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# THE EFFECT OF CORPORATE GOVERNANCE MECHANISMS AND ENVIRONMENTAL PERFORMANCE TO SUSTAINABILITY REPORTS

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**Abstract:** Sustainability report is a reporting tool that can be used by companies to achieve sustainability goals by measuring, and describing the environment, social and economic in a transparent manner. In order to achieve a good quality of sustainability report, it is necessary to have a corporate governance mechanism and environmental performance. The research purpose is to examine the effect of corporate governance mechanisms consists of commissioners' council, managerial ownership, and audit committee, also environmental performance to sustainability report. The object of this research is the mining sector companies that at least once published a sustainability report and followed PROPER listed on the Indonesia Stock Exchange for the 2017-2020 period. The data obtained from annual reports and sustainability reports. The data analysis technique uses multiple linear regression analysis. The results of this study can be concluded that managerial ownership has a positive effect on sustainability reports. Meanwhile, the commissioners' council, audit committee, and environmental performance have no effect on sustainability report.

**Keywords:** *corporate governance mechanism, sustainability report, environmental performance.*

## 1. Introduction

The company usually focuses on generating maximum profit. In this case, the company will always try to provide a good image to stakeholders. Companies often ignore the social and environmental consequences of business processes, when in fact the actions taken by companies can cause potential damage to the surrounding environment, for example flooding, air pollution, soil pollution around the business environment, and climate change. According to Elkington (in Chariri and Nugroho, 2009) nowadays, the purpose of business is not just to get the maximum profit, but also to be responsible for the community and environment around the company's operating activities. The financial statements issued by the company have the objective of disclosing economic success indicators and not disclosing the impact of the company's activities to the environment and society (Suhardiyah et al., 2018).

Companies think that it is enough if they provide products that can be useful to meet consumer needs (Safitri & Saifudin, 2019). The Indonesian Ministry of Environment has issued Regulation No. 06 of 2013 which contains "Program Penilaian Peringkat Kinerja Perusahaan dalam Pengelolaan Lingkungan Hidup (PROPER)" (Kementerian Lingkungan Hidup, 2013).

The purpose of PROPER activity is an effort by the ministry of environment to provide encouragement for companies to manage the environment using formal instruments. PROPER itself is expected to have an impact on companies to comply with regulations related to the environment. PROPER itself contains the control of air and water pollution and the reprocessing of toxic hazardous waste (B3).

Nowadays environmental problems are often caused by company activities in Indonesia. As an example, the case of river pollution through waste done by PT Long Xing Logam, the incident of an overflowing sedimentation pond carried out by PT Adaro Indonesia, the incident of hot mud leak by PT Lapindo, the illegal dumping of *fly ash* and *buttom ash* by PT Indominco Mandiri in Kutai Kertanegara, damage to headwaters of the river which was done by PT Kaltim Prima Coal in the Sangatta River, East Kalimantan, disposal of B3 waste by PT Klampis Ireng, air pollution through forest fires done by PT Merbau Pelalawan Lestari, environmental pollution caused by diesel fuel spills done by PT Soechi Lines Tbk in 2019, incidents of tailings arising in rivers by PT Freeport Indonesia in Papua, environmental pollution in the form of B3 waste by PT Greenfields and many other cases (Marlina, 2012).

Sustainability reports can be a reporting platform used by a company in order to achieve sustainability goals through disclosure, measurement, transparency and efforts to achieve social, economic and environmental impacts (Global Reporting Initiative, 2016). Throughout 2016, 120 companies have published sustainability reports. POJK regulations released by the Financial Services Authority No.51/POJK.03/2017, which state that it encourages public companies to develop sustainability reporting which will be reported in stages in 2020 (Otoritas Jasa Keuangan Republik Indonesia, 2017). Sustainability reports are reports that provide information related to impact on the economy as well as information on Environmental, Social and Governance (ESG). Sustainability reports provide information about the environment which aims to provide information on how much the company is responsible for the nature around the company's operations. Differences in interests between principals and agents also have an impact in the sustainability report. Where as we know the main goal of establishing a company is to get the maximum profit or return, while in carrying out this process especially when a company that publishes a sustainability report is required to provide quality information by presenting it from the ESG side which requires the company to provide responsibility for operational activities related to the environment, consumers, employees and other communities.

