The effect of conditional conservatism on cost of debt and mediation role of CSR disclosure: Empirical evidences from IDX[1]

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Abstract: A number of previous studies have found evidences that corporate social responsibility disclosure (CSRD) are positively related corporate sustainable performance. These result indicate that socially responsible firms have good management system, more transparent, good reputation that will impact to financial outcomes. Other significant findings regarding CSR initiatives shown that CSR reporting has positive market consequences, where social responsible firms is likely to have ease of access to financing. A number of studies have been conducted with consistent result to consensus that the higher level of CSRD, the lower cost of equity capital. However very limited studies have been conducted to study relation of CSRD and cost of debt. Further studies about this topic are important because debt financing play an important role as external financing to enhance firms' growth. Characteristics of debt market which is less risky and less volatile than equity market, attract wider coverage of firms to implement CSR practices. Under contracting theory, the banks as dominant lenders require borrowers to adopt accounting conservatism principle in their debt covenant. Accounting conservatism is a mean of constraining moral hazard caused by parties of the firms having asymmetric information, asymmetric pay-off. Especially in the debt contract the existence of conservatism as stringent standard in revenue recognition largely derived from the need to protect the lenders. Scholars argue CSRD that are prepared under spirit of conservatism could be perceived to give information to predict borrowers' risk. This study aimed to find evidences how CSRD could effect in lower COD. This research is questioning "Do banks give value on CSRD on their lending decision?" This study argue that quality of CSRD should be determined by level adoption of accounting conservatism adopted in firms accounting system. This research proposes to examine direct effect of conditional conservatism (CONSV) on COD, and the indirect effect of CONSV on COD through mediation role of CSRD. In addition we propose to examine three links: 1) Whether CONSV have negative effect on COD, 2) Whether CONSV have positif effect on CSRD, and 3) Whether CSRD have negative effect on COD. This study using sample manufacturing firms listed at Indonesia Stock Exchange (IDX) period 2011-2014. This research consider CSRD as endogenous variable that is predicted to have mediation role on the relation of CONSV and COD. Result of endogeneity test showed CONSV and audit committee mechanism (ACM) are instrument variables for CSRD. Furthermore we use ordinary least square (OLS) to examine link.1 and 2, and two stages least square (TSLS) for link 3. The result show that: 1) CONSV have no significant effect on COD directly, 2) CONSV have no significant effect on CSRD, while ACM have positive effect on CSRD, 3) CSRD have significant mediation role, where endogeneity variable CSRFITT have negative effect on COD. Result of examination led to conclusion that banks gave value to CSR disclosure in their lending decision. CSR disclosure is perceived to give additional information for bank in assessing borrowers' risk, when there are no adequate conservatism level. CSRD could be perceived as representation of

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good management and good governance of the firm that can give assurance in bank lending decision.

Keyword: Audit committee mechanism, Borrowers' risk, Conditional conservatism, CSR disclosure, Cost of debt, Estimation risk.

Introduction

Corporate Social Responsibility (CSR) becomes increasing trend in the business community in this planet, including in Indonesia. World Business Council for Sustainable Development (WBCSD) have introduce the concept of CSR as vehicle to sustainability, as follows;

"CSR is a term describing company obligation to be accountable to all of its stakeholders in all of its operation and activities. Social responsibility company consider the full scope of their impact on communities and the environment when making decision, balancing the needs of stakeholders with their needs to make profit" [51]

Since then scholar suggested business firms to incorporate triple bottom line (TBL) in business operation, including economic, social and environment (Elkington, 1994). So far most of business firms around the globe has shown increasing awareness of importance sustainability by reporting their CSR initiatives in annual report, stand-alone sustainability report, (SR) as well as integrated reporting following Global Reporting Initiatives (GRI) [17, 45].

A number of global initiatives have been taken by several financial institution, such as RIO+ Agreement that include commitment of developed countries to reduce greenhouse gas emission, and to help developing countries to undertake economic development programs that are environment friendly. United Nation Environmental Program Financial Initiatives (UNEP-FI 1992), have issued Principle of Responsible Investment (PRI) that require investment feasibility analysis that include social, environment as well as governance aspect. PRI was followed by signatory statement by banks on the environment and sustainable development, where banks as dominant lenders committed not to provide loan to prospective debtor that does not comply with social and environment regulation. Until 2013 UNEP-FI has more than 200 financial institution members from all over the world including two Indonesian banks.

To date the concept of CSR are understood as multidimensional concept, as well as a "new paradigm" that raise question about the uncertainty of CSR benefit to sustainable business. Therefore CSR practices are still found some obstacles and constrains. Aguinis and Glavas stated that CSR definition is refer to policies and actions taken by organizations, that are influenced by actors at all levels [2]. Some previous empirical and conceptual literature defined CSR as "context-specific organizational actions and policies that take into account stakeholders' expectations and the triple bottom line of economic, social, and environmental performance" [2].

A number of studies have conducted to explain firms' CSR practices using shareholders theory [25] and stakeholders theory [24, 41]. Shareholders theory argued that firms aim to maximize profits for owners, and conduct social responsibility within certain limits as long as the activities relate to prosperity of shareholders [25]. This view stated that CSR activities are driven by intrinsic motivation of "doing the right things" that is the nature of the generosity of individual shareholder to meet legal regulations, moral values and ethics. Shareholders' view has implication of firms to initiate CSR philanthropy. In this typology, CSR spending tend to be treat as expense or profit distribution.

Stakeholders theory argue that the existence of the company is not solely for the maximum benefit of shareholders, rather includes the interests of other key stakeholders [24]. In addition stakeholders' view argue that CSR can improve financial performance since the success of the firms depend on how do firms manage their concern of various stakeholders interest in good stakeholders management. The way their manage their stakeholders' concern will determine in what extend they satisfy their key stakeholders [9, 16, 24]. The stakeholders' view has implication firm to initiate CSR strategically, by integrating CSR initiatives into firms value chain. In this typology, CSR spending will be treat as operational cost, and even could be seen as long term investment.

