THE WORK EXPERIENCE OF INTERNAL CONTROL PERSONNEL AND CORPORATE SOCIAL RESPONSIBILITY

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ABSTRACT

Firms are increasingly undertaking corporate social responsibility (CSR) activities. However, an organization's CSR activities also generate costs, and do not directly translate into its profitability. While CSR activities may improve the image of the company and its products, and positively affect the reputation of top managers, they are sometimes strategically used by the latter for personal advantage, which could result in an agency problem. In this context, this study examines the effect of the operational level of a firm's internal accounting control system on the quality of its CSR activities, which monitors and keeps the senior management in check.

The results show that a lengthier work experience (higher number of months) of the personnel in charge of the internal accounting control system leads to a higher quality level of CSR activity adoption and performance. These results suggest that a higher average number of months of experience in internal accounting increases the learning effect of the personnel, as they perform the same work repeatedly over time and hone their skills. The higher work experience effectively controls the agency problem, and subsequently prevents CSR activities from being used as a means of satisfying managers' personal interests.

Keywords: Internal Control Personnel, Agency Problem, Corporate Social Responsibility.

JEL codes: G34, M14.

INTRODUCTION

A firm's corporate social responsibility (CSR) activities are generally regarded as voluntary and continuous activities that consider the varied interests of the stakeholders, including employees, consumers, local communities, and the environment. This awareness raises the question of what necessitates and incentivizes organizations to continue to perform CSR activities. Some argue that as a firm and its influence grow, it should not only contribute to economic development but also meet the needs and interests of stakeholders, as a responsible member of society. However, others argue that it is difficult for an institution to continuously conduct CSR activities that do not translate into profits, because all CSR activities bear some costs, from the organizational or investor's perspective.

Moreover, seeking CSR activities at the expense of shareholders, and catering only to the advantage of stakeholders who have not invested any money in the firm, would go against the principle of good faith, and perhaps induce shareholders to withdraw their investments in the company. Hence, to ensure that voluntary CSR activities continue to be performed within the current legal system, it is important to link CSR to the greater corporate value and establish appropriate controls over top management to undertake and perform quality CSR activities. The level and scope of CSR activities are decisions made by top managers and depend on their

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willingness and attitudes. These decisions may sometimes lead to agency problems in relation to CSR activities, as top managers may choose business policies that do not align with shareholders' interests. They sometimes use the decision-making authority vested in them inefficiently, and utilize the firm's available resources to enjoy personal gains at the expense of the shareholders (Jensen & Meckling, 1976; Jensen, 1986; Stulz, 1990). Thus, if top managers can enjoy personal gains or increase their reputations from CSR involvement, they are incentivized to pursue CSR activities that may not be relevant to a firm's value.

Against this backdrop, this study aims to examine the relationship between the level of a firm's CSR activity and its systems of control. Considering that varying operational levels of the firm's internal accounting control system may lead to different levels of CSR performance, this study analyzes whether an organization with more experienced internal accounting personnel can outperform others on CSR.

This paper consists of the following sections: Sections 2 and 3 review previous studies on the same topic and suggest a study hypothesis. Section 4 describes the variables, study model, and sample selection process. Section 5 describes the basic statistics and correlations for the variables, and explains the results of the empirical analysis. Finally, section 6 presents the conclusions and implications.

THEORETICAL BACKGROUND

Internal Accounting Control System

The US legislated the Sarbanes Oxley Act (SOX), wherein Section 404 requires US firms to establish and evaluate internal control over accounting information and disclose such information. Korea also introduced an internal accounting control system in 2001, in an effort to increase the reliability of financial information. In 2002, the Financial Supervisory Commission amended the template of the Internal Accounting Control System Operational Report, and firms are now required to disclose their internal accounting controls and organizational structures in detail.

The purpose of introducing the internal accounting control system was to increase the reliability of accounting information by controlling errors and potential wrongdoing. It is worth noting that only Korea requires organizations to disclose data about their internal accounting control and organizational structures. The Financial Supervisory Commission requires companies to disclose such data because it allows external information-users to understand the level and detail of internal control exerted by the firm, while encouraging institutions to operate their internal control systems more effectively. Studies have reported that firms with better internal accounting control personnel and operational organization controlled the agency problem created by top managers more effectively. It led to fewer discretionary expenditures and displayed no vulnerabilities in the internal accounting control system (Choi et al., 2013).

