



FINANCIAL REPORTS QUALITY AND CORPORATE SOCIAL RESPONSIBILITY

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ABSTRACT

This study explores the correlation between CSR and the quality of financial reports according to Stewardship Theory for 100 Best Corporate Citizens. The empirical results of the overall samples indicated that by practicing CSR, companies can effectively reduce their level of earnings management, providing quality financial reports. The cluster sampling results show that CSR has a mediating effect, reducing the direct effects of corporate governance board structures on the quality of financial reports. This study considers the emergence of Stewardship Theory compensates for the defects and deficiencies of agency theory in explaining the behaviors of managers. This study offers deeper insights to policy makers and investors to understand the association between company CSR performance and their financial reporting quality. The results suggest that company stakeholders should pay more attention when considering the influence of company CSR investment performance.

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Keywords: Corporate governance, Corporate social responsibility (CSR), Financial report quality, Stewardship theory.

Jel Classification: M41, M14.

Contribution/ Originality

The study is one of very few studies which have investigated and proofed that companies practicing CSR will have a higher financial reporting quality, and the findings is consistent with stewardship theory.

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1. INTRODUCTION

The term corporate social responsibility (CSR) is not recent; however, its definition and content have gradually been expanded and extended by the development of historical background, and it differs substantially from its original meaning. Corporations previously focused exclusively on financial and economic factors, vigorously pursuing the maximization of shareholder interests. A transitional period followed, in which perceptions of CSR gradually expanded to improving the work environments and equity of employees. Contemporary perceptions of CSR are based on the ultimate objectives of corporations such as sustainable management and contributions to society, which is the source of corporate profits. After realizing the interdependence and inseparability of CSR promotion and shareholder equity, corporations expanded their environmental protection and social welfare efforts, and commitment to satisfying the basic profitability objectives and stakeholder requirements.

A report by the World Business Council for Sustainable Development indicated that when corporations promote CSR, issues related to core company values can be categorized into worker equity, human rights, environmental protection, community participation, relationships with suppliers, transparency and disclosure, and stakeholder equity. This report highlights the wide range of dimensions covered by CSR. However, mainstream studies in the accounting field have continued to explore the relationships between CSR and stakeholder equity. Few studies have analyzed whether voluntarily disclosing CSR-type information affected transparency and disclosure, delivered additional information, or increased company value.

Financial reports provide the basis for policy decisions by the investing public and high quality financial reports can increase company value. Thus, whether a CSR investment influences the earnings manipulation of high-level corporate personnel has attracted considerable attention. Previous studies have followed the assumptions of agency theory, which suggest that managers are self-serving and only promote CSR when it yields benefits. Corporations invest in CSR to camouflage their manipulation of earnings, negatively affecting the quality of financial reports (Prior *et al.*, 2008). In contrast to agency theory, other scholars proposed stewardship theory, maintaining that managers are organization-oriented. This perspective explains why managers actively implement CSR when no short-term returns on investment exist. This standpoint was employed to re-examine the relationship between CSR and the quality of financial guarantees. Previous studies have indicated that board structure of corporate governments affects the quality of financial reports and CSR. Therefore, this study involved exploring the role of CSR by examining the relationships among CSR, corporate governance, and the quality of financial reports.

The rest of this paper reviews the literature and develops the research hypotheses of related to CSR and Stewardship Theory, empirically tests the hypotheses and provides conclusions about the results.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Recently, corporate investors, customers, and stakeholders have focused on CSR-related topics; this is primarily because the involuntary disclosure of information involved in CSR, which investors can use to assess and understand corporations. Thus, CSR is frequently discussed. Grant (2008) asserted that CSR should not be limited to the development of large corporations, but should be employed by all corporations. Recent mainstream CSR research has explored the correlation between CSR and financial performance. Scant research has investigated the relationship between CSR and the quality of financial reports; because of the differences in the agency and stewardship theories regarding manager behavior, no unified conclusion exists within the current literature.

