**Journal of International Conference Proceedings (JICP) Vol.5 No.3, pp. 79-87, September, 2022**
**P-ISSN: 2622-0989/E-ISSN: 2621-993X**
**https://www.ejournal.aibpmjournals.com/index.php/JICP**

# The Effect of Profitability, Liquidity, and Solvency on Sustainable Reporting with Corporate Governance as Moderating Variable

**Niken Betari Muslimah[1], Baldric Siregar[2], Dody Hapsoro[3]**
STIE YKPN Yogyakarta[1,2,3]
Jl. Seturan, Yogyakara, Indonesia 55281
Correspondence Email: baldricsiregar@gmail.com
ORCHID ID: 0000-0003-0079-2004

**ARTICLE INFORMATION**

**Publication information**

**Research article**

**HOW TO CITE**

Muslimah, N. B., Siregar, B., & Hapsoro, D. (2022). The Effect of Profitability, Liquidity, and Solvency on Sustainable Reporting with Corporate Governance as Moderating Variable. *Journal of International Conference Proceedings*, *5*(3), 79-87.

**DOI:**
**https://doi.org/10.32535/jicp.v5i3.1761**



Received: 26 July 2022
Accepted: 25 August 2022
Published: 16 September 2022

**ABSTRACT**

This study aims to examine the effect of profitability, liquidity, and solvency on sustainable reporting. This study also examines the impact of corporate governance in moderating the effect of profitability, liquidity, and solvency on sustainable reporting. We use data on finance, governance, and sustainability reporting obtained from financial reports and sustainability reports for financial institution companies over 5 years, from 2016 to 2020. We use multiple regression to estimate the research model. Empirical findings show that profitability and liquidity positively impact sustainable reporting. Other findings also show that corporate governance can increase the positive impact of profitability on sustainable reporting.

**Keywords:** Corporate Governance, Liquidity, Profitability, Solvency, Sustainability Report

## INTRODUCTION

Environmental damage causes global warming. Although has emerged for a long time, the issue of global warming remains a hotly discussed issue both in government, the business world, and the accounting profession is no exception as well. Countries that are members of the United Nations hold talks every year to tackle global warming in the COP (Conference of Parties) forum. The COP Forum has been held since 1995 and has been consistently held every year until 2022. Countries involved in the COP forum are also committed to reducing greenhouse gas emissions so that global warming can be controlled.

The business world is required to be involved in dealing with global warming. The previous business focus on profit is demanded to be changed where the company applies a triple bottom line by paying attention to three elements, namely profit, people, and the planet. This triple bottom line concept is used to build competition between industries. The concept of the triple bottom line was first introduced by Elkington (1998) where the company's activities must focus on three pillars, namely economic, social and environmental. Meanwhile, the world of the accounting profession takes the role of compiling a sustainable report that describes the business undertaken by the company and its disclosures related to the environment.

A sustainability report is a report published to the public that contains the economic, financial, social, and environmental performance of a financial service institution, issuer, and public company in running a sustainable business. This report reflects the transparency of business activities related to the environment (Sulistyawati & Qadriatin, 2019). Sustainability reports also have the benefit of building shareholder interest in demonstrating how to increase company value related to social and environmental issues. The report provides various information including corporate governance and corporate responsibility in managing the environment (Susianti & Yasa, 2013).

This study examines the financial elements that affect disclosure in the sustainability report. The sustainability report is prepared based on the relevant financial services authority regulations as well as a standard known as GRI (global reporting initiative). GRI standards require companies to disclose items of company activities related to economic, social, and environmental. The GRI guidelines used in this study are the G4 Guidelines which consist of 91 disclosure items.

