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Connection Between the Audit Characteristics and Corporate ESG Performance in Indonesia

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ABSTRACT: This research delves into the essential connection between audit committee characteristics and the ESG performance of corporations in Indonesia. Existing studies emphasize the pivotal role of audit committees in shaping ESG outcomes, focusing on factors like independence, expertise, and committee size. However, there is a limited comprehensive examination of these dynamics within the context of Indonesian businesses. The study seeks to empirically examine the correlation between audit committee characteristics and corporate ESG performance among listed companies on the Indonesia Stock Exchange, explicitly exploring four key attributes. The results highlight a noteworthy influence of Audit Expertise and Internal Auditor characteristics on corporate ESG performance. These findings provide valuable insights for companies, auditors, and policymakers, offering empirical evidence to enhance comprehension and practices related to corporate governance and ESG performance. Furthermore, the study's implications extend beyond the Indonesian context, contributing to a broader understanding of the global discourse on sustainable business practices.

KEYWORDS: Include at least 5 to 6 keywords or phrases

I. INTRODUCTION

Increased attention to environmental, social, and corporate governance (ESG) aspects has increased interest in companies' ESG performance from various stakeholders. Therefore, studying the relationship between audit committees and company ESG performance is crucial to increase company transparency and accountability on ESG issues. This study investigates the relationship between audit committee characteristics and the ESG performance of companies in Indonesia.

Previous research shows that audit committee characteristics are essential in improving a company's ESG performance. For example, Pozzoli et al. (2022) found that the audit committee's independence, expertise and size significantly influenced the ESG performance of companies in Indonesia, South Korea and Australia [1]. Likewise, Arif et al. (2020) stated that audit committee attributes such as independence, financial expertise, and meeting frequency positively influence the quality and quantity of ESG disclosures [2]. In addition, Zahid et al. (2022) stated that audit quality significantly impacts the ESG-corporate financial performance relationship in companies in Western Europe [3]. On the other hand, the Giudice & Rigamonti (2020) study emphasizes that audits improve the quality of ESG scores, especially in corporate violation cases [4]. These studies show that audit committees play an essential role in ensuring the accuracy and completeness of ESG disclosures and improving a company's ESG.

The urgency of this research lies in the importance of increasing company transparency and accountability regarding ESG issues. The findings of this research can provide insights for companies, auditors and policymakers to improve ESG performance and disclosure. Furthermore, this research can contribute to the literature on corporate governance and ESG performance by providing empirical evidence on the relationship between audit committees and corporate ESG performance.

II. LITERATURE REVIEW

According to Eisenhardt (1989), agency theory states that there is a principal-agent relationship between shareholders (principals) and management (agents). According to this theory, the agent may have different goals from the principal, giving rise to a conflict of interest [5]. This conflict can arise due to information asymmetry, where the agent has more information about the company than the principal. In such situations, principals may need to rely on mechanisms such as monitoring and incentives to align agents' interests with their own.

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The audit committee plays an important role in monitoring management actions and ensuring that financial reports are accurate and reliable. In this context, the audit committee is a mechanism for aligning management interests with the interests of shareholders.

Stakeholder theory, on the other hand, argues that companies should be responsible not only to their shareholders but also to other stakeholders such as employees, customers, suppliers, and the environment. In this theory, the focus is on the long-term sustainability of the company and the creation of value for all stakeholders.

ESG performance measures a company's environmental, social and governance practices. Stakeholder theory suggests that companies prioritising ESG performance will create long-term value for stakeholders and improve their financial performance. Research has shown that companies with higher ESG scores tend to have lower risk profiles, better operational performance, and higher financial returns.

Research on the relationship between audit committees and ESG performance is still limited, especially in the context of the COVID-19 pandemic. However, existing literature suggests that audit committees can be crucial in promoting ESG performance. For example, a study by Jizi et al. (2014) found that companies with stronger audit committees tend to have higher sustainability ratings [6]. Furthermore, research by Aggarwal et al. (2021) shows that the audit committee can positively influence a company's environmental disclosure.

