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Islamic Social Reporting Disclosure: The Role of Audit Committee and Institutional Ownership

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***Abstract** – In Islam, social responsibility is part of worship to create a balance in human social relations. It means that the public has the right to know various information about the activities of companies that have relations with the public. This is a form of corporate responsibility to the community, whether the activities achieve the goals that have been set are following sharia and do not harm the surrounding community. This study aims to determine the effect of the audit committee and institutional ownership on ISR disclosure (ISRD) at 70 annual financial reports of 14 companies on the Jakarta Islamic Index from 2015-2019. All data in this study were processed by multiple linear regression analysis. The results show that the audit committee does not affect the ISRD. At the same time, institutional ownership can improve the ISRD. These results indicate that a company's small number of audit committees does not affect the ISRD. On the contrary, the higher the institutional ownership ratio, the higher ISRD. ISRD becomes a media of communication, a form of commitment, and corporate responsibility in maintaining good relations and trust on an ongoing basis to gain support from stakeholders to realize the company's goals. In addition, the ISRD can also positively impact the company, attracting investors' attention to investing and assisting decision-making for stakeholders and Muslim companies to fulfill their obligations to Allah SWT and society.*

***Keywords:** ISR Disclosure, Audit Committee, Institutional Ownership, Jakarta Islamic Index*

***Abstrak** — Dalam Islam, tanggung jawab sosial merupakan bagian dari ibadah untuk menciptakan keseimbangan dalam hubungan sosial antar manusia. Artinya, masyarakat mempunyai hak untuk mengetahui berbagai informasi mengenai aktivitas perusahaan yang mempunyai hubungan dengan publik, hal tersebut sebagai bentuk pertanggung jawaban perusahaan kepada masyarakat, apakah kegiatan mencapai tujuan yang telah ditetapkan sudah sesuai syariah dan tidak merugikan masyarakat sekitarnya. Penelitian ini ingin menguji pengaruh komite audit dan kepemilikan institusional terhadap pengungkapan ISR pada 70 laporan keuangan tahunan pada 14 perusahaan Jakarta Islamic Index tahun 2015-2019. Seluruh data dalam penelitian ini diolah dengan analisis regresi linier berganda. Hasil penelitian menunjukkan bahwa*

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pengungkapan ISR tidak dipengaruhi oleh komite audit namun dipengaruhi oleh kepemilikan institusional. Hasil ini mengindikasikan bahwa banyak sedikitnya jumlah komite audit dalam sebuah perusahaan tidak mempengaruhi pengungkapan ISR sebaliknya semakin tinggi rasio kepemilikan institusional maka semakin tinggi pengungkapan ISR-nya. Pengungkapan ISR ini menjadi media komunikasi, wujud komitmen, tanggung jawab perusahaan dalam menjaga hubungan baik dan kepercayaan secara berkesinambungan sebagai upaya memperoleh dukungan dari stakeholders untuk mewujudkan tujuan perusahaan. Selain itu, pengungkapan ISR juga mampu memberikan dampak positif bagi perusahaan, yakni menarik perhatian investor untuk berinvestasi serta membantu pengambilan keputusan bagi pemangku kepentingan dan perusahaan Muslim sebagai bentuk pemenuhan kewajibannya kepada Allah SWT dan masyarakat.

Kata Kunci: *Pengungkapan ISR, Komite Audit, Kepemilikan Institusional, Jakarta Islamic Index*

1. Introduction

The corporate social responsibility (CSR) concept is currently developing in the sharia economy, as indicated by the implementation of CSR in sharia-based companies. In 2000, the Indonesia Stock Exchange inaugurated an Islamic stock index, the Jakarta Islamic Index (JII). The companies listed on the JII make annual reports containing social responsibility disclosures under Islamic principles, known as Islamic Social Reporting (ISR). This sharia philosophy provides a basis for interacting with Muslims with all stakeholders (Choi et al., 2018). Khan et al. (2019) said that ISR is mandatory for Islamic companies because Islamic rules do not allow hiding, exaggerating, or understating information.

