InCAF PROCEEDING OF INTERNATIONAL CONFERENCE ON ACCOUNTING AND FINANCE

Volume 3, 2025, PP: 15-25

The influence of ESG scores on firm value: audit quality as a moderation variable

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Abstract

This study aims to provide empirical evidence of the influence of ESG scores on firm value (TobinsQ) and the influence of audit quality in moderating the influence of ESG on firm value. The population used in this study are companies that have ESG scores listed on the Indonesia Stock Exchange (IDX) for the 2021-2023 period. This study uses a sampling technique, namely purposive sampling. The sample companies are non-financial companies that have ESG scores and present complete financial reports. The results of the study prove that the ESG Score has a positive effect on firm value, which means that the higher the ESG Score, the higher the risk that investors must accept, resulting in a decrease in the company's value. The results of the study further prove that audit quality moderates the influence of ESG on firm value. Quality can play an important role in increasing the credibility of financial reports from companies that have ESG scores so that audit quality provides accurate and reliable information about a company's ESG performance, which can be used by investors to make more informed investment decisions

Keyword: Firm Value, ESG, Audit Quality.

INTRODUCTION

In recent decades, there has been increasing global awareness of environmental, social, and corporate governance (ESG) issues. Investors, consumers, and other stakeholders are increasingly paying attention to how companies operate not only in terms of profitability but also their impact on the environment, society, and good governance. ESG has become an important indicator in assessing corporate sustainability and social responsibility (Faller & Knyphausen-Aufseß, 2018; Eccles et al., 2014; Ionescu et al., 2019) coupled with the COVID-19 pandemic that hit the world in 2020.

In the stakeholder theory explained by Martínez-Ferrero & Frías-Aceituno (2015), company management is responsible for the decision-making process and must consider all or part of the interests of shareholders so that shareholders will give a positive reaction to the company's shares and have an impact on increasing company value. Stakeholder theory states that companies have a responsibility to create value for various stakeholders, and provides theoretical justification for the influence of ESG disclosure on company value. In this context, ESG disclosures provide stakeholders with useful information about a company's commitment to sustainability and social responsibility, which can help build their trust and reputation. This can produce various benefits for companies, such as increased access to capital, increased consumer loyalty and increased employee morale (Tarmuji et al., 2016, Alsayegh et al., 2020). For the case in Indonesia, the ESG score is divided into 5 categories, namely (1) Category 1 (Score 0-10), low impact on the environment and society. Negligible risk for the company, (2) Category 2 (Score 10-20), Moderate impact on the environment and society with minimal risk for the company, (3) Category 3 (Score 20-30), significant impact on the environment and society with significant business risk, (4) Category 4 (Score 30-40), high impact on the environment and society with high business risk, (5) Category 5 (Score >40), heavy impact on the environment and society with serious business risk has poor controversy management.

The credibility of ESG disclosures will be better if the company uses high audit quality so that audit quality can moderate the influence of ESG disclosures on company value. Higher audit quality provides assurance that the information presented is accurate and trustworthy. This can increase stakeholder trust in the company's commitment to sustainability and social responsibility, thereby improving stakeholder relationships and improving company performance. Conversely, poor audit quality can reduce trust and confidence in a company's ESG disclosures, which can result in reputation damage, weakened stakeholder relationships and a decrease in company value (Asante-Appiah, 2020, Zahid et al., 2022, Zahid et al.., 2023).

ESG disclosures are especially important when it comes to pollution from the chemical and petroleum industries, which may have negative impacts on the environment. Companies operating in these industries tend to have higher ESG performance because this performance needs to be improved and protect their reputation, otherwise this will affect the interests of shareholders López & Salmones, (2017), Hsiao & Kelly (2018) stated Voluntary disclosure or integrated reporting is a good way to communicate to the public or stakeholders about company performance, strategy and governance so that it has an impact on increasing company value. Currently, most companies, both listed and not, are starting to engage in disclosure. ESG (Yang et al., 2020, Hamed et al., 2022), in addition, ESG disclosure is used by managers as a tool to maximize the relationship between company value and its sustainable growth (Wahba, 2008, Popa et al., 2021).

