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The Importance of CSR in Financial Reporting Standards

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I. Introduction

In an effort to stay abreast with corporate social responsibility (CSR) and financial reporting standards, this article will introduce four subject areas (1). Corporate Social Responsibility (CSR) Historical Approach, (2). Corporate Social Responsibility (CSR) Background Theories, (3). Corporate Social Responsibility (CSR) and Financial Reporting, and (4). Three Sustainability Factors that are relevant to small and publicly traded companies around the globe. In 1929, the market crash on Wall Street led to the emergence of CSR. Four background theories are presented throughout the study as the pillar of CSR in the financial market. In 1999, the AA1000 series began to promote financial reporting sustainability. By 2000, the Global Compact was established by the United Nations (UN). Since the inception of the Global Compact, 10 principles have been designed to promote human rights, labor, environmental, and anti-corruption standards. In the evolution of international accounting, Carnegie and Napier (2002) presented seven dimensions from a comparative aspect surrounding how to treat CSR and financial reporting in different financial markets. In 2005, at the World Summit, the three factors of environment, social, and economic were reaffirmed as efficient and effective in a company's financial decision-making process.

In the 21st century, CSR is an emerging field in the accounting and finance industry. Sustainability is understood as having environmental, social, and economic components. As mentioned by Marimon, Alonso-Almeida, and Rodriguez (2012), CSR has received several classifications, including "UN Global Compact Principles, OECD Guidelines for Multinational Enterprises, GRI, ISO 26000, AA1000, ISO 14001 and SA88000" (p. 183). In 2011, Noble, Mattison, and Matsumura (2015) their statistical research showed that about 57% of the U.S. Fortune 500 companies reported CSR practices on their websites. In the global market, about 95% of the largest 250 companies issue CSR reports and follow CSR compliance guidelines. Typically, the CSR report covers important areas such as the company's goals and objectives, environmental performance, and the human impact.

II. Review of the Literature

a) *Historical View of Corporate Social Responsibility (CSR)*

In 1929, the market crash on Wall Street led to the emergence of CSR. The main goal and objective of CSR is to align social aspirations and compliance with governance in the business sector. CSR continues to drive small and large business enterprises by helping them achieve the status of a "good citizen." For instance, small companies have increased their social engagement activities. In Australia, the business sector found that there is a mutual relationship between stakeholder and social capital theory. Ferrell, Fraedrich, and Ferrell (2015) indicated that stakeholder theory is understood by three approaches such as normative, descriptive, and instrumental. The normative approach deals with ethical guidelines. The descriptive approach suggests the importance of understanding a firm business behavior in addressing business decision strategies. The instrumental approach embraces management and organizational process. According to Sen and Cowley (2013) defined social capital theory as "Social capital, broadly speaking, refers to social networks, the reciprocities that arise from them and their value within the business environment" (p.416). Therefore, research studies indicate that the CSR

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conceptual framework brings more alignment in small companies than in medium and larger enterprises (Sen & Cowley, 2013).

The definition of CSR consists of five important aspects: (a) environment, (b) social dimension sustainability, (c) economic advancement, (d) stakeholder behavior, and (e) ethical evolution of society. CSR can be adopted by multinational corporations (MNCs) and enterprises that operate in different cultural background settings. As a result, CSR in the international market as noted by Jacob (2012) acts as an ambassador among communities and the business sector.

MNCs in the global market can reduce poverty by promoting their good citizen status and improving the living standards of their employees. Solid CSR guidance policies require innovation and new avenues to settle the cultural differences that exist among small companies and large enterprises. For example, the triangulation that exists (as cited in Montinho & Souther, 2010, p. 281) between the organizational evaluation, stakeholder criteria, and employees' cultural environment is known as CSR. Therefore, CSR is understood as the universal language of business compliance that provides social benefits to small and medium sized enterprises in the international arena (van Tonder & Roberts-Lombard, 2013).

III. Background Theories

a) System theory

This theory ensures democracy and economic freedom by promoting equality among citizens in society by building sustainability through a value chain. The primary foundation of system theory consists of an open market economy. System theory shares three unique aspects: social values, entity, and the environment. These three aspects contribute to economic creation, social changes, and the evolution of nature.