Corporate Social Responsibility

By enhancing CSR activities, top managers can promote the interests and rights of stakeholders, the pride of employees or shareholders, maximize productivity, and improve a firm's reputation (Garbett, 1988; Hart, 2005; Pava & Krausz, 1996; Preston & O'Bannon, 1997). Renneboog et al. (2008) claim that it is unclear whether the level of CSR is reflected adequately in a company's value on the capital market. Another study suggests that excessive costs incurred

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by a firm to achieve CSR may naturally lead to worsening profitability, thereby preventing it from adopting a highly profitable business strategy, and consequently making it difficult to increase shareholder value (Brammer et al., 2006). Barnea & Rubin (2010) argue that it is difficult to visualize the benefits of CSR in the short term, and it may be abused to maximize top management's personal gains; therefore, an appropriate means of control is necessary. The reason is that CSR activities may backfire on a firm and the society in the long term if the activities are short-term strategies setup to obtain positive reactions in the capital market or misused to enhance top managers' reputations.

HYPOTHESIS DEVELOPMENT

Barnea & Rubin (2010) and Beltratti (2005) pointed out that while CSR may be developed in a way that improves a firm's market image, increases employee productivity, and reduces costs and fines due to environmental pollution, the expenditure incurred may turn into a liability and undermine the organizational value, if it aims to enhance top managers' personal reputations.

Based on these studies, it may be expected that different levels of monitoring of top managers through control systems lead to diverse levels of CSR activity. It is because the control system serves as a mechanism that prevents insiders from taking advantage of resources, protects external investors, and enhances corporate value by efficiently tackling the agency problem (Smith, 1996; La Porta et al., 2002; Shleifer & Wolfenzon, 2002; Gompers et al., 2003; Cremers & Nair, 2005; Drobetz et al., 2004). Studies suggest that corruption may be caused or exacerbated by weak internal control (Bell & Carcello, 2000; Albrecht et al., 2008), and it can be inferred that the level of a firm's internal control system may lead to different levels of CSR performance.

This study examines the effect of the level of a firm's internal accounting control system on the quality of its CSR activities. Intuitively, operational efficiency in an internal accounting control system may vary depending on the characteristics of the internal accounting personnel. Brickley et al. (1994) reported that personnel with more years of experience served as efficient monitors in similar organizations. Similarly, Monks & Minow (1995) found that directors with longer experience performed more efficiently than those with fewer years of experience. Personnel with more experience of internal accounting showed a higher learning effect due to repeated performance.

Furthermore, the understanding of their responsibilities enables them to control agency problems, such as fraud among top managers, more effectively. Thus, a firm with more experienced internal accounting personnel is expected to control top managers more effectively by preventing them from seeking their personal interests, and by enabling the performance of better-quality CSR. This study establishes the following hypothesis:

H1: *A firm with more experienced internal accounting personnel will perform better-quality CSR.*

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RESEARCH MODEL

Identifying the Characteristics of Internal Accounting Personnel and Collecting CSR Data from the KEJI Index

The internal accounting control and organizational structure of Korean firms are reported in the Internal Accounting Control System Operational Report. It is one of the documents to be submitted when publicly listed firms report their business activities to the Financial Supervisory Service's Data Analysis, Retrieval and Transfer System (DART), and includes details on the number of internal accounting personnel, the average number of months of experience, affiliation or department, and information on the certified public accountants. To examine whether more experienced internal accounting personnel translated into better-quality CSR activity, this study collected information regarding the average number of months of experience among internal accounting personnel from the Internal Accounting Control System Operational Report and converted it into a logarithm, by considering the data distribution. In addition, the Korean Economic Justice Institute (KEJI) index was used to determine the quality of CSR activities performed by firms.

Under the auspices of the Citizens' Coalition for Economic Justice, the KEJI measures publicly listed firms for their CSR achievements and discloses a list of the top 200 firms in the KEJI index. The KEJI index consists of six evaluation items: soundness, fairness, contribution to social welfare, customer protection, environmental management, and employee satisfaction. This study considered the top 200 firms listed in the KEJI index to be the outperformers in CSR activity, assigning 1 to these firms and 0 to the others; further, the dummy variable was set accordingly.