Initially, corporate governance was developed to solve the agency problem that resulted from separating ownership and management rights. As a result, agency theory rapidly developed, becoming the mainstream theory for corporate governance. Since the 1997 Asian financial crisis, agency theory (which is based on self-interest) has been inadequate for explaining corporate governance issues and numerous flaws have been identified in its system. Bad publicity regarding “fat cat” supervisors has led scholars to reflect on and review agency theory. Thus, the altruism-based stewardship theory was developed and seriously analyzed. On a certain level, stewardship theory compensated for the flaws in agency theory. The difference between the agency and stewardship theories is similar to the difference between the innate goodness and innate evil concepts in the Confucian thinking that is prevalent in Taiwan.

2.1. The Influence of Stewardship Theory and Agency Theory on CSR

Agency theory appeared in its earliest form in a report by Berle and Means (1932). When corporations attempted to locate additional external resources and funding to achieve and maintain competitiveness, the funding providers were often not the managers of the corporation. This generated a separation between corporate management rights and ownership. When managers hold little share in the company and ownership rights are dispersed (making it difficult for owners to effectively constrain managers), they may deviate from the objectives of the corporate management to maximizing their self-interests; this situation caused an agency problem, which agency theory was developed to relieve (produced by the agent relationship), reducing agency costs. This was accomplished by establishing an oversight mechanism and contract award incentive, allowing managers to simultaneously maximize personal and shareholder interests (Jensen and Meckling, 1976; Fama and Jensen, 1983).

Stewardship Theory was developed by Davis *et al.* (1997) by using Theories X and Y, which were established by McGregor (1960). This theory assumed that two opposite types of people exist, one of which demonstrates passive work motivation (X theory) and one of which demonstrates active work motivation (Y theory, also called innate goodness theory). These assumptions were used to explain why agency theory mechanisms failed in current society. Agency Theory involves

one-sided assumptions regarding managerial behavior. In the real world, certain managers achieve intrinsic satisfaction or obtain the recognition of others by completing the tasks assigned by their organizations. This desire for self-actualization allows their behaviors to surpass the limitations of money and other incentives. Stewardship theory holds that certain managers possess innate goodness, pursuing the maximal benefit to shareholders as a primary objective and valuing their commitments toward the organization. In organizations, these managers play the roles of stewards, safeguarding the benefits of the corporation. Manager behavior is driven by social perceptions and self-achievement. Thus, the self-interests of managers and benefits to the company and all company personnel are mutually linked, and no conflicts arise (Block, 1996; Davis *et al.*, 1997; Peggy and Hugh, 2001).

Previous explorations of CSR were often founded on the assumptions of Agency Theory. In other words, managers are driven by self-interest, viewing CSR as simply a tool, and promoting CSR activity only when it yields benefits (Friedman, 1970; Shank *et al.*, 2005; Karnani, 2010; Dhaliwal *et al.*, 2011). For example, Kim and Venkatachalam (2011) indicated that in the gambling and tobacco industries, corporations developed CSR to improve their business reputations. Based on this self-interest perspective, scholars discovered that corporations invested in CSR to camouflage earnings manipulations, resulting in a negative relationship between CSR and the quality of financial reports (Prior *et al.*, 2008). However, certain scholars indicated that CSR affected the quality of financial reports in various ways depending on proxy variables (Chih *et al.*, 2008).

Alternate scholars have asserted that corporations often develop CSR even if it reduces the benefits of corporate stakeholders (Carroll, 1999; Friedman *et al.*, 2005; Grow *et al.*, 2005; Kolstad, 2007; Reinhardt *et al.*, 2008). The perspectives of these scholars are biased toward stewardship theory, maintaining that managers are influenced by self-actualization and morals, often electing to do things that benefit the company and avoiding poor social behaviors, even if doing so reduces the short-term benefits to corporate stakeholders. Thus, managers are not affected by self-interests when they promote corporate policies. According to this theoretical perspective, managers avoid behaviors that harm the company, demonstrating of self-restraint and not using CSR to conceal earnings manipulations. This reduces the degree of earnings management by managers, resulting in high-quality financial reports. Therefore, Hypothesis 1 was established to verify the correlation between CSR and the quality of financial reports as follow:

