



## The effect of corporate social responsibility on financial performance: Audit quality as moderation

Abimata Dwiokta Rochaddi, Mutiara Tresna Parasetya

Department of Accounting, Faculty of Economics and Business, Diponegoro University, Indonesia

### Abstract

With the existence of differences in opinions regarding the influence of corporate social responsibility on financial performance of companies and the amount of waste generated by the manufacturing industry, this study aims to test the effect of corporate social responsibility on the financial performance of manufacturing companies with audit quality as a moderating variable. The examination in this study uses corporate social responsibility as the independent variable, financial performance as the dependent variable, and audit quality as the moderating variable. The sample tested in this research consists of manufacturing companies listed on the Indonesia Stock Exchange during the period 2017-2021. The sample was obtained using purposive sampling, a sampling method based on specific criteria, with a total of 94 research samples. The analysis method used is multiple linear regression with tests for classical assumptions and goodness of fit for the regression model. The research conducted obtained results that show audit quality does not have a significant positive influence in moderating the relationship between corporate social responsibility and financial performance. And also, corporate social responsibility does not have a significant influence on financial performance.

**Keywords:** Corporate social responsibility, financial performance, audit quality

### Introduction

Financial performance define as company capacity to manage and utilize its resources. Analysis of the results of these financial ratios can be used by management to assess company performance, provide awards and impose appropriate fines (Mahrani & Soewarno, 2018) <sup>[12]</sup>. measuring a financial performance is not only measured through financial ratios but also through assessing company value (Dakhli, 2022) <sup>[5]</sup>. Even though the company focuses on profit, the company has a social responsibility.

A clause in Chapter 5 of Law of the Republic of Indonesia Number 40 of 2007 concerning Limited Liability Companies which regulates social and environmental responsibility. These rules outline the responsibilities of corporate companies that manage natural resources must be responsible towards society and the environment. The law further stipulates that failure to uphold social and environmental obligations by companies will be subject to sanctions.

Handling hazardous waste generated by company production processes is a major concern of the Indonesian government in its efforts to realize corporate social and environmental responsibility. This attention is stated in Government Regulation no 101 of 2014 defines hazardous and toxic waste (B3) as residual material from activities that are dangerous and toxic, or that can damage the environment or harm living creatures. Therefore, significant increase arise in attention to the management of B3 waste produced and managed by the manufacturing industry in 2020 and 2021.

Every year, manufacturing companies in Indonesia typically publish sustainability reports. A total of 58 companies listed on the IDX in 2018 published sustainability reports. In 2019, 94 companies published sustainability reports. In 2020, 140 companies published sustainability reports. The results of ROA (Return on assets) for companies that have an ESG score, there was a decrease in the average ROA of

the company in 2018-2020, but there was an increase in the average ROA in 2021.

**Table 1:** The Average ROA with ESG Scores

Year	Average ROA (Return on Assets)
2017	0.057
2018	0.054
2019	0.047
2020	0.028
2021	0.040

**Source:** Data processed, 2023

According to agency theory, managers and shareholders have a principal-agent relationship in which one or more principals hire agents to carry out tasks on their behalf. The principal delegates decision-making power to the agent in this relationship. If the principal and agent have different goals in maximizing profits, the agent may not always operate in the principal's best interests. This conflict of interest creates agency costs, such as monitoring fees paid by the principal, binding fees paid by the agent, and potential residual losses (Jensen & Meckling, 1976). According to agency theory, participating in corporate social responsibility (CSR) activities can be seen as a departure from shareholder oversight, which can increase information asymmetry and require more capital allocation by businesses (Bacha *et al.*, 2021) <sup>[2]</sup>.

Audit quality is considered an important management mechanism to overcome agency conflicts (Watkins *et al.*, 2004). Considering the agency costs that arise from information imbalances between stakeholders and management, conducting an audit process is one method used to limit opportunistic behavior (Imen & Anis, 2021) <sup>[7]</sup>. However, there are differences in audit standards presented by public accounting firms. When it comes to ensuring compliance with applicable accounting standards, domestic legal requirements, and other business-related rules, audits

conducted by “Big 4” companies are considered to offer a higher level of assurance (Kaawaase *et al.*, 2016) <sup>[9]</sup>.