The financial elements that are used as factors that influence sustainable reporting are profitability, liquidity, and solvency. The financial aspect has an impact on the company's performance (Chayandito, 2006; Sulistyawati & Qadriatin, 2019;). Various other studies have shown that financial performance is related to sustainable reporting (Natalia & Tarigan, 2014; Simbolon & Sueb, 2016; Suryono & Prastiwi (2011). On the other hand, some studies do not find a significant relationship between financial performance and sustainable reporting (Aggarwal, 2013; Pinasti & Mustikawati, 2018; Putri & Suwarti, 2013). These inconsistent findings provide an opportunity for us to explore further the relationship between financial aspects and sustainable reporting. We examine the relationship between financial aspects to sustainable reporting by using corporate governance as a moderating variable. The company's performance is better if it is run with good governance (Hussain, Rigoni, & Orij, 2018). The existence and process of good governance have an impact on company performance (Nuswandari, 2009; Salahudin et al., 2019; Siregar, 2008). We argue that good governance will further strengthen the impact of the financial aspect on sustainable reporting. The better the governance process in the company, the better the management of the organization, including the better in preparing sustainable reports.

## LITERATURE REVIEW

There are two relevant theories to explain the topic of this research. The two theories are stakeholder theory (Freeman, 1984) and signal theory (Ross, 1977). Based on the stakeholder theory, companies are not entities that operate for their interests but must also benefit other stakeholders such as employees, shareholders, creditors, consumers, suppliers, government, communities, and other stakeholders. Stakeholders have the right to obtain information about company activities that can influence their decision-making. Stakeholder theory explicitly considers the impact of a company's disclosure policy when there are different stakeholder groups in a company. Disclosure of information by companies is used as a tool by management to manage the information needs needed by various stakeholder groups. Therefore, management discloses this social and environmental responsibility information to gain support from various stakeholders. This support can affect the survival of the company (Gray, Kouhy, & Lavers, 1995). Managers are expected to carry out activities that are considered important by stakeholders and report on these activities (Freeman, 1984).

According to Ross (1997) company executives have better information about their company than other parties outside the company and therefore executives are encouraged to convey this information to users of financial statement information. The information conveyed describes the signal. The signal is an action taken by the company to guide investors, creditors, and other users of financial statements about how management views the company's prospects. This signal is in the form of information about what management has done to realize the owner's wishes. Signal theory explains that signals are deliberately issued by companies in the hope that the market can distinguish between good and bad quality companies. This signal relates to the disclosures made by the company in financial statements and other reports. Disclosures in the sustainability report also provide a good signal. Through continuous disclosure, management conveys a signal that the company is well run and friendly to the company's social and environmental conditions.

Research by Damanik (2017) and Diono dan Prabowo (2017) shows that financial performance, as measured by profitability, has a positive effect on the disclosure of sustainable reporting. Profitability describes the company's management’s ability to earn profits. The greater the profitability of the company, the greater the level of company performance. Profit does not only describe the company's business activities but also describes all activities carried out by the company, both social and environmental activities. High profitability is interesting information for users of financial statements. The higher the profitability, the more attractive it is for managers to submit disclosures to the public, including the disclosure of sustainability reports. Carrying out good economic, social, and environmental activities is also related to good profitability. The implementation of business and social activities, as well as environmental management, does not make profitability bad on the contrary it will be good. That's why the company is interested in showing that good profitability is obtained and social and environmental activities are also carried out and disclosed to the public. Corporate governance reflects the structure and mechanisms carried out by the company to ensure the achievement of company goals. With good governance, it can be said that the company's business processes and the implementation of social and environmental activities are also good. In line with the logic above, good governance has an impact on sustainable reporting.

The better the governance, the more positive the impact of profitability on the disclosure of sustainable reporting is expected. Based on the description above, the following hypothesis is formulated:
H1: Profitability has a positive effect on the disclosure of sustainable reporting.
H2: Corporate governance moderates the effect of profitability on sustainable reporting disclosures.