Previous research examining the effect of ESG disclosure on company value has mostly been researched in developed countries and there is still limited research conducted in developing capital markets such as Indonesia. This creates a gap in research results that needs to be re-examined on the influence of ESG disclosure practices on company value in different business and capital market environments so as to provide deeper insight into the challenges, opportunities and impacts of ESG disclosure practices.

Other research linking ESG performance and company value uses legitimacy theory. Deegan & Blomquist (2006) and Cho & Patten (2007), Hardiyansah et al., (2021) and Noor & Ginting (2022) state that companies have responsibilities and obligations towards society, such as sustainability reports and other non-financial voluntary disclosures. periodically; where non-financial disclosures may be seen as a means of legitimation. The legitimation process can be obtained from the company's perspective as a method for setting expectations and finding indicators related to the external environment and revealing the level of compliance with policies.

From several previous research results, there are several gaps in the research results. Gaps in the relationship between ESG disclosure and firm value. Some studies show a direct relationship between ESG disclosure practices and company value, while others find that this relationship is not direct. This suggests that other factors, such as corporate reputation, consumer awareness, or industry factors, may mediate the relationship between ESG disclosure and firm value. Regional and industry gaps. Some studies may focus more on specific markets and industries, such as research emphasizes on the Egyptian market. This may create gaps in the generalizability of findings, as market and regulatory conditions can vary significantly across regions and industry sectors. Gaps in understanding the mechanisms between ESG disclosure and firm value. Although many studies show a positive relationship between ESG disclosure and firm value, the underlying mechanisms may not always be clearly understood. This creates a gap in understanding of how ESG practices directly or indirectly impact firm value.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Literature Review and Hypothesis Development

Several previous studies such as research by Clarkson et al., (2008), Jizi et al., (2014), Chouaibi & Zouari (2022) stated that stakeholder theory is a conceptual framework that recognizes that companies are not only responsible to shareholders. , but also to various parties who have an interest or stake in the company's operations and success, such as employees, customers, suppliers, local communities, the environment and government. In the context of ESG (Environmental, Social, and Governance) disclosure and corporate value, stakeholder theory explains that companies actively interact with

various stakeholders in making strategic and operational decisions. In the context of company value, stakeholder theory emphasizes that company value is not only reflected in financial aspects, but also in how the company pays attention to the interests and needs of various stakeholders. When companies pay attention to and respond well to stakeholder interests, this can increase trust and support from various related parties, including investors. Thus, the principles of stakeholder theory explain that the existence of a company cannot be separated from its social responsibility towards stakeholders, and that managing relationships with stakeholders positively can contribute to firm value and attract investor interest. Legitimacy theory is a framework used to explain how organizations attempt to maintain or increase their legitimacy in the eyes of stakeholders by taking into account prevailing social norms. (Cho et al., 2015; Abdullah et al., 2019; Saher et al., 2023). Legitimacy theory can be used to explain how companies seek to maintain or enhance their legitimacy through ESG disclosures and practices.

Social disclosure in ESG and corporate value are interrelated in the context of Long & Driscoll's (2008) legitimacy theory. Good ESG disclosure can increase a company's legitimacy by strengthening transparency, accountability, reputation, risk management, innovation and regulatory compliance. This in turn can increase firm value by improving stakeholder perceptions of the long-term value and sustainability of the firm.

Through ESG disclosures, companies demonstrate their commitment to transparency and accountability. They provide information about their business practices, social and environmental impacts, and efforts to improve their performance in these areas. This can increase a company's legitimacy by showing that they are not only focused on financial profits, but also care about relevant social and environmental issues (Cho & Patten, 2007).

Elsayed & Paton's (2005) research shows that there is a significant relationship between environmental performance and company performance. The results of further research prove the importance of environmental performance in creating long-term value for companies. The results provide support for the view that sustainable and environmentally responsible business practices are not only important for environmental sustainability, but can also improve a company's overall financial performance. Al-Najjar & Anfimiadou (2012) prove that companies that implement environmentally friendly strategies experience an increase in company value as measured by return on assets (ROA), return on equity (ROE), and Tobin's Q. Research results illustrates that environmental initiatives are not only good for the environment but also financially beneficial for companies. Good environmental policies not only help companies fulfill corporate social responsibilities but also increase the company's value in the market.