A number of previous empirical research have found several strong evidences as justification for CSR activities. Several research found mixed result on relation between CSR initiatives and firm financial performance, although majority documented positive relation [36, 37, 39]. Conceptual literature "Corporate Sustainability Model" by Epstein & Buhovac [19] described that CSR initiatives produce intermediate nonfinancial output such as; increasing customer satisfaction, customer loyalties, employee commitment, enhanced brand and reputation. Scholar and practitioners perceived the nonfinancial outcomes is a kind of intangibles that reflect firms' future potential capability in value creation that will ultimately impact to financial outcomes [19]. Others perception believed that CSR can give the benefit easier access to sources of financing. Previous studies found evidences that market gave response to voluntary nonfinancial disclosure on CSR reporting [11]. The findings showed that firms with high cost of equity capital in the previous years tend to initiate disclosure of CSR activities in the current year, and the initiating firms with superior responsibility performance enjoy subsequent reduction of in the cost of capital. CSR disclosure also found related to lower analyst forecast error [12]

However, to date there are limited study on relation of CSR initiatives and cost of debt, exception several studies from western developed countries [29, 38]. Several empirical evidences are needed to explain the relation between CSR initiatives and cost of debt financing in various context, since this will give strong justification about the benefit of CSR. Logic of thinking from previous studies stimulate idea questioning how CSR disclosure relate to cost of debt ? Do creditors or lender give value on CSR disclosure by customizing the interest rate in debt contract? This question is important because debt financing play an important role as external financing to enhance firms' growth. Characteristics of debt market which is less risky and less volatile than equity market, attract wider coverage of participant. In several countries proportion of debt financing accounted for 72% of external financing among US listed firm, 79% for UK listed firm, 66% Japan and 49% Germany [20 in 52].

Previous studies found CSR initiatives have positive effect on banks efficiency, as well as impact level of corporate governance [15]. In line to this findings, Goss and Robert, (2011) found that CSR have negative impact on cost of bank loan. The next study found CSR and environment consciousness could be a determinant cost of banks debt [38] using US firms data from KLD database. Ye and Zhang [52] is the first that documented U-shaped relation between CSR and cost of debt in emerging market context in China. Other supporting findings are debt market in particular loan market posses the capacity to forecast the market default before the equity market as well as the bond market [5]. The emerging trend have shown the important of debt financing, and debt market have role in encouraging information efficiency.

Prior studies in contracting theory, banking as lenders require borrowers to adapt accounting conservatism in debt covenant. Accounting conservatism is an important convention of financial reporting and has become an economic demand in various firm contracts. Conservatism is defined as idea where the tendency of accountant require a higher degree of verification to recognize good news as gains than to recognize bad news as losses in financial statement [6]. Conservatism emerged as efficient contracting mechanism because it optimal for contracts' performance measure to have more stringent verification standard for gain than for loss recognition. Scholar and practitioner viewed that in the debt contract conservatism reduce the likelihood management will forgo positive net present value project, overstate revenue and asset, and make what is effectively a liquidating dividend payment to stakeholders at the expense of debt holders [49]. Furthermore It was stated that conservatism is in corporate governance perspective that provide timely signal for investigating the existence of negative net present value project and taking appropriate action if they exist conservatism protect the shareholders' option to exercise their property right [49].

According to risk mitigating theory, lenders consider and assess the borrowers' risk, anticipate cost of moral hazard and adverse selection at ex ante debt contract [32]. Lenders will rely on their monitoring function during period of contract [52]. In a debt contract CSR disclosure play role as proprietary information of borrowers' risk, allow the lenders getting in-depth knowledge to customize the debt contract (44 in 38]. From lenders perspective CSR disclosure will play a role in reducing information asymmetry and anticipate for moral hazard problem [14, 20]. By gathering information through CSR disclosure the bank more likely to do risk diversification in the loan decision making.

This study underlines two important limitations of previous research regarding relation between CSR and cost of debt that we seek to address. First, previous studies conducted mostly in western developed countries. To date, there are limited studies addressed the benefit of CSR in emerging countries especially in Indonesia. Compared with those in western countries, institutional legal frameworks in emerging countries are not yet well developed and limit the extent to which firms can benefit from their CSR efforts. Hence limitation on CSR law and regulation predicted to have significant influence on firms' motive in CSR practice. Epstein and Buhovac [19] argues that managerial values and attitudes towards CSR in a given institutional context are likely to have a strong influence on the outcomes of CSR initiatives.

CSR practices in Indonesia have been understood as philanthropy in most private sector, as well as community development in most of state-owned firms [21, 43]. This understanding is very common for Indonesian business practitioners to date. Prior studies underlined that law instrument regarding CSR activity contribute to "narrow mind" in viewing CSR as vehicle to sustainability. CSR practice in Indonesia have been regulated under Law No. 40. 2007 (Financial Authorities and Services/OJK) in private listed firm, that emphasized CSR as social responsibility and environment. While Government Rule No.5/2007 (Ministry of State Owned Companies) is regulate state-owned firm listed as well as non-listed firms, that emphasized CSR as PKBL. Under this regulation any firms listed in Indonesia Stock Exchange (IDX) obliged to conduct CSR and report their CSR in annual report. Especially for state owned companies, they should conduct PKBL as their CSR practice. The existing regulation shown partial understanding of CSR concept in Indonesian companies.

To date although with some limitation regarding CSR regulation in Indonesia, yet previous studies documented increasing level of CSR disclosure in annual report as well as sustainability report by firm listed in Indonesia Stock Exchange (IDX). By the end of 2015 most of Indonesian listed firms in IDX have reported their CSR in annual report, and there are 34 firms (including non-listed state-owned firms) report CSR in stand-alone sustainability report (SR)[2] based on GRI, and it is the highest number among ASEAN countries. By the end of 2014 OJK have issued roadmap for sustainable finance in Indonesia (2015 – 2019) that is expected to reinforce commitment of private sector in contributing to sustainable development.

Second, although previous studies have found strong argument for potential benefit of CSR initiatives scholar have not reached a consensus on whether or not and how CSR effect to the performance [37, 39] and how they impact that on cost of debt [29, 52, 38]. Relation of CSR on cost of debt can be explained by risk mitigation theory [52]. Basically increasing awareness on social and environmental issues will reduce business operation risk by generating positive moral capital among stakeholders, and making firm less vulnerable to business interruption or other related negative event. As business operating risk is the primary driver of cost of debt, reduction in operating risk will lead to lower cost of debt.

