CHAPTER I
PRELIMINARY

1.1 Background

Companies are typically established with the objective of maximizing profit while minimizing capital expenditure, in accordance with economic principles. This is done to ensure stakeholders' satisfaction, often causing firms to neglect the environmental and social repercussions resulting from their corporate operations. As awareness of environmental and social consequences grows among populations in industrialized countries, organizations are facing increasing pressure to uphold the natural environment and consider the well-being of affected communities, regardless of their location (Vachon, 2010). Indonesia has witnessed numerous instances of environmental degradation that have sparked vehement public criticism, including demands for the corporation responsible to be shut down due to the adverse effects it has created.

One of the cases that received special attention from the public and was widely well-known in particular was the PT. Lapindo Brantas accident. The case, better known as "Lapindo Mud Tragedy" which happened due to poor risk assessment and environmental management, resulted in catastrophic losses in the local area, economically, socially and environmentally (Lestari, 2022), with people losing their houses, an increase in cases of respiratory infections in the company's operational areas as well as rivers that got contaminated with cadmium and lead. In addition, in recent years, mining operations by PT. Freeport Indonesia have been of great concerns. The mining operations have led to extensive environmental damage, including deforestation, habitat destruction, and the creation of massive waste dumps or tailings (waste containing dangerous and/or toxic material due to its characteristics and concentration or volume) that pollute rivers and endanger health (Prakoso et al., 2023). The Indonesian Forum for the Environment (WALHI), the largest environmental movement organization in Indonesia, even stated in its 2019 report that Freeport's long-term mining extraction in Papua is an international crime.

Aside from environmental damage, in the social aspect, Freeport's presence has also sparked conflict with local communities, including indigenous Papuan tribes such as Amungmene who have been displaced from their ancestral lands and their traditional way of life was distorted (Eichhorn, 2022). Another case about social impacts is PT Astra Agro Lestari Tbk. According to a press release by WALHI in March 2023, PT. Astra Agro Lestari committed human rights violations by seizing land and criminalizing farming communities in Central Sulawesi and West Sulawesi as well as ecological damage. According to Walhi for Central Sulawesi, as many as 10 communities have been criminalized with accusations of stealing palm fruit, occupying land without permission and threatening by the company on them. This issue has led several large companies such as PepsiCo, L'Oréal, Procter & Gamble, Nestle, Danone and Hershey's to suspend PT Astra Agro Lestari Tbk from their supply chains.

In addition to some of the cases above, there are additional regions designated for mining purposes where firms lack clear accountability in safeguarding the area from environmental harm. This is the case in South

Kalimantan. As the largest mining producing area in Indonesia, there are several large mining companies operating in the area, including PT. Adaro Indonesia, PT. Arutmin Indonesia and PT. Pertambangan Batubara Bantala. There is still a lack of awareness of the damage to the ecosystem around the former coal mine from the many unexploited mining pits, and the mining of rock debris which is only waste and chemicals left behind in the mining area of the "artificial lake" of the former mining excavation, which has a negative impact on the people in the area and can cause health problems and even death. This is due to the thick dust caused by mining activities and the many very deep mining pits. One highlighted example is in PT Adaro's mining area where there are several large pits or craters from old mines, leaving the land exposed in such a way that it is impossible to reclaim (Habibi, 2022).

Not only that, environmental pollution that affects local communities as a result of the mining activities of the companies above is river water pollution from coal mining waste. According to Greenpeace Indonesia (in Habibi, 2022), around 3,000 kilometers, equivalent to roughly 45% of rivers in South Kalimantan pass through coal mining regions and are at risk of contamination by harmful waste produced by coal mining activities. Out of the 29 samples examined by Greenpeace, 22 samples taken from tailings ponds and disused mine pits in South Kalimantan, five coal mining concessions exhibited significantly low levels of acidity (pH), which were well below the government's established standard. Out of all the samples collected from tailings storage ponds and extraction wells, 18 had pH levels below four, and nearly all of them contained significant amounts of metals.

These cases demonstrate that certain companies, despite prioritizing financial success, are sometimes found not very mindful about their responsibilities and concerns for the environment and the surrounding community, which then sparks the demands from stakeholders for transparent, coherent and extensive information disclosure regarding their activities. Financial statements issued by companies are considered no longer sufficient to fulfill these demands, since environmental and social conditions are also matters of concern and whose information is not thoroughly, if at all, reported; therefore, non-financial reports are needed (Sari & Nurkhin, 2020). Non-financial reports summarized in the concept of sustainability are known as sustainability reports. Sustainability reporting allows stakeholders to find out how companies link their business strategies with financial and non-financial performance, letting them know how sustainable the company's business is. Sustainability report discloses information regarding 3P or what is often called the triple-bottom line that aligns with the seventeen Sustainable Development Goals (SDGs) adopted by the United Nations (UN) (Acuti et al., 2020). *People* addresses the social aspect, *planet* focuses on the environmental component, and *profit* pertains to the economic aspect, respectively. Sustainability reports are utilized to document the financial, ecological, and societal effects of a company's activities.

