CORPORATE GOVERNANCE MECHANISMS AND IMPRESSION MANAGEMENT THROUGH SUSTAINABILITY REPORT

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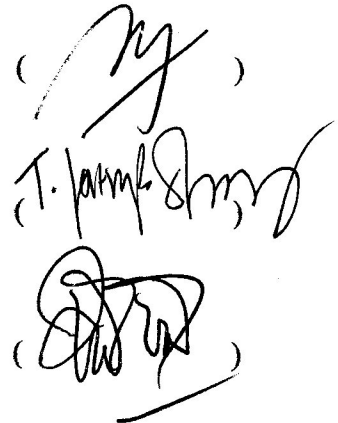NIP. 197505272000121001

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Declaration of Originality

I, Dita Amalia, hereby declare that this thesis is real and accurate to be my own work, especially written for partial requirement to complete Undergraduate Program of Accounting, and has not been presented in any other occasion before. I bear full responsibility for my undergraduate thesis.

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MOTTO AND DEDICATION

"Sesungguhnya Allah tidak akan mengubah keadaan suatu kaum sehingga

mereka mengubah keadaan yang ada pada diri mereka sendiri"

(Qur'an Surah Ar-Ra'd : 11)

"When you put Allah first, you will never be the last"

I dedicate this thesis for:

My beloved Mom, my beloved Dad

My dearest sister and all my family

Who will always be a reason to go home

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ABSTRACT

The aim of the study was to analyze the influence of corporate governance mechanisms on impression management through sustainability report. The corporate governance mechanisms that were applied in this research are Proportion of Independent Commissioner, Number of Board Commissioner Meetings, Board of Commissioner Size, Audit Committee Meetings and Audit Quality. This research adopted the GRI 4 to provide guidance in measuring selectivity, and used RGDI to measure distortion. The population of this research was all companies listed in Indonesia Stock Exchange and published their sustainability report in the year of 2012-2015. The total samples were 102 companies selected using purposive sampling. This study was analyzed using Multiple regression analysis with SPSS 22. The result of this study indicated that proportion of independent commissioner have positive effect on selectivity. Meanwhile, number of board of commissioner meetings and audit quality has negative effect on selectivity. However, there are no corporate governance mechanisms used in this study affect the distortion. The limitation of this study is that there is limitation of previous studies that examines the association of corporate governance and impression management, especially for distortion variable.

Keywords: corporate governance, impression management, sustainability report, graphical disclosure, selectivity, Relative Graph Discrepancy Index (RGDI).

ABSTRAK

Penelitian ini bertujuan untuk menganalisis pengaruh mekanisme corporate governance pada manajemen kesan melalui laporan keberlanjutan. mekanisme tata kelola perusahaan yang digunakan dalam penelitian ini adalah proporsi komisaris independen, jumlah rapat dewan komisaris, ukuran dewan komisaris, rapat komite audit dan kualitas audit. Penelitian ini mengadopsi GRI 4 sebagai pedoman dalam mengukur selektivitas, dan menggunakan RGDI untuk mengukur distorsi. Populasi penelitian ini adalah semua perusahaan yang terdaftar di Bursa Efek Indonesia dan menerbitkan laporan keberlanjutan pada tahun 2012-2015. Total sampel yang digunakan sebanyak102 perusahaan yang dipilih dengan menggunakan purposive sampling. Penelitian ini dianalisis dengan menggunakan analisis regresi berganda dengan SPSS 22. Hasil penelitian ini menunjukkan bahwa proporsi komisaris independen berpengaruh positif pada selektivitas. Sementara itu, jumlah rapat dewan komisaris dan kualitas audit berpengaruh negatif terhadap selektivitas. Namun, tidak ada mekanisme tata kelola perusahaan yang digunakan dalam penelitian ini mempengaruhi distorsi. Keterbatasan penelitian ini adalah bahwa terbatasnya penelitian sebelumnya yang meneliti hubungan tata kelola perusahaan dan manajemen kesan, terutama untuk variabel distorsi.

Kata kunci: tata kelola perusahaan, manajemen kesan, laporan keberlanjutan, pengungkapan grafis, selektivitas, relatve graph discrepancy index (RGDI).