Hypothesis Analysis Model

To test the hypothesis, we set the logistic regression model with CSRD as the dependent variable, which indicates whether a firm is included in the list of the top 200 CSR firms in the KEJI index, using IC, a natural logarithmic variable for the average number of months of experience of internal accounting control personnel, as the independent variable. If $\beta_1$for IC shows a positive value, it indicates that top managers in a firm with more experienced internal accounting personnel refrain from selecting CSR activities for personal gain, and thus, perform quality CSR activities in Table 1. The model is represented by the following equation.

$$CSRD_{i,t} = \beta_0 + \beta_1 IC_{i,t} + \beta_2 GROUP_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 LEV_{i,t} + \beta_5 MB_{i,t} + \beta_6 ROE_{i,t} + \beta_7 LARGE_{i,t} + \beta_8 FOREIGN_{i,t} + \sum IND + \sum YR + \varepsilon_{i,t} \quad (1)$$

Table 1
VARIABLE DEFINITIONS(n = 4,700)

CSRD	= 1 if a firm is included in the KEJI index as engaging actively in CSR, 0 otherwise
IC	= The log of the average work experience of internal control personnel in months
GROUP	= 1 if the firm belongs to a large business group (Chaebol), 0 otherwise
SIZE	= Log (total assets)
LEV	= Total liabilities/total assets

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MB	= The ratio of the market value to the book value of total assets
ROE	= Net income/total equity
LARGE	= Largest shareholder ownership
FOREIGN	= Foreign investor ownership

Sample Selection

This study tested the hypothesis on firms publicly listed in the Korea Composite Stock Price Index (KOSPI) from 2011 to 2018. The sample was selected by the following process: financial data and stock price information required for the analysis were extracted from Kis-Value. Work experience data of the personnel in charge of the internal accounting control system were manually collected from firms' business reports available from DART, while the KEJI index was used for CSR data. All variables except the dummy variable were winsorized at 1% and 99% to control for the effect of extremes on the results in Table 2.

Table 2
SAMPLE SELECTION

Sample selection process	No. of firms
Non-financial industry and non-December year-end firm observations from the Korea Stock Exchange (KSE) during the period 2011-2018	6,232
(Less) Firms with insufficient financial data	(643)
Final sample size used for the hypothesis	4,700

EMPIRICAL RESULTS

Descriptive Statistics and Correlations

Table 3
DESCRIPTIVE STATISTICS

Variable	N	Mean	Standard deviation	Min	Median	Max
CSRD	4,700	0.817	0.387	0.000	1.000	1.000
IC	4,700	4.610	0.646	-3.135	4.636	8.105
GROUP	4,700	0.270	0.444	0.000	0.000	1.000
SIZE	4,700	26.896	1.501	23.994	26.657	31.163
LEV	4,700	1.030	1.233	0.007	0.696	8.180
MB	4,700	1.322	1.226	0.208	0.946	7.493
ROE	4,700	0.015	0.217	-1.360	0.044	0.581
LARGE	4,700	0.435	0.165	0.089	0.435	0.841
FOREIGN	4,700	0.103	0.131	0.000	0.047	0.603

1) Variable definitions: See Table 1.

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Table 3 reports the descriptive statistics for the variables. IC is a natural logarithmic variable for the average number of months of experience of internal accounting control personnel, showing a mean value of 4.610, maximum of 8.105, and a minimum of -3.135. When converted into the average number of months of experience, the average number of months of experience of internal accounting control personnel is 124.5, with a maximum of 3,310 and minimum of 0.04.

Table 4 reports Pearson's correlations between the variables included in the model. IC showed a positive correlation with CSRD. The results show that firms with more experienced internal accounting personnel were more likely to perform better-quality CSR and be proclaimed as outperforming CSR firms. ROE, LARGE, and FOREIGN have a positive correlation with CSRD. This result suggests that a firm with higher profitability and greater largest-shareholder and foreign investor ownership voluntarily conducts better-quality CSR activities. However, as these results were derived from a univariate analysis, we also test the study hypothesis with multivariate analysis, which controls for other variables that may potentially affect CSRD. Furthermore, the variance inflation factor (VIF) for regression analysis, which includes the variables used in this study, was less than ten. Therefore, it is considered that the analysis results are unlikely to be distorted by multicollinearity.