In early 2000, system theory (Emery, 2000) was interpreted as a reliable conceptual framework. Bala (2010) suggested three theoretical aspects that contribute to economic growth. The first theoretical aspect emphasizes the importance of reducing inflation and encourages consumers to contribute to the economy. The second theoretical aspect is to establish rules and regulations by accurately measuring international investment portfolios. The third theoretical aspect predicts the sustainability of the global economy.

b) Triple bottom line theory (TBL)

In 1997, John Elkington was the founding father of the triple bottom line (TBL) theory. The conceptual accounting framework of the TBL theory is measured through social sustainability performance, economic, and financial environment. The most important dimensions of the TBL theory are the 3Ps, or people, planet, and profits. Over the past 30 years, organizations have adopted the TBL theory to be better corporate citizens. Therefore, the core value of the TBL theory is to promote sustainability through the value chain (Slaper & Hall, 2011).

Christofi, Christofi, and Sisaye (2012) argued that the TBL is sustainable when CSR is standardized, because CSR addresses the importance and relevance of the well-being of both citizens and corporations. Since the creation of the TBL theory, researchers in the accounting arena have recommended expanding the standardization aspects and the development of corporate social performance. Sethi (1975) contributed to the aspects and development of corporate social performance in the accounting field. Then it was expanded by Carroll (1999) challenging the corporate sector and adapting to the rapid change of globalization.

In Australia, the TBL theory helped overcome corporate boundaries in the public sector and built the groundwork for sustainability. The main objective of the TBL theory is to promote compliance and sustainability among businesses. In the era of globalization, the TBL theory helps introduce reliability, accuracy, and transparency into the world's financial reporting market (Mitchell, Curtis, & Davidson, 2012).

c) Agency theory

The agency theory indicates that companies can use different sources of information related to results by decreasing asymmetries across the market (Cormier, Magnan, & Van Veltoven, 2005). Adequate CSR disclosure helps reduce differences between a company's performance and their stakeholders expectations (Bonsón & Bednárová, 2015; Ferrero et al., 2013).

d) Stakeholder theory

In 1984, Freeman introduced the stakeholder theory and mentioned that the core value of this theory is social responsibility. In order for a company to reduce information asymmetry, there needs to be equilibrium among stakeholders and CSR financial reporting. Therefore, the stakeholder theory should be viable to companies and easy the relationship among stakeholders (Bonsón & Bednárová, 2015).

IV. Corporate Social Responsibility (CSR) and Financial Reporting

Presently, CSR remains at a premature developmental stage. It seems inevitable that CSR will be a part of financial reporting standards. For example, in accounting, the areas that are related to CSR are financial accounting, managerial accounting, and income tax reporting. In the 21st century, CSR is an emerging field in the accounting and finance industry. The three most important financial reporting standards under CSR are Global Reporting Initiative (GRI) G3 standards, AA 1000 series, and the UN Global Compact's Communication on Progress (COP; Tschopp & Huefner, 2015).

a) Global Reporting Initiative (GRI) G3 standards

In 1999, for the first time in history, the G3s were issued as an exposure draft. By 2000, the GRIs were revised and officially launched in 2002. In 2006, the G3 guidelines were published and the new G4 standard was launched in 2013. Under G3, five guidelines are promoted by meeting the company's reporting principles, financial reporting guidance, and followed by disclosure requirements as illustrated by Tschopp and Huefner (2015): "strategy and analysis; organizational profile; report parameters; governance, commitments, and engagement; [and] management approach and performance indicators" (p. 566). G3 standards promote quality assurance and reliability (Tschopp & Huefner, 2015).

b) AA1000 series

In 1999, the AA1000 series began to promote financial reporting sustainability. The main standards included in the AA1000 series are assurance principles standards and stakeholder engagement. By 2008, AA1000 help companies implement CSR into their financial reporting systems. The AA1000 series is designed to help companies address financial reporting issues in the areas of stakeholder engagement, social identity, and environmental key leading indicators. The AA1000 framework should follow CSR guidelines. For example, the AA1000 Accounting Principles Standard focuses on financial reporting and auditing, the AA1000 Assurance Standard follows the CSR audit guidelines report, and the AA1000 Stakeholder Engagement Standard promotes stakeholder quality engagement and compliance (Tschopp & Huefner, 2015).

