

CHAPTER I

INTRODUCTION

A. Background

Issues of pollutant factories, pollution, degradation, global warming, and climate change are increasing concern for the government, environmentalists, shareholders, and creditors. It becomes a heavy pressure for companies to operate more environmentally responsible and provide information about the performance, policies, programs and environmental risks in annual reports (Herman and Saleh, 2018).

The development of the industrial sector is part of the national development process in promoting economic growth. Industrial development has an impact on society, either positive or negative. The development of an industry can reduce unemployment. Reduced unemployment will boost economic growth in Indonesia. However, the results of the development of the industrial sector will also have a bad impact for the environment that is environmental pollution that causes huge problems (Sari *et al.*, 2019).

Environmental issues began during the implementation of the International Conference on the Human Environment in Stockholm, Sweden and the Earth Summit in Rio de Janeiro, Brazil in 1992 (Nuraini, 2010). Environmental Disclosures is a form of company responsibility with environment around the society. The company that discloses the environment

tend to get legitimacy and supporting from the surrounding community. Furthermore, the Environmental Disclosures is form to give positive signal to external parties especially investors. That way, the Environmental Disclosures is important to do.

Forms of environmental responsibility disclosures on the company's activities go through corporate environmental disclosures. Corporate environment disclosure is a collection of data and information that contain the disclosure of social and environmental responsibility to society as a result of activities undertaken by the company (Suratno *et al.*, 2006). Environmental disclosures include one aspect of CSR (Corporate Social Responsibility). There are three kinds of groups that disclose; there are economic, social and environmental disclosure. But in practice, until now the number of companies that disclose information about the environment is small compared to social disclosure (Gray *et al.*, 2001).

Disclosures are related to the company's financial report containing the financial statements. The financial report should contain information about the activities of all business units carried out by the company. The regulation that describes Voluntary Disclosures (Environmental Disclosures) in Indonesia is *Ikatan Akuntan Indonesia* (IAI) through the statements contained in *Pernyataan Standar Akuntansi Keuangan* (PSAK) Number 1 (2012) paragraph 9 and in Malaysia is regulated in Malaysia Accounting Standard Board (MASB) 1 and 20. There are two categories of disclosures; mandatory disclosures and voluntary disclosures. Mandatory disclosures are the

disclosures required by accounting standards and applicable regulations. While voluntary disclosures are the company's operational activities which are informed by the disclosure that is voluntary, it means that the company is allowed not to carry out the disclosure (Suwardjono, 2005).

Hendry (2017) states that one of the real impacts of mining companies in Indonesia is environmental damage caused by waste coal along the river in Bengkulu to coast in the city of Bengkulu and Central Bengkulu that has occurred since the 1980s until now. Environmental disclosure will be a reflection of the seriousness of the company in dealing with environmental problems, but in Indonesia there is limited companies that make this kind of disclosure. There are two kinds of disclosures of corporate environmental responsibility; voluntary disclosure and mandatory disclosure (Sari *et al.*, 2019).

Constitution of the Republic of Indonesia Number 23 Article 5 Year 1997 states that the goodness and health of environment is a fundamental right and constitutional right for every citizen of Indonesia and companies have the right to get environmental information related to the role in environmental management. Therefore, the state, the government and all stakeholders are obliged to pass environmental protection and management in the implementation of sustainable development, so that Indonesian environment can be a source of life and support for the people of Indonesia as well as other living creatures. Sustainable development is a conscious and planned effort that

combines aspects of environmental, social, and economic development strategies to ensure environmental integrity and safety, capability.

The Environmental Disclosures are measured with General Reporting Standards (GRI). GRI provide guidelines to help companies in disclosing the environment. GRI Standards that used is GRI 300 (Environmental) that consists of 8 sub topic there are materials, energy, water, biodiversity, emissions, effluents and waste, environmental compliance and supplier environmental assessment with 32 indicators.