Liquidity is used to measure the company's ability to pay short-term obligations. The company expects good liquidity. Good liquidity illustrates good management of current assets and short-term liabilities as well. A high level of liquidity indicates the company's strong financial condition. Such companies tend to disclose wider information to outsiders because they want to show that the company is credible. The strong financial condition of the company will provide a good image for the company. One way to convince stakeholders is to disclose sustainable reporting that is separate from the annual report (Suryono & Prastiwi, 2011). Governance is an indication of how well the company is managed. The better the governance, the better the company runs its business and ultimately achieves the company's goals. Good governance can lead to better management in managing liquidity. Good governance can also lead to better companies disclosing sustainable reporting. This is in line with Damanik (2017) and Diono and Prabowo (2017) who state that governance has a positive impact on the disclosure of sustainable reporting. The implementation of good governance describes the implementation of the company's business processes well. Thus, if good governance is present, the effect of liquidity on sustainable disclosure is also getting bigger. Based on the description above, the following hypothesis statement is formulated:
H3: Liquidity has a positive effect on the disclosure of sustainable reporting.
H4: Corporate governance moderates the effect of liquidity on the disclosure of sustainable reporting.

Solvency describes the company's ability to meet long-term obligations. Solvency is measured by comparing debt with capital or assets (Husnan, 2009). Solvency indicates the extent to which each rupiah of equity or asset is funded from debt. According to Yi and Yu (2016), more and more investors are considering sustainability reports in the decision process. Creditors pay attention to financial statements and other reports, especially those related to solvency. Management intends to show creditors that the company is doing the company's business processes well. The greater the solvency, the more interesting management is to convince creditors about the company's business processes through continuous disclosure. Continuous disclosure shows a good image. Management wants to convey this image to all users of financial statements. To realize sustainable reporting, companies are required to have good governance. Governance is not only for the company's business processes as a whole but also for specific governance of social and environmental activities. The better the governance of social and environmental activities, the more impact solvency will have on the disclosure of sustainable reporting. Based on the description above, the following hypothesis is formulated:
H5: Solvency has a positive effect on the disclosure of sustainable reporting.
H6: Corporate governance moderates the effect of solvency on the disclosure of sustainable reporting.

**Journal of International Conference Proceedings (JICP) Vol.5 No.3, pp. 79-87, September, 2022**
**P-ISSN: 2622-0989/E-ISSN: 2621-993X**
**https://www.ejournal.aibpmjournals.com/index.php/JICP**

## RESEARCH METHOD

We use a sample of financial institutions listed on the Indonesia Stock Exchange. The financial institutions that are used as research samples are financial institutions that present annual financial and sustainability reports for the 2016-2020 period and are available at www.IDX.co.id. Researchers took various data from those reports including financial ratio data, governance data, and sustainable reporting data.

Research variables include independent, dependent, and moderating variables. There are three independent variables, namely profitability, liquidity, and solvency. The dependent variable in this study is sustainability reporting. While the moderating variable is corporate governance. The measurements of those various variables are as follows:
1. Profitability is measured by comparing profit after tax with total assets.
2. Liquidity is the ratio between current assets and current liabilities.
3. Solvency is measured by comparing total debt with equity.
4. Sustainability reporting is measured by referring to GRI G4. Based on GRI G4, companies are required to disclose as many as 91 disclosure items. The sustainability reporting index is calculated by tabulating all these disclosures. The researcher gave a score of 1 for certain items that were disclosed and a score of 0 for certain items that were not disclosed.
5. Corporate governance is measured by Bapepam's provisions stipulated in the Decree of the Chairman of Bapepam number 134 of 2006. This regulation regulates the items of governance that must be reported by the company. The researcher assigns a score of 1 to the reported governance item and 0 to the unreported governance item.