Hypothesis 1: *Corporations that demonstrate superior CSR performance provide high-quality financial reports.*

2.2. The Mediation Effect of CSR

Studies of both the stewardship and agency theories have continued to explore how board structures affect corporate governance mechanisms. A highly independent board can increase the

supervision and control over managers. Combining the chairman of the board and the CEO positions and increasing inside directors can allow the manager to function in the role of the steward in high-trust environments. From a corporate governance perspective, the board is responsible for hiring and dismissing corporate managers, setting a reward system, and supervising the performance levels of corporate policies. Therefore, the board structure provides a critical internal control mechanism for corporate governance.

Previous studies of the correlation between corporate governance and the quality of financial reports used agency theory as a basis for exploring how board structures affected the quality of financial reports. These scholars have maintained that when a chairman of the board served as the CEO, the dual managerial position reduced the supervisory function of the board. This increased the incentive for the manager to conduct earnings management, thereby, producing inferior quality financial reports (Core *et al.*, 1999; Shivdasani and Yermack, 1999; Anderson *et al.*, 2004). Regarding board independence, agency theory maintains that the lower the ratio of inside directors, the more effective it is for the board to implement supervisory functions, because no close relationship exists between the board and the manager, which facilitates implementation of internal corporate governance and reduces the likelihood of managers manipulating earnings (Dechow *et al.*, 1996; Hillman and Dalziel, 2003).

However, stewardship theory maintains that managers link the success or failure of the company to themselves by using self-actualization. When they encounter the dual position problem posed by combined chairman of the board and CEOs, managers become comparatively more concerned about their commitment toward the organization (Boyd, 1995) and consequently less likely to engage in earnings management. Regarding board independence and structure, stewardship theory involves a distinct view compared with agency theory. Stewardship Theory maintains that boards should be formed by inside directors, who should familiarize themselves with company operations, aiding the directors in executing their functions (Corbetta and Salvato, 2004).

Previous studies have also indicated that the corporate governance mechanism of board structure can influence CSR investment. Johnson and Greening (1999) explored the correlation between internal corporate governance mechanisms and CSR performance levels by examining the proportion of outside directors and the ratios of shares held by managers and investors, subsequently evaluating the effectiveness of those mechanisms. The results showed that efficient internal governance mechanisms yielded a strong social responsibility performance levels. However, certain scholars have maintained that inside directors are committed to charitable activities; thus, when a high proportion of inside directors is present, a corporation is expected to perform relatively frequent charitable undertakings (Wang and Coffey, 1992). Stewardship theory maintains that when the chairman of the board acts as the CEO, he or she is expected to combine self- and corporate interests. The behavior of the CEO is influenced by social perceptions; thus, he or she is expected to heavily invest into CSR (Davis *et al.*, 1997). However, agency theory

maintains that the closer the relationship between a corporation and its stakeholders is, the more it actively invests in CSR. Thus, the concentration of authority generated by dual positions should be avoided. Previous studies have reported that the corporate governance mechanism of board structure influences CSR investments and the quality of financial reports. However, CSR may be critical to influencing the quality of financial reports; thus, its role in corporate governance and the quality of financial reports is notable. In other words, a mediating effect may exist between corporate governance and the quality of financial reports. Therefore, Hypothesis 2 was established to test whether CSR was a mediating variable between corporate governance and the quality of financial reports as follow:

Hypothesis 2: CSR mediates the influence of corporate governance on the quality of financial reports.

3. RESEARCH METHODOLOGY

3.1. Source of Data

Corporations were selected from the 2009–2011 editions of the 100 Best Corporate Citizens List, which is published annually by the Corporate Responsibility Office. Of 300 corporations, 34 were eliminated for a lack of related financial data and 45 exclusive or oligopolistic corporations were rejected, forming the experimental group. The pairing method was used to form a comparison group based on industry type, and total assets and sales. The samples comprised 442 corporations, with 221 corporations that implemented CSR and 221 that did not implement CSR. Regarding corporate governance variables, dual position data and the number of inside directors were obtained from 10-K and def-14a forms in the U.S. Securities and Exchange Commission website. Finance data for the sample corporations were collected from the Standard & Poor's COMPUSTAT (North American edition).