According to the findings of several studies, the negative impact on a financial performance occur from corporate social responsibility (Cavaco & Crifo, 2014 <sup>[3]</sup>; Lioui & Sharma, 2012) <sup>[11]</sup>, where CSR expenditures in aspects of environmental, social and sustainable activities increase company costs and reduce company profitability (Zahid *et al.*, 2022) <sup>[15]</sup>. Studies have also been conducted in developing countries, and the findings show that there is generally an inverse relationship between corporate social responsibility and financial performance. The decline in corporate financial performance is known to be caused by excessive spending related to human resources and the environment (Lima Crisóstomo *et al.*, 2011) <sup>[10]</sup>.

According to the findings of various studies, a beneficial effect on a financial performance can be exerted by corporate social responsibility (Dakhli, 2022) <sup>[5]</sup>. Companies social responsibility increases business value through greater spending on CSR, which has a beneficial effect on the financial performance in both the short and long term (Cho *et al.*, 2019) <sup>[4]</sup>. In addition, there are study results which state that there is no correlation between CSR and a company's financial performance, arguing that the contribution of CSR to excellent financial performance is just an assumption (Nelling & Webb, 2009) <sup>[14]</sup>.

The aim of this study is to investigate the impact of corporate social responsibility on the financial performance of manufacturing companies and to evaluate the role of audit quality in moderating this relationship. There are various ways in which this study differs from previous ones. First, by considering audit quality criteria, this study shows a dynamic relationship between corporate social responsibility and corporate financial performance. This study goes deeper into revealing how audit quality can influence this relationship than other studies, which only examine the direct relationship between CSR and financial organizational performance. Second, this study was conducted in Indonesia.

## Literature review and hypothesis development

### Agency Theory

In this arrangement, an individual or group (the principal) hires an additional individual (the agent) to carry out certain tasks on their behalf, including giving the agent the authority to make decisions. It is possible that the agent will not always act in the principal's interests if the principal and agent are both motivated to maximize profits. This conflict of interest results in agency costs (Jensen & Meckling, 1976). Agency costs are further defined as monitoring expenditures by the principal, bonding costs by the agent and residual losses (Jensen & Meckling, 1976).

From an agency perspective, CSR activities are associated with shifting oversight by shareholders that may exacerbate information asymmetry problems and damage corporate reputation, resulting in higher capital constraints (Bacha *et al.*, 2021) <sup>[2]</sup>. Managers are inherently inclined to allocate company resources beyond optimal limits to projects related to CSR activities in order to maximize personal interests by imposing costs on shareholders and stakeholders (McWilliams, 2006) <sup>[13]</sup>, such as personal reputation, possibly creating agency costs (Javed *et al.*, 2016) <sup>[8]</sup>, and leads to reduced company value (Friedman, 1970 <sup>[6]</sup>; McWilliams, 2006) <sup>[13]</sup>. Expenditures for environmental,

social and sustainable CSR activities increase business expenditures and reduce profitability; these additional costs may arise from excessive corporate governance (Zahid, 2022) <sup>[15]</sup>.

In Agency Theory, CSR is considered an agency cost, because CSR can increase and sharpen information asymmetries that occur in companies. Audit quality is considered to be able to inhibit opportunistic behavior and improve the company's CSR performance and CSR disclosure through tests and procedures to ensure financial information including information related to the company's CSR (Agyei-Mensah, 2019 <sup>[1]</sup>; Watkins, 2004). High audit quality is expected to provide quality financial reporting, higher credibility and less opportunistic behavior, thereby improving the financial performance (Watkins, 2004).

### Research Framework and Hypothesis Development

Conflicts of interest between principals and agents are the cause of company agency problems. The conflict of interest between two parties and delegating of management responsibilities by the principal to the agent creates problems. From an agency perspective, CSR activities are associated with a shift in oversight by shareholders that may exacerbate information asymmetry problems and damage a firm's reputation, resulting in higher capital constraints. Managers are inherently inclined to allocate corporate resources beyond optimal limits on projects related to CSR activities in order to maximize personal interests by imposing burdens on shareholders and stakeholders, such as personal reputation, may create agency costs and lead to reduced firm value.