Companies in presenting sustainability reports can be influenced by corporate governance mechanisms and environmental performance (Aniktia & Khafid, 2015; Suharyani et al., 2019; Antara et al., 2020; Indriastuti & Chariri, 2021). Corporate governance is a system of balance and control both internally and externally in a company, which provides assurance that the company will carry out its obligations to fulfill the wishes of stakeholders (Solomon, 2010). In implementing governance, mechanisms are needed, which in this study used the commissioners council, managerial ownership, and audit committees. The commissioners council within the company can provide an increase in the right, fast and effective decision-making in an action to be taken by a company, then can independently make decisions without being influenced by other parties. The effectiveness of supervision in the business activities of a company can be influenced by how the commissioners council is formed and whether the commissioners council is organized (Safitri & Saifudin, 2019). Managerial ownership in a company can be interpreted as the number of company shares owned by management (Nurrahman & Sudarno, 2013).

According to Aniktia & Khafid (2015), managerial share ownership in a company can have an effect on encouraging a manager to provide positive performance for the company. The audit committee is defined as a committee formed by the commissioners council in order to assist the inspection process which aims to examine the implementation of the functions of a director to manage a company (FCGI, 2002). The audit committee is part of the oversight board in a company's governance system (Safitri & Saifudin, 2019). Environmental performance is the choice of ways by companies in their activities which are directly related to the environment. Companies will be positively assessed in the eyes of society if they carry out environmental performance well, because the activities held by companies are not solely to gain an advantage but to provide mutual benefits. This is in accordance with legitimacy theory where the company will be more legitimate if it can carry out that. From this explanation, the research objective is to test empirically the influence of corporate governance mechanisms which include the commissioners council, managerial ownership, and audit committees, as well as environmental performance on sustainability reports.

*Agency Theory*

Agency theory is a theory that can be aimed to understand the concept of corporate governance which includes the relationship between principals and agents within the company. According to Jensen & Meckling (1976), agency theory says that if the separation of responsibilities between the owner as the principal and the company's management acts as an agent managing the company, an agency conflict can arise because each party will try to maximize their interests. The emergence of agency conflicts can be reduced by making corporate governance as a mechanism that aims to regulate and control companies (Rudyanto & Veronica, 2016).

*Legitimacy Theory*

Legitimacy theory reveals that entities will continuously ensure that company activities are done accordingly with regulations or norms upheld in society and ensure that the activities of a company will be accepted by outsiders. Ghozali & Chariri (2007) explain that legitimacy theory is a condition or status of an entity when a company's value system is aligned with a system of larger social values in which the entity is part of it.

*Stakeholder Theory*

Stakeholder theory proposes that companies carry out their activities not at the will of the company and must provide benefits to stakeholders. With this theory the viability of the company can be seen from the support of stakeholders to the company. Stakeholder theory provides an overview of how managers can manage company tasks, so that there is a reciprocal relationship between the company and stakeholders. Disclosure of sustainability reports is the application of corporate governance concepts and mechanisms that have a principle where stakeholders need better oversight of the rules and establish active relationships in the framework of the long-term welfare of stakeholders and the company (Aliniar & Wahyuni, 2017). The survival of the company lies in the support of stakeholders so that the activities held by the company are in order to gain support from stakeholders. One strategy to gain stakeholder support is to disclose sustainability reports covering governance, environmental, social and economic aspects (Tarigan & Samuel, 2014; Sari et al., 2013).