We use moderated regression analysis (MRA) to test the hypotheses. To test the hypotheses, we estimate the following statistical equation:
LAB = a + b1PRO + b2LIK + b3SOL + b4TKP + b5PRO*TKP + b6LIK*TKP + b7SOL*TKP + e
Where:
LAB = Sustainability Report
PRO = Profitability
LIK = Liquidity
SOL = Solvency
TKP = Corporate governance

## RESULTS

We used OLS (ordinary least square) regression estimation to test the hypothesis. OLS estimation requires various conditions (such as normality, multicollinearity, autocorrelation, and heteroscedasticity) so that the model is valid in estimating. The results of the Kolmogorov-Smirnov test produce a probability value of 0.70 and of course, this indicates that the data is normally distributed. The results of the multicollinearity test show that the tolerance value varies between 0.512 to 0.875 and the VIF (variance inflation factor) value varies between 1.142 to 1.952. Thus, it can be said that there is no collinearity problem because the tolerance value for various variables is greater than 0.1 and the VIF value is less than 10.0. Autocorrelation also does not occur because the value of Durbin Watson (DW) is greater than Durbin Upper (DU). Based on Park's test, it was found that the regression equation was free from heteroscedasticity problems.

Researchers processed and analyzed as many as 50 observations. Information in the form of minimum, maximum, average, and standard deviation of each variable is presented in the following table.

**Table 1**. Descriptive Statistics (N = 50)

| LAB = a + b1PRO + b2LIK + b3SOL + b4TKP + b5PRO*TKP + b6LIK*TKP + b7SOL*TKP + e | | | | |
|---|---|---|---|---|
| Variables | Minimum | Maximum | Mean | St. Deviation |
| PRO | -4,90 | 28,91 | 3,4070 | 6,8370 |
| LIK | 1,07 | 4,11 | 1,5302 | 0,8026 |
| SOL | 0,32 | 16,08 | 6,1642 | 3,4190 |
| LAB | 0,00 | 0,81 | 0,4880 | 0,2700 |
| TKP | 0,22 | 0,84 | 0,5530 | 0,1310 |

PRO (profit after tax/total assets); LIK (current assets/short-term liabilities); SOL (total debt/equity); LAB (1 if the item is disclosed and 0 if the item is not disclosed); TKP (1 if the item is presented and 0 if the item is not presented).

Based on the profitability variable, the company's performance is more than average. This can be seen in the lowest PRO score of -5.90 and the highest of 28.91 with an average of 3.40. The company's liquidity is also very good. This good liquidity can be seen from the minimum LIK figure of 1.07 with an average of 1.53. Generally, the company's debt is six times the company's equity. It can be seen in the table above that the average value of SOL is 6.16. Based on sustainable reporting data, it can be said that there are still many sustainable disclosure items that have not been disclosed by the company. Based on corporate governance data, it can be stated that more than half of the companies have presented various elements of governance demanded by regulators.

The estimation results of the regression equation found that the F value was 0.301 with a probability value of 0.049. Although the F value is quite small, the research model is a good model for estimating data. The test results also show that the coefficient of determination (R2) is 0.723. This figure shows that the independent variables can explain the change in the dependent variable by 72.3%. Based on table 2, it can be said that hypotheses 1, 2, and 4 are supported, namely profitability and liquidity positively impact sustainability reporting, and corporate governance moderates the effect of profitability on sustainable reporting. However, the data do not support hypothesis 3 about the effect of solvency on sustainable reporting. The researcher also does not find the ability of corporate governance to moderate liquidity and solvency towards sustainable reporting as predicted in hypotheses 5 and 6.

**Table 2.** Hypothesis Testing Results

| LAB = a + b1PRO + b2LIK + b3SOL + b4TKP + b5PRO*TKP + b6LIK*TKP + b7SOL*TKP + e | | | | | | |
|---|---|---|---|---|---|---|
| Hypotheses | Variables | Coefficients | T | Prob. | Predictions | Findings |
| 1 | PRO | 0,001 | 0,594 | 0,046 | + | + |
| 2 | PRO*TKP | 0,001 | 0,655 | 0,016 | + | + |
| 3 | LIK | 0,002 | 0,628 | 0,033 | + | + |
| 4 | LIK*TKP | -0,005 | -0,598 | 0,553 | + | 0 |
| 5 | SOL | 0,000 | 0,335 | 0,739 | + | 0 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 6 | SOL*TKP | -0,001 | -0,517 | 0,608 | + | 0 |

PRO (profit after tax/total assets); LIK (current assets/short-term liabilities); SOL (total debt/equity); LAB (1 if the item is disclosed and 0 if the item is not disclosed); TKP (1 if the item is presented and 0 if the item is not presented).