3.2. Empirical Model

First, a multiple regression analysis was employed to examine how CSR affected the quality of financial reports. Estimations were conducted by employing ordinary least squares (OLS). Multiple regression Equation (1) was established to verify Hypothesis 1.

$$FQR_t (DA \text{ or } RAM) = \alpha_0 + \alpha_1 CSR + \alpha_2 NEGCFOT_{t-1} + \alpha_3 LOSSD_{t-1} - \alpha_4 LEV_{t-1} + \alpha_5 BETA_{t-1} + \alpha_6 OC_{t-1} + \varepsilon \quad \dots(1)$$

Financial reporting quality (FRQ) is measured by discretionary accruals and real earnings management of companies of companies. Discretionary accruals (DA) are measured from the model provide by Kothari *et al.* (2005), and are divided into positive and negative DA based on its value and its absolute value obtained (ABS_DA). Real earnings management (RAM) is measured from the model proposed by Roychowdhury (2006) and Cohen *et al.* (2008), and is divided into cash flow from abnormal operating activities (AB_CFO), abnormal production costs (AB_PROD),

abnormal discretionary expenditure (AB_DISEXP), and the RAM comprehensive index RAM ($-AB_CFO + AB_PROD - AB_DISEXP$).

Corporate social responsibility (CSR) is an indicator variable that equal to one when sample company is one of the 100 Best Corporate Citizens. Both NEGCF0 and LOSSD are indicator variables which are taken to be one for the negative value of operating cash flow and profit for the quarter. LEV is the debt ratio which was measured by the total liabilities divided by total assets of a company. BETA represents the systematic risks to the corporate asset, and a value greater than 1 represents that the risk is higher than market volatility. Finally, Operating cycle (OC) is measured by the average number of the summation of accounts receivable collection and the average number of inventory turnover days. Second, this study verified whether CSR was a mediating variable in corporate governance variable, influencing financial report quality. Based on the method of Baron and Kenny (1986), regression Equation (1) was used to establish regression Equation (2) to sequentially verify (3) whether a significant correlation existed between the mediating variable and dependent variable, independent variable and mediating variable, and independent variable and dependent variable. When these correlations were established, the mediating variable was placed in regression Equation (4). If the effects of independent variables were weakened or eliminated, it suggested mediating effects.

- (a) Verifying whether a significant correlation existed between the independent variable (corporate governance) and dependent variable (financial report quality).

$$FQR_t(DA \text{ or } RAM) = \alpha_0 + \alpha_1 INSIDER_t + \alpha_2 DUALITY_{t-1} + \varepsilon \quad \dots(2)$$

- (b) Verifying whether a significant correlation existed between the independent variable (corporate governance) and mediating variable (CSR).

$$CSR_t = \alpha_0 + \alpha_1 INSIDER_t + \alpha_2 DUALITY_{t-1} + \varepsilon \quad \dots (3)$$

- (c) Verifying whether the effects of the independent variable (corporate governance) were reduced.

$$FQR_t(DA \text{ or } RAM) = \alpha_0 + \alpha_1 CSR + \alpha_2 INSIDER_t + \alpha_3 DUALITY_t + \alpha_4 NEGCF0_{t-1} + \alpha_5 LOSSED_{t-1} + \alpha_6 LEV_{t-1} + \alpha_7 BETA_{t-1} + \alpha_8 OC_{t-1} + \varepsilon \quad \dots(4)$$

INSIDER represent the ratio of inside directors and was measured by dividing the number of inside directors and related directors by the scale of the board. DUALITY represents the dual positions of managers and is equal to one when the chairman of the board is acting in the role of CEO.