This study differs from previous that focus on examining the effect of CSR disclosure of cost of debt [29, 52, 38], or other that examined relation of conservatism and CSRD [22]. Rather this study try to combine the both examination to find evidences how CSRD could effect in lower COD. This study is questioning main research question "Do banks give value on CSRD on their lending decision ?" This study argue that quality of CSRD should be determined by level adoption of conservatism in firms accounting system. This research proposes to examine direct effect of conditional conservatism (CONSV) on COD, and the indirect effect of CONSV on COD through mediation role of CSRD. In addition we propose to examine three links: 1) Whether CONSV have negative effect on COD, 2) Whether CONSV have positive effect on CSRD, and 3) Whether CSRD have negative effect on COD. This study contribute in several ways. *First*, contribute to literature of information content of CSR disclosure in lenders perspective, this study filling the gap by examining direct and indirect effect conditional conservatism on cost of debt financing using CSRD as intervening variable. *Second*, this study provide several input to regulatory body related to loan policy in banking as well as CSR disclosure policy. *Third*, this study provide several input to lenders, borrowers, analyst and other related stakeholders for better decision making.

Materials and Methods

Literature review

Conservatism and it's importance in information quality

There are no authoritative definition of conservatism though it has a long history. Scholars have consensus that conservatism is an important convention of financial reporting. It implies the exercise of caution in the recognition and the measurement of income and asset [27]. FASB Statement of Financial Accounting Concepts No.2 (1980) defines conservatism with seeming approval as ''prudent reaction to uncertainty''. While Watts [49] defined conservatism as the differential verifiability required for recognition of profit versus losses. Basu [6] defined conservatism as idea where the tendency of accountant require a higher degree of verification to recognize good news as gains than to recognize bad news as losses in financial statement. Among several definition of conservatism, Basu [6] was the one that explained conservatism as an equivalent bias conditional on firms experiencing

[2]The number of firms that publish Sustainability Report increased since 2005. The increasing amount identified through Indonesia Sustainability Reporting Award (ISRA) that were conducted by National Center for Corporate Social Responsibility (NCSR). At the first time ISRA was held in 2005, there were 7 firms participated, in 2009 there were 22 participated, and in 2015 there were 34 firms participate that include both from high and low profile industry. Overall, to date there were 120 Sustainability Report that have been published by listed as well as non-listed firms in Indonesia.

contemporaneous economic losses. Accounting conservatism is perceived an efficient financial reporting mechanism and exerts a positive effect on the quality of the financial information.

Lenders and borrowers context of CSR disclosure

The increasing important of environment issue, and social responsibility among corporation around the world have invited the bank signed 'Statement by Banks on the Environment and Sustainable Development' (UNEP 1992). By signing the statement, the bank agreed to consider environmental issue in their operation. After two decades of signatories the question is how far banks considers CSRD in their loan decision need to be examined. Under risk mitigating theory increasing level of CSR initiatives are perceived as reduce operation risk by generating positive moral capital among stakeholders and making firm less vulnerable to negative [52]. As lenders need to assess the borrower risk through operating risk, it could be the primary driver of cost of debt in their lending decision. Previous studies showed that most of banks that consider environmental and social issues in their decision have increasing profit and positively affected to banks' reputation [47].

From the context of borrowers, the focus of CSR disclosure has shifted from the maximization of shareholders value to the satisfaction of the wider set of stakeholders which leads to better performance and enhances corporate reputation [10]. Goss [28] stated that the idiosyncratic risk generated by a firm and its governance can change the term of bank loan. Bebington [7] stated that CSR disclosure could be viewed as part of reputation risk management process. While reputation is conceptualized from economic and strategic management as sociologically informed perspective that view reputation as the outcomes of shared socially constructed impression of the firm [7]. Reputation is viewed as strategic intangible asset that is expected to produce tangible benefit such as lower cost of external financing, increase customer and employee loyalty as well as increasing quality of decision making [19].

Conceptual Framework

The following conceptual framework will explain direct effect of conditional conservatism on cost of debt and indirect effect of conditional conservatism on cost of debt through mediation of CSR disclosure. The examination will conducted in three link of hypothesis, they are; (1) The effect of conditional conservatism (CONSV) on cost of debt COD, (2) The effect of conditional conservatism (CONSV) on CSR disclosure (CSRD), and (3) The effect of CSRD on COD.

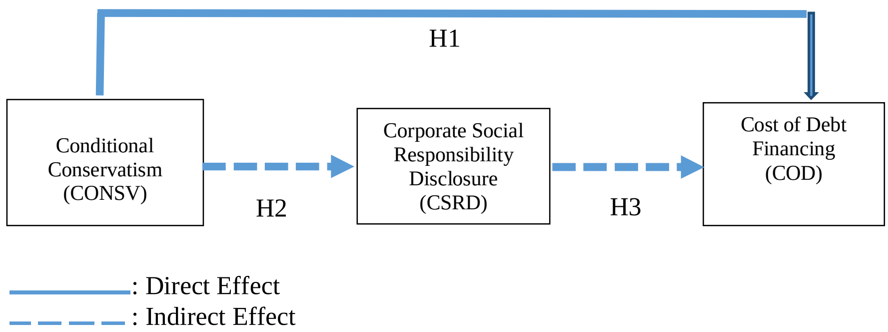

Figure 1: Conceptual framework

Hypothesis Development

The effect of conditional conservatism on cost of debt

Under contracting theory accounting conservatism is suggested as a mean of constraining moral hazard caused by parties of the firms having asymmetric information, asymmetric payoff, limited horizons and limited liability (Watt, 2003). Scholar in previous studies explained the conservatism could be adopted in various firms contract, such as; i) in debt covenant to reduce the likelihood management will forgo positive net present value project, overstate earnings and asset, and make what is effectively a liquidating dividend payment to stakeholders at the expense of debt holders, ii) in compensation contract, to reduce the likelihood that manager will exert effort to overstate net asset and cumulative earning in order to distribute the net asset of the firm to themselves instead of exerting effort to take positive net present value project, iii) in corporate governance to provide timely signals for investigating the existence of negative net present value project and taking appropriate action if they exist. Furthermore the adoption of conservatism is suggested benefit users of firms accounting report, can attract attention of the investor through disclosure that is one of the best mechanism to optimize the allocation of resources to the owners [50].

Risk mitigating theory stated that banks rely on their monitoring function in assessing borrowers' risk. The risk is defined and associated with price and non-price term of debt [13]. The banks will try to do effective monitoring by getting access to proprietary information, gather in-depth knowledge about the borrowers to customize interest rate in the debt contract. In debt contract, investor have an asymmetric payoff with respect to net asset. Furthermore it was pointed out that the existence of conservatism as stringent standard in revenue recognition largely derived from the need to protect the lenders [50]. Based the explanation we derive hypothesis 1 as follows: Based on the explanation above, we derived hypothesis 1 as follow;

Hypothesis 1: Conditional conservatism have negative effect on cost of debt.