In the Holy Qur'an, surah Al-Araf verse 56 explains the environmental management responsibilities, which reads:

وَلَا تُفْسِدُوا فِي الْأَرْضِ بَعْدَ إِصْلَاحِهَا وَادْعُوهُ خَوْفًا وَطَمَعًا إِنَّ رَحْمَتَ اللَّهِ قَرِيبٌ مِّنَ الْمُحْسِنِينَ

This means:

"And do not make mischief on the earth after (God) to fix it, and pray to Him with fear (not accepted) and expectations (be granted). Allah's mercy is very close to people who do well".

From these verses it can be concluded that we as human beings are prohibited by God to ruin everything that exists on earth including the environment. Our obligation as Muslims is to keep the universe in well condition. We just need to do well with small things like not polluting the river, not littering, using environmentally friendly products and so on. That way, with God's willing we will find mercy and kindness from Allah. One way to

maintain an environment that can be done by the company or industry is to disclose environmental reporting.

The mechanism of corporate governance is the company management procedure designed to regulate the operation of the company. Besides that, it is to protect the interests of the stakeholders and the shareholders. Other than that, it can handle the activity of managers in its company management. The role of the manager, in this case, affects the company's decision whether or not to issue the environmental disclosures. Mechanism of corporate governance mechanisms in this study are the proportion of independent commissioners on boards, the audit committee, board of commissioner size, board of gender, political visibility, and foreign ownership.

An independent board of commissioners is a member that is not included in the part of management, officer, majority shareholders, nor communicate directly or indirectly with the majority shareholders of a company (Restu *et al.*, 2017). In addition, according to a research conducted by Prasetianti (2014) and Sanjaya (2013) the independent board has positive effect on environmental disclosure.

The Audit Committee is a component in the control system of companies that are considered as a link between the shareholders and the board of commissioners with the management in managing about control issues. According to FCGI (Forum for Corporate Governance in Indonesia, 2002) states that the audit committee should consist of individuals who are

independent and not involved with the management in the conduct of its operations, and must have experience in effectively accomplish their supervisory functions. This is because to maintain the integrity and objective view in the report and the preparation of recommendations made by the Audit Committee.

Restuningdiah (2010) finds that the Board of Commissioners has an important role in firm governance because it has oversight of the board of directors in making decisions and measures taken against the company. The number of commissioners in the company can affect the activity of each business unit of the company, with the number of commissioners that is greater than it can minimize the problem of information asymmetry in the company.

The diversity of the Board of Directors is a diversity that exists within the membership of the Board of Directors. The diversity of the Board of Directors is biased based on a variety of things; ethnicity, expertise, gender, religion, age, education background and other kinds of diversity in the Board of Directors. As the development of the emancipation of women, one of the developing issues in board diversity is gender-based. Board of gender-based diversity is defined as the existing gender diversity on Boards of Directors (Prasista, 2016).

Political Visibility is basically about how the public and government attention to the companies. Political Visibility is measured by the size of the company. This is because large companies will tend to get higher attention from the public and the government. The amount of Political Visibility will result in

increased costs related to political and tighter regulation. In general, larger companies conduct environmental disclosures in larger scale. Company that has greater assets will perform their social responsibility activities on the environment greater than small companies (Oktafianti and Rizki, 2015).

This research is a replicates from Sari *et al.* (2019) and Fashikhah *et al.* (2018) by adding independent variables namely Board Gender (Percentage Female Directors), Board of Commissioners Size, Political Visibility, and Foreign Ownership. Besides this, the author adds a dependent variable that is Firm Value. Those variables are indicate have significant influence towards Environmental Disclosures. In addition, this study is compare with other countries to know what the differences. The country that has been choose is Malaysia.