## DISCUSSIONS

Hypothesis 1 which states that profitability has a positive impact on the disclosure of sustainable reporting is supported empirically. Empirical evidence also shows that hypothesis 2 is supported where corporate governance moderates the effect of profitability on corporate governance disclosures. This finding is in line with the empirical evidence presented in the research of Damanik (2017) and Diono & Prabowo (2017). The positive impact of profitability on the disclosure of sustainable reporting is in line with stakeholder theory. The greater the profitability of the company, the more interested the company is to conduct and disclose information to stakeholders through continuous reporting. Good governance shows good company management mechanisms and processes. The better the governance, the more likely companies are to disclose their activities on sustainable disclosure to various stakeholders. Empirical findings on profitability and its impact on sustainable disclosure are also in line with signaling theory. Management provides adequate disclosure through continuous reporting to show that the company is well managed and its profitability is also good.

The statement in hypothesis 3 which shows that liquidity has a positive effect on the disclosure of sustainable reporting is also supported empirically. This finding is in line with research conducted Suryono and Prastiwi, 2011). By stakeholder theory, companies seek to disclose various information needed by various stakeholders, including information about liquidity and environmental disclosures. Good liquidity also shows a signal that the company has good prospects. However, hypothesis 4 which states that governance moderates the effect of liquidity on sustainable disclosure is not empirically supported. This empirical finding contradicts the findings of Damanik (2017) and Diono and Prabowo (2017) research. We suspect that the reason for this hypothesis is not supported because information about liquidity is not the main information needed by users of financial statements to make decisions. Another reason is that the job descriptions of the parties in the governance structure related to social and environmental activities are not related to the company's liquidity but are more related to social and environmental activities themselves.

Solvency does not affect the disclosure of sustainable reporting. In addition, based on the results of data testing, corporate governance also does not moderate the effect of solvency on the disclosure of sustainable reporting. It seems that the provisions in the debt agreement are more prominent as the basis for management's consideration to meet creditor expectations rather than providing a signal to creditors through continuous reporting. Management is required to fulfill all debt covenants that have been agreed upon between the company and creditors. Fulfillment of this debt covenant is sufficient for creditors without looking at sustainable reporting.

## CONCLUSION

Two elements in the financial statements, namely profitability, and liquidity, are factors considered by management in disclosing sustainable reporting. Management uses signals of company performance, especially earnings performance and working capital management as signals to be disclosed to users of financial statements. Management also intends to prove that the company cares about all stakeholders in running its business and this can be seen in the company's commitment to disclosing all economic, social, and environmental activities in sustainable reporting. This study has limitations related to the sector under study and governance measures. Identifying disclosure items is not an easy job. Therefore, this research only focuses on the financial sector. Future research can use samples from other sectors or a wider sector. Second, this study measures governance based on the presence of elements of governance in the company. Alternative governance measures can be considered in future research.

## ACKNOWLEDGMENT
This research is supported by STIE YKPN Yogyakarta.

## DECLARATION OF CONFLICTING INTERESTS
The authors declare that they have no affiliations with any organization or entity with any financial or non-financial interest in the subject matter or materials discussed in this manuscript.

## REFERENCES

Aggarwal, P. (2013). Impact of corporate governance on corporate financial performance. *IOSR Journal of Business and Management, 13*(3), 1-5.

Chayandito, F. (2006). Pembangunan berkelanjutan, ekonomi dan ekologi, sustainability communication dan sustainability reporting. *Jurnal Fakultas Ekonomi dan Bisnis LMFE, 1*(22), 1–12.

Damanik, L. Y. (2017). Pengaruh kinerja keuangan dan karakteristik perusahaan terhadap kuantitas dan kualitas pengungkapan sustainability report. *PROFITA*, *10*(3), 228-246.