The mediation role of CSR disclosure on relation of conditional conservatism and cost of debt.

The effect of conditional conservatism on CSR disclosure

Previous studies in contracting theory suggested requirement to adopt conservatism principle in various firms contract. CSR disclosure is information release for wider contract with wider scope of stakeholders. Multiple stakeholders can trigger higher conflict of interest and higher agency cost. Conservatism is an important convention of financial reporting and has become an economic demand in various firm contract [50]. Under of stakeholder theory (Freeman, 1984), it is stated that organization have social contract with their key stakeholders, so they should manage stakeholders relationship by balancing all the stakeholders interest as well as making equitable distribution of wealth, (Donaldson and Preston, 1999). In conceptual literature corporate sustainability model, Epstein and Buhovac [19] suggested organization to be accountable by following accountability cycle in conducting CSR. It means that organization should integrate the concern of stakeholders into organization' decision making system. There are four steps to become accountable organization, they are i) improve corporate governance, ii) improve measurements, iii) improve reporting and iv) improve management systems [19].

CSR reporting as combination of financial and nonfinancial information should be developed as an integrated link to firms accounting information system. Liu and Wang [35] stated that it is necessary to keep companies from being too optimistic deliberately about their CSR activities and disclosure through regulation and differential standard for positive and negative information. Consistent to this idea Bebington [7] stated that CSR disclosure is part of reputation risk management. The conservatism principle can be applied at the stage of recognition, measurement of corporate social responsible events, and so forth are part of the CSR reporting, and the requirements of conservatism should be carried out in fact and appearance. The conservatism in fact means that companies should be cautious and honest about the positive CSR information during the process of fulfilling, gathering, recognizing and so on of corporate social responsible events. While conservatism in appearance is about way of presenting information that relate to format, presenting time as well as order of the contents, in order to avoid variance of understanding of difference users [35].

Prior research on relation of conservatism and corporate social performance by Francis [22] found evidence that there are positive relation of accounting conservatism on corporate social performance. Research by Smith [46] questioned "Do the adoption of IFRS affect CSR disclosure in annual report?" They find the evidence that IFRS adoption had a differential effect on CSR disclosure based on a firm's institutional setting. Firms in the stakeholder countries did not have a significant change in the level of CSR disclosure following the mandatory adoption of IFRS, while firms from the shareholder countries experienced a significant increase over the same period resulting in shareholder countries providing an overall higher level of CSR after IFRS adoption than stakeholder country

In the middle of limited research that analyze the relation of conservatism on CSR disclosure it can be stated that Smith [46] support Francis [22]. As IFRS rely on prudential principle both gave early insight for further explore CSR disclosure. According to the explanation above, We predict that conditional conservatism will have positive effect on CSR disclosure, and based on the explanation we derived hypothesis 2 as follows.

Hypothesis 2: Conditional conservatism have positive effect on corporate social responsibility disclosure.

CSR disclosure and cost of debt

The indirect effect of conditional conservatism on cost of debt can be seen from dashed arrow from conceptual framework (Figure 1). This indirect effect explained through the positive effect of conditional conservatism on CSR disclosure and continued by the negative effect of CSRD on cost of debt. Previous studies showed that conditional conservatism have positive effect on CSRD. In addition previous studies also shown evidences that banks used CSRD as additional information in assessing borrowers' risk in their lending decision [38, 52]. Other previous studies regarding potential benefit from CSR disclosure where the higher level of CSRD, easier access to external financing. And in most of studies previous found consistent result that CSR disclosure have negative association with cost of equity capital. The desire to get lower cost of capital is alleged become motive to increase the disclosure in CSR initiatives. This findings stimulate the same idea to analyze the relation of CSR disclosure on cost of debt.

Under risk mitigating theory, CSR disclosure can play role as proprietary information and handling information asymmetric and moral hazard problem [14, 20]. Basically banks need to assess the borrowers risk in their lending decision. Adverse selection problems will arise when banks fail to identify high risk and low risk borrowers, which lead to probability to make a contract with a firm that have high risk of default. This studies supported by preposition that when firms identified as social responsible firms through their CSRD, the firms predicted to be able to attract their key stakeholders, customer, investors, and suppliers. And these will be future potential that lead to increase in current and long-term revenue, hence will reduce risk of default. By gathering information through CSRD, the bank more likely to do risk diversification in the loan decision making [38].

Previous studies on relation CSR disclosure on cost of debt shown inconsistent result. Horvathova [31] and Orlitzky [39] conclude that there are an unclear relationship between firms' social responsibility disclosure and corporate debt. Other findings [38] using US firms sample concluded that bank incorporate firm's environment consciousness in their corporate lending decision. While [52] using sample of firms in China, found that CSR philanthropy disclosure have an inverted U shape relation to cost of debt financing. Other study in Indonesia [4] using sample from manufacturing firms from IDX, found there are no significant effect of voluntary disclosure on cost of debt. Based on the explanation above we derived hipotheses 3 as follows

Hypothesis 3: CSR Disclosure have negative effect on cost of debt

Research Method

The following 3 research model (equations) are developed to explain direct effect of CONSV and COD and indirect effect of CONSV and COD through mediation of CSRD.

$$COD_{it} = \beta_0 + \beta_1 CONSV_{it} + \beta_2 ACM_{it} + \beta_3 CSRD_{it} + \beta_4 LN\_TA_{it} + \beta_5 PBV_{it} + \beta_6 EBIT_{it} + \beta_7 DTOTA_{it} + \beta_8 LITIG_{it} + \beta_9 AUDQ_{it} + \varepsilon_{it} \quad (1)$$

$$CSRD_{it} = \alpha_0 + \alpha_1 CONSV_{it} + \alpha_2 ACM_{it} + \alpha_3 LN\_TA_{it} + \alpha_4 PBV_{it} + \alpha_5 ROE_{it} + \alpha_6 DTOTA_{it} + \alpha_7 LITIGATION_{it} + \alpha_8 AUDQ_{it} + \varepsilon_{It} \quad (2)$$

$$COD_{it} = \lambda_0 + \lambda_1 CONSV_{it} + \lambda_1 CSRDFITT_{it} + \lambda_2 LN\_TA_{it} + \lambda_3 PBV_{it} + \lambda_4 EBIT_{it} + \lambda_5 DTOTA_{it} + \lambda_6 LITIGATION_{it} + \lambda_7 AUDQ_{it} + \varepsilon_{it} \quad (3)$$

We expect :
$\beta_1 < 0$; $\beta_2 < 0$ for model (1);
$\alpha_1 > 0$; $\alpha_2 > 0$ for model (2);
$\lambda_1 < 0$ for model (3).