Expenditures for environmental, social and sustainable CSR activities increase business expenditures and reduce profitability; these additional costs may arise from excessive corporate governance. This expenditure on CSR ultimately increases the company's burden and reduces the company's profitability, which causes a decline in the financial performance. Agency theory argues that audits are a monitoring mechanism to mitigate problems of information asymmetry, obstacles to opportunistic behavior and improve CSR performance and CSR disclosure. High audit quality is expected to provide quality financial reporting, greater credibility and less opportunistic behavior. Through the explanation and premises that have been outlined, a framework of thought is formed to make it easier to understand the research concept shown in Figure 1:

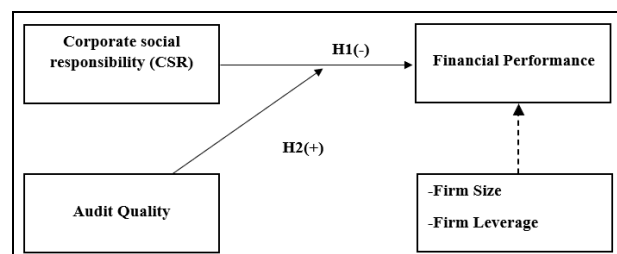


Fig 1: Research Framework

### The Influence of CSR on Financial Performance

According to agency theory, CSR is considered as an additional cost that can exacerbate information asymmetry problems. Shareholder interests are harmed when managers exploit resources through corporate social responsibility excessively for personal gain. This ultimately reduces the value and performance of the company.

There is a view on how a company's CSR influences financial performance. According to a study conducted in France, CSR has a negative impact on a financial performance because not all aspects of CSR are paid attention by society (Cavaco & Crifo, 2014) [3]. According to a study in Brazil, CSR has a detrimental impact on a company's financial performance due to excessive spending on social and employee issues. The negative impact caused by excessive spending in these two aspects is not a concern for people in developing countries so that the company's financial performance does not increase (Crisóstomo *et al.*, 2011). Another study found that CSR attention and actions contribute negatively to financial performance because attention to the environment is considered an additional cost by investors which can reduce short-term financial performance (Lioui & Sharma, 2012) [11].

**H1:** CSR contributes negatively to financial performance.

**1. The Influence of Audit Quality on The Relationship Between Corporate Social Responsibility and Financial Performance**

According to agency theory, improving audit quality is a way to reduce agency problems and can increase the impact of corporate social responsibility on financial performance (Watkins, 2004). In an agency arrangement, information asymmetry between stakeholders and managers creates agency costs, thus the company will ask for independent

auditors to mitigate opportunistic behavior. With opportunistic behavior that can be overcome, the company will be able to minimize agency costs arising from CSR costs and improve the financial performance (Bacha *et al.*, 2021) [2]. Studies on audit quality have revealed that audit quality improves the relationship between corporate social responsibility and financial performance. This relationship arises from the fact that the stakeholders are more likely to pay attention to effective CSR strategies implemented by the company, especially when the company's agency costs are reduced by high audit quality (Bacha *et al.*, 2021) [2]. Another study shows that CSR has a negative impact on a financial performance, can be improved by strong audit quality when both are implemented simultaneously (Zahid, Khan, *et al.*, 2022) [15].

**H2:** Audit quality contributes positively in moderating the relationship between CSR and financial performance

**Research method  
Research Variables**

The dependent variable of this research is financial performance. The independent variable whose influence on the dependent is CSR. In addition, the research explores audit quality as moderating variables. Furthermore, researchers added control variables consisting of firm size and firm leverage.

**Table 2:** Variable and Measurement

Variable	Measurement
Financial Performance	Return on Assets = $\frac{\text{Net Income}}{\text{Total Assets}}$ Tobin's Q = $\frac{\text{Market Value of Equity} + \text{Book Value of Debt}}{\text{Book Value of Assets}}$
CSR	ESG Scores
Audit Quality	Dummy variable, Score 1 is given to auditors who have industry specialization and Score 0 is given to auditors non-industry specialization. Dummy variable, Score 1 is given to companies audited by Big Four Public Accounting Firm and Score 0 is given to companies audited by non-Big Four Public Accounting Firm
Firm Size	The natural logarithm value of total assets owned by the company
Firm Leverage	Leverage = $\frac{\text{Total Debt}}{\text{Total Equity}}$

Financial performance is proxied through return on assets because ROA is a strong aspect for indicating the level of financial performance and Tobin's Q. Return on assets is one of the best metrics for measuring financial performance. A company's ability to create money from its assets is shown by calculating ROA (Dakhli, 2022) [5]. Meanwhile, the Tobin's Q value measures how well a financial organization performs based on market-based measures. CSR is proxied by the ESG Score (environmental, social, governance) sourced from the Bloomberg ESG database, where CSR is measured based on performance (Environmental, Social and Governance) through 93 aspects and produces a score between 0-100. The moderating variable of this research is audit quality, chosen because this form of transparency requires appropriate disclosure (Deangelo, 1981). There are two control variables in the research. Firm size can be measured by calculating the natural logarithm of total assets owned by the company (Dakhli, 2022) [5]. Corporate Leverage, is a ratio used by businesses to measure how much of their funds come from debt. Leverage shows the company's capacity to fulfill its obligations.