4. RESULTS AND ANALYSIS

4.1. Descriptive Statistic Analysis

Prior to conducting the regression analysis, a descriptive statistical analysis was conducted for the overall and cluster samples and the variables to elucidate the differences between and characteristics of the samples, facilitating subsequent research. Companies on the 100 Best

Corporate Citizens List from 2009 to 2011 were used as the study samples. Companies that demonstrated excellent CSR performance levels were paired with companies that demonstrated poor CSR performance levels to form the overall samples. After eliminating oligopolistic industries and samples that lacked data, the valid samples comprised 442 companies. Tables 1 and 2 show the mean, median, standard deviation, and quartile descriptive statistic results for each variable.

Tables 1 and 2 show that companies that demonstrated excellent levels of CSR performance produced financial reports of superior quality, exhibiting fewer discretionary accruals manipulations than did companies that demonstrated poor levels of CSR performance. Regarding real earnings management, companies that achieved excellent CSR performance levels were relatively more conservative, and had less real earnings management in all three dimensions and the combined indicators compared with the controls. Concerning independent variables, the experimental group demonstrated a lower inside director ratio ($0.135 < 0.177$) and often a higher value in chairman of the board acting as CEO (0.75) compared with the controls (0.57). For control variables, the cluster samples showed significant differences in BETA, NEGCF0, LEV, and LOSSD. The control group demonstrated comparatively higher system risks compared with the experimental group, easily generating negative cash flows and losses.

Table-1. Full Sample Descriptive Statistics

	Mean	Median	S.D.	Min.	Max.
Dependent Variables					
ABS_DA	0.035	0.023	0.045	0.0002	0.432
Positive_DA	0.033	0.021	0.044	0.0002	0.432
Negative_DA	-0.037	-0.026	0.045	-0.403	-0.0003
DA	0.002	0.005	0.057	-0.403	0.432
AB_CFO	-0.004	-0.007	0.065	-0.414	0.215
AB_PROD	0.006	0.012	0.161	-0.846	0.549
AB_DISEXP	0.002	-0.022	0.190	-0.371	1.198
RAM	0.007	0.045	0.360	-2.089	1.012
Independent Variables					
CSR	0.500	0.500	0.501	0.000	1.000
INSIDER	0.156	0.125	0.086	0.000	0.546
DUALITY	0.660	1.000	0.475	0.000	1.000
Control Variables					
NEGCF0	0.030	0.000	0.163	0.000	1.000
LOSSD	0.130	0.000	0.338	0.000	1.000
LEV	0.609	0.615	0.184	0.147	0.729
BETA	1.957	1.041	10.135	0.664	1.461
OC	4.702	4.629	0.829	4.304	4.969

DA: discretionary accruals; RAM: Real earnings management, is divided into cash flow from abnormal operating activities (AB_CFO), abnormal production costs (AB_PROD), abnormal discretionary expenditure (AB_DISEXP), and the RAM comprehensive index RAM (-AB_CFO + AB_PROD - AB_DISEXP); CSR: is 1 when sample company is one of the 100 Best Corporate Citizens otherwise 0. INSIDER: represent the ratio of inside directors and was measured by dividing the number of inside directors and related directors by the scale of the board. DUALITY: represents the dual positions of managers and is equal to one when the chairman of the board is acting in the role of CEO.

Table-2. Grouped Sample Descriptive Statistics

	CSR Companies			Non-CSR Companies		Differences P-value
	Mean	Median		Mean	Median	
Dependent Variables						
ABS_DA	0.028	0.021		0.041	0.025	0.002
Positive_DA	0.031	0.022		0.036	0.021	0.530
Negative_DA	-0.025	-0.017		-0.047	-0.032	0.000
DA	0.008	0.007		-0.005	0.000	0.004
AB_CFO	0.001	-0.005		-0.009	-0.010	0.083
AB_PROD	-0.005	0.005		0.016	0.015	0.170
AB_DISEXP	0.009	-0.018		-0.005	-0.027	0.466
RAM	-0.015	0.034		0.029	0.058	0.030
Independent Variables						
INSIDER	0.135	0.100		0.177	0.154	0.000
DUALITY	0.750	1.000		0.570	1.000	0.000
Control Variables						
NEGCF0	0.010	0.000		0.040	0.000	0.058
LOSSD	0.060	0.000		0.200	0.000	0.000
LEV	0.630	0.622		0.589	0.601	0.008
BETA	1.060	0.910		2.854	1.174	0.064
OC	4.695	4.636		4.710	4.618	0.685
Stewardship	0.120	0.000		0.230	0.000	0.000

