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FINANCIAL REPORT QUALITY, ESG DISCLOSURE, RISK DISCLOSURE, AUDIT QUALITY AND IDIOSYNCRATIC RISK: EVIDENCE FROM INDONESIAN COMPANIES

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ABSTRACT
This research aims to examine how the quality of financial reports, environmental, social and governance (ESG) performance disclosures and risk disclosures influence idiosyncratic risks in a company. Furthermore, this research also aims to identify the role of a quality audit in strengthening the influence of financial information and non-financial information on idiosyncratic risks. This role is important to test considering that International Standards on Auditing (ISA) 720 expects a review by the auditor of all information accompanying financial reports. The difference between this research and other research is that in this research a quality audit is measured using a composite index that includes dimensions. input and process. By using cross section data on 348 firms. The data obtained was then processed using Structural Equation Modelling (SEM). The test results show that, in Indonesia, ESG disclosure and audit quality are able to reduce idiosyncratic risks. However, this does not happen with quality financial information and risk disclosure. However, this research cannot prove the role of a quality audit in strengthening the influence of financial and non-financial information on idiosyncratic risk. These results open opportunities for further research to explore the role of a quality audit based on SA 720. This research contributes in the form of empirical evidence regarding the role of non-financial information in investor decision making so that it can be used as a reference for regulators in formulating related provisions. presentation of financial and non-financial information.

Keywords: Financial report quality, ESG disclosure, risk disclosure, audit quality, idiosyncratic risk.

1. INTRODUCTION

In financial theory, the rate of return increases in direct proportion to the level of risk assumed by investors. Systematic and unsystematic risk are the two constituents that comprise securities risk (Markowitz, 1952). Diversification is incapable of eradicating systematic risk, which is a ubiquitous phenomenon. Systematic risk concerns external company elements, including but not limited to economic conditions, tax policies, and socio-political circumstances. Diversification, meanwhile, protects against unsystematic risk. The influence of internal elements on changes, including market share, management, and annual earnings, classifies this as an internal risk for the organization. Diversifying a portfolio serves as a mechanism to reduce or eliminate

risk (Markowitz, 1952). In light of this diversified risk, it follows that the returns on an investment portfolio must have a positive correlation. Unsystematic risk is termed unique risk or idiosyncratic risk within the domain of financial economics.

The literature hasn't given much attention to the function of idiosyncratic risk in asset pricing up until now (Firmansyah et al., 2020). This is due to the Capital Asset Pricing Model's (CAPM) underlying assumptions, which state that idiosyncratic risks shouldn't affect asset values. Idiosyncratic risk have no value on asset because they can be perfectly diversified through the formation of an investment portfolio. However, the three-factor model developed by Fama and French demonstrates that the unsystematic risk factors eliminated by the CAPM can account for a sizable portion of asset returns. According to Merton (1987), investors with less diversified portfolios should be priced for idiosyncratic risk. In actuality, there are a number of reasons why individual investors are unlikely to have well-diversified portfolios, including investment style selection, transaction costs, and information costs (Firmansyah et al., 2020).

Idiosyncratic risks have the potential to reduce company performance in the future. Managers are free to implement decisions that may not be in the best interests of shareholders. The policies taken by the manager can harm or endanger the company in the future. Shareholders as company owners do not know the activities carried out by managers, which creates information asymmetry between the two. The manager's actions can give rise to risks originating from within the company which contribute to the company's total risk. Risks originating from within the company (idiosyncratic risks) should be mitigated or minimized because idiosyncratic risks through diversification or manager policies can be monitored by shareholders so that policies are aligned. Thus, a review of idiosyncratic risks is important for further research.

Additionally, several researchers have tried to pinpoint idiosincratic risk factors. The majority of independent variables in earlier research used determinants from company characteristics because idiosyncratic risk in these studies is determined by corporate factors. Using data from the United States, Hsu & Jang (2008), Vozlyublennaia (2013), and Dalbor et al. (2014) studied the impact of firm fundamentals (such as profitability, size, dividend payments, and liquidity) on idiosyncratic risk. Research in other countries has also been carried out; for example, Liu et al. (2014) used Australian data; Kumari et al. (2017) used Indian data; and Firmansyah, et al. (2020) utilized Indonesian data. Furthermore, using data from Pakistan and Taiwan, respectively, Chen et al. (2016) and Ghafoor et al. (2019) conducted research on the impact of governance on idiosyncratic risks in relation to non-financial company information. Kong et al. (2020) used data from China, and Tzouvanas et al. (2020) used data from Europe to investigate the impact of CSR disclosure on idiosyncratic risk. Kong (2013) and Chichernea et al. (2015) used data from the United States to study the impact of institutional ownership on idiosyncratic risk, while Firmansyah et al. (2020) and Butar (2020) used data from Indonesia. Tan & Liu (2016) used Australian data to examine the impact of manager competency on idiosyncratic risk in more detail. Using data from Indonesia, Firmansyah et al. (2020), Firmansyah & Suhanda (2021), investigated the impact of earnings quality on idiosyncratic risk.