**Population and Sample**

The population of this research is manufacturing companies listed on the IDX between 2017 - 2021. Manufacturing companies were chosen as the research objects because of resources used in manufacturing industrial processes which have the potential to produce waste both directly and indirectly, as well as the amount of B3 waste produced and managed by the manufacturing industry increased significantly in 2020 and 2021. Sample determination, collection method used purposive sampling method. The type of data in the research is secondary data. The secondary data sources for this research are financial reports and annual reports of manufacturing sector companies listed on the IDX between 2017 - 2021. This study uses the Bloomberg ESG database which is derived from Bloomberg's equity screening (EQS). Using several criteria, 94 samples were obtained which were company data according to the criteria with the selection description as follows

**Table 3:** Population and Sample

Sample Criteria	Total	Percentage
Manufacturing companies listed on the IDX in 2017 – 2021	171	100%
Manufacturing companies that consistently publish annual reports in 2017 – 2021	161	94%
Manufacturing companies that have ESG score (available on Bloomberg) in the scope of governance, environment and social in 2017 – 2021	23	13,4%
Total Research Sample (23 x 5 years)	115	100%
Sample Outliers	21	18,3%
Total Net Research Sample	94	81,7%

Data was collected through documentation review from financial reports, annual reports and the EQS Bloomberg terminal. The data collected is in the form of various

financial information through access to the equity screening function (EQS) and financial analysis (FA) as well as ESG scores.

**The equation model as follows**

$$ROA_{i,t} + 1 = \alpha + \beta_1 CSR_{i,t} + \beta_2 Spe_{i,t} + \beta_3 Big4_{i,t} + \beta_4 TA_{i,t} + \beta_5 Levi_{i,t} + \beta_6 CSR_{i,t} \times Spe_{i,t} + \beta_7 CSR_{i,t} \times Big4_{i,t} + \epsilon$$

$$ROA_{i,t} + 1 = \alpha + \beta_1 CSR_{i,t} + \beta_2 Spe_{i,t} + \beta_3 Big4_{i,t} + \beta_4 TA_{i,t} + \beta_5 Levi_{i,t} + \beta_6 CSR_{i,t} \times Spe_{i,t} + \beta_7 CSR_{i,t} \times Big4_{i,t} + \epsilon$$

**Analysis Method**

Hypothesis testing is carried out by multiple linear regression analysis to describe the relationship between more than one independent variable and the dependent variable. This research, which aims to investigate the impact of corporate social responsibility on the financial

performance of manufacturing organizations and to evaluate the role of audit quality in changing this relationship.

**Results and discussion**

The research interprets the actual value by applying the Goodness of Fit value, which consists of the F statistical test, t statistical test, and adjusted R<sup>2</sup> coefficient of determination to test the hypothesis.

**Table 5:** Hypothesis Test Results

F Statistical Test					
Model		F	Sig.		
1	Regression Residual Total	8,304	0,000		
2	Regression Residual Total	2,902	0,009		
T Statistical Test					
Model		Unstandardized Coefficients		T	Sig.
		B	Std. Error		
1	Konstanta	0.124	0.122	1.012	.314
	CSR	0.001	0.001	1.323	.189
	SPE	-0.011	0.041	-.268	.789
	BIG	0.087	0.036	2.444	.017
	TA	-0.002	0.004	-.407	.685
	LEV	-0.052	0.008	-6.870	.000
	CSR*SPE	0.000	0.001	.385	.701
CSR*BIG	-0.002	0.001	-2.550	.013	
2	Konstanta	1.597	1.735	.921	.360
	CSR	-0.010	0.010	-1.003	.319
	SPE	-0.983	0.580	-1.696	.094
	BIG	0.548	0.506	1.081	.283
	TA	-0.024	0.055	-.434	.665
	LEV	-0.237	0.107	-2.208	.030
	CSR*SPE	0.030	0.015	2.036	.045
CSR*BIG	-0.011	0.012	-.854	.395	
Model				Adjusted R Square	
1				0,355	
2				0,125	

Dependent Variable: Financial Performance  
 Source: Secondary data processed with SPSS 26, 2023

### The Influence of CSR on Financial Performance

This study refers to the study Bacha *et al.*, (2021) <sup>[2]</sup> where the independent variable in this study is CSR and the dependent variable is financial performance. Hypothesis testing was carried out to test the influence of CSR on company financial performance. The results in 2 test models found that CSR contribute insignificantly to financial performance. On this basis, the first hypothesis in this study is rejected.