In the evolution of international accounting, Carnegie and Napier (2002) presented seven dimensions from a comparative aspect surrounding how to treat CSR financial reporting in different financial markets. The 7Ps are illustrated below:

1. *Period:* understood as the accounting development through a given period of time by considering economic, political, and social aspects.
2. *Places:* the treatment of accounting policies in different geographical regions.
3. *People:* the interests of people in leadership by transforming the development of accounting policies into a robust framework.
4. *Practices:* promote financial transparency and sustainability by preventing accounting fraud.
5. *Propagation:* the requirement of speaking one singular accounting language in the world's financial market.
6. *Products:* the creation of reliable accounting software and constructing better financial reports by meeting the auditing principles outcomes of assurance, transparency, and accuracy.
7. Profession: promote a code of conduct in the accounting profession by leading organizational groups in a sustainable manner.

The 7Ps can serve as road map guidance in developing a sustainable and adequate CSR financial reporting system.

c) UN Global Compact's Communication on Progress (COP)

In 2000, the Global Compact was established by the UN. Since the inception of the Global Compact, 10 principles were designed to promoted human rights, labor, environmental, and anti-corruption standards. According to Tschopp and Huefner (2015), "The Global Compact network is currently comprised of almost 800 business associations, 57 labor organizations, over 2,200 civil society organizations, over 700 academic participants, 171 public sector organizations, and 73 municipal organizations (UNGC 2013)" (p. 566). The participation of stakeholders in the UN Global Compact increased by 56% from 2003 to the present. Therefore, the main objective of the Global Compact is to promote transparency in corporate governance.

d) Pillars of Sustainability

Triangulation is the support and representation of three important factors that support sustainability (See Figure 1). The three pillars that support sustainability are environmental, social, and economic. In 2005, at the World Summit, these three factors were reaffirmed as efficient and effective in a company's financial decision-making process. In other words, if companies are not able to adopt these three important factors, they are not likely to survive (Noble, Mattison, & Matsumura, 2015).

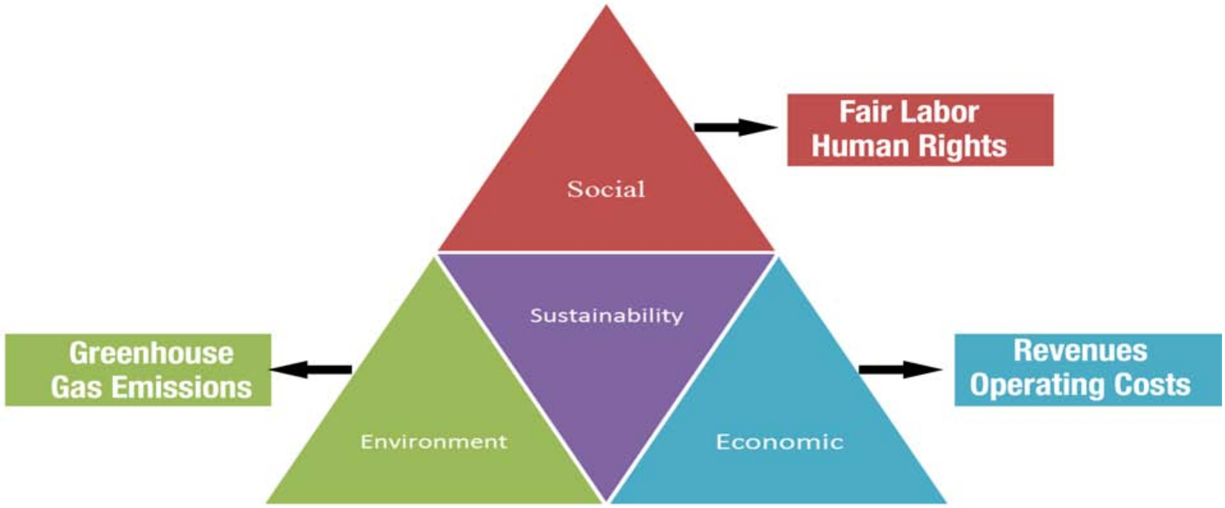

Figure 1 : What do we know about sustainability?