Variables are defined in Table 1.

4.2. Correlation between Variables

If a linear correlation exists between each variable, this can affect the explanatory power of the variables. Therefore, a Pearson correlation coefficient was employed to analyze whether significant correlations existed among the variables prior to conducting the regression analysis. Table 3 shows the results of the correlation coefficient analysis, indicating that except for the combined indicator of real earnings management and its three proxy variables (which have a high collinearity), the

correlation coefficients of the remaining variables were between -0.4 and 0.4. Thus, the model generated no serious collinearity problems.

Table-3. Pearson Correlation

Variables	CSR	ABS_DA	AB_CFO	AB_PROD	AB_DISEXP	RAM	INSIDER	DUALITY	NEGCF0	LOSSD	LEV	BETA	OC
1.CSR	1												
2.ABS_DA	-0.145 ***	1											
3.AB_CFO	0.079 *	-0.133 ***	1										
4.AB_PROD	-0.064	0.031	-0.518 ***	1									
5.AB_DISEXP	0.035	0.034	0.155 ***	-0.800 ***	1								
6.RAM	-0.061	0.020	-0.494 ***	0.962 ***	-0.913 ***	1							
7.INSIDER	-0.242 ***	0.147 ***	-0.044	-0.012	0.134 ***	-0.068 *	1						
8.DUALITY	0.196 ***	-0.087 *	0.047	0.060	-0.130 ***	0.087 **	-0.254 ***	1					
9.NEGCF0	-0.040	0.163 ***	-0.241 ***	0.136 ***	-0.007	0.108	-0.008	-0.101 **	1				
10.LOSSD	-0.214 ***	0.190 ***	-0.156 ***	-0.021	0.077	-0.022 ***	0.015	-0.186 ***	0.174 ***	1			
11.LEV	0.111 **	-0.024	-0.257 ***	0.119 **	-0.104 **	0.154 ***	-0.148 ***	0.095 **	0.089 *	0.065	1		
12.BETA	-0.089 *	-0.027	-0.099 **	0.130 ***	-0.099 **	0.128 ***	-0.027	-0.068	0.120 **	-0.009	-0.032	1	
13.OC	-0.009	0.038	0.049	-0.209 ***	0.224 ***	-0.220	-0.025	-0.012	0.086 *	0.000	0.095 **	-0.020	1

All Variables are defined in Table 1.

Statistical significance: *p < .05; **p < .01; ***p < .001.

4.3. CSR and Financial Report Quality

Tables 4 and 5 show the empirical results of Hypothesis 1

Regression analysis of CSR and discretionary accruals. Table 4 shows the proxy variable of financial report quality, for which discretionary accruals were employed to examine the relationship between CSR and financial report quality. The regression results were consistent with expectations and CSR improved the quality of financial reports. Regarding earnings management, CSR and the proxy variable ABS_DA exhibited a significant and negative correlation ($p = .02$). This indicates that a company that demonstrates excellent CSR performance levels can reduce its manipulation of discretionary accruals, subsequently improving the quality of financial reports. A significant and positive correlation existed between Negative_DA and CSR ($p < .01$), indicating that companies that demonstrate excellent CSR performance levels cease lowering profits and losses to manage earnings. Although the Positive_DA results were non-significant, they were consistent with expectations and can reduce the earnings manipulation that is conducted through increasing gains or losses. Regarding the control variable, the negative cash flow of a company, losses produced, and operating cycle were all significantly and positively correlated with ABS_DA. This indicated that negative cash flow, operating losses, and long operating cycles can increase the likelihood of manipulated discretionary accruals, consequently deteriorating the quality of financial reports.