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CHAPTER I

INTRODUCTION

This chapter explains the reason why this research conducted, and formulation of the problems. This chapter also explains the research objective, contribution of the study, and structure of the study.

1.1 Background

Social responsibility receives special attention by the company. The implementation of Corporate Social Responsibility (CSR) is important to the company because it changes people's awareness (Daniri, 2008). The demand to implement CSR is stipulated in *Undang-undang Nomor 40 Tahun 2007 tentang Perseroan Terbatas Pasal 74 ayat 1* stated that "The company is conducting its business activities in the field and/or related to the natural resources required to fulfill its social and environmental responsibility". The reasons behind the development of CSR is that natural resources are limited, and the company must be efficient in the use of resources and ensure that these resources can be used by the next generation (Fahrizqi, 2010 in Ratnasari, 2011).

Companies have begun to develop their report based on the triple bottom line. Therefore, the company does not only reveals the economic condition, but also disclose the social and environmental condition. The company's report that includes the information of economic, social and environmental is called sustainability report.

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The sustainability report compiled by guidelines of Global Reporting Initiative (GRI) and reported separately from the annual report or financial statements.

Sustainability report shows a positive trend, due to an increase in the number of companies that publish sustainability reports every year. The reason is that the disclosure of the sustainability report becomes one of the criteria for assessing the social responsibility of the company (Ratnasari, 2011). Based on the data obtained from the Global Reporting Initiatives (GRI), as of February 2016, there were 85 companies (either listed in IDX or not) that have been made and publish their reports.

Sustainability report is a voluntary disclosure statement issued by the companies. Sustainability report becomes one of the media used by the company to improve their positive image. This is because "corporate voluntary disclosure is a potential tool to present self-serving views on firm and management performance and these disclosures are normally need not be audited and unregulated" (Osma & Guillamon-Saorin, 2011). As noted by Merkl-Davies and Brennan (2007), non-regulated disclosure (in this study is sustainability report) increases the opportunity for management to doing impression management. Sustainability report can be used as a strategy for the company to improve their positive image. One way of the company to maintain their positive image is to do an impression management, but with the good corporate governance, it is expected that the practices of impression management will be reduced.

Impression management is an action taken by the management to manage the positive image in the public eye. Impression management "occurs when management selects the information to be displayed and presents information in a way that can distort the perception of the readers" (Godfrey et al., 2003 in Mather and Ramsay, 2007 and Cho et al., 2010). Impression management practices consist of selecting to include the most favorable items within the whole range of information available in the report (Osma & Guillamon-Saorin, 2011). "In the context of accounting, the aim of impression management is to present a self-serving view of corporate and managerial performance" (Neu et al., 1998 in Osma & Guillamon-Saorin, 2011). "A growing body of literature examines whether various governance mechanism is effective in controlling opportunistic managerial behavior" (Beasley, 1996; Peasnell et al., 2005; Xie, Davidson, & DaDalt, 2003 in Osma & Guillamon, 2011). The manager allegedly using the company's report as a tool to doing impression management to manipulate the perceptions and decisions of the stakeholder (Yuthas et al., 2002).

The implementation of good corporate governance has a positive impact on the company. Good corporate governance can improve positive image of the company naturally, and expected can reduce the practices of impression management conducted by the management. The effective implementation of corporate governance is expected to drive management companies to behave in a professional, transparent and efficient. In addition, the implementation of good corporate

governance is expected to resolve the agency problem that happened in the company (Irawan and Aria, 2012 in Meilinda, 2013).

Impression management is the reflection of agency problem (Osma & Guillamon-Saorin, 2011). This is because Goffman (1959) in Osma & Guillamon-Saorin (2011) explains that the way where the manager manages the image of themselves on their audiences is called impression management. The implementation of good corporate governance can solve agency problem and it is expected can reduce the practices of impression management. The success of the implementation of corporate governance will depend on the strength of securities and corporate law, good accounting standard, strong regulations and efficient judicial system, and a strong determination to fight against corruption (Barton et al, 2004 in Meilinda, 2013).