*Sustainability Report*

A sustainability report is a report disclosed by a company in which there is information about social, environmental and economic performance that has a relationship with the business activities of an entity that has an impact on maintaining the company's viability (Global Reporting Initiative, 2016). GRI is a benchmark of sustainability reports, which recently made several improvements and changes, because in disclosing sustainability reports it must be done effectively and efficiently. In the process of preparing a sustainability report using the basis of the *Sustainability Report Guidelines* (SRG) issued by GRI which has made several adjustments to the characteristics of the company's business. The principle of completeness can be applied to the presentation of information in a sustainability report, which consists of a reporting profile, scope and boundaries of reporting, corporate governance, involvement of stakeholders, indicators on aspects of economic performance, indicators on aspects of environmental performance, employment and natural resources, human beings, aspects of customer protection and others. Disclosure of good quality sustainability reports focuses on how extensive disclosure is applied by a company, or in other words how much social and environmental information is available (Hooks & van Staden, 2011).

*Corporate governance*

Corporate governance is a system of balance and control both internally and externally for a company, which provides assurance to the company that it will carry out its obligations to fulfill stakeholders's desire (Solomon, 2010). In its implementation, a good governance mechanism is needed, which in this study used the commissioners council, managerial ownership, and audit committees. The commissioners council has the aim of providing oversight and advice to the board of directors and to ensure whether the applicable rules regarding corporate governance have been properly implemented. According to (FCGI, 2002) the commissioners council is the representative of the shareholders and has the responsibility of overseeing management behavior and preventing excessive control by management.

Managerial ownership is the number of shares acquired by the company's management of the total shares of a company. The higher the proportion of managerial ownership, the more productive and efficient management will be in producing company performance and corporate image by voluntarily disclosing information that contains social information (Astriani, 2014). The audit committee is one of the organs in charge of overseeing the corporate governance system (Safitri & Saifudin, 2019). The important role of the audit committee is to carry out their duties effectively in the context of overseeing financial reports, internal controls, and implementing corporate governance (FCGI, 2002). It is hoped that the frequent meetings held by the audit committee will lead to better coordination, which can carry out more effective oversight of management. Based on BAPEPAM-LK No.Kep-643/BL/2012 (Badan Pengawas Pasar Modal dan Lembaga Keuangan, 2012), the audit committee is required to hold regular meetings at least 4 times a year (Marsha & Ghozali, 2017).

*Environmental Performance*

Environmental management activities can be evaluated through environmental performance that has been implemented by a company. Environmental performance is carried out with the aim of assessing the company's activities in an effort to maintain, manage and improve the surrounding environment that is affected by the company's commercial activities. Environmental performance can be measured from PROPER which is organized by the Ministry of Environment. PROPER is one of the government's efforts to encourage companies to increase environmental management activities around the company's business activities. The company's activities in environmental management must continue to be carried out in order to create an increase in the quality of the environment around the company's business activities.

*Hypothesis*

One of the factors in implementing good corporate governance is the commissioners council who must be responsible for the company in accordance with the applicable principles, namely accountability. Supervising management actions so that they are in accordance with what is desired by stakeholders is the main task and responsibility of the commissioners council. This creates different interests and each party will work or manage based on its own interests so as to create conflicts of different goals, namely agency conflicts. Shareholder representatives who have the duty to oversee actions taken by management and prevent control regulated by management constitute the commissioners council (FCGI, 2002). Therefore, to facilitate coordination, a meeting of the commissioners council is needed, where the increasing number of meetings held by the commissioners council is believed to make it easier to realize good corporate governance through discussion and coordination (Suryono & Prastiwi, 2011). The results of research by (Sari & Marsono, 2013) show that the effectiveness of commissioners council can influence sustainability reports that are disclosed, as well as the results of research by Jaya et al. (2019) also shows that commissioners council positively influences sustainability reports.

$H_{1a}$ : commissioners council has a positive effect on sustainability report

According to Nurrahman & Sudarno (2013) in a company where there is managerial ownership, it can be expected that more and more information will be provided to the public, so that the company will gain public legitimacy and to reduce agency conflicts will provide full accountability for its performance. The higher managerial ownership is expected to increase the enthusiasm of managers to take actions that can create benefits for the company (Aniktia & Khafid, 2015). If there are shareholders who are leaders of the management team, then it can be expected to provide disclosure of information related to economic, environmental, social and corporate governance in published sustainability reports (Nurrahman & Sudarno, 2013). Research by Suryono & Prastiwi (2011) also shows consistent results where managerial ownership applied to companies will encourage managers to provide information related to the company's economic, social, corporate governance and environment in sustainability reports.