These studies reveal that all information presented in the capital market, both financial and non-financial information, will influence idiosyncratic risk. This is in accordance with the semi-strong efficient market hypothesis which states that in a semi-strong capital market, all information available in the market will be reflected in stock prices (Malkiel, 1989). This research will examine how the quality of disclosure of financial and non-financial information will influence idiosyncratic risk in issuers in Indonesia. This information is financial information, environmental, social and governance (ESG) disclosures and risk disclosures. These three pieces of information are information presented by management to investors regarding how management manages finances, manages the environment, social and governance and manages risks.

This study is different in a number of ways from earlier research. First off, while many CSR measures were still employed in earlier research, we now quantify the impact of ESG disclosure quality on idiosyncratic risk in this study. Secondly, we assess the impact of risk disclosure in our study, whereas prior research has, as far as we are aware, assessed the impact of risk disclosure on overall risk. Third, we additionally consider audit quality's function as a mediator in this study. This considers Audit Standard 720: The Auditors Responsibilities Relating to Other Information, which mandates that auditors make ensuring that financial reports and other data the company presents are consistent (IAASB, 2015).

2. LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1.Literature review

Within the framework of Agency Theory (Jensen & Meckling, 1976), the separation between the company owner (principal) and the company's operational management (agent) creates agency problems. This problem arises because the agent (management) his problem arises because agents (management) have more information than owners have or what is known as information asymmetry. Fama & Jensen (1983) further explained that agency problem does not only arise from information asymmetry, but is also caused by the separation between decision-making and monitoring functions, especially in complex companies. In this complex company, decision making and implementation are carried out by parties whose wealth is not affected by the decision (Fama & Jensen, 1983). Therefore, shareholders who are dissatisfied with management decisions will choose to divest shareholdings in companies where top managerial behavior reduces their welfare and therefore share price movements are affected (Tan & Liu, 2016). Thus, the more often management makes decisions that are contrary to the interests of shareholders, the more share price volatility will increase, resulting in an increase in the company's idiosyncratic risk.

Idiosyncratic risk has actually caught the interest of scholars since 1990, when the significance of asset pricing was first examined (Liu, 2014). The Capital Asset Pricing Model (CAPM) theory assumes that investors own a portion of the market portfolio, which is capable of being well-diversified. However, prior research indicates that investors do not actually own this portfolio. Idiosyncratic risk, according to Merton (1987), should be priced in accordance with the circumstances in which investors own diversified portfolios due to information costs, transaction costs, and other factors.

One study that tries to identify factors that influence idiosyncratic risk is research conducted by Vozlyublennaia (2013). In his research, Vozlyublennaia (2013) investigated the effects of several company characteristics that can influence idiosyncratic risk. By using data from companies listed on the NYSE, AMEX and NASDAQ in the period 1980-2008, The researchers came to the conclusion that idiosyncratic risk is influenced by a number of factors, including book-to-market, size, leverage, earnings per share, institutional ownership, and turnover. Dalbor et al. (2014) also identified factors influencing idiosyncratic risk in the restaurant industry in the United States. According to Dalbor et al. (2014) manager's ability to manage a restaurant is an important factor determining idiosyncratic risk in restaurants in the United States. Apart from that, the size of the restaurant also determines the restaurant's idiosyncratic risk, the bigger the restaurant, the lower the idiosyncratic risk (Dalbor et al., 2014). In Australia, Liu et al. (2014) conclude that small companies tend to have higher idiosyncratic volatility compared to large companies, as well as companies that have higher leverage, lower profits and lower value will also create higher idiosyncratic volatility. Furthermore, characteristics such as momentum, company size, liquidity, book-to-market ratio, ratio return on assets and cash flow-to-price are determinants that determine the level of idiosyncratic volatility in India (Kumari et al., 2017). While in Indonesia, factors that reduce the idiosyncratic risk are dividend policy, firm size, profitability, price earnings ratio, and interest rates (Firmansyah, 2020a).

As previously mentioned, investors will evaluate the company's idiosyncratic risk using all available information, as per the semi-strong Efficient Market Theory. This information is not only financial information, but also non-financial information Several studies examining how financial information influences idiosyncratic risk. Firmansyah et al. (2020a) demonstrate that idiosyncratic volatility is unaffected by comprehensive income volatility, net income volatility, or other comprehensive income volatility. Idiosyncratic volatility, however, is positively impacted by the relationship between derivative transactions and comprehensive income volatility, net income volatility, and other comprehensive income volatility. Firmansyah & Suhanda (2021) discovered that accrual and real earnings management had a favorable impact on idiosyncratic risk. Additionally, this study reveals that the favorable correlation between accrual earnings management and real earnings management with idiosyncratic risk is not diminished by corporate governance (Firmansyah & Suhanda, 2021). Nguyen et al. (2021) conclude that idiosyncratic risk can be decreased by high-quality financial reports was likewise similar. Nguyen et al. (2021) argue that in addition to these high-quality financial information considerations, state ownership can also lower idiosyncratic risk; nevertheless, board size actually raises idiosyncratic risk. Rajgopal & Venkatachalam (2011) in the US and Zhou et al. (2017) in China both found that high-quality financial disclosures can lower idiosyncratic risk.