Operational Variables

Dependent variable:
Cost of debt financing (COD): Cost of debt (COD) is measured as the ratio of firms' i interest expense and finance charge in year $_{t+1}$ to average interest bearing debt for bank loan outstanding during years t [23].

Endogenous variable*:*
CSR disclosure (CSRD): This study consider endogeneity problem with CSR disclosure (CSRD) in explaining how conditional conservatism have relation to decreasing cost of debt financing. We predict that when management prepare CSR disclosure under conservatism principle, there would be a negative relation to cost of debt.

We measure index of CSR disclosure as checklist of CSR disclosure published on annual report following Lanis and Richardson [34]. There are 52 checklist items that consist of 6 group of topic: 1) CSR and strategy items, 2) Human resource strategy items, 3) Social investment items, 4) Environment items, 5) Customer and supplier items, and 6) Community and political involvement items. Index measured by content analysis with dichotomous approach, where if each CSR items disclosed was given value 1, and 0 if it is not disclosed. Next each item summed to obtain the overall value to calculate the CSR disclosure index according to the formula as follows:

CSRD j = Σ Xij / nj

Where:
CSRD j: Corporate Social Responsibility Disclosure Index for company j
Nj: Total item for company j, nj <= 52
X ij : Content analysis; 1=if item is disclosed; 0=if item I is not disclosed.
So that, 0 <= CSRD <= 1.

Independent Variables:

Conditional conservatism (CONSV): Conservatism is defined as asymmetric requirement for gain and losses [49], interpreted as the tendency of accountant require a higher degree of verification to recognize good news as gains than to recognize bad news as losses [6]. This study use accrual measure of conservatism based on conditional conservatism by Givoly and Hayn [27], that defineconditional conservatism as relative sensitivity of earnings to bad news compared with their sensitivity to good news, measured by the ratio ($\beta_0 + \beta_1$)/ β_0 from the following regression model.

$$EPS_{it}/P_{i,t-1} = \alpha_0 + \alpha_1 DR_{it} + \beta_0 R_{it} + \beta_1 R_{it}^{*} DR_{it} + \varepsilon_{it}, \qquad (4)$$

Where:
EPS_{it} : Earnings per share of firm i in fiscal year t
$P_{i,t-1}$: Price per share at the beginning of year
R_{it} : Return of firm i over the 12 months beginning nine months prior to the end of fiscal year t
DR_{it} : Dummy variable set equal to 1 if R it is negative and 0 otherwise.

The value for conditional conservatism obtained from cross section regression for 11 years period (t-11) until (t). In addition values of conservatism ratio ($\beta_0 + \beta_1$)/ β_0 are multiplied by minus one (-1) to ensure positive value indicates higher conservatism.

Control Variables

This study uses several control variables in Eq.1 and Eq.3, including; firms' size, market as well as sales growth, profitability including ROE and EBIT, leverage, potential litigation measures by type of high-profile and low-profile industry, and audit quality. While in Eq.2,control variables including; audit committee mechanism, firms' size, market growth, profitability, leverage, potential litigation measures by type of high-profile and low-profile industry, and audit quality.

Audit committee mechanism (ACM): This study uses effectiveness on audit committee mechanism as proxy for corporate governance. We predict that the more effective audit committee mechanism is, will have positive effect on CSR disclosure. And an effective corporate governance mechanism are also the factors that determine on loan decision [52]. That is why this variable will be used in explaining direct and indirect relation of conservatism on cost of debt.

The effectiveness of audit committee mechanism measured by corporate governance index follow Hermawan [30]. In this study audit committee mechanism measured by 11 checklist items, namely a) Activity - 8 items, b) Size - 1 item, d) Skills and competencies - 2 items. Index measured by content analysis, where if each items disclosed was given value 3 for good disclosure, 2 for fair disclosure and 1 for poor disclosure. The sum of score will be calculated to get index of audit committee mechanism.

Firm's size (LN_TA) capture various factor motivating firm to issue CSR report such as public pressure of financial resources [33]. The larger size of firm tend to attract stakeholders attention that are likely to lead to increasing political cost. Management tends to avoid political cost by choosing a more conservative accounting [49]. Firms size's are measured as natural logarithm of total asset (LN_TA).

Profitability (ROE) capture information on resources that more likely to allocate for CSR initiatives as well as firms capability to fulfill the debt contract minimize the potential covenant violation. The higher firms profitability is predicted will lead to increase CSR disclosure while decrease cost of debt financing. Two measure of profitability are used here, they are return on equity (ROE) and natural logarithm of earnings before interest and tax (LN_EBIT) the higher firm profitability there is tendency to be more conservative.

Growth (GROWTH): Firm in expansionary period are more financially constrain and have fewer resources for CSR activities and disclosure. Growth firms tend to have higher level of asymmetry information that could induce managers to make more disclosure to attract potential investor. We use two measurement of growth to capture phenomena of asymmetry information and conservatism, they are market growth; price to book value (PBV) and sales growth (S_GROWTH) [3].

Leverage (DTOTA): Leftwich et al. (1983) stated that debt play a monitoring role for debt holders demand for greater disclosure. Leverage is measured by debt to total asset (DTOTA). The higher DTOTA the more likely managers to increase the revenue (less conservative) to give confidence and creditors over repayment loan . In addition the higher leverage reflect higher risk lenders perspective as the more likely conflict will arise between shareholders and debtholder, then will induce contractual demand for accounting conservatism [3].

Litigation (LITIG): Skinner (1997) argued that firm that facing higher level of litigation risk are more likely to make more voluntary disclosure to preempt potential lawsuit. Litigation measured as indicator variables that equals 1 if firm operate in high-profile industries, and 0 otherwise.

Audit Quality (AUDQ): Audit quality play role as external monitoring or corporate governance function that increase information quality and reliability. Audit quality is measured using proxy of big 4 accounting firms auditor as dummy variables, indicator 1 if firms use BIG4 auditor and 0 otherwise.