Certo and Certo (2012) indicated that businesses are highly motivated by managerial obligations and need the right to protect society. They developed a conceptual framework in prior research studies to triangulate business, society, and cross-cultural settings. The conceptual framework embraces sustainability and is supported by five areas: (a) social responsibility, (b) business and economic freedom, (c) social cost, (d) consumer behavior, and (e) business operating as an independent institution. Milton Friedman argued that society should be run by citizens, not by businesses. For example (as cited in Jayakumar, Anbalagan, & Kannan, 2012), the primary focus of an MNC is society. An MNC possess the unique characteristic of cross-cultural diversity. It has been proven over the years that MNCs act as good citizens in the international business arena.

CSR plays an essential role in audit committees because the audit committees are constantly dealing with regulatory governance and compliance. Presently, Bonsón and Bednárová (2015) in their study indicate that audit committees are taking an active role in organizational governance and also in the area of risk management. An existing area that is underdeveloped under CSR is the measurement and performance of audit committees. For example, in Australia, those in the accounting and financial sector are investigating how to expand CSR to audit committees by evaluating practice performance. Therefore, three areas that are crucial when evaluating the practice performance under CSR are corporate governance, policy measurement, and assessment processes (Bonsón & Bednárová, 2015).

Companies that have adopted CSR into their financial reporting experience a high auditor quality standard as compared to companies that have not adopted CSR. The areas of high auditor quality standard encompass the company's reputation, financial improvement, less financial risk, and higher earnings accruals. On the other hand, companies that do not adopt CSR into their financial reports tend to experience low auditing quality standards and increased financial risk. Prior studies conducted by Bonsón and Bednárová (2015) in this field demonstrated that there is a positive relationship between audit committee quality and auditor for tenure, because this positive relationship contributes to audit quality. For example, companies filing CSR reports prevent internal financial reporting weakness, experience a higher return on assets, and are more likely to have the support of the Big Four accounting audit firms.

Companies in the international market want to understand the existing relationship between stakeholder theory and the TBL theory. CSR appears to be a promising concept in academia and the business world. Companies that have adopted CSR have been forced to disclose more information in their financial statements related to the environmental and social activities. As a result, CSR came under discussion after serious financial scandals took place in 1929 with the fall of Wall Street, 2001 the collapse of Enron Corporation, the 2008 economic recession, and labor rights and protection in the emerging economies market (Noronha, Tou, Cynthia, & Guan, 2012). Presently, CSR is a necessity in financial statements because it promotes financial sustainability among financial institutions, boosts corporate profitability, and fosters good public relations (Bonsón & Bednárová, 2015).

Over the past 10 years, several standards under CSR have been promoted in the global arena. As mentioned by Marimon et al. (2012), CSR has received several classifications, including "UN Global Compact Principles, OECD Guidelines for Multinational Enterprises, GRI, ISO 26000, AA1000, ISO 14001 and SA88000" (p. 183). Research studies have shown that it is imperative to seek uniformity in a CSR international financial reporting system. For example, 40% of companies worldwide follow and comply with GRI standard (Bonsón & Bednárová, 2015).

The EU proposed the need for publicly traded companies to expand their CSR reporting. The EU defined CSR as the responsibility of enterprises within society. The challenge in the business world is to link CSR and leadership competitiveness. For example, in 2003, the EU mandated under article 46 of the Fourth Company Law Directive that companies must properly disclose financial and non-financial items as key leading performance. The goal and objective under article 46 was to promote corporate governance by public companies and most importantly demonstrate diversification in the organization's CSR policy (Ambrose, 2013).

In 2011, Aktas, Kayalidere, and Kargin (2013) statistical research showed that about 57% of the U.S. Fortune 500 companies reported CSR on their websites. In the global market, about 95% of the 250 largest companies issue CSR reports and follow CSR compliance guidelines. Typically, the CSR report covers important areas such as the company's goals and objectives, environmental performance, and the human impact. As a result, the company's 10K report at year end covers CSR and financial reporting in depth. The top four accounting firms are leaders in providing quality assurance information as related to CSR data. Therefore, the future of the TBL theory will be known as an integrated report (IR). Notably, the IR remains in its infancy stage and is being piloted by publicly traded companies. The idea behind IR is to provide a holistic view to stakeholders where material financial information and non-financial information can be consolidated in one report.