Table-4. Full Sample Regression Results(DA)

	ABS_DA Coefficient (t-stat)		Negative_DA Coefficient (t-stat)		Positive_DA Coefficient (t-stat)	
CSR	-0.112 (-2.326)	**	0.194 (2.705)	***	-0.053 (-0.840)	
NEGCF0	0.131 (2.720)	***	-0.053 (-0.743)		0.230 (3.344)	***
LOSSD	0.153 (3.145)	***	-0.108 (-1.505)		0.159 (2.428)	**
LEV	-0.006 (-0.133)		0.162 (2.304)	**	0.152 (2.403)	**
BETA	-0.051 (-1.082)		0.067 (0.981)		-0.094 (-1.397)	
OC	0.094 (1.995)	**	-0.078 (-1.117)		0.079 (1.251)	
Adj R ²	0.066		0.084		0.104	
N	442		199		243	

Variables are defined in Table 1. Statistical significance: *p < .05; **p < .01; ***p < .001

Regression analysis of CSR and real earnings management. Table 5 shows the proxy variable for financial report quality, which involved used real earnings management to verify the regression analysis results of Hypothesis 1. The results were similar to the regression analysis for discretionary accruals. Companies that demonstrated excellent CSR performance levels reduced their involvement in real earnings management, provided relatively more transparent financial information, and subsequently improved their financial report quality compared with the control group. In the combined indicator, CSR exhibited a negative correlation, reaching the 10% level of significance. This indicated that CSR allows companies to remain conservative, reducing the possibility of involvement in real earnings management. For abnormal production costs, CSR exhibited a significant negative correlation. Thus, companies that demonstrated excellent CSR performance levels can reduce the possibility of excessive production being used to manipulate earnings. Although CSR remained non-significant regarding abnormal cash flow and abnormal discretionary expenditure (p = .113 and .187), the value was extremely close to the 10% level of significance. The expected result was consistent with Hypothesis 1, and can reduce the level of earnings management. Concerning the control variable, when companies possessed high levels of debt ratio and system risks, real earnings management showed a significant correlation to all three proxy variables and the combined indicator, increasing the level of earnings management.

Table-5. Full Sample Regression Results (RAM)

	AB_CFO Coefficient (t-stat)		AB_PROD Coefficient (t-stat)		AB_DISEXP Coefficient (t-stat)		RAM Coefficient (t-stat)	
CSR	0.074 (1.588)		-0.078 (-1.662)	*	0.063 (1.321)		-0.081 (-1.737)	*
NEGCF0	-0.196 (-4.240)	***	0.145 (3.085)	***	-0.026 (-0.544)		0.114 (2.434)	**
								<i>Continue</i>

LOSSD	-0.092 (-1.966)	*	-0.078 (-1.636)		0.111 (2.311)	**	-0.077 (-1.621)	
LEV	-0.253 (-5.559)	***	0.121 (2.620)	***	-0.114 (-2.437)	**	0.160 (3.474)	***
BETA	-0.077 (-1.685)	**	0.104 (2.249)	**	-0.088 (-1.898)	**	0.107 (2.327)	**
OC	0.065 (1.446)		-0.253 (-5.519)	***	0.267 (5.780)	***	-0.266 (-5.832)	***
Adj R ²	0.135		0.105		0.092		0.117	
N	442		442		442		442	

Variables are defined in Table 1. Statistical significance: *p < .05; **p < .01; ***p < .001

Analysis of the mediating effect of CSR. Table 6 shows the test results for mediating effects of CSR. When all three factors for mediating effects were satisfied, the regression results from Equation (4) were subsequently examined to determine whether the mediating effects were complete or partial. When the quality of financial reports was evaluated using discretionary accruals, a partial mediating effect was evidenced, in which CSR served as the mediating variable in the effects the ratio of inside directors in corporate governance structure have on financial report quality. The mediating effect reduced the influence of the inside director ratio on financial report quality (p increased from .006 to .015). When financial report quality was measured using real earnings management, a complete mediating effect existed, negating the effects of duality on financial report quality (p increased from .098 to .130). This explains why the cluster sample test (Table 7) shows that the board characteristic of companies that demonstrated excellent CSR performance levels non-significantly affected financial report quality. The mediating effects of CSR reduced or eliminated the effects of corporate governance on financial report quality.