Apart from financial information, several researchers have also identified the influence of non-financial information in the form of ESG or CSR information on idiosyncratic risks, among others Reber, (2022); Bassen & Senkl (2021); Sassen (2016); Hu et al. (2021) and Izcan & Bectas (2022). Other researchers have actually tried to look at the influence of risk disclosure on total risk

as done by Kim & Yasuda (2018) and Malafronte et al. (2018) or its effect on the cost of equity as done by Haj-Salem et al. (2020).

In general, research related to the influence of ESG or CSR disclosures concludes that ESG or CSR disclosures are able to reduce idiosyncratic risks (Reber, 2022; Sassen, 2016; Hu et al., 2021) although Izcan & Bectas found that among environmental, social and governance factors , in the banking sector only environmental and governance factors are able to reduce idiosyncratic risk, while there is no evidence that disclosures related to social factors have a negative effect on idiosyncratic risk.

Kim & Yasuda (2018) tested the impact of risk disclosure on a company's total risk. The results obtained indicate that risk disclosure is able to reduce the company's total risk. The same thing was also obtained by Malafronte et al. (2018) who concluded that risk disclosure was able to reduce the volatility of stock returns of insurance companies in Europe. Likewise, Haj-Salem et al. (2020) who concluded that risk disclosure can reduce the company's cost of equity.

Apart from the information provided by management, audit quality also influences idiosyncratic risks. Although not many studies have revealed the role of audit quality, several researchers have paid attention to this issue. One of them is research conducted by Chen et al. (2017). In their research, Chen et al. (2017) aims to test whether audit quality will influence investors' desire to obtain additional company-specific information. The results obtained show that quality audits are able to reduce investors' desire to seek additional company-specific information, this is indicated by low stock return volatility (Chen et al., 2017). This shows that idiosyncratic risk decreases with quality audits. Another research that examines audit quality against idiosyncratic risk is research conducted by Houqe et al. (2017) who tested the effect of audit risk on the cost of capital. As is known, the cost of capital will be greatly influenced by the company's risk. Houqe et al. (2017) conclude that companies that employ high-quality auditors have lower levels of earnings management and lower costs of equity capital. Additionally, Thu et al. (2018) also found something similar in Vietnam where there was a negative relationship between audit quality, company size, return on assets and cost of debt on the cost of debt. With these results, it can be concluded that audit quality is able to reduce debt costs due to reduced company risk.

2.2.Hypothesis Development

2.2.1. The effect of quality financial report on idiosyncratic risk

According to agency theory, there is an information asymmetry between the agent and the principal as a result of a connection developing between them. This is because the agent determines what kind of information will be presented to the principal. One of the types of information submitted by management as an agent is a financial report. As an agent, management is more aware of the real conditions in the field and is able to direct the numbers that will be presented in the financial reports. Figures that have been directed not to present real field information are low-quality information because they can mislead users of financial reports in making decisions. Investors will evaluate whether the financial information can be trusted. This investor assessment will be reflected in the stock market price. The more the share price fluctuates, the higher the company's risk. This includes idiosyncratic risks which are company-specific risks. In the semi-

strong efficient market theory, this information will be directly reflected in stock prices when the information is available on the market.

The influence of the quality of financial reports on isyncratic risk has been carried out by several researchers. Among them is research conducted by Firmansyah et al. (2020b) which tests the quality of net income, other comprehensive income and comprehensive income against idiosyncratic risks. The results of the tests carried out show that income quality does not affect idiosyncratic risk, however, if transactions are included as a moderating variable, then this derivative transaction is able to strengthen the negative influence of income quality on idiosyncratic risk. Research conducted by Firmansyah and Suhanda (2021) also shows the influence of earnings quality on idiosyncratic risk, where the existence of earnings management increases idiosyncratic risk. Specific research related to the quality of financial reports was conducted by Nguyen et al. (2021) where the results obtained show that quality financial reports can reduce idiosyncratic risk. A similar thing was also obtained by Zhou et al. (2017) and Rajgopal & Venkatachalam (2011).

Numerous scholars have examined the impact of financial report quality on idiosyncratic risk. One study that examines the quality of net income, other comprehensive income, and comprehensive income against idiosyncratic risks is Firmansyah et al. (2020). The study indicates that income quality has no effect on idiosyncratic risk; however, when transactions are taken into account as a moderating variable, the negative impact of income quality on idiosyncratic risk can be amplified. Firmansyah and Suhanda's research (2021) also demonstrates the relationship between idiosyncratic risk and earnings quality, demonstrating that the presence of earnings management raises idiosyncratic risk. Nguyen et al. (2021) carried out specific research on the quality of financial reports, and the findings indicate that idiosyncratic risk can be reduced by high-quality financial reports. Similar results were also achieved by Rajgopal & Venkatachalam (2011) and Zhou et al. (2017).