There are limited studies examining the relationship between corporate governance with impression management. In a study conducted by Suripto (2012) explained that in 2012, there are only three studies that examined the relationship between corporate governance and impression management (Abrahamson and Park, 1994; Mather and Ramsay, 2007; Osma and Guillamon-Saorin, 2011). He also investigated the relationship between earnings management and impression management. The result indicates that earnings management has a negative effect on impression management. This suggests that both impression management and earnings management are the intended to build the positive image of the company,

but the management is usually only choosing one, whether earnings management or impression management. Therefore, this study successfully provides evidence to support agency theory that good corporate governance can reduce the incentive for opportunistic managers to do impression management in the context of a public company (Beasley, 1996 in Suripto, 2012).

In Indonesia, the implementation of good corporate governance is important because it can improve the efficiency of the company (FCGI, 2002) and create value-added to the stakeholder (Kaihatu, 2006 in Waryanto 2010). The effective implementation of the good corporate governance would improve a good performance of the company so that the company does not need to make an impression management for scaling up their positive image. To test the ability of corporate governance in addressing the manipulation of information and minimize the managerial bias, this study suspect companies with good corporate governance will reduce the urge managers to manage impression.

This study did not use board of director but using board of commissioners, it is adjusted to the conditions of Indonesia, where companies in Indonesia implement a Two Tier Board System. The implementation of Good Corporate Governance must be supported by the corporate governance structure (Ratnasari, 2011). Corporate governance structure consists of General Meeting of Shareholder or RUPS, board of commissioners, board of directors, corporate secretary, audit committee and other committee that assist the implementation of good corporate governance. Corporate

governance mechanisms suspected can influence impression management practices conducted by the management. The mechanism of corporate governance that used in this study are proportion of independent commissioner, the number of board of commissioners meetings, board size, the number of audit committee meetings and audit quality.

Board of commissioners has a duty and a responsibility to supervise the policies of the board of directors in running the company and provide advice to them *(Undang-undang Perseroan Terbatas No. 40 Tahun 2007)*. Board of commissioner should be able to oversee the performance of directors and ensuring that the performance is accordance with the interest of stakeholder (Wardhani, 2006 in Hanifah, 2013). Appropriate the number of board of commissioner makes the commissioner can work effectively and responsibly in implementing corporate governance (Ruvisky, 2005) in (Noorizkie, 2013). Coles et al., (2008) found that the optimal number of commissioner depends on the characteristics of the company. In Indonesia, the number of board of commissioner at most three and five people (Regar, 2000 in Ratnasari, 2011).

OJK *(Otoritas Jasa Keuangan)* requires that 30% of the number of board commissioner must be independent of the company and majority shareholders. This is because the independent commissioners can help provide continuity and objectivity required for a company to grow and prosper (Reiter, 1999 in Pujiningsih, 2011). The existence of independent commissioner became a balancer in the decision-making

process (Mayangsari, 2003) and in improving the effectiveness of the board of commissioners (Mangel and Singh, 1993). Research that has been conducted by Osma and Guillamon-Saorin (2011), examines the relationship between the proportion of independent commissioners with impression management in annual result press release. Their finding showed that the proportion of independent commissioners have a negative relationship with the impression management. This result in line with the research conducted by Mather and Ramsay (2007), in their study showed that "boards with a higher proportion of independent commissioners appear to be more effective in curbing any potentially opportunistic impression management."

In carrying out their duties and function, the board of commissioners held the meeting in order to evaluate the policies that have been taken by the board of directors. The number of board of commissioners meetings is a one of corporate governance mechanism that expected can reduce the impression management. That is because the board of commissioners meetings is a media of communication and coordination among commissioners in performing duties as supervisory management. Research conducted by Osma and Guillamon-Saorin (2011) showed that the number of the board meeting with impression management has a negative relationship. It means that the greater number of board meetings, the better supervision to the management of the company. Then the practice of impression management is expected can be reduced.

In performing their duties, board of commissioners formed several committees to support the effective implementation of good corporate governance, one of which is the audit committee. The audit committee is one of corporate governance mechanism that is assumed to be able to reduce agency problem (Hanifah, 2013). The number of audit committee meetings is a media for the audit committee to coordinate and communicate in controlling the process of corporate governance. The more frequent meetings of the audit committee to implement the controls carried out by the management can be better. Thus, the number of audit committee meetings is considered as one of the corporate governance mechanisms to mitigate the practice of impression management.