Viewed through agency theory, CSR is a form of agency problem as a deviation from shareholder oversight, which can increase information asymmetry and require more capital allocation by businesses (Bacha, 2021) <sup>[2]</sup>. When a company carries out CSR, there is a possibility that CSR is carried out excessively, causing higher use of capital and reducing the company's financial performance.

One measurement index that can be used to measure a company's CSR is the assessment of environmental, social and corporate governance aspects (Cini & Ricci, 2020). However, there are significant differences in CSR disclosure practices and public attention to CSR in developed and developing countries, where public attention to environmental and social aspects in developing countries is considered not to be as massive as in developed countries (Crisóstomo *et al.*, 2011). The number of manufacturing companies that have ESG scores in Bloomberg's equity screening is only 23 companies. This can be caused by a lack of pressure by society and the government on companies regarding CSR due to the lack of public attention in developing countries.

The results of the study conducted are in line with the study conducted by (Nelling & Webb, 2009) <sup>[14]</sup>, where CSR does not contribute significantly to the company's financial performance. that the assumption that CSR contributes significantly positively to the company's financial performance is considered an assumption in the company's expenditure. Moreover, this study was also conducted in Indonesia, which is a developing country, where there are differences in conditions in developing countries where the financial performance of companies is not as good as in developed countries and public attention to CSR is not as massive as in developing countries (Crisóstomo *et al.*, 2011).

### The Moderating Effect of Audit Quality on the Relationship between Corporate Social Responsibility and Financial Performance

The next test was carried out to test the moderating effect of audit quality on the relationship between Corporate Social Responsibility and Financial Performance. In this study, audit quality is a moderating variable on the relationship between Corporate Social Responsibility (CSR) and financial performance. Audit quality as proxied through auditor industry specialization and Big 4 Public Accounting Firm provides mixed results in moderating the relationship between Corporate Social Responsibility (CSR) and financial performance. On this basis, the second hypothesis in this study was rejected.

According to agency theory, problems can be overcome through audit quality. The company always measures and monitors company performance, this supervision is aimed to achieving company goals. Audits are seen as a way to solve the problem of information inequality that occurs in a business context, especially when principals and agents

have different goals in achieving company goals. This is done by examining and processing financial information (Jensen & Meckling, 1976).

This study found a positive and significant positive influence between the CSR variable and auditor industry specialization in its influence on Tobin's Q in model 2. The results of this study are in line with the study conducted by (Dakhli, 2022) <sup>[5]</sup>. Audit quality is considered an effort of good corporate governance, where companies that have good audit quality are able to minimize opportunistic behavior within the company. Good audit quality goes hand in hand with the implementation of the company's corporate social responsibility which is associated with the public as a reflection of the company's good financial performance so that it can improve the company's performance which is measured not only using accounting indexes but market indices.

The opposite result was found where the CSR interaction variable with Big 4 Public Accounting Firm in study model 1 produced a significant negative effect. The results of this study are in line with the study conducted by Zahid *et al.*, (2023) <sup>[16]</sup>. The study states that Big Public Accounting Firm can contribute a significant negative in moderating the relationship between CSR and financial performance as measured using ROA in the current period. This is because CSR is considered to have a positive impact on the company's long-term financial performance, and the audit quality of Big 4 Public Accounting Firm can cause higher costs incurred by the company in that period, thus contributing negatively to the company's ROA in a certain period.