It is evident from the preceding statement that idiosyncratic risk can be influenced by the quality of financial reports, with the higher the quality of financial reports, the lower the idiosyncratic risk. In light of this, a hypothesis that can be developed is
H1: The quality of financial reports has a negative effect on idiosyncratic risk.

2.2.2. The effect of ESG disclosure on idiosyncratic risk

Regulatory developments and increasing awareness among stakeholders show that financial performance is not the only information needed in making decisions. Information regarding ESG is one crucial piece of information. Investors can learn more about the company's governance, social, and environmental accomplishments from this information

However, returning to agency theory, management's knowledge regarding the company's real performance in environmental, social and governance aspects is better than investors' knowledge. This is normal because management implements various policies and activities related to ESG. Even though management presents this information in a report, management has the ability to determine what information needs to be presented in ESG-related reports.

From the standpoint of efficient market theory, investors will utilize the company's ESG data when making decisions. Stock returns will typically be stable, suggesting little idiosyncratic risk, if ESG-related policies disclosed to investors align with investors' interests.

Numerous scholars have examined the impact of ESG disclosure on idiosyncratic risk. Reber et al. (2022) discovered that ESG disclosure will lower idiosyncratic risk. In a different words, Sassen (2016) came to the same conclusion: ESG disclosure lowers idiosyncratic risks Several studies use the term CSR to explain ESG disclosure. Numerous studies, including Hu et al. (2021), Li et al. (2021), Albuquerque et al. (2019), and Mishra & Modi, demonstrate that CSR has a negative impact on idiosyncratic risk (2013). The following hypothesis can be made based on the description given above: H2: Idiosyncratic risk is negatively impacted by ESG disclosure.

2.2.3. The effect of risk disclosure on idiosyncratic risk

Companies are currently faced with rapidly changing circumstances and various problems. This condition has increased investor awareness of the importance of risk management within the company. Risk management can help companies mitigate the risks they face so they can survive. Disclosures regarding how management identifies risks and how management responds to these identified risks are starting to be disclosed by management in the company's annual report.
In terms of agency theory, there is a possibility that management discloses the risks it handles in accordance with management's interests, so that the reports or information submitted do not reflect the real conditions faced by management.

In the semi-strong form of competitive market theory, information about the company's risk will be assessed by investors and reflected in the stock return rate. The better the risk disclosure presented by management, the lower the company's idiosyncratic risk will be.

Several studies have identified how risk disclosure influences idiosyncratic risk. One of them is Kim and Yasuda (2018). Although Kim & Yasuda's (2018) research does not specifically refer to idiosyncratic risk, Kim & Yasuda succeeded in showing that risk disclosure can reduce a company's total risk. Research conducted by Malafronte et al. (2018) found that risk disclosure in insurance companies was able to reduce stock return volatility. Haj-Salem found a slight difference in the effect of risk disclosure on the cost of capital, where risk disclosure will reduce idiosyncratic risk for companies that are making profits, but not for companies that are experiencing losses. The conclusion that risk disclosure can reduce the cost of capital was also obtained by Heinle & Smith (2017).

From the description above, it can be seen that risk disclosure will help investors identify whether management has managed the risks faced well. So if investors believe that the risk information is in line with expectations, it will reduce idiosyncratic risk. Thus, the hypothesis that is built is
H3: Risk disclosure has a negative effect on idiosyncratic risk

2.2.4. The effect of audit quality on idiosyncratic risk

Within the framework of agency theory, auditing is a mechanism carried out to reduce the existence of information asymmetry between management as agents and company voters as principals. Thus, with an audit, the information received by shareholders will be of higher quality in decision making so that theoretically, this can reduce idiosyncratic risk.

A number of earlier studies have also demonstrated that an audit can lower idiosyncratic risk. Chen et al. (2017), for example, found that a quality audit can lessen shareholders' desire to look for more information in order to lower idiosyncratic risk. Similar findings were made by Houqe et al. (2017) and Thu et al. (2017), who also came to the conclusion that a quality audit can lower the cost of equity since it lowers corporate risk. Therefore, the following is the hypothesis that can be developed:

H4: Audit quality has a negative effect on idiosyncratic risk.

2.2.5. Audit quality moderates the influence of financial report quality, ESG disclosure and risk disclosure on idiosyncratic risk

As explained above, agency problems cause information asymmetry between management as agents and investors as principals. Management as the decision maker in the company is able to determine what information will be conveyed to investors. So there is a risk that the information submitted does not reflect the actual situation.

Audit as a service that improves the quality of information submitted by management, needs to carry out various procedures systematically to determine how well the information submitted reflects existing conditions. So it is able to increase the reliability of information and reduce idiosyncratic risk.

Several studies related to the influence of quality audits on idiosyncratic risks include those carried out by Chen et al. (2017) who concluded that quality audits result in a reduction in investors' desire to seek additional company-specific information, thereby reducing idiosyncratic risk. The research results of Houqe et al. (2017) also show that quality audits can reduce the cost of capital, this is because idiosyncratic risks decrease (Coffie et al., 2018; Thu et al., 2018; and Orazalin & Akhmetzhanov, 2019).