Diono, H., & Prabowo, T. J. (2017). Analisis pengaruh mekanisme corporate governance, profitabilitas, dan ukuran perusahaan terhadap tingkat pengungkapan sustainability report. *Diponegoro Journal of Accounting, 6*(3), 1-10.

Elkington, J. (1998). Triple bottom line. *Environmental Quality Management, 8*(1), 37–51.

Freeman, R. E. (1984). *Strategic management: A stakeholder approach*. Boston: Pitman.

Gray, R., Kouhy, R., & Lavers, S. (1995). Corporate social and environmental reporting: A review of the literature and a longitudinal study of UK disclosure. *Accounting, Auditing & Accountability Journal, 8*(2), 47-77.

Husnan, S. (2009). *Dasar-dasar teori portofolio dan analisis sekuritas* (4th ed.). Yogyakarta: UPP STIM YKPN.

Hussain, N., Rigoni, U. & Orij, R.P. (2018). Corporate governance and sustainability performance: Analysis of triple bottom line performance. *Journal Business Ethics, 149*(2), 411–432.

Natalia, R., & Tarigan, J. (2014). Pengaruh sustainability reporting terhadap kinerja keuangan perusahaan publik dari sisi profitability ratio. *Jurnal Ekonomi*, 2(1), 111–120.

Nuswandari, C. (2009). Pengaruh corporate governance perception index terhadap kinerja perusahaan pada perusahaan yang terdaftar di Bursa Efek Jakarta. *Jurnal Bisnis dan Ekonomi, 16*(2), 70-84.

Pinasti, W. F., & Mustikawati, R. I. (2018). Pengaruh CAR, BOPO, NPL, NIM Dan LDR terhadap Profitabilitas Bank Umum Periode 2011-2015. *Nominal: Barometer Riset Akuntansi dan Manajemen*, 7(1), 126-142.

Putri, W. O. P., & Suwarti, T. (2013). Penyaluran jumlah kredit perbankan dan faktor yang mempengaruhinya: Studi pada perusahaan perbankan go public yang terdaftar di Bursa Efek Indonesia. *Jurnal Manajemen dan Bisnis Indonesia, 2*(2), 1–14.

Ross, S. A. (1977). The determination of financial structure: The incentive-signalling approach. *Bell Journal of Economics, 8*(1), 23-40.

Salahudin, A. N., Fajar, M., Mutiarin, D. M., Siregar, B. S., Sulistyaningsih, T., Jainuri, A. R., & Karinda, K. (2019). Developing integrity university governance model in Indonesia. *International Journal of Higher Education, 8*(5), 185-199.

Simbolon, J., & Sueb, M. (2016). Pengaruh pengungkapan sustainability report terhadap kinerja keuangan perusahaan (Studi empiris pada perusahaan yang terdaftar dalam Bursa Efek Indonesia). *Prosiding Simposium Nasional Akuntansi XIX*.

Siregar (2008). Eksproriasi pemegang saham minoritas dalam struktur kepemilikan Ultimat. *Jurnal Riset Akuntansi Indonesia, 11*(3), 237-263.

Sulistyawati, A. I., & Qadriatin, A. (2019). Pengungkapan sustainability report dan faktor-faktor yang mempengaruhinya. *Solusi, 16*(4), 1–22.

Suryono, H., & Prastiwi, A. (2011). Pengaruh karakteristik perusahaan dan corporate governnce terhadap praktik pengungkapan sustainability report. *Prosiding Simposium Nasional Akuntansi XIV*.

Susianti, M. N. L., & Yasa, G. W. (2013). Pengaruh kinerja keuangan terhadap nilai perusahaan dengan pemoderasi good corporate governance dan corporate social resposibility. *E-Jurnal Akuntansi Udayana, 3*(1), 73–91.

Yu, Y., & Yi, L. (2016). Progress in China's sustainable development research: Contribution of Chinese geographers. *Journal of Geography Sciences, 26*(8), 1176-1196.