Internationally recognized disclosures enable stakeholders to access and compare the information included in sustainability reports, thereby offering supplementary data for informed decision-making (GRI, 2016). In the preparation of a sustainability report, the most popular and acknowledged reference used is the guidelines issued by the Global Reporting Initiative (GRI) called the GRI Standards which has two separate sections, Universal Standards and 3 main topic-specific standards, namely GRI 200: Economic, GRI 300: Environmental and GRI 400: Social. Each of the aforementioned topic-specific standards has their respective items which then companies can adjust as to which and how many of them will be disclosed based on their needs and business characteristics. The principles of balance, comparability, accuracy, timeliness, clarity, and reliability are necessary to determine the quality of the report.

A sustainability report can be included as an essential component of a company's annual report, or it can be issued separately as an independent report. The existence of sustainability reports is very important to provide information that is not contained in annual reports and financial statements as one of the decision-making instruments for existing and potential investors, since it is issued with the aim of disclosing information to all stakeholders not only regarding the company's economic performance, but also its social, environmental and corporate governance aspects in an accountable manner (Widowati & Mutmainah, 2023). Hence, the disclosure of sustainability reports for public companies is deemed to be necessary.

Sustainability reports are required to comply with the provisions of Law No. 40 of 2007 Article 66 paragraph 2 point (c.) which requires companies to report on social and environmental responsibility. In Government Regulation No. 47 of 2012 article 2, it is explained that every company as a legal subject has social and environmental responsibilities. In Indonesia, Sustainability reporting is regulated in the Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Application of Sustainable Finance for Financial Service Institutions, Issuers, and Public Companies. The regulation states that the goal of implementing sustainable finance is to ensure that all financial institutions, issuers, and public companies are aware of and committed to following Sustainable Finance principles. This will help in the creation of products, such as goods and services, that take into account economic, social, and environmental factors. Furthermore, this arrangement is anticipated to establish circumstances conducive to fair competition and prevent capricious actions that detrimentally affect one party.

The latest data show a positive development in sustainability reporting in Indonesia, with a recent report by Karisman Consulting in 2023 stating that there are as many as 627 public companies issued their 2022 sustainability reports. Moreover, 154 companies published their 2020 sustainability reports as of December 2021 and only 54 companies that published their sustainability reports in 2019 (Ananda et al., 2023). This implies that the practice of sustainability reporting in Indonesia is experiencing significant growth, although the massive increase in the number of companies that published their sustainability report is due to it no longer voluntary since 2021 onwards. In addition, the National Centre for Corporate Reporting (NCCR), the pioneering independent organization in Indonesia to develop sustainability reporting as well as the first one to introduce the term "sustainability report" in the country, has been organizing the Sustainability Reporting Awards (now ASRRAT) on an annual basis since 2005. The latest event was held in late 2023 with the participation of 68 Indonesian companies and 7 representatives from The Philippines, Bangladesh, Russia, and Australia. One of the criteria for the sustainability report award is the use of GRI Standards as the framework for sustainability reporting. This emphasizes the importance of sustainability reporting practices to achieve the goal of being an accountable, transparent and trustworthy company in the eyes of stakeholders. GRI Standards create a consistent language for organizations and stakeholders to communicate about the company's impact on three main aspects; economic, environmental and social (Akadiati et al., 2023; Natalia & Soenarno, 2021).

The growth of sustainability report disclosure practices is in line with the aforementioned OJK Regulation No. 51/POJK. 03/2017 regarding the implementation of sustainable finance for financial services institutions, issuers, and public companies. It is stated in article 3 paragraph (1) that the Application of Sustainable Finance must be carried out with the provisions for Financial Services Institutions, Indonesian Export Financing Institutions, secondary housing finance companies, Social Security Organizing Bodies, Issuers other than Issuers with small-scale assets and Issuers with medium-scale assets, and Public Companies taking effect on January 1, 2020. Although, due to the COVID-19 pandemic, it was pushed back to 2021 (PwC Indonesia, September 5, 2023).