Method of Estimation

Method of estimation that is used to examine the direct effect is ordinary least square estimator (OLS). While method of estimation to examine the indirect effect is two stage least square estimator (2SLS) with Pooled Least Square (PLS). PLS method is similar to regression method with cross section or time series data, which is applied to panel data and does not see the difference between individual and across time.

Result and Discussion

Descriptive statistic

This study uses sample of manufacturing companies listed in Indonesia Stock Exchange during the period of 2011-2012. The number of firms that are used as sample totaling 60 firms with 240 firm-years. The sample selection method can be seen from Tabel.1 , and the result of descriptive statistic in Tabel.2

Table 1. Sample Selection

Criteria	Years				Total Firm-years
	2011	**2012**	**2013**	**2014**	
Population of Manufacturing Industry	176	179	184	184	723
Randomly selected based on year 2014	70	70	70	70	280
Minimum listed 11 years and available financial data for (t-11) – (t)	65	67	67	67	266
Final Sample: Published CSR Disclosure and Corporate Governance disclosure on annual report for 2011 - 2014	60	60	60	60	240
Percentage (%)	34.1%	33.5%	32.6%	32.6%	33.2%
Total	100%	100%	100%	100%	100%

Table 2. Descriptive Statistic

Variable	Mean	Std, Dev	Min	Max	Obs
COD	0.113	0.106	0.003	0.860	240
CSRD	0.529	0.175	0.150	0.820	240
CONSV	1.689	8.347	-27453	31.537	240
ACM	0.692	0.072	0.350	0.830	240
LN_TA	14.638	1.722	9.383	19.279	240
PBV	1.847	1.677	-0.410	9.300	240
ROE	0.121	0.232	-0.787	1.258	240
EBIT	0.092	0.122	-0.261	0.656	240
DTOTA	0.513	0.378	0.000	3.244	240
S_GROW	0.143	0.366	-1.000	3.532	240
LITIGATION	0.550	0.498	0.000	1.000	240
AUDQ	0.562	0.497	0.000	1.000	240

From Tabel 2 it can be seen that the average value of cost of debt (COD) is 0.113 with minimum 0.003 and maximum 0.860. Average value of CSR disclosure (CSRD) is 0.529 with minimum value 0.150 and maximum 0.82. If value 70 is used as the minimum standard of CSR disclosure, this value describe CSR disclosure practice in Indonesia relatively low. Our data show that some of the samples did not follow CSR disclosure as required by Financial Authorities and Services /OJK. While average value conditional conservatism (CONSV) is 1.689 with minimum value -27.453 and maximum value 31.535

Correlation analysis

Table 3. explains correlation analysis. The correlation among variables show the value less than 0.8. This indicator can be a guide that no potential multicollinearity problem with the data. Correlation between CSR disclosure and cost of debt (COD) show the value positive (0.101), and this is in opposite direction as expected in the model. While correlation between conditional conservatism (CONSV) and CSR disclosure (CSRD) is negative (-0.022) and between CONSV and COD is negative (-0.106). Correlation between audit committee mechanism (ACM) and CSRD is positive (0.545), while ACM and COD is negative (-0.104). This correlation value can be prior guide in estimate the result,

Table 3. Pearson Correlation

	COD	CSRD	CONSV	ACM	LN_TA	PBV	ROE	EBIT	DTOTA	LITIG	AUDQ
COD	1.000										
CSRD	0.101	1.000									
CONSV	-0.106	0.022	1.000								
ACM	-0.104	0.545	-0.064	1.000							
LN_TA	-0.121	0.528	0.028	0.359	1.000						
PBV	-0.178	0.384	-0.122	0.3169	0.354	1.000					
ROE	-0.051	0.189	-0.057	0.137	0.182	0.407	1.000				
EBIT	-0.083	0.241	-0.118	0.156	0.130	0.551	0.858	1.000			
DTOTA	0.068	0.039	0.083	0.011	-0.129	-0.244	-0.116	-0.219	1.000		
LITIG	-0.179	0.376	-0.109	0.286	0.322	0.257	0.112	0.174	-0.219	1.000	
AUDQ	-0.177	0.265	-0.138	0.257	0.293	0.293	0.182	0.208	-0.220	0.283	1.000
Sources: Processed data by Stata 13											

Classical assumption test

Classical test assumption is conducted to fulfill econometric criteria in order to get BLUE estimator (Best Linear Unbiased Estimator). The result show that the data fulfill robust for normality, homogeneity of variance and multicollinearity (Gujarati, 2012).

Endogeneity test

We consider there is endogeneity problem in the model that we developed, especially for model CSRD (Eq.2). Theoretical foundation suggest that CSR disclosure will be affected by conditional conservatism and corporate governance mechanism. We conducted endogeneity test by using instrument variables conditional conservatism (CONSV) and audit committee mechanism (ACM). The result show statistical indicator (p-value) for both Durbin Score and Wu-Hausman test is significant below 5% (0.000). It can concluded that CSR disclosure (CSRD) is endogenous variable.

Regression result

The overall significant test (F-Test) and partial significant test (T_Test) are conducted to fulfill statistical criteria for the model and hypothesis testing. We use Ordinary Least Square (OLS) and Two Stage Least Square (TSLS) as method of estimation. The regression result for all the model presented in Tabel 4.

F-Test results for each model presented in related column. The result show the adjusted R-squared value for (Eq.1: 0.062; Eq.2: 0.463; and Eq.3; 0.084; and Eq.3X: 0.083). While F-Stat and probability value (p-value) for each model (Eq.1: 3.09 (0.010); Eq.2: 26.79 (0.00); Eq.3: 4.16 (0.0002); Eq.3X: 3.70 (0.0004). Based on overall test (F-Test) the model is significant, and can be concluded that all independent variables in Model 1,2,3, and 3x, can explain the dependent variable significantly.

We can highlight and compare result for direct and indirect test effect of Conditional conservatism on cost debt (Eq1 and Eq.3). Where adjusted R-squared and F-Stat in in direct test (Eq 1) less than adjusted R-square and F-Stat in indirect test (Model3). This indicator show potential explanation mechanism of relation between CSR disclosure and cost of debt.