Khan et al. (2019) added that each company represents the community and takes on certain social functions, namely consuming natural resources. As a result, the company must give compensation to the community and the environment. Therefore, CSR is one of the media to attract the attention of stakeholders toward other goals. In addition to maximizing profits and ensuring the environment, growth, and sustainable development (Sarea and Salami, 2021). The orientation of such a company shift is a company activity in caring for people and the planet to conserve the environment. It is for the best interests of future generations, as stated in the Holy Qur'an: "Islam commands its people to protect nature (Al Qur’an Surah Al-Araf verse 56).

Othman et al. (2009) disclosed that ISR helps decision-making for Muslim stakeholders and companies to fulfill their obligations to Allah SWT and society. The absence of Islamic-based standards causes inequality in ISR reporting. Therefore, the insistence of Muslim investors and other users of Muslim company reports becomes one of the essential considerations in disclosing ISR by companies listed on the JII.

ISR is an implication of the ownership teachings in Islam, in which Allah is the absolute owner (*haqiqiyah*). At the same time, humans are only temporary owners that become the recipients of the mandate (Othman and Thani, 2010). The measurement of ISR is different from the measurement of CSR. The measurement of ISR has used the ISR Index, which reveals matters relating to Islamic principles (Othman and Thani, 2010), that consists of a compilation of standard CSR items set by the AAOIFI (Haniffa, 2002; Maali et al., 2006; Othman et al., 2009; Ousama and Fatima, 2010). Moreover, the measurement of CSR still refers to the GRI Index, which has not stated that it is free from elements of usury, *gharar*, and transactions or activities forbidden by Islam (Haniffa, 2002). Hussain et al. (2021); Amran et al. (2017); Kamla and Rammal (2013); Haniffa and Hudaib (2007); Maali et al. (2006) said that the concept of ISR is a human guideline in all aspects of life that has an impact on the social welfare of the entire community.

Sharia enterprise theory (SET) is the responsibility of Allah SWT, so companies, especially sharia-based companies, must take responsibility for their performance (Triyuwono, 2015). Legitimacy theory also allows companies to form a social contract with the community by carrying out and reporting all company operational activities into an ISR disclosure (ISRD). Ghozali and Chariri (2014) added that companies tend to use environmental-based performance and environmental information disclosure to avoid social and environmental conflicts. It intends to gain legitimacy or a positive reaction for the company to gain public trust.

ISRD is related to good corporate governance (GCG), especially about the structure of GCG, namely the audit committee (AC) and institutional ownership (IO). GCG has a significant role, especially in regulating the governance used by the company to control the company. As a result, the company runs according to its proper function, aiming for stakeholders to get satisfactory results. The AC is a committee that creates effective management control (KNKG, 2012). Hasanah et al. (2018); Indrawaty and Wardayati (2016); Rachmania and Alviana (2020) exposed that the existence of an AC can increase the ISRD and encourage the number of voluntary disclosures (Gantyowati and Nugraheni, 2014). It indicates that the more the number of audit committees owned by the company, the greater the number of ISR disclosures made by the company. On the other hand, the AC can also reduce the ISRD (Ariyani, 2020; Sari and Helmayunita, 2019) and reduce CSRD (Rizki et al., 2014). It can be said that the existence of an audit committee in the company is proven to reduce the number of ISR disclosures. Despite its existence, this AC does not affect the ISRD (Kurniawati and Yaya, 2017; Puspawati et al., 2020). It means that the number of audit committees owned by the company does not affect the number of ISR disclosures.

Institutional ownership (IO) is shares owned by institutions to the total outstanding shares (Cox et al., 2004; Graves and Waddock, 1993; Johnson and Greening, 1999; Shahid, 2003). Tonello and Rabimov (2010) added that the number of institutional ownership investors could own, holding more than 50% of the company's outstanding equity. IO can improve the effective supervision of management performance by increasing ISR disclosures. Ningrum et al. (2013) revealed that IO positively affects ISRD (Purwaningsih and Wibowo, 2020). It indicates that a high ratio of institutional ownership can increase the number of ISR disclosures. On the other hand, Widyanti and Cilarisinta (2020) stated that IO has a negative effect on ISR. It means that a high ratio of institutional ownership can reduce the amount of ISR disclosure. IO does not affect ISR (Sari and Helmayunita, 2019) and CSR (Laksmitaningrum and Purwanto, 2013). It can be concluded that the high or low ratio of the company's institutional ownership does not affect the amount of ISR disclosure