### Conclusion

This study shows the relationship between corporate social responsibility and financial performance using audit quality as a moderating variable. Manufacturing companies listed on the IDX from 2017 to 2021 and consistently disclosing ESG scores on Bloomberg are the sample used in this study. In the manufacturing sector, there are 23 companies that consistently publish financial reports and share the ESG scores from 2017 to 2021. The results shows that CSR as proxied through ESG Scores has no effect on financial performance as proxied through ROA. This research concludes the first hypothesis, CSR has a positive effect on the financial performance, is rejected. There are significant and negative influences on audit quality in moderating the influence of CSR on the financial performance of manufacturing companies. Audit quality contributes positive and insignificant in moderating the influence of CSR on financial performance. This research concludes the second hypothesis is rejected

The limitations of this research were found as consideration for further research, including that only 23 manufacturing companies that published financial reports and had an ESG Score assessment within a period of five years and there were anomalies in 2019 to 2021 due to the Covid-19 pandemic. The suggestions for future research are to differentiate findings from this study, it is recommended to concentrate in various industries and to extend the study time.

### Reference

1. Agyei-Mensah BK. The effect of audit committee effectiveness and audit quality on corporate voluntary

- disclosure quality. *Afr J Econ Manag Stud*,2019;10(1):17–31. doi:10.1108/AJEMS-04-2018-0102.
2. Bacha S, Ajina A, Ben Saad S. CSR performance and the cost of debt: does audit quality matter? *Corp Gov Int J Bus Soc*,2021;21(1):137–158. doi:10.1108/CG-11-2019-0335.
  3. Cavaco S, Crifo P. CSR and financial performance: complementarity between environmental, social and business behaviours. *Appl Econ*,2014;46(27):3323–3338. doi:10.1080/00036846.2014.927572.
  4. Cho S, Chung C, Young J. Study on the relationship between CSR and financial performance. *Sustainability*,2019;11(2):343. doi:10.3390/su11020343.
  5. Dakhli A. The impact of corporate social responsibility on firm financial performance: does audit quality matter? *J Appl Account Res*,2022;23(5):950–976. doi:10.1108/JAAR-06-2021-0150.
  6. Friedman M. Comment on Tobin. *Q J Econ*,1970;84(2). Available from: <https://www.jstor.org/stable/1883017>.
  7. Imen F, Anis J. The moderating role of audit quality on the relationship between auditor reporting and earnings management: empirical evidence from Tunisia. *EuroMed J Bus*,2021;16(4):416–430. doi:10.1108/EMJB-03-2020-0024.
  8. Javed M, Rashid MA, Hussain G. When does it pay to be good – A contingency perspective on corporate social and financial performance: would it work? *J Clean Prod*,2016;133:1062–1073. doi:10.1016/j.jclepro.2016.05.163.
  9. Kaawaase TK, Assad MJ, Kitindi EG, Nkundabanyanga SK. Audit quality differences amongst audit firms in a developing economy. *J Account Emerg Econ*,2016;6(3):269–290. doi:10.1108/JAEE-08-2013-0041.
  10. Lima Crisóstomo V, de Souza Freire F, Cortes de Vasconcellos F. Corporate social responsibility, firm value and financial performance in Brazil. *Soc Responsib J*,2011;7(2):295–309. doi:10.1108/17471111111141549.
  11. Lioui A, Sharma Z. Environmental corporate social responsibility and financial performance: Disentangling direct and indirect effects. *Ecol Econ*,2012;78:100–111. doi:10.1016/j.ecolecon.2012.04.004.
  12. Mahrani M, Soewarno N. The effect of good corporate governance mechanism and corporate social responsibility on financial performance with earnings management as mediating variable. *Asian J Account Res*,2018;3(1):41–60. doi:10.1108/AJAR-06-2018-0008.
  13. McWilliams A, Siegel DS, Wright PM. Guest editors' introduction corporate social responsibility: strategic implications. *J Manag Stud*,2006.
  14. Nelling E, Webb E. Corporate social responsibility and financial performance: the “virtuous circle” revisited. *Rev Quant Financ Account*,2009;32(2):197–209. doi:10.1007/s11156-008-0090-y.
  15. Zahid RMA, Khan MK, Anwar W, Maqsood US. The role of audit quality in the ESG-corporate financial performance nexus: empirical evidence from Western European companies. *Borsa Istanbul Rev*,2022:22–S212. doi:10.1016/j.bir.2022.08.011.
  16. Zahid RMA, Taran A, Khan MK, Chersan I-C. ESG, dividend payout policy and the moderating role of audit quality: empirical evidence from Western Europe. *Borsa Istanbul Rev*,2023;23(2):350–367. doi:10.1016/j.bir.2022.10.012.