Sampling is derived from the financial statements of the mining sector registered in Indonesian Stock Exchanges and Bursa Malaysia. The reasons for the selection of mining companies are, because the company is in direct contact with the natural environment, such as forests, water, soil conditions, and other kinds of natural environment. The activities of the companies may be harmful to human being and other creatures. Therefore, mining companies have important roles or more responsibilities to pay attention and maintain the condition of the natural environment in accordance with a predetermined standard. The reason to choose Malaysian companies as a comparison is because Malaysia is the member of ASEAN same as Indonesia. Furthermore, Malaysia have also mining industries. The cultures of Indonesia and The

Malaysia are almost the same. The geographic location in Indonesia and Malaysia is close each other's. Thus, that way Malaysia is really comparable with Indonesia.

Based on the above background, the researcher is interested in conducting a study entitled "**The Effect of Corporate Governance Mechanism Towards Environmental Disclosures and The Impact on Firm Value**" (Empirical Study on Mining Company Listed in Indonesia and Bursa Malaysia Year 2018).

B. Research Scope

The scope in this research is the independent variable that is tested empirically. In this research the independent variable is corporate governance mechanism which consists of Proportion of Independent Commissioners on Boards, Audit Committee, Board of Commissioners Size, Board Gender (Percentage of Female Directors), Political Visibility, Foreign Ownership. These variables were not really able to show the factors that would affect the company in the environmental disclosure. The dependent variable which was tested empirically was corporate environmental disclosures. Then we measure environmental disclosures on Firm Value. The samples are mining companies listed in Indonesia Stock Exchange and Bursa Malaysia Year 2018.

C. Research Questions

1. Does the Proportion of Independent Commissioners on Boards has positive significant effect towards Environmental Disclosures in Indonesia and The Malaysia?

2. Does the Audit Committee has positive significant effect towards Environmental Disclosures in Indonesia and The Malaysia?
3. Does the Board of Commissioners Size has positive significant effect towards Environmental Disclosures in Indonesia and The Malaysia?
4. Does the Board Gender (Percentage of Female Directors) has positive significant effect towards Environmental Disclosures in Indonesia and The Malaysia?
5. Does the Political Visibility has positive significant effect towards Environmental Disclosures in Indonesia and The Malaysia?
6. Does the Foreign Ownership has positive significant effect towards Environmental Disclosures in Indonesia and The Malaysia?
7. Does the Environmental disclosure has positive significant effect towards Firm Value in Indonesia and The Malaysia?
8. What is the difference between the level of Environmental Disclosures in Indonesia and The Malaysia?

D. Objectives of the Study

The objectives of the study are as follows:

1. To examine the positive significant effect of Proportion of Independent Commissioners on Boards towards Environmental Disclosures in Indonesia and The Malaysia.
2. To examine the positive significant effect of Audit Committee towards Environmental Disclosures in Indonesia and The Malaysia.

3. To examine the positive significant effect of Board of Commissioners Size towards Environmental Disclosures in Indonesia and The Malaysia.
4. To examine the positive significant effect of Board Gender (Percentage of Female Directors) towards Environmental Disclosures in Indonesia and The Malaysia.
5. To examine the positive significant effect of Political Visibility towards Environmental Disclosures in Indonesia and The Malaysia.
6. To examine the positive significant effect of Foreign Ownership towards Environmental Disclosures in Indonesia and The Malaysia.
7. To examine the positive significant effect of Environmental Disclosures towards Firm Value in Indonesia and The Malaysia.
8. To examine and compare the difference of Environmental Disclosures level in Indonesia and The Malaysia.

E. Significance of the Study

1. Theoretically
 - a. This research is expected to provide empirical evidence of factors affecting environmental disclosure.
 - b. This research is expected to add and develop concepts of environmental disclosure.
 - c. This research hopefully will be a reference for future research about environmental disclosure.

2. Practically

- a. This research is expected to provide the importance of disclosing environmental information in the annual report.
- b. This research is expected to encourage the company to be detail in disclosing the environmental in order to provide the information for stakeholders and other parties.

3. Decision Making

- a. This research is expected to help managers or directors of any entities in making decision about the social and environment.
- b. This research is expected to help managers or directors of any entities in making decision about how to improve the company value through the disclosures of environmental information.