According to the research gap, this study analyzes and empirically tests the effect of AC and IO on the ISRD in companies listed on the JII. This research is interesting to study because the ISRD shows the organization's success in managing the negative impacts resulting from the organization's operational activities on the environment and around the community to contribute to the company's concern for the environment and toward sustainability of company performance. Meanwhile, the investors can use it as a reference regarding investment decision-making by looking at the company's social performance.

2. Theoretical Framework and Hypothesis Development

The basic theory of this research is the theory of legitimacy and SET. Ghozali and Chariri (2014) asserted that the theory of legitimacy is a social contract between the company and the public. Every company considers the social contract and its various operations in society. The company's survival will be at stake if this social contract is not considered. In comparison, the SET recommends awareness of all commands from Allah SWT in all operating activities and company performance (Triyuwono, 2015). Thus, every company as an individual association needs to carry out ISR as a form of role and responsibility as caliph on earth because the company has managed and used the resources owned by Allah SWT (Triyuwono, 2015).

2.1 Audit Committee and ISR Disclosure

The audit committee (AC) is a committee that has a responsibility to the board of commissioners in carrying out their duties and functions (FSA Regulations No. 55/POJK.04/2015). The larger the AC size, the higher the effectiveness of top management monitoring and control (Hasanah et al., 2018). Supervision by the AC is aimed at improving the company's internal control and social responsibility disclosure (Kurniawati and Yaya, 2017). Accordingly, financial reports submitted to interested parties can be trusted and help improve corporate social performance. In addition, the role of an effective AC can reduce the occurrence of irregularities by managers.

Based on the point of view of legitimacy theory, the AC is crucial for the supervision and control of the company. It makes the AC in a company increase the effectiveness of supervision, including ISR disclosure. Thus, it is hoped that with a larger AC, the supervision will be better, and the quality of social information disclosure by the company will increase or become more comprehensive. It can result in a positive social contract with the community. In line with SET's perspective, every company that has used the resources of Allah SWT for all its operational activities needs to disclose ISR as a company's good faith towards the community and as a form of worship to Allah SWT (Khurshid et al., 2014; Triyuwono, 2015).

In other words, the SET's perspective is not only concerned with the vertical relationship with Allah SWT (*hablumінallah*) but also emphasizes the horizontal relationship with fellow human beings (*habluminnas*). Aspects of the environment and the natural surroundings are also regulated in SET as a horizontal relationship (*habluminal'alam*) to maintain and preserve the environment and natural surroundings. The relationship between SET and this research is a form of vertical corporate responsibility to Allah SWT, indicated by the ISR disclosure related to what has been done by the company with the primary goal of getting the blessing of Allah SWT.

Gantyowati and Nugraheni (2014); Indrawaty and Wardayati (2016) provided empirical evidence that the audit committee (AC) has a positive effect on ISRD. This research is supported by Hasanah et al. (2018); Rachmania and Alviana (2020) that AC could enhance the number of ISR disclosures. The size of the audit committee is an expectation that the AC can better supervise the management in realizing responsibility to the company and the community, especially related to ISRD. The AC is the person chosen by the board of directors to monitor the process of reporting financial statements for credibility. The more the credibility of the financial statements, the more the company will be required to disclose the ISR to improve social performance.

H1: Audit committee has a positive effect on ISR disclosure.