Overall, agency and stakeholder theories provide insight into the relationship between audit committees and corporate ESG performance. By reducing agency costs and encouraging stakeholder engagement, audit committees can help companies achieve long-term sustainability and create value for all stakeholders.

Companies, auditors and policymakers to improve ESG performance and disclosure. Furthermore, this research can contribute to the literature on corporate governance and ESG performance by providing empirical evidence on the relationship between audit committees and corporate ESG performance.

III. METODE

This research aims to analyze and provide empirical evidence about the relationship between audit committees and company ESG performance. The object of this research is companies listed on the Indonesian Stock Exchange. This research is quantitative research using data obtained from financial reports, annual reports, and other quantitative data through the Refinitiv Eikon database. The total number of companies analyzed in this research was 90, with an observation period of 10 years, 2013-2022. The independent variables in this research are the characteristics of the audit committee, which are represented by four characteristics, namely Audit Committee Expertise (ACE), Audit Committee Independence (ACI), Auditor Tenure Score (ATS), and Internal Audit Reporting Score (IAS). The dependent variable examined in this research is ESG performance, as shown in the ESG Score measurement.

This research analyzes the influence of audit committee characteristics on environmental, social and governance (ESG) performance. The data analysis technique in this research uses the panel regression method using the Eviews 9.0 application. This research uses unbalanced panel analysis where cross-sectional units do not have the same number of time-series observations. The regression equation model for this research is formulated as follows.

$$ESG_{it} = \alpha + \beta_1 ACE_{it} + \beta_2 ACI_{it} + \beta_3 ATS_{it} + \beta_4 IAS_{it} + \varepsilon_{it}$$

To estimate model coefficients with panel data, the EVIEWS program provides several techniques, namely the Common Effect Model, Fixed Effect Model, and Random Effect Model. From the three models that have been estimated, one model will be chosen as most appropriate/suitable for the research objectives. There are test stages that can be used to select a panel data regression model (CE, FE or RE) based on the characteristics of the data held, namely Chow Test and Hausman Test.

Table 1. Panel Data Regression Model Selection Test

	Hipotesis	Kriteria Pengujian
Chow-Test	H0: Common Effect (CE) H1: Fixed Effect Model (FE)	H0: not accepted if p-value < α (5%)
Hausman-Test (after Chow-Test)	H0: Random Effect Model H1: Fixed Effect Model	H0: not accepted if p-value < α (5%)
Lagrange-Test (after Hausman-Test)	H0: Common Effect Model H1: Random Effect Model	H0: not accepted if p-value < α (5%)

If the Chow test results show a p-value > 0.05, which means that the selected model is the Common-Effect Model, then the Hausman test and Lagrange Test does not need to be carried out.

IV. HASIL DAN PEMBAHASAN

This research investigates the influence of audit committee characteristics on the ESG performance of companies in Indonesia. This research provides insight for companies, auditors, and policymakers to improve ESG performance and disclosure. This research can also contribute to the literature on corporate governance and ESG performance by providing empirical evidence about the relationship between audit committees and corporate ESG performance. In the table below, we present the results of descriptive analysis on all research variables.

Table 2. Descriptive Analysis

	ESG_SCORE	ACE	ACI	ATS	IAS
Mean	47.56268	19.78965	49.78814	50.56564	47.82987
Median	47.47307	5.854273	61.44578	52.97619	59.52381
Maximum	88.85740	75.92483	71.79487	96.42857	68.94737
Minimum	5.753849	3.138061	0.574713	0.595238	0.000000
Std. Dev.	20.29702	27.98117	23.58756	27.87001	26.29057

Based on the Chow test, Hausman test, and Lagrange test results, the appropriate regression model for this research data is the Random-Effect Model. The table below summarises the results of regression testing of this research data.