Given the fact that there are still many companies whose operating activities have an unfavorable impact on the environment and the surrounding social conditions which then require companies for transparent, coherent and extensive information disclosure regarding their activities, the increase in the number of sustainability report disclosures in recent years, together with the inconsistencies found in earlier research involving certain variables in particular, sparked interest about the factors that are believed to affect or influence sustainability report disclosure.

The variables that will be used in this study are firm size, institutional ownership, profitability and external assurance. Previous study on firm size by Nuraeni & Darsono (2020) stated that firm size has a negative and significant effect on the disclosure of sustainability reporting. Widyaningsih (2020) and Yuliana (2019) stated that firm size has a positive and significant effect on the level of sustainability report disclosure. In contrast, research conducted by Lestari & Vadila (2020) and Indrianingsih & Agustina (2020) stated that firm size does not significantly influence the disclosure of sustainability reports. Meanwhile, Katoppo & Nustini (2022) stated that firm size negatively and insignificantly affects the level of sustainability report disclosure. Firm size is the size of a company which can be seen from the amount of equity value, sales value, or asset value (Khoiriyah, 2018). Generally, larger companies tend to disclose more data and information than companies of small sizes. This is because the level of human resources and information as well as the level of economic availability in larger companies are more readily available, qualified and sufficient, so that the costs incurred to make a complete disclosure are considered not large. Conversely, small companies have relatively fewer resources which result in a lack of information ready to be presented and require additional costs that are considered large to make complete disclosures. In addition, the larger the size of the company, the more it attracts attention from various parties, especially stakeholders so that it will provide more complete information for various parties (Orazalin & Mahmood, 2019).

Institutional ownership is the ownership of company shares owned by institutions or financial institutions such as pension fund banks, insurance companies, investment companies, companies in the form of companies (PT), and other institutions, except subsidiaries and other institutions that have special relationships (Edison, 2017). Increased institutional ownership will result in heightened scrutiny from institutional investors, which could deter management from engaging in opportunistic activity. It has a crucial role in mitigating agency conflicts that arise between managers and shareholders (Muliani, 2019). Institutional investors tend to be more concerned and more interested in long-term results or gains than short-term results. Companies' disclosure of sustainability reports serves as an indirect long-term investment that enhances public trust in the company, so ensuring the continuity of its business activities in the future. Previous study on the relationship between institutional ownership and sustainability report disclosure conducted by Nurleni, et al (2018) stated that institutional ownership has a positive and significant influence on the disclosure of sustainability reports. However, research conducted by Eryadi et al. (2021) and Rochayatun (2016) stated that institutional ownership has no influence on the disclosure of sustainability reports. Meanwhile, Sidiq, et al. (2021) found that the higher the institutional ownership, the lower the company's sustainability report disclosure.

Profitability is the company's ability to make profit by deploying and managing resources and capabilities such as capital, debt, assets, employees, and raw materials in a certain period (Sukmarani et al., 2021). In relation to resource management, it is necessary to disclose transparent information in sustainability reports as a form of accountability to stakeholders and efforts to improve the quality of the company's business. In addition, companies that have good financial performance capabilities will have a high level of confidence to provide information to stakeholders, because said companies are able to show them that they can meet their (stakeholders') expectations. Thus, the higher the level of profitability of the company, the greater the level of their sustainability report disclosure. Studies related to profitability on sustainability report disclosure conducted by Qomariah, Nurul (2021) and Setiani & Sinaga (2021) stated that profitability has a negative effect on sustainability report disclosure. Meanwhile Orazalin & Mahmood (2019) and Yohana & Suhendah (2023) stated that profitability has a positive and significant effect on sustainability report disclosure. In contrast, research conducted by Sukmarani et al. (2021), Nuraeni & Darsono (2020), and Syakirli et al. (2019) stated that profitability has no influence on sustainability report disclosure.

The last variable is external assurance. External assurance is a service provided by an independent party to assess the feasibility of a sustainability report. To improve the credibility and reliability of sustainability reports, some organizations involve external assurers from independent parties in relation to the disclosure of their sustainability reports (Junior et al., 2014). This is done to provide adequate certainty to stakeholders regarding the completeness, validity, accuracy, and reliability of reporting social and environmental information (Darus et al., 2014). Independence from third parties (assurers) is necessary to gain a higher level of trust from the community. In the case of using the services of external assurers, the company should not have any relationship with them to ensure the independence of the assurer and the credibility of the results of the sustainability report examination. Research conducted on how external assurance affect the disclosure of sustainability report has not been as much as other variables, especially of publicly listed companies in Indonesia. Several previous studies on external assurance conducted by Dutta & Dutta (2021) and Maroun (2019) stated that external assurance has a highly significant positive impact of sustainability report, Meanwhile, another study conducted by Trihatmoko, et al. (2020) and Anugerah, et al. (2018) stated that external assurance has no influence on the disclosure of sustainability reports.