This study also adds audit quality as the independent variable to see its influence on impression management. Based on agency theory the presence of an independent third party as a mediator in the relationship between principal and agent is indispensable (Ningsaptiti, 2010), and in this context is the independent auditor. The companies that used KAP Big 4 is expected have a good corporate governance and high-quality audit (Mitton, 2002 in Arifin, 2011). Therefore, it is expected the signal from external auditor can increase investor confidence, and decrease the practices of impression management.

This study was conducted because limited studies that examine corporate governance and impression management in Indonesia. Besides that, this study was conducted to determine whether some of the corporate governance mechanisms can

influence impression management practices in the sustainability report conducted by companies that listed in Indonesia Stock Exchange. Therefore, this research is expected to add literature related to the topic of impression management associated with corporate governance in Indonesia through sustainability report. This study refers on research that conducted by Osma and Guillamon-Saorin (2011) who studied corporate governance and impression management in annual result press release with the sample of public listed companies in Spanish and adapted to the circumstances in Indonesia. This study has some difference with previous studies, such as this study used sustainability report as a data source to measure impression management and adding audit quality as the independent variable.

1.2   Problem Statement

Prior research about impression management practice in an annual report that is associated with the role of corporate governance has been done by researchers in both developed and developing countries (Abrahamson and Park, 1994; Mather and Ramsay, 2007; Osma and Guillamon-Saorin, 2011; Suripto, 2012). However, there is limited research in the sustainability report that focusing on corporate governance and impression management. Corporate governance has an important role in the company.

Good corporate governance could improve company's performance and decreases management's opportunistic behavior. Therefore, the companies with good

governance likely to have a positive image in the society as of the practice of impression management are no longer needed in the company.

In addition to annual reports, sustainability reports are also becoming the concern of the shareholders. This is because in addition to economic conditions, shareholders are also interested in how social and environmental performance of the companies has an impact on the sustainability of the company. Therefore, the purpose of this study is to provide empirical investigation through the question:

1. Does proportion of independent commissioner influence the practices of impression management?
2. Does the number of board of commissioners meetings influence the practices of impression management?
3. Does board size influence the practices of impression management?
4. Does the number of audit committee meetings influence the practices of impression management?
5. Does the audit quality influence the practices of impression management?

1.3   Research Objectives

Based on the problem formulation above, there are some research objectives:

1. To analyze the influence of proportion of independent commissioners on impression management.

2. To analyze the influence of the number of board of commissioners meetings on impression management.

3. To analyze the influence of the board size on impression management.

4. To analyzed the influence of number of audit committee meetings on impression management.

5. To analyzed the influence of audit quality on impression management.

1.4   Contribution of Study

The contribution of the study is based on background, problem formulation, and research objective. There are several contributions of study, such as:

1. Theoretical Contribution

   This study expected can be an additional reference and provide empirical evidence about the influence of corporate governance mechanism on impression management. Additional reference regarding the influence of corporate governance on impression management is expected could encourage further research.

2. Practical Contribution

   This study provides information for the company that is expected can provide inputs in monitoring management behavior in the practice of impression management related to corporate governance.

1.5   Structure of the Study

Structure of the study provides a general overview of the content and discussion of the result of research, which has the aim to facilitate the reader to follow the flow of the discussion in this study.

CHAPTER I : INTRODUCTION

This chapter contains the introduction which is about the background of the problem in the research, the scope of the problem to be studied, objectives and benefits of the research conducted, and lastly the structure of this study.

CHAPTER II: LITERATURE REVIEW

This chapter explains the underlying theories and the other concepts that relevant with this study. In addition, to explain the theories and relevant concept this chapter also explains and summarizes prior researchers, theoretical framework, and the hypothesis development.

CHAPTER III: RESEARCH METHODS

This chapter explains research methods employed in this study that consists of research variables and operational definition of variables, population and sample, type and source of data, data collection method, and analysis methods.

CHAPTER IV: RESULT AND ANALYSIS

This chapter consists of the description of research object, data analysis, and data interpretation. Argumentations about the result also explained in this chapter.

CHAPTER V: CONCLUSION

This chapter draws conclusions based on the analysis of results. This chapter also explains the limitations of this research, and suggestions for future research.