For example, according to Noble et al. (2015), "As of 2012, over 1,100 institutional investors with over $30 trillion of assets under management had signed on to the Principles of Responsible Investing (PRI) backed by the United Nations (UN)" (p. 139). This is a reflection of sustainability and financial reporting by institutional investors making a rational investment decision to include the environment, social, and corporate governance.

Primary financial statements, such as the income statement, balance sheet, and statement of cash flow, are the main sources of relevant information to users. The decision-makers are investors, lenders, and other creditors in the financial sector. The financial statements are constructed for the public interest. Also, it has been argued that non-financial information is important. Evidently, information reported in the financial statements helps decision-makers to execute better financial strategies. As a result, CSR and sustainability play vital roles when the numbers are reported in financial statements. For instance, financial reports and sustainability have been analyzed from a GRI perspective. Therefore, a company utilizing sustainability for its financial reporting approach should select a disclosure management approach and financial key performance leading indicators (Aktas, Kayalidere, & Kargin, 2013).

Yu and Ting (2012) indicated that financial investors and shareholders have a corporate commitment to society. Companies that are willing to adopt CSR into their financial reports experience higher financial sustainability. Corporate commitment is the path to reaching sustainability. Companies that focus on climate change issues can protect investors, stakeholders, and the community. In the global market arena there is an existing relationship between country-level characteristics and a country's commitment to sustainability (Yu & Ting, 2012).

In 2008, the financial crisis marked an important unprecedented value in the world financial market. Antonia García-Benau, Sierra-Garcia, and Zorio (2013) evaluated CSR reporting and CSR assurance strategy in Spain under an economic recession. Companies in Spain witness CSR reporting as a business threat because companies had to cut cost and discontinue operations. Also, the Return On Equity (ROE) was affected in the long-run. On the contrary, CSR assurance added value to CSR reporting as companies were navigating through an economic recession. Therefore, it is evident that stakeholder trust can be reinforced by embracing CSR reporting and a CSR assurance strategy (Antonia García-Benau et al., 2013).

Financial analysts in the world's financial market understand the importance of incorporating corporate sustainability into financial reports to achieve better economic performance and realize social performance as related directly to the company's goals and objectives. Indeed, GRI promotes sustainability in financial statements and establishes financial policies across the board. Therefore, companies that have adopted CSR in their financial reporting promote within organization environmental transparency and economic social performance (Lin, 2010).

Scholars and practitioners acknowledge that there is an existing relationship between corporate governance and CSR. This existing relationship promotes corporate strategy, accountability, stakeholder engagement, and the company's social responsibility. The success of previous existing relationships will depend upon the amount of support that the board of directors is willing to provide to the company. For example, in a study by Bogart (2013), results indicated that 14 independent directors of the board of trustees of seven of the U.S. Fortune 1,000 publicly traded companies acknowledged that CSR was an important key performance leading indicator in promoting sustainability. Therefore, it can be determined that boards of directors in major publicly traded companies can influence CSR by promoting four important aspects: (a) the board of trustees needs to have a clear understanding of the definition of CSR and how it is related to the organization's strategy; (b) the engagement of stakeholders and company's alignment opportunity cost; (c) promote respectful relationships among board management team and CSR investment; and (d) the board of directors can influence CSR through financial reporting, internal reporting assurance, and key financial leading indicators (Bogart, 2013).

Financial reporting quality is an important subject in the investment arena. Over the past decade, educating managers in the investment sector has broadened a degree of challenge in embracing agency problems and investment decisions from a CSR perspective. Research studies have shown that there is a positive relationship between investment in CSR and future profitability. For example, Vollono (2010) identified a positive relationship between CSR and corporate financial performance (CFP). Therefore, companies that opt to implement CSR into their financial reports will experience high financial quality performance and improve the relationships among stakeholders (McDermott, 2012).