Servaes and Tamayo's (2013) research shows that there is no direct relationship between corporate social performance and company value. However, this research finds that advertising expenditure is a mediator in the relationship between CSR and company value. Advertising spending is considered a proxy for the visibility of a company's social behavior to investors. Plumlee et al., (2015) research shows that environmental disclosure has a significant impact on investor decisions. Investors tend to place a higher value on companies that are actively involved in environmental initiatives, even if the information does not provide a clear direct financial benefit. This shows that investors consider environmental aspects as an important factor in making their investment decisions.

Dienes et al. (2016) tested the influence of corporate governance mechanisms on environmental reporting and the research results proved that good corporate governance has a positive effect on better environmental reporting practices. The results of this research prove that strong corporate governance can encourage companies to be more responsible for the environment social disclosure in ESG and corporate value are interrelated in the context of Long & Driscoll's (2008) legitimacy theory. Good ESG disclosure can increase a company's legitimacy by strengthening transparency, accountability, reputation, risk management, innovation and regulatory compliance. This in turn can increase firm value by improving stakeholder perceptions of the long-term value and sustainability of the firm. On the other hand, low ESG disclosure results in a higher level of company risk, which is indicated by a higher ESG score, which in turn will increase investors' perception of investment risk, which will result in a decrease in company value.

Legitimacy theory suggests that organizations need legitimacy from various stakeholders to survive and develop. Social disclosure in ESG is one way for companies to gain and maintain legitimacy from external stakeholders, such as the general public, investors, governments and NGOs. Through ESG disclosures, companies demonstrate their commitment to transparency and accountability. They provide information about their business practices, social and environmental impacts, and efforts to improve their performance in these areas. This can increase a company's legitimacy by showing that they are not only focused on financial profits but also care about relevant social and environmental issues (Cho & Patten, 2007).

Elsayed & Paton's (2005) research uses empirical data to explore the relationship between environmental performance and company performance. The research results show that there is a significant relationship between environmental performance and company performance. In other words, companies that have better environmental performance tend to have better financial performance as well. The results of further research prove the importance of environmental performance in creating long-term value for companies. The results provide support for the view that sustainable and environmentally responsible business practices are not only important for environmental sustainability but can also improve a company's overall financial performance.

Good audit quality is considered capable of increasing the credibility of a company's financial and non-financial reports. A high-quality audit can provide investors with confidence that the ESG-related information presented by the company is accurate and reliable. Therefore, audit quality can moderate the influence of ESG on company value, strengthening investor confidence in the ESG information provided.

The negative impact of environmental, social and governance (ESG) disclosures affects audit efforts and audit quality carried out by auditors in carrying out the audit process with the aim of increasing the credibility of financial reports (Asante-Appiah, 2020). The results of the research prove that auditors tend to increasing audit efforts when a client has a negative reputation regarding ESG. This negative reputation can stem from adverse environmental incidents, unethical social practices, or significant governance failures. Increased audit effort includes more time spent examining financial statements, performing more audit procedures, and evaluating risks more rigorously. Auditors do this to reduce their own risk associated with auditing a disreputable client. Auditors are increasing audit effort and quality because they are aware that companies with a negative ESG reputation are at higher risk of engaging in inaccurate or unethical financial reporting. Auditors also want to avoid the negative impact on their own reputation that could arise from an audit that fails to identify or address major problems within the client company.

Al-Najjar & Anfimiadou (2012) prove that companies that implement environmentally friendly strategies experience an increase in company value as measured by ROA, ROE, and Tobin's Q. The research results illustrate that environmental initiatives are not only good for the environment but are also financially beneficial for the company. Good environmental policies not only help companies fulfill corporate social responsibilities but also increase the company's value in the market.