2.2 Institutional Ownership and ISR Disclosure

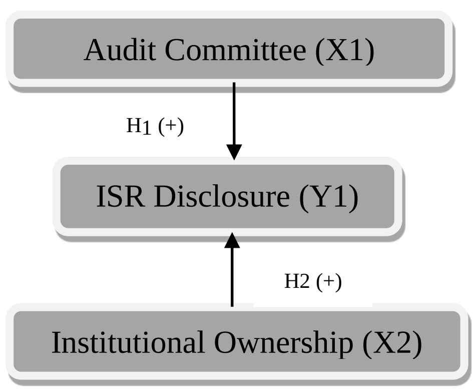
Institutional ownership (IO) is a shareholder with larger shares and voting rights (Chang and Zhang, 2015; Schnatterly et al., 2008) than their interests by only looking at short-term profits in the company they invest in. Nevertheless, they are also concerned about long-term performance. It is a way to improve through sound management practices such as ISR, and it indicates that the greater the ownership of institutional shares, the greater the supervision by institutional investors. As a result, companies are encouraged to disclose their social and environmental responsibility reports. Through an annual report, the company will describe the impression of its social responsibility to attract the company and reach institutional investors.

Institutional investors tend to invest in companies that implement CSR and prevent or avoid investing in companies with poor social performance. Institutional investors will fully support social disclosure initiatives (Mahoney and Roberts, 2007) to get legitimacy from the community that the company they invest in is responsible for society, the environment, and Allah SWT (Triyuwono, 2015). Institutional investors' ability, experience, and responsibility protect the rights of all shareholders so that they oblige companies to communicate transparently and improve voluntary disclosures.

Oh, et al. (2011); Soliman et al. (2013) showed that IO positively correlates with social disclosure. IO also positively affects ISR (Ningrum et al., 2013) and voluntary disclosure (Purwaningsih and Wibowo, 2020). It implies that institutional ownership can improve the quality and voluntary disclosure to increase ISRD. It is because sizeable institutional ownership will cause pressure on management to disclose corporate social responsibility more extensively.

H2: Institutional ownership has a positive effect on ISR disclosure.

Figure.1.
Research Model



3. Methodology

This study comprised companies listed in the JII as a population. The reasons for choosing JII are: (1) the company's shares in JII include selected liquid shares covered in sharia criteria (Sharia Securities List issued by OJK). The selection criteria consider liquidity and market capitalization, and (2) JII selects issuers based on the best 30 ratings in terms of sharia compliance during the review period conducted in May and November every year (www.idx.co.id). Thereby investors are more interested in choosing stocks with the best index values. It is shown when Islamic investors choose shares listed in JII.

The sample of this research was taken by the method of purposive sampling, with criteria:

1. Companies that are consistently registered in JII during the 2015-2019 period
2. JII companies that provide annual financial reports available on www.idx.co.id in the form of a summary or Indonesian Capital Market Directory (ICMD) to obtain financial data publications.
3. JII companies with complete data.

The variables in this study consisted of the independent variable, which is audit committee (AC) and institutional ownership (IO), whereas the dependent variable includes Islamic Social Responsibility (ISR) disclosure. The AC is responsible for the duties and functions of the board of commissioners. The measurement for the AC uses the number of AC members (FSA Regulation Number 55/POJK.04/2015). IO is the ownership of shares of a company by institutions that can be measured by the number of institutional shares divided by the total outstanding shares (Chang and Zhang, 2015).

Social reporting reflects new and broader societal expectations regarding the business community's role in the economy (Haniffa, 2002). ISR in this study is measured by ISR disclosure based on each company's ISR index score every year (Haniffa, 2002); Othman et al., 2009). It refers to 43 items (see table 1). ISRD is calculated using a dichotomous approach. Each indicator item gets a value of 1 if it is disclosed and 0 if it is not disclosed. The use of the ISR index is because the ISR index is an extension of the social responsibility report, which includes community expectations, where these expectations are not only about the role of companies in the economy but also the role of companies in a spiritual perspective. This is following the findings of Haniffa (2002) that there are two points that companies must disclose from an Islamic perspective, namely full disclosure and social accountability.