$H_{1b}$ : Managerial ownership has a positive effect on sustainability reports

One of the supervisory boards in corporate governance is the audit committee. The audit committee plays an important role in assisting the commissioners council to monitor and minimize risks that can occur between management and stakeholders. Based on the decision of Bapepam No.Kep-643/BL/2012 (Badan Pengawas Pasar Modal dan Lembaga Keuangan, 2012) which regulates the audit committee, it is required to hold a meeting that is at least the same as the provisions based on the company's articles of association so that it can lead to good management of the company. Suryono & Prastiwi (2011) argue that the higher the ability of audit committee members, the more likely they are to understand the strategies and information disclosed and the desires of stakeholders. The presence of an audit committee in a company is believed to create a condition for reporting a sustainability report. With the encouragement from the audit committee to issue a sustainability report, the risk of information asymmetry can be minimized. Because of this, it is expected that shareholders and interested parties will obtain comprehensive company information. Research by (Sari & Marsono, 2013) revealed that audit committees have a positive effect on sustainability reports. This result is also in accordance with the results of research by Safitri & Saifudin (2019).

$H_{1c}$ : audit committee has a positive effect on sustainability report

Companies with good environmental performance will get a positive response in the eyes of stakeholders. Companies that have high concern for the surrounding environment and have good environmental performance can also have a good impact on a company where this is the essence of legitimacy theory, namely there will be a link between the company and society, where the company is emphasized to pay attention to the norms and regulations that apply in the environment the company operates which will make the company more legitimate. Based on stakeholder theory which aims to help management create value for the impact of a company's activities will make stakeholder and company relationships interdependent, where stakeholders certainly need companies in order to fulfill their interests and companies also need stakeholders to achieve goals and maintain sustainability of the company (Ghozali & Chariri, 2007). Sustainability reports are needed as information by stakeholders as an answer from the company regarding the social and environmental activities that have been carried out, namely the company has given a positive response to social and environmental issues so that it has given a positive response to the sustainability report or vice versa. This is in accordance with research by Antara et al. (2020) and Tusiyati (2019) which show that environmental performance has a positive impact on sustainability reports.

$H_2$ : Environmental performance has a positive effect on sustainability reports

## 2. Research Method

The research design is quantitative research. The research variables used are corporate governance mechanisms which include the commissioners council, managerial ownership, audit committees, and environmental performance which are the independent variables, and the Sustainability Report is the dependent variable.

Commissioners council is an organ that has the power to oversee the activities of a company. Supervision is said to have been well achieved as seen from how the commissioners council was formed and in the implementation of its responsibilities, one of which is by routinely holding meetings for coordination and discussion. The commissioners council is measured based on the number of meetings held in the current year (Hilnicputro, 2019).

Managerial ownership is the number of shares acquired by the company's management of the entire company's shares. Managerial ownership is measured based on the percentage of the number of shares owned by management compared to the total number of company shares outstanding (Fitria & Kurnia, 2015).

The Audit Committee is a committee formed by the commissioners council in order to help carry out inspections or supervision of the implementation of the directors' functions in managing the company. Based on BAPEPAM-LK regulation No.Kep-643/BL/2012 (Badan Pengawas Pasar Modal dan Lembaga Keuangan, 2012), the audit committee is required to hold regular meetings at least 4 times a year (Marsha & Ghozali, 2017). The audit committee is measured by a dummy, namely a value of 1 if the audit committee meets at least 4 times in one year, while a value of 0 if less than 4 times.

Environmental Performance is the relationship between the environment and the company, including the impact of the environment on the resources consumed by the company, the impact on the company's business processes. Environmental performance is measured using PROPER (Tusiyati, 2019). The PROPER rating is divided into 5 colors, the best is gold with value 5; green with value 4; blue with value 3; red with value 2; and black with value 1 indicating the worst environmental performance.