Abdelfattah & Aboud (2020) stated that with the ESG index, investors are provided with disclosure of companies whose performance is determined by the ESG characteristics of each company thereby creating incentives for companies to improve their performance in terms of environmental, social and corporate governance in order to meet investor expectations regarding ESG issues. Aydoğmuş et al., (2022) research concluded that companies with high ESG performance tend to have higher company value. Empirical findings further prove that high ESG performance has a positive relationship with profitability (ROA and ROE). Companies that prioritize ESG practices reduce operational risk and increase efficiency. Abdi et al., (2022) research shows that there is a positive relationship between ESG disclosure and company value, which means that companies that are more active in disclosing ESG information have higher company value. From the research results above, the hypothesis proposed is:

H1: ESG scores have a negative effect on fim value

High audit quality increases transparency, reduces risk, and lowers the cost of capital, all of which contribute to increased company value. Therefore, both companies, investors and regulators must pay more attention to aspects of audit quality to support the growth and stability of the capital market in Indonesia. The negative impact of environmental, social and governance (ESG) disclosures affects audit efforts and audit quality carried out by auditors in carrying out the audit process with the aim of increasing the credibility of financial reports (Asante-Appiah, 2020). The results of the research prove that auditors tend to increasing audit efforts when a client has a negative reputation regarding ESG. This negative reputation can stem from adverse environmental incidents, unethical social practices, or significant governance failures. Increased audit effort includes more time spent examining financial statements, performing more audit procedures, and evaluating risks more rigorously. Auditors do this to reduce their own risk associated with auditing a disreputable client. Auditors are increasing audit effort and quality because they are aware that companies with a negative ESG reputation are at higher risk of engaging in inaccurate or unethical financial reporting. Auditors also want to avoid the negative impact on their own reputation that could arise from an audit that fails to identify or address major problems within the client company.

High audit quality increases transparency, reduces risk, and lowers the cost of capital, all of which contribute to increased company value. Therefore, both companies, investors and regulators must payi more attention to aspects of audit quality to support the growth and stability of the capital market in Indonesia. Wijaya's research (2020) proves that audit quality has a positive effect on company value. Research by Samy El-Deeb et al., (2023) proves that audit quality moderates the positive influence of ESG disclosure on company value. This shows that companies that are more active in disclosing information about their environmental, social and governance practices tend to have higher corporate value.

From several previous studies, the second hypothesis proposed:
H2: Audit quality moderates the influence of ESG scores on firm value

METHODS

This research is explanatory research. Research is carried out on the basis of theory and empirical facts using secondary data sources and combined with research method designs to find relationships between phenomena and research findings so that they can be generalized to a predetermined population. The population used in this study are companies that have ESG scores listed on the Indonesia Stock Exchange (IDX) for the 2021-2023 period. This study used a sampling technique, namely purposive sampling, with a technique based on considerations (judgement sampling) which is a type of non-random sample selection whose information is obtained using certain considerations (Sekaran, 2006). The sample companies are non-financial companies that have ESG scores and present complete financial reports

The dependent variable in this study is Firm Value. Firm Value (Tobin's Q) in this study uses the research proxy of Ismail & El-Deeb (2022) and Samy El-Deeb et al., (2023) with the formula:

$$\text{Tobin's Q} = \frac{Stock\ Market\ Value}{Total\ Assets}$$

The independent variable in this study is the ESG (environmental; social and governance) score issued by the Indonesia Stock Exchange, presented in table 1 below

Table 1. ESG Scoring Criteria

Index Score	Category	Description	Level
0-10	Negligible	ESG risk is considered negligible	5
10-20	Low	ESG risk is likely to be low	4
20-30	Medium	Estimated moderate ESG risk	3
30-40	High	Considered a high ESG risk	2
>40	Severe	ESG at severe risks	1

ESG Score = $\sum Environment + \sum Social + \sum Goverment$

The moderating variable in this study uses the audit quality (AQ) variable (Kusumah & Manurung, 2017, Samy El-Deeb et al., 2023, Zahid *et al.*, 2023). The audit quality variable uses the BIG4 proxy which is a dummy variable, namely if the Public Accounting Firm is affiliated with BIG4 and has a value of 0 if it is not affiliated with BIG4. The Public Accounting Firms affiliated with BIG4 are presented in table 2 below.

Table 2. KAP affiliated with BIG4

No	KAP BI4	Affiliated KAP
1	PwC (PricewaterhouseCoopers	KAP Tanudiredja, Wibisana, Rintis & Rekan
2	EY (Ernst & Young)	KAP Purwantono, Suherman dan Surja
3	Deloitte Touche Tohmatsu	Satrio Bing Eny & Rekan
		KJPP Lauw & Rekan
		Hermawan Juniarto & Partners
4	KPMG	Siddharta Widjaja & Rekan

The control variables used in this study use proxies from research (Konar & Cohen, 2001, Serrasqueiro & MaçÃs Nunes, 2008, Dal Maso *et al.*, 2017) (Samy El-Deeb *et al.*, 2023).