Although the audit process in general is still only mandatory for an entity's financial reports, however, in accordance with International Standars on Auditing (ISA) 720 concerning the auditor's responsibility for other information, the auditor must ensure that there is consistency in the information submitted between the various information submitted by management (IAASB, 2015). This is also in line with Cohen et al. (2000) who concluded that non-financial information is also used by auditors as audit evidence in assessing the fairness of financial information.

Based on the description above, we can see that a quality audit in theory and based on previous research has the effect of reducing idiosyncratic risk. Furthermore, considering that the role of audit is an effective control mechanism in ensuring the credibility of information submitted by management, the hypothesis that can be built is as follows.

H5: Audit quality strengthens the negative effect of financial report quality on idiosyncratic risk.

H6: Audit quality strengthens the negative effect of ESG disclosure on idiosyncratic risk.

H7: Audit quality strengthens the negative effect of risk disclosure on idiosyncratic risk.

3. RESEARCH METHODOLOGY

This research is quantitative research. The data used in this research is secondary data consisting of information relating to the quality of financial reports, ESG disclosure and risk disclosure, audit quality and idiosyncratic risks. The data used in this research was obtained from listed companies annual reports. Meanwhile, for audit quality, data was obtained from reports on the business activities of Audit Firms submitted to the Finance Profession Supervisory Center (PPPK) of the Ministry of Finance of the Republic of Indonesia. Data collection was carried out for 2021 for information related to the independent and moderating variables, while for the dependent variable the data used was 2022 data to see the impact of disclosure of the previous year's information.

The population in this research is listed companies in the Indonesia Stock Exchange. Using a purposive sampling technique some companies are selected. The criteria used in sampling are companies that have conducted an Initial Public Offering (IPO) no later than 2017, this is necessary to measure the quality of financial reports, the company is not a company in the financial sector, and publishes an annual report for 2021. Based on these criteria There are 348 firms.

Because they are more pertinent (Izcan & Bectas, 2022), this research employs a market model based on Firmansyah et al. (2020b) and Izcan & Bektas (2022) to evaluate idiosyncratic risk (IDIOSIN) . Regression of stock returns versus market returns is the basis of the market model. In accordance with Firmansyah et al. (2020b), the standard deviation of the monthly residuals from the regression equation below is used to estimate the annual idiosyncratic risk. After Firmansyah et al. (2020b), the results are multiplied by √12 to produce the yearly idiosyncratic value.

$$R_{it} = \beta_0 + \beta_1 R_{Mt} + \varepsilon_t \quad \text{.....(1)}$$

Notes:

Rt	:	monthly stock rate of return
RMt	:	Monthly market rate of return
εt	:	Residuals of the equation

In this research, a quality financial report is a financial report that is free from earnings management. In this case, earnings management is measured using the Stubben (2010) model. Earnings management is measured from income accruals based on the following formula:

$$\Delta AR = \alpha + \beta_1 \Delta R1\_3_{it} + \beta_2 \Delta R4_{it} + \varepsilon_{it} \quad \text{.....(2)}$$

Notes:

ΔAR	:	changes in accounts receivable
$\Delta R1\_3$	:	changes in revenue in the first three quarter.

$\Delta R4$: Changes in revenue it the forth quarter

εt : Residuals of the equation

Earnings management which is denoted as "ε" is then taken as an absolute value and multiplied by minus 1 to indicate the level of quality of financial reports. The highest value indicates higher quality financial reports.

ESG disclosure in this research was measured using a content analysis approach. Disclosure indicators are measured using Global Reporting Initiatives (GRI) 4 with details as presented in Table 1.

Table 1 ESG Disclosures Measurement

Aspecs	Dimensions	Indicators	Sources
Environmental	9 Dimensions	30 indicators	GRI 300
Social	19 Dimensions	34 indicators	GRI 400
Governance		22 indicators	GRI 102.18-102.39
Total		86 indicators	

Each disclosure of an indicator will be given a score between 0 and 3 where 0 indicates the lowest score and 3 is the highest score. The scoring guide follows Morhardt et al (2002) and Yadava & Sinha (2016) with the guidelines as stated in Table 2.

Table 2 ESG disclosure scoring method

Criterion	Score
No disclorusure	0
Short statement or general statement	1
Full disclosure but no more than one year	2
Full disclosure comparing performance over one year	3

Based on content analysis, each disclosure presented by an entity in its annual report will be assessed based on the above guidelines and then compared with the maximum score that can be obtained (225 points). The formula for measuring the quality of disclosure is presented with the following notation:

$$ESGD_{it} = \frac{Score\ obtained}{Maximum\ score\ can\ be\ obtained} \ldots\ldots\ldots\ldots (3)$$

In this research, risk disclosure is proxied by the Enterprise Risk Management (ERM) disclosure index based on the risk management framework as prepared by COSO (2017). The indicators for measuring risk disclosure are as mention in Table 3.

Table 3 Risk Disclosure Indicators

No.	Dimension	Indicators
1.	Governance and culture	5 indicators
2.	Strategy and strategy setting	4 indicators
3.	Performance	5 indicators
4.	Review and revision	3 indicators
5.	Reporting	3 indicators
Total		20 indicators

Using the same method used by Morhardt et al (2002) and Yadava & Sinha (2016), every risk disclosure made by the company will be given a value between "0" and "3" with the following guidelines.