Sustainability Report is a report disclosed by the company in which there is information about social, environmental and economic performance that has a relationship with the business activities of an entity that has an impact on maintaining the company's viability (Global Reporting Initiative, 2016). Sustainability reports are measured using the GRI G4 standard with 91 disclosure items, which are given a value of 0 if not disclosed, and a value of 1 if disclosed. Furthermore, the total disclosures made by the company are compared with the total disclosures that should be, namely 91 items so that the percentage of the company's sustainability reports is obtained (Sriwahjuni & Luhur, 2017).

The research object is a mining sector company that publishes sustainability reports and is listed on the Indonesia Stock Exchange and participates in PROPER which discloses sustainability reports at least once during the period 2017 to 2020. The stages of analysis include data description, normality test, classic assumption test (multicollinearity, heteroscedasticity, autocorrelation ), model feasibility test, and multiple linear regression test.

## 3. Results and Discussion

### 3.1. Results

Tabel 1. Descriptive Statistics

| Variable | N | Minimal | Maximal | Average |
|---|---|---|---|---|
| KSR | 33 | 0.109 | 0.648 | 0.331 |
| EDK | 33 | 3 | 33 | 8.70 |
| KM | 33 | 0.00 | 17.04 | 0.972 |
| KL | 33 | 3 | 5 | 4.21 |
| *Dummy* | | Frequency 1 | Frequency 0 | Total |
| KA | 33 | 30 (90.91%) | 3 (9.09%) | 33 (100%) |

Average descriptive statistics on sustainability report is 33.1% shows that the information disclosed in a sustainability report is 30 items out of 91 items. The commissioners council holds an average of 8.7 meetings in a year. The average managerial ownership of 0.972% indicates very small managerial ownership. On average, the audit committee has held meetings in accordance with applicable regulations, namely 4x in a year, only 3 are still below 4x. The average environmental performance is 4.21 indicating the company is in green PROPER where the company has carried out environmental management beyond what is required in the regulations.

The results of the normality test with the Kolmogorov-Smirnov obtained a value of 0.123 with a significance level of 0.200, indicating that it is normally distributed. The autocorrelation test was carried out using the Durbin-Watson test, showing a value of 2.183 so that it can be concluded that it is free of autocorrelation. The heteroscedasticity test using the scatterplot shows that the dots do not spread and do not gather and do not form a clear pattern, therefore it can be concluded that there are no symptoms of homoscedasticity. The results of the multicollinearity test are that all independent variables have a tolerance value of $\geq 0.10$, and the value of Variance Inflation Factors $\leq 10.00$, meaning that the regression model does not have multicollinearity. The coefficient of determination test yields an adjusted R Square of 0.225 indicating that the Sustainability Report can be explained by 22.5% by independent variables (EDK, KM, KA, KL) while 77.5% by variables outside this study. F test of 3.324 with sig. 0.024 indicates a feasible research model.

Tabel 2. t test results

| Variable | Coefficient | t | Sig. | Conclusion |
|---|---|---|---|---|
| (konstan) | 0,179 | 1.231 | 0.229 | |
| EDK | 0,008 | 2.141 | 0.410 | Not Significant |
| KM | 0,024 | 2.915 | 0.007 | Significant, Positive |
| KA | -0.008 | -0.095 | 0.925 | Not Significant |
| KL | 0,015 | 0.455 | 0.652 | Not Significant |

$$KSR = 0.179 + 0.008EDK + 0.024KM - 0.008KA + 0.015KL + e$$

The t test shows the results of commissioners council, Audit Committee and Environmental Performance have no significant effect on sustainability report, while Managerial Ownership has a significant positive effect on sustainability report.