A survey conducted by King and Bartels (2015) indicated that CSR is a norm driven by regulation. The percentages in Figure 2 reveal that corporate responsibility (CR) in annual reports can be identified as a trend. For example, in 2011, only 20% of companies adopted CR reporting into their annual reports. Four decades later, the adoption of CR in annual reports increased by 36%. The countries that were leading in CR financial reporting in the world's financial market between 2013 and 2015 were Taiwan (+64), South Korea (+43), and Norway (+31) by average points (King & Bartels, 2015).

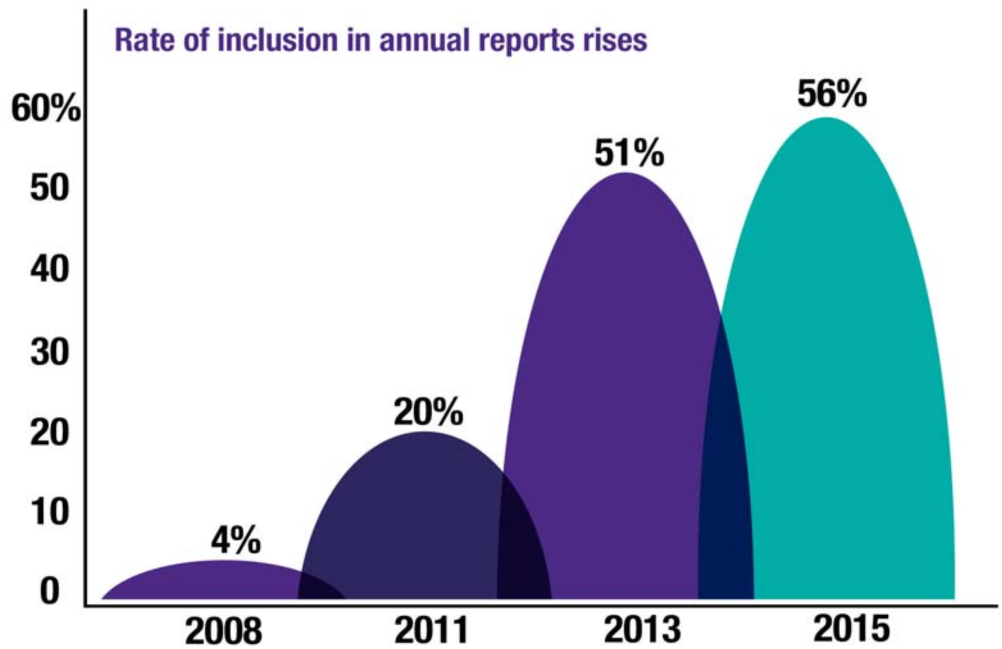

Figure 2 : Rate of inclusion in annual reports rises (King & Bartels, 2015, p. 36)

Figure 3 reveals the percentages of eight countries in three different continents including Europe, Asia, and Africa with the highest acceptance rate of CR reporting. This will improve the financial reporting quality of the world's biggest companies (G250) operating in 15 different industry sectors and 31 different countries. According to Choi and Meek (2005), 14 years ago half of the largest companies (G250) were reporting social responsibility in their financial statements in the following regions: France, Germany, Japan, the United Kingdom, and the United States. Evidently, the adoption of CR in financial statements has the ability to increase the amount of relevant information provided to shareholders and stock exchange markets around the world, which is presently enforcing the importance of adopting CR into financial statements.