Table 4 Risk discosure scoring method

Criterion	Score
No disclorusure	0
Short statement or general statement	1
Full disclosure but no more than one year	2
Full disclosure comparing performance over one year	3

The values obtained from each indicator are then added up and calculated using the following formula.

$$RISKD_{it} = \frac{Total\ score\ obtained}{Maximum\ score\ can\ be\ obtained} \ldots\ldots\ldots (4)$$

Audit quality is measured using the Audit Quality Composite Index which is built using the input-output production model approach. Measurement using a composite measurement approach aims to cover weaknesses in measuring audit quality which generally uses a single proxy. Several previous studies used characteristics of auditors such as Big-N or Non-Big-N audit firm (Bacha et al., 2020; Chae et al., 2020, Orazalin & Akhmetzanov, 2019; Ugwunta et al., 2018 and

Thu, 2018) or auditor experience and audit fees (Sattar, et al., 2020). Apart from using the characteristics of audit firms, several studies use the quality of earnings from financial reports as a proxy for audit quality (Ali & Aulia, 2015; and Martinez & Moraes, 2014). Another approach used to measure audit quality is to use whether there are lawsuits or violation of audit standards based on the results of the regulator's examination (Rajgopal et al. 2021; by Aobdia, 2019 and Christensen et al., 2023).

However, these approaches to measuring audit quality has weaknesses. The main weakness of the proxy used by these researchers is that it only uses one measure and does not consider input and process factors in measuring whether an audit is quality (Knechel et al., 2013). Furthermore, measuring audit quality by using output in the form of whether there are discretionary accruals in the financial reports or restatements in the financial reports actually obscures the purpose of the measurement, whether to measure the quality of the financial reports or the quality of the audit itself. Because a high quality financial report will still have a high quality even if it is audited with poor quality.

This research uses an input-output production model approach by considering that an audit is a process where the auditor collects and evaluates evidence for an assertion and concludes the level of conformity of the assertion with relevant criteria (Arens et al., 2012). In the basic concept of the process, the process is an interrelated production system that connects input factors to produce output (Lin & Polenske, 1998). When conducting an audit, the resources needed to provide a specific level of output are considered inputs to the audit process. Audit output is more elusive to describe than the auditing process itself, which is the activity of gathering and assessing audit data (Arens et al. 2012). O'Keefe et al. (1994), however, define the output of the audit production process as the degree of assurance attained on the accuracy of the financial statements.

From the definition of O'Keefe et al. (1994), it can be concluded that the output of a quality audit is an opinion regarding the real condition of the level of conformity of an assertion with the criteria. Among these three dimensions, professions and regulators see that input and process factors are internal factors that have a greater role in determining the quality of an audit (PCAOB, 2015). Based on these considerations, the audit quality index constructed will consist of two dimensions, namely input and process dimensions, two internal factors that play a role in determining audit quality. Each dimension is identified based on content analysis of research related to audit quality.

The input dimension in an audit is the resources used in an audit. In an audit, human resources are the main aspect of the audit apart from the audit methodology. Consequently, the resources required for an audit depend on the personnel available for the engagement, the capabilities and expertise of the audit team, and the support of the audit program used. Apart from that, the ability to make good judgments will also influence audit quality, so that the better the personnel, the better the chances of audit results (Knechel et al. 2013). The ability of personnel to carry out assessments is influenced by two things, namely independence and competence (Arens et al., 2012). In addition to independence and competence, Bills et al. (2016) also emphasize that alliances also determine the quality of an audit. This is because the alliance is able to provide a

standardized audit methodology that is carried out by each KAP personnel in providing services to clients (ICAEW, 2020). From the explanation above, the input factors that can influence audit quality are auditor's independence, competence, specialization and alliances.

The process dimensions in an audit include the process of measuring risk, responding to risk, testing and reporting. In conducting an audit, the auditor is tasked with obtaining relevant and reliable audit evidence as a basis for drawing conclusions (IAPI, 2021). Considering that audits are carried out in a team, there is a division of duties between Public Accountants and auditors who are under their control. The Public Accountant will carry out supervision to ensure that each member of the audit team has carried out tasks in accordance with the assignment, ensuring the adequacy of procedures and drawing conclusions on the audit evidence received (Carcello & Santore, 2015). On the other hand, audit team members are tasked with collecting appropriate and sufficient audit evidence to ensure that management's representation in the report is accurate (Carcello & Santore, 2015). For this reason, the auditor's workload needs to be maintained so that the audit process can be carried out well. Furthermore, the audit tenor will also influence the audit process (Rickett et al., 2016; Hohenfels, 2016). In the initial period of the engagement, the auditor needs time to understand the client's business, then this understanding will increase as time goes by. From the explanation of this process dimension, it can be concluded that Public Accountant workload, auditor workload and audit tenor are important indicators. The measurement for each indicators can be seen on Table 5.

