CHAPTER I

INTRODUCTION

1.1 Background of the Research

Audit quality is a fundamental aspect of the auditing profession, as the reliability and credibility of corporate financial reporting depend on rigorous, high-quality audits. Audit quality reflects the auditor's capacity to detect and report material misstatements while upholding objectivity and exercising professional skepticism throughout the audit process. Elevated audit quality fosters investor confidence, mitigates information asymmetry between management and stakeholders, and facilitates more efficient capital market decision-making (Hazaea et al., 2025; Zahid et al., 2022). Furthermore, regulators, investors, and other stakeholders increasingly demand enhanced audit quality to promote corporate transparency and accountability.

The notion of audit quality has evolved alongside the growing importance of non-financial reporting. In addition to evaluating financial information, auditors are increasingly expected to understand sustainability-related risks and non-financial disclosures that may influence corporate performance and stakeholder decision-making (Dierynck & Weijers, 2026). Consequently, the expanding role of auditors in providing assurance over sustainability disclosures has made audit quality an increasingly important issue in corporate reporting (Li et al., 2025).

ESG practices have become critical metrics for investors, creditors, regulators, and the public to assess corporate sustainability and long-term risk exposure. Firms with strong ESG performance are generally viewed as better able to manage risks, preserve their reputation, and create long-term stakeholder value (Zahid et al., 2022). As demand for sustainability information grows, companies increasingly publish sustainability reports to communicate their environmental, social, and governance performance and demonstrate their commitment to sustainable business practices (Li et al., 2025).

The rapid development of ESG reporting has also raised concerns regarding the credibility of sustainability information disclosed by companies.. ESG information is non-financial, lacks comprehensive standardization, and poses considerable verification challenges for stakeholders. This situation creates information asymmetry between corporations and report users. Moreover, the proliferation of greenwashing, often referred to as ESG washing, has intensified concerns regarding the reliability of sustainability disclosures. Greenwashing refers to the practice of companies exaggerating their sustainability efforts to cultivate a favorable corporate image without implementing substantial sustainability initiatives. Previous studies have shown that ESG-washing practices can increase information risk and undermine the credibility of sustainability disclosures. Therefore, independent ESG report assurance has become increasingly important to enhance the reliability of ESG information and reduce stakeholder concerns regarding greenwashing (Gielen, 2024; Zhou & Lou, 2026).

Besides concerns regarding greenwashing, another important challenge in ESG reporting is the inconsistency of ESG ratings assigned by different rating agencies. This inconsistency increases uncertainty surrounding ESG information and encourages stakeholders to demand independent assurance over corporate sustainability reports. In this context, ESG report assurance is important because it can enhance the reliability and credibility of the sustainability information companies disclose (Gielen, 2024).

To address concerns regarding the credibility of sustainability reporting, companies increasingly obtain independent ESG report assurance. ESG report assurance is an independent verification process that ensures sustainability information is prepared in accordance with applicable standards (Li et al., 2025). Independent assurance is expected to reduce the risk of greenwashing and enhance stakeholder confidence in sustainability reporting (Gielen, 2024; Zhou & Lou, 2026). Recognizing the growing importance of credible sustainability reporting, regulators in many jurisdictions have introduced regulations and reporting standards to improve the quality and reliability of ESG disclosures. In Indonesia, these efforts are reflected in Financial Services Authority (Otoritas Jasa Keuangan/OJK) Regulation No. 51/POJK.03/2017 concerning the Implementation of Sustainable for Financial Services Institutions, Issuers, and Public Companies. The regulation requires financial institutions, issuers, and public companies to implement sustainable finance principles and prepare sustainability reports that disclose economic, social, environmental, and governance performance. Since the implementation of the regulation, the number of companies publishing sustainability reports in Indonesia has continued to increase, indicating that ESG disclosure has become an increasingly important component of corporate governance practices among public companies.

Independent ESG assurance is expected to improve audit quality by enhancing the credibility and reliability of sustainability disclosures. Through independent verification, auditors evaluate whether ESG information is prepared in accordance with applicable standards, thereby enhancing the credibility of sustainability disclosures and strengthening stakeholder confidence (Gielen, 2024; Li et al., 2025). In addition to ESG assurance itself, the characteristics of the assurance provider may also influence audit quality. One important aspect is whether the same accounting firm performs both the financial statement audit and ESG assurance engagement. The use of the same accounting firm for both financial statement audits and ESG assurance may also influence audit quality. On the one hand, the same auditor may possess greater client-specific knowledge, enabling them to understand better the company's business characteristics, sustainability practices, and risk profile. This condition may create a knowledge spillover effect, enhancing audit effectiveness and efficiency. However, the provision of multiple assurance services by the same accounting firm may also raise concerns regarding auditor independence (Li et al., 2025).

Additionally, auditors involved in ESG assurance are required to develop a deeper understanding of companies' non-financial risks and sustainability-related issues as part of the audit process. In the context of ESG assurance, professional skepticism plays an important role in determining audit quality, as auditors with higher levels of skepticism tend to produce higher-quality audits (Dierynck & Weijers, 2026). Therefore, ESG assurance may improve audit quality by increasing audit effort and enhancing the auditor's understanding of the company's business and risk profile. In addition, the involvement of Big Four audit firms may affect audit quality due to their greater expertise, extensive resources, and stronger reputational concerns. Big Four auditors are generally considered to provide higher-quality audit and assurance services because they possess more sophisticated audit methodologies and greater experience in handling complex financial and non-financial disclosures, including ESG-related information (Li & Zhang, 2025; Zahid et al., 2022).