Table-6. Test results for mediating effects

	Model (2)		Model (3)		Model (4)			
	DA	RAM	CSR	DA	RAM			
CSR				-0.083	*	-0.105	**	
INSIDER	0.133	***	-0.023	-0.205	***	0.121	**	
DUALITY	-0.053		0.080	0.144	***	0.000	0.074	
NEGCFO						0.130	***	
LOSSD						0.157	***	
LEV						0.007	0.147	
BETA						-0.045	0.109	
OC						0.093	**	
Adj R ²	0.02		0.005		0.073		0.124	

Variables are defined in Table 1. Statistical significance: *p < .05; **p < .01; ***p < .001

Table-7. Cluster sample test

	CSR Companies		Non-CSR Companies	
	ABS_DA Coefficient (t-stat)	RAM Coefficient (t-stat)	ABS_DA Coefficient (t-stat)	RAM Coefficient (t-stat)
INSIDER	0.028 (0.385)	0.096 (1.322)	0.156 (2.325)	** -0.132 (-2.150)
DUALITY	-0.072 (-0.954)	0.060 (0.808)	0.007 (0.099)	0.127 (2.063)
				<i>Continue</i>

NEGCF0	0.108 (1.451)		-0.009 (-0.117)		0.156 (2.323)	**	0.173 (2.815)	***
LOSSD	0.018 (0.253)		0.065 (0.907)		0.192 (2.850)	***	-0.120 (-1.948)	*
LEV	-0.050 (-0.719)		0.133 (1.944)	**	0.047 (0.699)		0.154 (2.498)	**
BETA	0.180 (2.659)	***	0.182 (2.706)	*	-0.055 (-0.815)		0.113 (1.843)	*
OC	0.086 (1.278)		-0.167 (-2.496)	**	0.100 (1.503)		-0.341 (-5.615)	***
Adj R ²	0.043		0.056		0.071		0.220	
N	221		221		221		221	

Variables are defined in Table 1.

Statistical significance: *p < .05; **p < .01; ***p < .001

5. CONCLUDING REMARKS

Since the Asian financial crisis, agency theory perspective has been increasingly challenged. The emergence of stewardship theory compensates for the defects and deficiencies of agency theory, explaining the behaviors of managers. According to stewardship theory, managers invest in social responsibility because of self-actualization and morals, potentially influencing their involvement in earnings management. This study comprised companies that demonstrated excellent CSR performance levels from 2009 to 2011, assessing the correlation between CSR and financial report quality. The empirical results indicated that CSR reduced the manipulation of discretionary accruals and increased the quality of financial reports. Companies that demonstrate excellent CSR performance levels can reduce decreases in profits or losses that manipulate earnings. Regarding real earnings management, the combined indicators showed that CSR facilitates comparatively conservative attitudes. CSR reduced the use of real operating activities to manipulate earnings, particularly in abnormal production costs (e.g., increasing production quantities to reduce unit costs). The cluster sample results indicated that CSR is a mediating variable, which reduced the direct effects of corporate governance board structure on financial report quality. Thus, investors should examine company CSR investment to evaluate the quality and reliability of its financial statements and the direct effects of corporate governance board structure on financial report quality. However, several limitations must be considered. The financial and corporate governance data were collected from Standard & Poor's COMPUSTAT database and the SEC, but data gaps existed. The samples could not encompass all the appraised companies, potentially compromising the results of this study. In subsequent studies, information should be gathered from alternate appraisal organizations and global samples should be included, rather than those from a single region.

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