Table 5 Audit Quality Composite Index

No.	Indicators	Measurement	Maximum Score
A. INPUT			
1.	Independence of the audit firm	$1 - \frac{Audit\ Fee}{Total\ Audit\ Fee}$ ……..(5) (IAPI, 2019; Tepalagul & Lin, 2015; DeAngelo, 1984)	1
2.	Public Accountant's Competence	$\frac{CPE\ Credit\ on\ Audit\ and\ Accounting}{Total\ CPE\ Credit}$ …. …. (6) Dickins dkk (2018)	1
3.	Audit Firm's specialitation	$\frac{Audit\ Firm's\ clients\ in\ particular\ sector}{Total\ firms\ in\ particular\ sector}$ .. (7) (Rajgopal dkk, 2021; Minutti-Meza, 2013)	1

4.	Audit firm's alliance	$\frac{Number\ of\ alliance}{Number\ of\ alliance\ allowed} \ldots\ldots\ldots(8)$ (Bills dkk., 2016; Public Accountant Law 5/2011)	1
B. PROCESS			
5.	Public Accountant Workload	$1 - \frac{Average\ client}{Total\ audit\ client\ of\ audit\ firm} \ldots.(9)$ (Chang, 2017)	1
6.	Auditor work load	$1 - \frac{Average\ client\ handled\ by\ auditor}{Total\ audit\ client\ of\ audit\ firm} \ldots.(10)$ (Chang, 2017)	1
7.	Audit tenure	$\frac{Audit\ tenure}{Maximum\ audit\ tenure} \ldots\ldots(11)$ (Rickett dkk. 2016; Hohenfels, 2016)	1
FORMULA			
	Audit Quality Index	total score of 7 indicators measuring audit quality for clients i	7

Following Bontis et al. (2018), the scores obtained for each indicator are then added up to get a total score of audit quality. Thus, the greater the value obtained, the better the audit quality with a maximum value of 7.

In this research, control variables are also used, namely company size, leverage and cash flow from operations. By following Kong et al. (2020) and Firmansyah (2020b). To calculate the size of the corporation, we take the natural logarithm of all of its assets. Total debt at t divided by total assets at t-1 is used to calculate leverage, while cash flow from operating activities recorded in the cash flow statement at t divided by total assets at t is used to calculate operating cash flow.

Hypothesis testing was carried out by Structural Equation Modelling (SEM) testing by considering that the research samples came from different sectors. The following is the regression model used in this study.

$$IDIOSIN_{it} = \alpha + \beta_1 FRQ_{it-1} + \beta_2 ESGD_{it-1} + \beta_3 RISKD_{it-1} + \beta_5 AQ_{it-1} + \beta_6 \mathrm{FRQ}_{it-1} xAQ_{it-1} + \beta_7 \mathrm{ESGD}_{it-1} xAQ_{it-1} + \beta_8 \mathrm{RISKD}_{it-1} xAQ_{it-1} + \beta_9 SIZE_{it-1} + \beta_{10} LEV_{it-1} + \beta_9 OCF_{it-1} \ldots\ldots\ldots\ldots\ldots\ldots(12)$$

Notes:

IDIOSIN : Idiosyncratic Risk

FRQ : Financial reporting quality

ESGD : ESG Disclosure

RISKD : Risk Disclosure

AQ : Audit Quality

SIZE : The company's size

LEV : Financial leverage of the company

OCF : Operating cash flow of the company

4. RESULT AND DISCUSSION

4.1.Descriptive statistics

Descriptive statistics used in this research are the lowest value (minimum) and highest value (maximum), average (mean), and standard deviation (standard deviation) from the research.

Table 6 Statistics Descriptive

Variable	Min	Max	Mean	Std. Dev
IDIOSIN	0.053	3.146	0.408	0.341
FRQ	-2.386	0.000	-0.092	0.252
ESGD	0.002	0.542	0.232	0.105
RISKD	0.017	0.817	0.344	0.137
AQ	3.328	5.090	4.543	0.280
SIZE	17.365	36.924	29.360	2.535
LEV	0.003	269.978	1.593	15.092
OCF	-22.681	0.621	0.002	1.225

The Financial Report Quality (FRQ) variable illustrates the importance of high-quality profits; the greater the value attained, the better the profits. Table 6 above indicates that the highest FRQ value is 0 and the lowest is -2,386. The sample's average financial report quality score is -0.092 with a 0.252 standard deviation. This indicates that the quality of financial reports is on average good but very dispersed.

With a standard deviation of 0.105, the sample's average ESG disclosure value is 0.232. Since a company can only receive a score of 1, an average of 0.233 suggests that the quality of ESG disclosures given by companies is generally low.

Table 6 shows that 0.017 is the lowest risk disclosure value and 0.817 is the greatest number. With a standard deviation of 0.137, the sample's average risk disclosure value is 0.344. A company can only achieve a maximum value of 1 based on measurements. Based on this condition, we can observe that, in comparison to the 2017 COSO ERM Framework requirements, company disclosures are still very little, as the average quality of company disclosures is 0.344.

