is solely because of regulation imposed by the government and social contract with public policy.

Hassan et al. (2006) examined the disclosure levels of companies listed on the Cairo and Alexandria Stock Exchange. In their study they found out that mandatory disclosure had high compliance level than voluntary disclosure. The accounting conservatism concept to disclose information entails companies to be transparent by providing CSR disclosure in their report, whereas, transparency in disclosing CSR indicates good corporate governance in their s operation.

Moreover, Patten (1991) indicated that environmental disclosures may be linked to efforts to legitimize corporate actions and to the development of a positive corporate image due to social changes. With an increasing awareness of the society that requires company to be sustainable, disclosing CSR activities is viewed by companies as a tool to build the image of the company. CSR enhances the corporate image, discharges the social contract which exists between corporations and society, and informs stakeholders (Gray et al.1988). Rahendrawan (2006) stated that there is no incentive for a company to implement CSR other than to be considered a “good citizen” or to build a good image. In conjunction with the conservatism concept, reporting CSR activities in annual reports can be used by a company as a tool to smoothen out its reported accounting earnings and build the company’s image. The conservatism concept states that expense should be recorded in the period when it was made. , Reporting CSR expense enables companies to report lower earnings as well as build their image. Whether negative sanction or corporate image building motivates environmental disclosures in corporate annual reports, increasing the amount of information potentially may affect the perception of an enterprise's earnings and cash flows (Walden & Schwartz, 1997). Environmental issues can dramatically impact a company’s short time financial position and chances for long-term success (Surma, 1992). Additionally, Blacconiere and Patten (1994) suggested that investors may interpret more extensive environmental disclosures as a positive sign of the firm managing its exposure to future regulatory costs.

Regarding the notion that public policy motivates a company to report CSR, there is an assumption that business retains its social role and social power by responding to society's needs and giving society what it wants (Davis, 1973). Company responses are based on the concept of the social contract upon which organizational survival and growth are based (Shocker and Sethi 1974). Thus, a corporation constantly must evolve to adapt to the changing needs and expectations of society (Sethi, 1974),

## CONCLUSIONS

This study provides an examination of the conservatism sample of Indonesian banks. Conservatism in this concept is represented by discretionary accruals, which denote the level of conservatism of Indonesian listed banks.. Discretionary accrual is calculated using the Jones model (1991). The result of this study shows that Bank Mega is the most conservative of the banks under investigation, as it has the lowest discretionary accruals, followed by Bank Nusantara Parahyangan and Bank BCA. On

the other hand, Bank Buana Indonesia is seen as the least conservative bank, followed by Bank Danamon and Bank International Indonesia.

According to the statistical analysis, there is an insignificant relationship between conservatism and CSR disclosure score. This implies that an increasing CSR disclosure in recent years has been the result of obeying government regulation.

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**Appendix 1. Total Accruals of 21 Sample Companies**

	Total Accrual			
	2004	2005	2006	2007
BABP	-86998	-480795	-160101	108634
BBCA	-14913622	-3473648	-1083145	-2474827
BCIC	-478119	-924994	179170	388827
BDMN	10063664	5552494	306365	-2365660
BEKS	-11239	-104687	-64057	-10689
BNII	5419566	-1604754	718674	4523758
BKSW	-60117	-162591	268735	56558
LPBN	115977	5202211	-2961412	589897
BMRI	-14791835	-8994561	-9938004	-1576939
MAYA	-71094	94293	-18794.7	879731.7
MEGA	-5780388	-2363215	-5416096	798454
BBNI	4592378	4034303	-6990932	-9499027
BNGA	2205240	-1054227	-720023	1807432
NISP	64059	-766445	70761	1323363
BBNP	-91295	-148642	-266370	-390854
PNBN	361555	-1745325	3136474	2913608
BNLI	-857730	3221731	-1078107	582581
BBRI	8562532	1770390	-9828848	-19372301
BSDW	-100110	20383	-51102	-16240
BBIA	993679	2579843	-317141	1544563
BVIC	-74660	-54730	100532	46526

**Appendix 2.** Non-Discretionary Accruals of 21 Sample Companies from 2004 to 2007

	<b>Non-discretionary Accrual</b>			
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
BABP	-0.031442016	-0.13002536	-0.057314378	0.009991113
BBCA	0.017043909	0.021634278	0.028190397	0.017406223
BCIC	-0.003152399	0.021806981	0.025355523	0.005372767
BDMN	0.029490531	0.038351684	0.04001041	0.029481741
BEKS	0.007418953	0.008139106	0.032955073	0.039697807
BNII	0.017781219	0.033686383	0.028242489	0.013477276
BKSW	-0.006526939	0.001341522	0.008741561	0.003406007
LPBN	0.05013654	0.048470976	0.05542181	0.047493597
BMRI	0.015755193	0.026523072	0.028794486	0.021041595
MAYA	0.050937909	0.066877068	0.068417231	0.050254308
MEGA	0.027429286	0.037537185	0.010563374	0.048057019
BBNI	0.033463309	0.034964079	0.036832728	0.029556896
BNGA	0.012610582	0.023289419	0.021249882	0.007525662
NISP	0.013818309	0.026054416	0.033681416	0.026883189
BBNP	-0.01396296	-0.00325704	0.003419059	-0.00834463
PNBN	0.053632467	0.058234029	0.044651965	0.04418334
BNLI	0.022599751	0.0326376	0.04370184	0.026274513
BBRI	0.028363051	0.032975357	0.035233994	0.02555396
BSDW	-0.047521693	-0.01681911	-0.020833831	-0.031837224
BBIA	0.023549577	0.02893048	0.03777448	0.021981731
BVIC	-0.009271135	-0.01748434	0.001961919	0.02392668