Table 1.
Islamic Social Reporting (ISR) Index

A	**Funding and Investment**
1	*Riba*
2	*Gharar*
3	Zakat (Method used, Amount of zakat, Recipient)
4	Liability for late payment debts and debts write off
5	Current Value Balance Sheet (CVBS)
6	Value Added Statement (VAS)
B	**Products and Services**
7	Eco-friendly products
8	Product halal status
9	Product quality and safety
10	Consumer complaints/indicators that are not completed in regulations and voluntary codes (if any)
C	**Employees**
11	Work character (Working hours, Leave, Other benefits)
12	Education and training/human resource development
13	Equal opportunity
14	Employee engagement
15	Occupational health and safety
16	Work environment
17	Special employees of other groups (disabled, ex-convicts, ex-drug addicts)
18	The higher company's echelons perform *jama'ah* prayers with lower and middle-level managers
19	Muslim employees are allowed to perform their obligatory prayers during certain times and fasts of Ramadan on their working days
20	The right place of worship for employee
D	**Community**
21	*Saddaqa*/donation
22	*Waqf*
23	*Qardhassan*
24	Voluntary fees
25	Education (school adoption scheme, scholarship)
26	Work graduates
27	Young generation
28	Poverty
29	Childcare
30	Charities/gifts/social activities
31	Sponsoring public health/recreation projects/cultural events
E	**Environment**
32	Environmental conservation
33	Endangered wild animal
34	Environmental pollution
35	Environmental education
36	Environmental process/related products
37	Environmental audit/independent verification statement/government
38	Environmental management system / policy
F	**Corporate Governance**
39	Sharia compliance status
40	Ownership structure: the number of Muslim shareholders and their share ownership
41	Structural Muslim-boards vs non-Muslim
42	Prohibited activities: (monopolistic practice, stockpiling of necessary items, price manipulation, fraudulent business practices, gambling)
43	Anti-corruption policy

Source: Haniffa (2002); Othman et al., (2009) All research data were processed by multiple linear regression analysis with the following equation:

$$\mathbf{Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e}$$

Information:

Y : ISR Disclosure

α : Constants

$\beta_{1,2}$: Regression Coefficient

X_1 : Audit Committee

X_2 : Institutional Ownership

e : Error

4. Results and Discussion

4.1 Result

Descriptive Statistics

The descriptive statistical calculations result of the audit committee (AC), institutional ownership (IO), and ISRD are shown below:

Table 2.
Descriptive Statistic

	N	Min	Max	Mean	Std. Dev
AC	70	3	5	3.410	.628
IO		.45	.86	.751	.244
ISRD		.55	.78	.799	.175
Valid N (list wise)					

Table 2 shows that the AC shows an average value of 3.410. Specifically, the AC of the companies listed is satisfactory. The number of AC members for 14 JII companies for five years is under FSA Regulations 55/POJK.04/2015-chapter four that the AC shall consist of at least 3 (three) members from Independent Commissioners and Parties from outside the Issuer or Public Company. IO has an average of 70 samples of 0.751, which showed that the average companies listed in the JII have IO items for 75.1% during the 2015-2019 period. Notably, in five years, the large percentage of institutional ownership for the 14 JII companies is more than 50% of the outstanding company equity. ISR proxied by the ISRD index shows an average value of 0.799. The number of ISRD scores for 14 JII companies for five years is more than 30 ISR disclosure scores. In other words, the ISR of companies listed in the JII used as research samples is relatively high. These results indicate that the JII company has tried to fulfill its social responsibilities based on the sharia principle by considering the aspects of the ISR index.

Classic Assumption Test

Table 3 shows that all variables have met the classical assumption test criteria.

Table 3.
The Results of the Classic Assumption Test

Dependent Variable	Independent Variable	Normality Test		Multicollinearity Test		Heteroscedasticity Test (Glejser Test)		Auto Correlation Test (Run Test)
		K-S	Sig	Tolerance	VIF	t	Sig	Sig
ISR Disclosure	AC	.954	.487	.851	1.463	2.889	.185	.877
	IO			.815	1.531	2.597	.257	

Multiple Linear Regression Analysis

The below table presents the results of multiple linear regression analysis.