Table 4
PEARSON'S CORRELATION

	CSRD	IC	GROUP	SIZE	LEV	MB	ROE	LARGE	FOREIGN
CSRD	1	0.092	-0.002	0.010	-0.219	-0.089	0.267	0.164	0.087
		(<.0001)	(0.8908)	(0.4892)	(<.0001)	(<.0001)	(<.0001)	(<.0001)	(<.0001)
IC		1	-0.189	-0.177	-0.075	-0.103	0.013	-0.001	-0.064
			(<.0001)	(<.0001)	(<.0001)	(<.0001)	(0.3916)	(0.9417)	(<.0001)
GROUP			1	0.628	0.063	-0.015	0.074	-0.013	0.281
				(<.0001)	(<.0001)	(0.3191)	(<.0001)	(0.3814)	(<.0001)
SIZE				1	0.132	-0.033	0.136	-0.049	0.514
					(<.0001)	(0.023)	(<.0001)	(0.0008)	(<.0001)
LEV					1	0.091	-0.483	-0.098	-0.131
						(<.0001)	(<.0001)	(<.0001)	(<.0001)
MB						1	-0.063	-0.162	0.186
							(<.0001)	(<.0001)	(<.0001)
ROE							1	0.106	0.169
								(<.0001)	(<.0001)
LARGE								1	-0.189
									(<.0001)
FOREIGN									1

1) Variable definitions: See Table 1.
2) Values in parentheses are p-values.

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Results

Table 5 reports the results of multivariate analysis for the hypothesis. If a firm with more experienced internal accounting personnel performs better-quality CSR, IC will show a positive coefficient. The results show that β_1, the coefficient for IC, is 0.335 (t-value=27.4929) and significant at 1%.

These results mean that personnel with a higher number of months of experience in internal accounting control and operational organization are more likely to regulate the agency problem created by top managers, thus leading to better-quality CSR, which makes the organization an outperforming CSR firm. The internal accounting control system includes an anti-corruption program intended to reduce agency problem costs by top managers, and decrease information asymmetry inside and outside the firm. The results in Table 5 suggest that more experienced internal accounting personnel effectively detect wrongdoing by top managers and reduce the effect of vested interests.

The results for the control variables confirmed that firms with higher ROE, LARGE, and FOREIGN were selected as outperforming CSR firms. These findings are consistent with the results of the aforementioned correlation analyses.

Table 5
THE EFFECT OF INTERNAL CONTROL ON CSR ACTIVITIES

Variables	Dep=CSRD	
	Coeff.	t-value
Intercept	2.699	5.2857**
IC	0.335	27.4929***
GROUP	0.100	0.6792
SIZE	-0.159	13.7461***
LEV	-0.102	7.728***
MB	-0.125	13.1312***
ROE	1.842	75.984***
LARGE	2.710	97.2791***
FOREIGN	3.447	46.2333***
Year Dummies	Included	
Industry Dummies	Included	
Model fit	Pseudo R^2	0.14
	Likelihood ratio	635.42***
Sample size	4,700	

1) Refer to Table 1 for variable definitions.
2) *, **, *** represent significance at the 10, 5, and 1% levels, respectively.

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CONCLUSION

Recently, CSR activities have been accepted as one of the critical factors that determine a firm's value and sustainability in the capital market. Accordingly, top managers approach CSR activities as a business strategy to enhance organizational value. However, CSR activities do not directly translate into a firm's performance but create costs, which potentially lead to agency problems. Therefore, this study attempted to examine whether the experience level of personnel in charge of the internal accounting control system enables proper control over decision-making by top managers and leads to better-quality CSR.

The results show that firms with more experienced personnel in internal accounting control systems were more likely to be included in the list of the top 200 CSR firms in the KEJI index. In other words, it was confirmed that a higher average number of months of experience in internal accounting work led to more efficient monitoring and control of decision-making by top managers, thereby curbing agency problems regarding CSR activities. These results suggest that a good corporate governance mechanism leads to CSR activities of better quality.

This study is significant as it tested the relationship between the level of internal accounting control system experience and the quality of CSR, thus noting that the agency problem may be caused by inappropriate intentions of top managers. In particular, the internal accounting control system in Korea requires the disclosure of information about personnel in charge of internal control, which allows the identification of the level of a firm's internal accounting control system. A follow-up study is needed to analyze the effect of the size of the control department, and the extent of inclusion of the people in-charge, on the quality of CSR.

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