Based on the background and inconsistencies in the results of various prior studies previously described, this study re-examines the factors that affect the level of sustainability report disclosure. This research uses variables such as firm size, institutional ownership, profitability and external assurance with the population of all manufacturing companies listed on the Indonesian Stock Exchange in 2023. This research chose manufacturing sector companies as research objects because manufacturing companies are the type of industry that are sensitive and have great impact on the environment due to their operational activities. Apart from that, the main problem that is often caused by the manufacturing industry is that there is still a large amount of B3 type waste (hazardous and toxic materials) which is thrown carelessly into the environment. For this reason, companies can publish sustainability reports as a form of social and environmental responsibility towards society and stakeholders (Lestari, 2023). The more sensitive a company is to environmental and social issues, the higher the pressure it will get to disclose its activities (Silvana & Khomsiyah, 2023). The year 2023 is used because this is the most recent reporting year, and it is hoped that the results of this study can help contribute to explain the actual circumstances and situations of the object of research. The results of the study are reported in the form of a thesis entitled "The Effect of Firm Size, Institutional Ownership, Profitability and External Assurance on Sustainability Report Disclosure of Manufacturing Companies on The Indonesian Stock Exchange in 2023".

1.2 Problem Identification

Based on the background that has been described, the problems identified in this study are as follows:

1. Companies with larger sizes indicate that they tend to publish their sustainability reports rather than their smaller counterparts, thus increasing the likelihood of a higher level of disclosure on their sustainability reports.
2. The greater proportion of institutional ownership in a company indicates that the company will increase the level of their sustainability report disclosure.
3. Companies with a high level of profitability indicate a greater level of disclosure of their sustainability reports.
4. The existence of external assurance indicates a greater level of disclosure of sustainability reports.
5. There are inconsistencies with the results of previous studies on factors related to the level of sustainability report disclosure.

1.3 Research Limitation

In focusing the research so that the problem under study has a real scope and direction and to minimize the deviation of results due to widespread problems, the applied limitations are listed below:

1. This research focuses on four independent variables; Firm Size, Institutional Ownership, Profitability and External Assurance and how they affect Sustainability Report Disclosure.
2. Limited to manufacturing companies on the Indonesian Stock Exchange in 2023.

1.4 Research Questions

Based on the identification and problems described above, the research questions are:

1. How does firm size affect sustainability report disclosure?
2. How does institutional ownership affect sustainability report disclosure?
3. How does profitability affect sustainability report disclosure?
4. How does external assurance affect the level of sustainability report disclosure?
5. How do firm size, institutional ownership, profitability and external assurance simultaneously affect sustainability report disclosure?

1.5 Research Objectives

Based on the research questions, the objectives of the research are as follows:

1. To analyze the effect of firm size on sustainability report disclosure of manufacturing companies listed on the Indonesia Stock Exchange in 2023.
2. To analyze the effect of institutional ownership on sustainability report disclosure of manufacturing companies listed on the Indonesia Stock Exchange in 2023.
3. To analyze the effect of probability on sustainability report disclosure of manufacturing companies listed on the Indonesia Stock Exchange in 2023.
4. To analyze the effect of external assurance on sustainability report disclosure of manufacturing companies listed on the Indonesia Stock Exchange in 2023.
5. To analyze the effect of firm size, institutional ownership, profitability and external assurance on sustainability report disclosure of manufacturing companies listed on the Indonesia Stock Exchange in 2023

1.6 Benefits of Research

The results of this study are hoped to be beneficial to:

1. Companies.

   The results of the research are expected to contribute knowledge about the importance of corporate social responsibility which is published in a separate report called sustainability report. This research can also contribute ideas on the importance of the obligation to protect the environment and the social impact caused by the company, as a consideration in making company policies to further increase its concern for stakeholders so as to create corporate sustainability.

2. Author

   This research holds significant benefits as it will allow to expand the author's knowledge in the vital area of corporate sustainability reporting and the factors influencing disclosure practices within Indonesia's unique business environment, also as one of the provisions for completing the undergraduate study program at the Faculty of Economics, Accounting Department, Universitas Negeri Medan.

3. Public

   This research is expected to provide insight into the level of corporate responsibility for environmental, economic and social aspects as outlined in the sustainability report to stakeholders so as to increase public awareness of the rights to information that must be disclosed by public companies. This research is also expected to be used as the latest reference for further research.