Table 4:
Multiple Linear Regression Results

Dependent Variable	Independent Variable	β Unstandardized	t	Sig	Decision
ISRD	AC	0.052	2.100	.054	Reject H1
	IO	0.326	2.669	.001	Accept H2
F count	4.531			.000	
Adj. R square	0.150				

Source: Regression estimation output, 2022

Table 4 shows that the model has F values of 4.531 with a p-value of 0,000 and can explain the dependent variables of 15%. The t-test value shows that the AC does not affect ISRD (p-value = 0.54). IO has a positive effect on ISRD (p-value = 0.01). Thus, reject H1 and accept H2.

4.2 Discussion

4.2.1 Audit Committee and ISR Disclosure

The audit committee (AC) does not influence ISR. Some ACs within the company do not influence some ISRD items. The company's large number of AC cannot provide comprehensive supervision in terms of financial reporting, supervision, and corporate governance. Whatever the number of the AC, ratios will not influence the extent of ISRD. The AC has not made an effective supervisory mechanism for the firm's management.

These research results are different from the legitimacy theory. The existence of an AC should be able to minimize management's efforts in manipulating data problems. It is regarding finance and accounting procedures and activates transparency efforts by disclosing broader financial statements. However, the sample data shows that the AC of companies listed on the JII is more focused on carrying out organizational governance and financial reporting responsibilities than social responsibility in disclosing ISR. The AC ensures that the internal control structure has been applied well.

This research is consistent with Kurniawati and Yaya (2017); Puspawati et al. (2020). They found that the existence of an AC does not affect ISRD. In contrast, the research of Hasanah et al. (2018), Indrawaty and Wardayati (2016), and Rachmania and Alviana (2020) prove that the existence of an AC could increase the ISRD. Gantyowati and Nugraheni's (2014) findings confirm that the AC can encourage the number of voluntary disclosures. Moreover, Ariyani (2020); Sari and Helmayunita (2019) considered that the existence of an AC could reduce ISR and CSRD (Rizki et al., 2014).

4.2.2 Institutional Ownership and ISR Disclosure

Institutional ownership (IO) can improve the ISRD. It indicates that a large IO ratio can encourage supervisory efforts by institutional investors on management to make extensive and complete ISRD. It is because the public needs transparent and accountable information and GCG practices. Thus it encourages companies to provide information about their social activities.

These research results are in line with the theory of legitimacy. The comparison between institutional shares and outstanding shares is getting bigger. It can encourage companies to monitor further the social performance of companies listed on the JII. The ratio of corporate IO in the JII of 75.1% will strengthen IO in improving the social performance of the JII. The greater the IO in the company, the more effective the supervision by IO will be. As a result, it minimizes the manipulation by managers in improving the social performance of the JII by disclosing ISR. Therefore, IO will fully support social disclosure initiatives (Mahoney and Roberts, 2007) to get legitimacy from the community that the company they invest in is responsible for society, the environment, and Allah SWT (Triyuwono, 2015).

This research is the same as Oh et al. (2011); Soliman et al. (2013), that IO can enhance the level of social disclosure. It is supported by the findings of Ningrum et al. (2013) that IO can increase ISR and voluntary disclosure (Purwaningsih and Wibowo, 2020). On the other hand, it is different from Widyanti and Cilarisinta's (2020) findings that IO has a negative effect on ISR. IO does not affect ISR (Sari and Helmayunita, 2019) and CSR (Laksmitaningrum and Purwanto, 2013).

5. Conclusion, Implications, and Limitations

Observing 70 annual reports from 14 companies listed on the JII in 2015-2019 proved that AC does not affect ISRD. Meanwhile, IO affects ISRD. This research has implications for the JII company to disclose ISR broader. It aims to ensure the public that the company has concern for the environment and society and a form of corporate responsibility to Allah SWT as the highest stakeholder. For Regulators, this study can be a material consideration in designing a policy and related regulations for ISRD. For investors, as a consideration for investment decisions.

This study has several limitations; first, the subjectivity of researchers regarding the calculation of the ISRD index. Second, the ability of the AC and IO to explain ISRD is 15%. Therefore, the following research can use other methods in calculating the ISRD index by sending questionnaires to the JII companies, adding other independent variables (such as company characteristics and financial performance), expanding the research object (such as companies listed on the ISSI), and extending a more extended year of observation.

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