However, using the same accounting firm for both annual financial statement audits and ESG report assurance may also threaten auditor independence. This risk is particularly significant in the ESG context, where sustainability information is generally more subjective and difficult to verify than financial information. Previous studies have shown that companies engaging in ESG washing may increase audit risk because misleading sustainability information can affect the audit process and the auditor's assessment of corporate risk (Zhou & Lou, 2026). Consequently, the impact of using the same accounting firm for both ESG assurance and financial statement audits on audit quality remains an important issue that warrants further investigation.

Prior research has examined the relationship between ESG assurance and audit quality, particularly regarding the use of the same accounting firm for both financial statement audits and ESG assurance services. Li et al. (2025), using evidence from China, suggest that employing the same accounting firm can improve audit quality by enhancing audit efficiency and increasing the auditor's understanding of the client's business and sustainability-related risks. Nevertheless, the findings of prior studies may not be fully generalizable to developing countries such as Indonesia, which have different capital market characteristics, regulatory environments, and levels of ESG reporting development compared to China and other developed economies.

Recent evidence further highlights the increasingly important role of audit quality in supporting corporate sustainability and ESG performance. Through a systematic literature review, Alfify and Sharaf-Addin (2026) examined 37 eligible studies and concluded that high-quality audits not only enhance the credibility of sustainability reporting but also contribute to improving corporate ESG performance. Their review also revealed that previous studies have primarily focused on ESG disclosure and reporting, while relatively limited attention has been given to ESG sustainability performance and the integration of internal control systems with audit quality. These findings indicate that further empirical research is needed to better understand how audit-related mechanisms contribute to improving ESG performance, particularly in emerging markets such as Indonesia.

In addition, previous studies on ESG and audit quality have predominantly focused on topics such as financial performance, audit pricing, cost of debt, cost of capital, and corporate governance (Hazaea et al., 2025; Zahid et al., 2022). Research specifically examining the effect of ESG report assurance and the use of the same accounting firm on audit quality remains relatively limited, particularly in the Indonesian context. Therefore, this study adopts and modifies the research framework developed by Li et al. (2025). While the present study retains ESG Report Assurance and the Same Accounting Firm as the main variables, it differs by treating Big Four Auditor as an independent variable rather than a control variable. Furthermore, this study applies the research model to Indonesian non-financial companies listed on the Indonesia Stock Exchange during the 2020–2024 period. Given the differences in institutional settings, ESG reporting practices, regulatory frameworks, and the modified research model, this study may produce different empirical findings from those reported by Li et al. (2025).

Research on the effect of ESG report assurance and the use of the same accounting firm for both annual financial statement audits and ESG assurance on audit quality is important to provide empirical evidence regarding the relationship between ESG assurance practices and audit quality in companies listed on the Indonesia Stock Exchange. This study focuses on the 2020–2024 period, during which the number of companies publishing sustainability reports and engaging independent assurance services increased significantly following the implementation of sustainable finance regulations in Indonesia. In addition, investors and other stakeholders have become increasingly concerned with ESG-related information in evaluating corporate performance and long-term sustainability. Therefore, examining the effect of ESG report assurance and the use of the same accounting firm on audit quality is expected to contribute to the development of literature on ESG assurance and audit quality, particularly within the context of developing countries such as Indonesia.

1.2 Research Question

Based on the background information provided, the research problem in this study is as follows:

1. Does ESG report assurance have a positive effect on audit quality in companies listed on the Indonesia Stock Exchange during the 2020–2024 period?
2. Does the use of the same accounting firm for ESG report assurance and annual financial statement audits have a positive effect on audit quality in companies listed on the Indonesia Stock Exchange during the 2020–2024 period?
3. Do Big Four auditors have a positive effect on audit quality in companies listed on the Indonesia Stock Exchange during the 2020–2024 period?

1.3 Research Objectives

Based on the research problems that have been formulated, the objectives of this study are as follows:

1. To investigate the impact of ESG report assurance on audit quality among companies listed on the Indonesia Stock Exchange during the period 2020–2024.
2. To investigate the impact of engaging the same accounting firm for both ESG report assurance and annual report audits on audit quality among

companies listed on the Indonesia Stock Exchange during the period 2020–2024.

3. To investigate the impact of Big Four auditors on audit quality among companies listed on the Indonesia Stock Exchange during the period 2020–2024.

1.4 Research Benefits

This research is expected to provide benefits both theoretically and practically. The benefits of this research are as follows:

1. For Stakeholders

   This research is expected to provide stakeholders with a better understanding of the relationship between ESG report assurance, the engagement of the same accounting firm for both ESG assurance and financial statement audit services, and audit quality. The findings may also serve as useful information in evaluating the credibility of sustainability reporting and supporting decision-making related to corporate governance and sustainability practices.

2. For Researchers

   This research is expected to contribute to the existing literature on ESG reporting, ESG report assurance, and audit quality. In addition, the findings may serve as a reference for future research by providing empirical evidence and encouraging further studies using different measurements, variables, or research settings.