Table 3. Panel Regression Result

		ESG Score Indonesia	Hypothesis Result
		REM β (p-value)	
Constanta	C	33.7431 (0.000)	
Audit Committee Expertise	X_ACE	**0.0389* (0.063)**	Accepted
Audit Committee Independence	X_ACI	0.0202 (0.530)	Not Accepted
Audit Tenure Score	X_ATS	0.0050 (0.825)	Not Accepted
Internal Audit Score	X_IAS	**0.1824*** (0.000)**	Accepted
R Square		**5.00%**	
Adj-R Square		**4.19%**	

*** Correlation is significant at the 0.01 level

** Correlation is significant at the 0.05 level

* Correlation is significant at the 0.10 level

Based on the analysis results, it shows that the Audit Committee Expertise Score and Internal Audit Score have a positive effect on the Company's ESG performance, further discussion as follows.

A. *The Influence of Expertise Audits on ESG Performance*

Companies have social obligations to the surrounding environment and society and are closely related to moral hazard responsibility [7]. An audit committee with financial and accounting expertise can help improve ESG performance, especially in presenting sustainability reports [8]. Auditors will enhance their abilities in carrying out tasks, overseeing financial and non-financial reporting and the company's internal controls [2]. Financial and accounting expertise will help auditors in their supervisory function by providing in-depth questions to company management regarding the financial and non-financial activities that have been carried out [9]. A quality audit committee will increase the efficiency of the company's performance and make it easier for members to carry out their duties as an audit committee [10], [11]. Disputes between auditors and management [12], translating the auditor's scope of work [13], and reviewing audit findings [14] can be increased in efficiency through auditors with special skills. Thus, more auditors who have expertise will reduce agency problems [8] related to conveying information to stakeholders

The audit committee also ensures that the company has carried out its social, environmental and social responsibilities which have a long-term impact on stakeholders [15]. Companies with quality auditors tend to be more proactive and comprehensive in carrying out social duties because of the experience and strict supervision of the auditors [16]. Companies will try their best to carry out their social obligations to increase their environmental and social performance [17]. Therefore, the audit committee's effectiveness will be increased according to its financial expertise in accordance with the characteristics of the company's operations [18]. N However, an audit committee with particular expertise cannot fully guarantee improving ESG performance [19]. The effectiveness of auditor monitoring requires financial expertise that makes audit members contribute to developing internal management controls [20]. This deficiency can make auditors more likely to rely on external auditors' opinions [8]. Therefore, management must have maximum control even though the company has auditors

B. The Influence of Internal Auditor on ESG Performance

Internal auditors are widely involved in resolving cases related to ESG [17]. Internal auditors provide independent assessments of company performance, governance systems and social responsibility [21]. Viewed based on the ESG context, internal auditors are tasked with program audit activities, ESG disclosures, and facilitating management's self-assessment of ESG results and evaluation [22]. This will expand internal auditors' duties in ensuring compliance and facilitating ongoing consultation on corporate social obligations [23]. Internal auditors also need appropriate skills, expertise and techniques to maximize company performance [24]. Investigating the skills and competencies of internal auditors today requires internal auditors who can handle social, economic and environmental issues [25]. Thus, the company's ESG performance will increase because internal auditors have sufficient experience in areas related to ESG.

The internal audit profession needs to think about the best way to meet the needs and challenges of work in overseeing a company's ESG performance [26]. Internal auditors must have excellent and sustainable leadership to define their work and add value to the company in the eyes of stakeholders [27]. The focus on economic, social and environmental issues is of particular concern to auditors [28], because in presenting information with different stakeholders, more detailed information related to ESG may be needed [4]. This can also happen when the public expects to improve the company's ESG performance [13], efore internal auditors are required to help handle cases and the public's expectations of the company [2]. Internal auditors must optimally allocate limited human resource management to improve the company's ESG performance.

CONCLUSION

The results of this research show that audit expertise and internal audit positively affect the company's environmental, social and governance (ESG) performance. Increasing the number of independent audit committee members increases monitoring efforts and improves ESG performance. The addition of accounting or finance experts to the audit committee also plays a role in enhancing ESG performance. This research provides valuable insights into how audit committee characteristics influence ESG performance, highlighting the importance of strong reporting and monitoring entities in driving sustainability and engaging stakeholders.

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