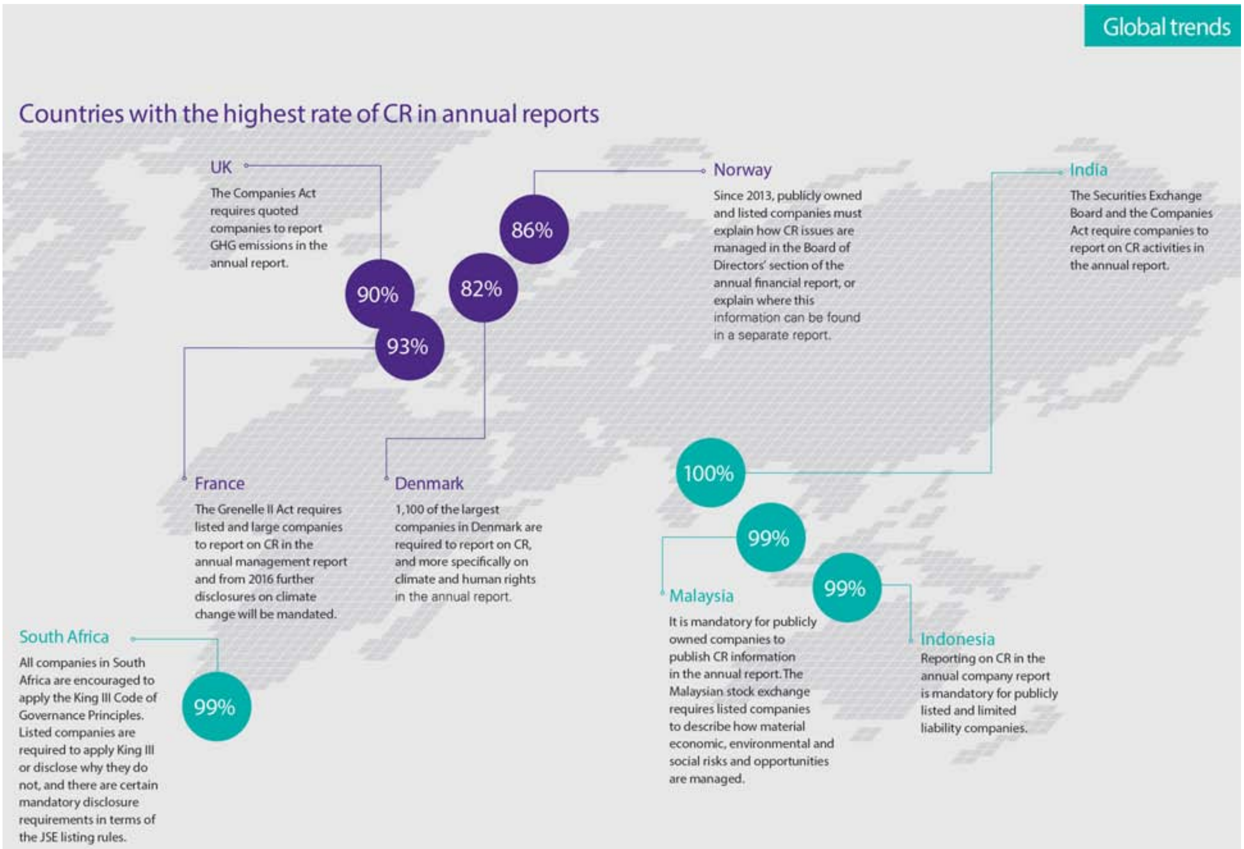

Figure 3 : Countries with the highest rate of CR in annual reports (King & Bartels, 2015, p. 36)

V. Conclusion

In conclusion, the CSR conceptual framework brings more alignment in small companies than in larger medium enterprises. CSR is understood as the universal business of compliance by providing social benefits to small and medium sized enterprises in the international arena. The three most important financial reporting standards under CSR are GRI G3 standards, AA 1000 series, and the UN Global Compact's Communication on Progress. Furthermore, the future of the TBL theory will be known as IR. Notably, the IR remains in its infancy stage where it is being piloted by publicly traded companies. The idea behind IR is to provide a holistic view to stakeholders where material financial information and non-financial information can be consolidated in one report. The countries that were leading CR financial reporting in the global financial market between 2013 and 2015 were Taiwan (+64), South Korea (+43), and Norway (+31) by average points (King & Bartels, 2015).

a) Recommendations for Future Studies

The author of this article suggests that the following aspects be considered for future studies surrounding CSR and financial statement analysis:

- Examine the relationship between CSR disclosure requirements and sustainability in the stock exchange markets world-wide.
- Study the impact of G4 development guidelines under GRI on the TBL theory.
- Explore the integration of sustainability into financial statements and the evaluation of social return on investment (SROI).
- Examine the importance of CSR measurement and the performance of audit committees.

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