The effect of conditional conservatism on cost of debt

Eq 1 is used to examine hypothesis 1 that stated there are negative effect of conditional conservatism (CONSV) on cost of debt (COD). The T-Test result shows that CSR disclosure does not have any significant effect on cost of debt, because p-value is 0.341 which is more than level of significant 5%. This finding lead to conclusion that that hypothesis 1 is rejected. While other control variable found have negative effect at 5% level of significant, they are price to book value of equity (PBV) and auditor quality (AUDQ). While variable proxy for litigation risk (LITIG) have negative effect at 10% level of significant. Other variables that are found do not have any significant effect are firms' size, earnings before interest and taxes (EBIT) and leverage or debt to total asset ratio (DTOTA).

Test result of Eq. 1 explained that CONSV could not provide information to assess borrowers' risk, then it lead to no significant decrease in cost of debt. The result specifically explained firms that are in expansionary period and high risk of litigation (high-profile industry) enjoy lower cost of debt. This condition may be due to higher pressure for this industry type to give more disclosure compare to low-profile industries. However the findings do not show any significant effect on relation of firms' size (LN_TA) as proxy of information environment and earnings the company as well as earnings before interest and taxes (EBIT) as proxy for ability for loan repayment, leverage (DTOTA) as significant variable in reducing cost of debt. However there is significant negative effect of audit quality on cost of debt. This condition could because of less confident on firms earnings information, so then lenders more rely on external audit monitoring function in estimating borrowers' risk.

The mediation role of CSR disclosure on relation of conditional conservatism and cost of debt.

Mediation analysis requires the following conditions hold: (1). a significant relation between the independent variable of interest and dependent variable, (2) a significant relation between the independent variable and proposed potential mediator, (3) a significant relation between the potential mediator and the dependent variable when controlling for the effect of the independent variable, and (4) a decline in the significance of the relation between the independent variable and the dependent variable when controlling for the effect of the potential mediator (Baron and Kenny 1986).

So the conclusion of mediation effect of CSR disclosure on the relation of conditional conservatism on cost of debt is based on the following step; (1) a significant relation between CONSV and COD. (2) a significant relation between the CONSV and proposed potential mediator CSRD. (3) a significant relation between the potential mediator (CSRDFITT) and the COD when controlling for the effect of the independent variable, and (4) a decline in the significance of the relation between the CONSV and the dependent variable (COD) when controlling for the effect of the potential mediator (CSRD) (Baron and Kenny 1986).

Table.4. Regression Result

$$COD_{it} = \beta_0 + \beta_1 CONSV_{it} + \beta_2 ACM_{it} + \beta_3 CSRD_{it} + \beta_4 LN\_TA_{it} + \beta_5 PBV_{it} + \beta_6 EBIT_{it} + \beta_7 DTOTA_{it} + \beta_8 LITIG_{it} + \beta_9 AUDQ_{it} + \varepsilon_{it} \quad (1)$$

$$CSRD_{it} = \alpha_0 + \alpha_1 CONSV_{it} + \alpha_2 ACM_{it} + \alpha_3 LN\_TA_{it} + \alpha_4 PBV_{it} + \alpha_5 ROE_{it} + \alpha_6 DTOTA_{it} + \alpha_7 LITIGATION_{it} + \alpha_8 AUDQ_{it} + \varepsilon_{It} \quad (2)$$

$$COD_{it} = \lambda_0 + \lambda_1 CSRDFITT_{it} + \lambda_2 LN\_TA_{it} + \lambda_3 PBV_{it} + \lambda_4 EBIT_{it} + \lambda_5 DTOTA_{it} + \lambda_6 LITIGATION_{it} + \lambda_7 AUDQ_{it} + \varepsilon_{it} \quad (3)$$

	(+) / (-)	**Model 1 CONSV, ACM, CSRD → COD**		(+) / (-)	**Model 2 CONSV, ACM → CSRD**		(+) / (-)	**Model 3 CSRDFITT→COD**		**Additional Test (3x) CSRDFITT, SR →COD**	
		Coeff	**p-value**		**Coeff**	**p-value**		**Coeff**	**p-value**	**Coeff**	**p-value**
CSRD	-	0.020	0.341								
CSRDFITT							-	-0.0591	0.000***	-0.058	0.000***
SR										-0.0172	0.240
CONSV	-	0.008	0.402	+	-0.004	0.345					
ACM	-	-0.023	0,306	+	0.788	0.000***					
LN_TA	+	-0.002	0.373	+	0,038	0.001***	+	-0.005	0.451	-0.003	0,472
PBV	-	-0.008	0.047**	+	0.016	0.008***	-	-0.008	0.049**	-0.008	0.053*
ROE				+	0.015	0.334					
EBIT	-	-0.236	0.353				-	-0.027	0.043	-0.025	0.347
DTOTA	+	-0.005	0.382	+	0.072	0.022**	+	-0.006	0.433	-0.006	0.435
LITIG	-	-0.026	0.052*	+	0.059	0.012**	-	-0.025	0.042**	-0.027	0.039**
AUDQ	-	-0.024	0.004**	+	0.011	0.018**	-	-0.025	0.050**	-0.024	0.053*
C		0.166	0.007		-0.587	0.100		0.182	0.022	0.067	0.028
Adj-R2		**0.062**			**0.463**			**0.084**		**0.083**	
F-Stat		**3.09**			**26.79**			**4.16**		**3.70**	
Prob FStat		**0.010**			**0.000*** **			**0.0002** **		**0.0004*** **	
Hettest		**Robust**			**Robust**			**Robust**		**Robust**	
VIF		**1.45**			**1.25**			**1.28**		**1.30**	
Instrument Variables : CONSV, ACM , LN_TA, PBV, ROE, DTOTA, LITIG, AUDQ											

Note: *** Significant at 1%; ** Significant at 5% ; * Significant at 10%

COD: Cost of debt measured as ratio of interest and adm expense per bank loan outstanding at period $_{t+1}$ (Francis et al.2005); CSRD: CSR disclosure index Lanis and Ricardson (2012); CSRDFITT: Fitted Value of CSRD; CONSV: Conditional conservatism (Givoly and Hayn (2000); ACM: Audit committee mechanism index (Hermawan 2009); LN_TA: Firms size measured as natural logarithm of total asset; PBV: Proxy for market growt measured as ratio of Price and book value per share; ROE; Proxy for profitability measure as ratio of net income per book value equity; EBIT: Proxy for profitability measured earnings before interest and taxes scaled with total asset; DTOTA; Proxy for leverage measure as debt to total asset; LITIG: Proxy of litigation risk measure as dummy 1 for high-profile industry type and 0 otherwise; AUDQ: Proxy for audit quality measure as dummy 1 if firms use auditor big4 and 0 otherwise.