FSIZE = LN (Total Assets)

LEV $= \frac{Total\ Debt}{Total\ Assets}$

ROE $= \frac{Net\ Income}{Total\ Equity}$

The regression equation model in this research is presented as follows:
Regression Model for Hypothesis 1

$TOBIN'sQ = \beta_0 + \beta 1ESG_{it} + \beta_2 FSIZE_{it} + \beta_3 ROE_{it} + \beta_4 LEV_{it} + \varepsilon_{it}$

Regression Model for hypothesis 2:

$TOBIN'sQ = \beta_0 + \beta_1 ESG_{it} + \beta_2 AQ_{it} + \beta_3 ESG_{it}{*}AQ_{it} + \beta_4 FSIZE_{it} + \beta_5 ROE_{it} + \beta_4 LEV_{it} + \varepsilon_{it}$

RESULT AND DISCUSSION

The dependent variable in this research is company value (TobinsQ), the independent variable is ESG, the moderating variable is audit quality, which is a dummy variable, and the control variables in the research use company size (FSIZE), leverage, and profitability (ROE). The descriptive statistics for all research variables used are presented in Table 3 below.

Table 3. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
TOBINS	215	0.0325	32.0856	1.167644	2.4962496
ESG	215	3	97	79.374558	17.2982059
AQ	215	0	1	0.36	0.481
SIZE	215	24.5096	33.6552	28.872063	1.8655920
LEV	215	0.0004	3.2529	0.511004	0.3670094
ROE	215	-4.9623	2.7588	0.079173	0.5502142

Source: Processed Secondary Data, 2024

The Tobins Q variable has a maximum value of 32.085, which means the company has a market value of assets that is higher than the book value of its assets. On average, the companies sampled in the research have a Tobins Q value above 1, so on average, the companies have a market value of assets that is greater than their book value. The average ESG score is 79.374558, which

illustrates that on average the companies sampled in this study have ESG at severe risks. The average audit quality variable (AQ) is 0.36, which means that 36% of the companies sampled in this study were audited by BIG4 KAPs and 64% were audited by non-BIG4 KAPs. The average size of the companies sampled in this study is 28.872063, which means that the average company sampled in this study is a company with a fairly large asset size. The average variable leverage of the companies sampled in this study is 0.511004, which means the company's debt is 51.1004% of the total assets owned by the company. The company's profitability variable as measured by ROE has an average value of 0.079173, which means that the company is able to generate a net profit of 7,913% of the total equity owned by the company.

The Influence of ESG Scores on Firm Value

The first hypothesis testing is aimed at proving that ESG scores have a negative effect on firm value and the regression results are presented in table 4 below.

Table 4. Hypothesis Testing 1

$TOBIN'sQ = \beta_0 + \beta_1 ESG_{it} + \beta 2FSIZEeit + \beta_3 ROE_{it} + \beta_4 LEV_{it} + \varepsilon_{it}$			
Variabel	**Koefisien**	**t**	**Sig**
Konstanta	2.860	4.659	0.000
ESG	**-0.006**	**-2.584**	**0.011**
FSIZE	-0.073	-2.986	0.003
LEV	-0.676	-4.762	0.000
ROE	-0.018	-0.155	0.877
R Square	0.207		
Adjusted R Square	0.183		
F	8.682		
Sig.	0.000		

Source: Processed Secondary Data, 2024

Regression testing shows that the research variables are able to explain their influence on company value (TobinsQ) by 18.3% and the rest is explained by other variables not included in the regression model. The regression results of the ESG score variable show a negative and significant regression coefficient on company value. A negative regression coefficient indicates that the higher the ESG score, the lower the company value. Investors view companies with high ESG scores as companies that have a high level of risk which will reduce the company's value. The results of this research confirm stakeholder theory, where within the framework of stakeholder theory, good ESG disclosure can increase stakeholder trust and satisfaction, which in turn can increase company value in the long term. This is because companies that pay attention to ESG tend to be more sustainable, more valued by consumers, have lower risk, and may have better access to capital. The results of this research do not support the research of Samy El-Deeb et al., (2023) which proves that ESG performance has a positive effect on firm value. Testing of the control variables proves that company size (FSIZE) and leverage have a negative and significant regression coefficient which indicates that the smaller the company size and the lower the debt level, the higher the firm value.