### 3.2. Discussion

The commissioners council showed that it had no effect on the sustainability report so that $H_{1a}$ was rejected. The lack of influence of the commissioners council on the quality of the sustainability report can be based on several things, that is the commissioners council who have not carried out their duties and functions also held meetings to discuss the company's business activities to the fullest. Restuningdiah (2011) revealed that in fact the commissioners council does not have time to run the company due to their respective activities, so the existence of the commissioners council can be considered lacking or ineffective. Thus, the more the number of commissioners council meetings will not affect the sustainability report. The study’s results are the same as those of Aniktia & Khafid (2015) and Adhipradana & Daljono (2014) which revealed that the commissioners council has no effect on sustainability reports, but the results of the research are different by Jaya et al. (2019) where the commissioners council has a positive influence on sustainability reports, where the existing agency relationships will motivate each individual to obtain and maintain their respective interests.

Managerial ownership shows a positive effect on sustainability reports so that $H_{1b}$ is accepted. The greater managerial ownership in a company, it will have a positive impact on sustainability reports where managers will try to provide transparent and complete information to inform existing company conditions and reduce agency conflicts and information asymmetry. In addition, managerial ownership is expected to improve company performance so that managers will provide more complete information on company conditions, including increasing information on sustainability reports. This is in accordance with the results of Aziz (2014) research that when a company has managerial ownership it will make managers more motivated to improve their performance, including in terms of improving sustainability reports. However, this is not in accordance with the results of Nurrahman & Sudarno (2013) research where managerial ownership has no effect on sustainability reports, this statement is supported by the fact that many companies still have managerial shares in small amounts.

The audit committee has no effect on the sustainability report so $H_{1c}$ is rejected. It is suspected that the audit committee has no effect on the quality of sustainability reports due to several factors where the audit committee only carries out its duties, namely examining reports and selecting internal auditors who will carry out their duties in a company. The audit committee in its duties is unable to critically question or make specific observations regarding the control situation and the implementation of the company's management responsibilities. According to Aliniar & Wahyuni (2017) the reason why the audit committee has no effect on sustainability reports is presumably because many of the members of an audit committee do not have competence and independence, and many audit committee members do not yet understand in depth the main role of supervising and conducting meetings. audit committee during the current year. The results of this study are in accordance with the research of Hasanah et al. (2017) and Adhipradana & Daljono (2014) that the audit committee has no effect on sustainability reports, where the presence of an audit committee has not been able to motivate companies to publish quality sustainability reports. Meanwhile, the research by Safitri & Saifudin (2019), Barung et al. (2018), and Indrianingsih & Agustina (2020) provide different results, namely the audit committee has an effect on sustainability reports, where the presence of an audit committee can motivate management to disclose sustainability reports which can be used as a company communication medium with stakeholders.

Environmental performance has no effect on sustainability reports so $H_2$ is rejected. Environmental performance has no effect on the quality of sustainability reports, presumably because the company's efforts to improve environmental performance, such as making an active contribution to preserving the environment have not attracted the attention and legitimacy of stakeholders, so it does not make it a consideration for companies to improve sustainability reports. This study’s results are in accordance with the research of Indriastuti & Chariri (2021), which reveals that environmental performance has no effect on sustainability reports. However, the results were different in the research between Antara et al. (2020) which states that environmental performance affects sustainability reports, because good environmental actors believe that disclosing environmental performance through PROPER will provide a positive image for the company and become a form of corporate accountability to stakeholders which causes companies to improve sustainability reports.

## 4. Conclusion

The commissioners council has no effect on the sustainability report, where the commissioners council in carrying out their duties and commissioners council meetings have not discussed optimally about the company's activities and have not carried out effective supervision that resulting sustainability report is not yet maximal. Managerial ownership has a positive effect on sustainability reports where managerial ownership is able to increase information disclosure through sustainability reports to reduce existing agency conflicts. The audit committee has no effect on the sustainability report, where the audit committee does not yet understand its role in supervision and the meetings held are not maximal so that it has not been able to motivate management in presenting the sustainability report. Environmental performance has no effect on sustainability reports, because the company's efforts to improve environmental performance, such as actively contributing to preserving the environment, have not attracted the attention and legitimacy of stakeholders so that the company is not optimal in presenting sustainability reports.

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