Conditional Conservatism on CSR Disclosure

Eq2 is used to examine hypothesis 2 that stated there are no significant effect of conditional conservatism (CONSV) and CSR disclosure (CSRD), where The T-Test show p-value is 0.345 which more than level of significant 5%. This finding lead to conclusion that hypothesis 2 is rejected. While other control variables show positive effect at 1% level of significant, they are audit committee mechanism (ACM), firms' size (LN_TA) and price per book value of equity (PBV). Other variable found have positive effect at 5% level of significant, they are debt to total asset (DTOTA), variable proxy for litigation risk (LITIG) and auditor quality (AUDQ), While there are no no any significant effect of return on equity (PBV).

It should be highlighted that the results showed a contradictory findings, because there is no significant effect of CONSV, while ACM has a significant positive effect CSRD. Theoretically effective corporate governance mechanism will encourage conservatism to enhance information quality. This finding arise question about the effectiveness of ACM in manufacturing firms in Indonesia. The correlation analysis result show negative correlation between audit committee mechanism (ACM) and conditional conservatism (CONSV). This probably could be an explanation for rejected hypothesis 2. Less effective in audit committee activity, less efficient size of board and lower skill or competence of audit committee board predicted could contribute to this insignificant relation.

CSR disclosure and cost of debt

Eq.3 is use to examine the hypothesis 3 that stated, there are indirect negative effect of conditional conservatism (CONSV) on cost of debt (COD) through mediation of CSRD. To address conflicting finding we address CSRD as endogenous variable and we conducted endogeneity test using CONSV and ACM as instruments variables. Result of endogeneity test showed that CSRD is an endogenous variable with instruments variables conditional conservatism and audit committee. Theoretically effective corporate governance, with an independent board, efficient board activities and board size, as well as sufficient board skill and competence have role in controlling and reducing the amount of positive abnormal accruals and increased conservatism. Correlation variable analysis show there are negative correlation between ACM and CONSV. This correlation is in opposite direction of the prediction. This correlation could be an indicator that ACM in manufacturing firms in Indonesia has not shown effective performance that could enhance reporting quality in increasing level of conditional conservatism, yet ACM predicted can be influence the CSRD in appearance.

Result test of Eq. 2 showed there are no significant effect of conditional conservatism (CONSV) on CSRD, however there is a significant positive effect of ACM on CSRD. The regression result for Eq.3 by using (fitted value of CSRDFITT: T-Test result show that CSRDFITT have negative effect on cost of debt and significant at 1%. This finding lead to conclusion that hypothesis 3 is accepted. The T-Test for control variables show that variables proxy for growth (PBV), litigation risk (LITIG), and audit quality have negative effect on cost of debt and significant at 5%. While there are no any significant effect on cost of debt for variable firms' size (LN_TA), earnings before interest and taxes (EBIT), and leverage (DTOTA).

Additional test the mediation role of sustainability reporting (SR)

We try to examine additional test by using indicator variable dummy 1 for firms that release Sustainability Report using Global Reporting Standard. We don't use GRI standard by consideration just less 50% of my sample release Sustainability Report. We take this test into account to know whether there are lower cost of debt for firm that release SR. The show the same result there is no effect of Sustainability Report on cost of debt..

Conclusion, Limitation and Suggestion

The main research question of the this study is "Do lenders give value to CSR disclosure in their lending decision?" This study examine direct effect of conditional conservatism on cost on debt and indirect effect of conditional conservatism through mediation of CSR disclosure. This study examined three hypothesis; 1) The effect conditional conservatism on cost of debt, 2) The effect conditional conservatism on CSR disclosure, and 3) The effect of CSRD and cost of debt. By considering CSR disclosure as endogenous variable we conducted endogeneity test by using conditional conservatism and audit committee mechanism as instrument variables. We use OLS and TSLS as method of estimation, and using sample from manufacturing firms listed at Indonesia Stock Exchange 2011-2014.

Result of examination hypothesis 1 found there are no significant effect of conditional conservatism (CONSV) on cost of debt (COD), this finding lead to reject hypothesis 1, there are no direct significant effect of CONSV and COD. While result of examination of hypothesis 2 found there no significant effect of conditional conservatism (CONSV) on CSRD, and this finding lead to reject hypothesis 2. However it is important to highlighted the effect of audit committee mechanism (ACM) on CSRD that positively significantly at 1%. Based on these findings we conducted the next step examination of endogeneity, that showed CSR disclosure is significantly proven as endogenous variable using instrument variable conditional conservatism and audit committee mechanism. And result of examination hypothesis 3, shows that there are indirect significant positive effect of fitted value of CSR disclosure (CSRFITT) on cost of debt (COD). This result consistent to prediction direction, and support to conclusion that CSRD can play mediation role on relation on CONSV and cost of debt (COD).

The overall results of this study showed there are no significant effect conditional conservatism (CONSV) on cost of debt (COD) in manufacturing firms in IDX. The quality of CSR activities that identified through CSRD potentially provide additional information for lenders in assessing borrowers' operational risk. However the data support that will lenders give value on CSRD when they identified there adequate governance mechanism (audit committee mechanism) that give assurance in quality of CSRD preparation. Some part of this findings consistent to previous [29, 38,52].

Findings of these research give some implication for regulator to more explore and support the potential benefits of CSR disclosure on debt market. In order both party lenders and borrowers gain benefit of CSR disclosure in debt contract, should be supported by related regulation. The definition of firms performance should be extended to firms sustainable performance including aspect of economic, social and environment in regulation framework [21]. CSR practices in Indonesia should be enhanced by related guidance on CSR practice and improve governance mechanism. The adoption IFRS should be able to enhance level of conservatism, or prudence in conducting and reporting their CSR.

There are some limitation of this research that should be noted for future study. i) Additional of sample can enhance the result, ii) There is potential noise in measuring of cost of debt, because we only include interest and administrative expense divided by bank loan outstanding, it is better to include using denominator of notes payable and bond payable, iii) Additional measure of conservatism could enhance validation of result, iv) CSR disclosure index using the item disclosed in annual report using content analysis. Further study can use index from GRI using sustainability report (SR)

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