The Effect of Audit Quality in Moderating the Effect of ESG on Firm Value

The second hypothesis testing is aimed at testing the influence of audit quality as a moderating variable in explaining the influence of ESG on company value, where to reduce the high risk of a high ESG score, audit quality will reduce the risk of ESG risk. The test results are presented in Table 5.

The regression results show that all research variables are able to explain their influence on company value by 17.5%, and the remaining 82.5% is explained by other variables not included in the regression model. The regression results for the moderating variable of audit quality in explaining the influence of ESG on company value have a positive and significant regression coefficient. This shows that audit quality plays a role in improving the quality of financial reports when companies have high

ESG risks, thereby having an impact on increasing company value. The results of this research support research by Asante-Appiah (2020), which proves that auditors tend to increase audit efforts when clients have a bad negative reputation regarding ESG. The results of this research also support Wijaya's (2020) research, which proves that audit quality has a positive effect on company value, and research by Samy El-Deeb et al., (2023) proves that audit quality moderates the positive influence of ESG disclosure on company value. This shows that companies that are more active in disclosing information about their environmental, social, and governance practices tend to have higher corporate value. This research supports legitimacy theory, where companies need legitimacy from various stakeholders to survive and develop. Social disclosure in ESG is one way for companies to gain and maintain legitimacy from external stakeholders.

Table 5. Results of testing the audit quality variable as a moderating variable

$$TOBIN'sQ = \beta_0 + \beta_1 ESG_{it} + \beta_2 AQ_{it} + \beta_3 ESG_{it}*AQ_{it} + \beta_4 FSIZE_{it} + \beta_5 ROE_{it} + \beta_4 LEV_{it} + \varepsilon_{it}$$

Variabel	Koefisien	t	Sig
Konstanta	2.665	5.970	0.000
ESG	**-0.005**	**-2.811**	**0.005**
ESG_{it}*AQ	**0.002**	**2.682**	**0.008**
FSIZE	**-0.089**	**-4.522**	**0.000**
LEV	**-0.364**	**-4.102**	**0.000**
ROE	**-0.146**	**-2.623**	**0.009**
R Square	0.197		
Adjusted R Square	0.175		
F	8.882		
Sig.	0.000		

Source: Processed Secondary Data, 2024

CONCLUSION

The research results provide empirical evidence that ESG scores have a negative effect on other companies. In accordance with the descriptive statistics for the ESG variable, it shows that the average company that has an ESG score is ESG at severe risk, so investors consider higher ESG risks in their investment decisions, which has an impact on the decline in the firm value. The results of further research prove that quality moderate audits positively, and the significant influence of ESG on company value. The research results prove that high audit quality can increase the credibility of financial reports when a company has high ESG risk, thereby increasing firm value.

The results of this research confirm legitimacy theory and stakeholder theory where disclosure is one of the strategies that can be used by companies in providing information to stakeholders. Accurate ESG disclosure reflects the social and environmental impact of a company's operations so companies must participate in ESG disclosure for the benefit of stakeholders. Having a quality audit can give investor confidence that the ESG-related information presented by the company is accurate and reliable

This research makes a contribution to academics, namely it is hoped that it will contribute to the development of literature on ESG and company performance by highlighting the importance of audit quality in explaining the influence of ESG on company value so that it becomes the basis for further research. For practitioners, this research suggests that companies listed on the Indonesia Stock Exchange can focus more on ESG reporting so that companies are not at high risk which has a negative impact on company value. This research also has the implication that financial reports audited by quality auditors provide more useful information for investors in investing when the company has quite high risks. This research has several limitations, including (1) the number of companies with ESG scores is still very limited, (2) the observation period is relatively short. Future research can add the variables duality of the board of directors, ownership concentration, foreign ownership as moderating variables

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