The audit quality value consists of seven indicators with the maximum value for each indicator being 1, so a quality audit will get a maximum value of 7. With an average value of 4.543, it can be concluded that the audit quality sample is medium to high.

4.2.Structural Modelling

In this research, the criteria used include estimated path coefficient (β), coefficient of determination (R2), effect size (f2), predictive relevance (Q2) and model fit (SRMR) (Hair et al., 2019). Using SmartPLS 3.0 output, the implication of the independent variable on the dependent variable and the moderation effect are tested. Regression significance was obtained using the PLS-SEM Bootstrapping process. The results obtained are presented in Table 7.

The results presented in Table 7 shows that only Hypothesis 2 (ESG disclosure has a negative implication on idiosyncratic risk; β: -0.103 and p-values: 0.011) and Hypothesis 4 (audit quality has a negative effect on idiosyncratic risk; β: -0.119 and p -values: 0.023) are proven. The variables of financial report quality (hypothesis 1), risk disclosure (hypothesis 3) were not proven to have a negative effect on idiosyncratic risk. Additionally, Table 7 demonstrates that the negative effects of risk disclosure, ESG disclosure, and financial report quality on idiosyncratic risk are not amplified by audit quality (Hypothesis 5, 6 and 7).

In this research, we get an adjusted R2 value of 3%. This value shows that the independent variables are only able to explain variations in idiosyncratic risk of 3%, while the remainder (97%) is explained by factors other than those identified in the study. Furthermore, how strong the influence of each independent variable is on the dependent variable can be seen in the f2 value presented in Table 8. It can be seen in Table 8 that the influence of each independent variable (FRQ, ESGD, RISKD and AQ) is below 0.02 which shows that the influence of each variable is very low (Hair et al., 2019), as well as the moderating variable which is below 0.05 (Hair et al., 2019) which shows the influence of the moderating variable is low.

Table 7 Hypothesis Test

	Path Coefficient (β)	**T-statistics**	***p*-values**	**Hypothesis**
FRQ → IDIOSIN	0.105	3.232	0.001	Rejected

ESGD → IDIOSIN	-0.103**	2.302	0.011	Accepted
RISKD → IDIOSIN	-0.069	1.142	0.127	Rejected
AQ → IDIOSIN	-0.119**	1.995	0.023	Accepted
FRQ*AQ → IDIOSIN	-0.053	0.853	0.197	Rejected
ESGD*AQ → IDIOSIN	0.062	1.298	0.097	Rejected
RISKD*AQ → IDIOSIN	-0.065	1.036	0.127	Rejected
SIZE→ IDIOSIN	0.040	0.631	0.264	-
LEV→ IDIOSIN	-0.030	0.518	0.302	-
OCF→ IDIOSIN	0.027	0.763	0.223	-

Notes:

**Significance at 5%

IDIOSIN= idiosyncratic risk, FRQ=financial report quality, ESGD=ESG disclosure; RISKD=risk disclosure; AQ= audit quality; SIZE= company size; LEV= leverage; OCF= cash flow from operations.

Table 8 Effect size of research model

	***f*2 IDIOSIN**	**Effect Size**
FRQ	0.010	Very Small
ESGD	0.009	Very Small
RISKD	0.005	Very Small
AQ	0.010	Very Small
FRQ*AQ	0.001	Very Small
ESGD*AQ	0.004	Small
RISKD*AQ	0.004	Small
SIZE	0.001	Very Small
LEV	0.001	Very Small

OCF	0.001	Very Small
Notes: IDIOSIN= idiosyncratic risk, FRQ=financial report quality, ESGD=ESG disclosure; RISKD=risk disclosure; AQ= audit quality; SIZE= company size; LEV= leverage; OCF= cash flow from operations.		

To test how strong this model is in making predictions, we conducted a Q^2 test. By applying blindfolding, the results obtained were 2.6%. This value indicates that the model prediction value is low (Hair et al., 2019). Finally, to ensure that the model fit, we performed the Standardized Root Meansquare Residual (SRMR) test. The SRMR value obtained is 0.002 which indicates that the model is fit because the value obtained is below 0.08 (Hu & Bentler, 1999).

4.3.Discussion

This study is unable to demonstrate that idiosyncratic risk can be decreased by financial report quality. Idiosyncratic risk is seen to grow with the quality of financial reports. This phenomenon can be explained by research conducted by Hutton et al. (2009) who conducted research on the influence of financial report quality on the idiosyncratic volatility of companies in the United States. Hutton et al. (2009) found that the less clear the financial statements, the lower the idiosyncratic volatility. Unclear financial reports will reduce company-specific information so that it will have little impact on idiosyncratic volatility (Hutton et al., 2009). The same thing was also obtained by Aman (2011) who tested how the impact of management performance forecasting affects idiosyncratic volatility. The results obtained are also in line with Hutton et al. (2009) where the fewer errors management makes in forecasting its performance, the higher the idiosyncratic volatility in the company because specific information that is too clearly read can actually increase the company's risk.

This research proves that ESG disclosure has a negative effect on idiosyncratic risk. From an agency theory perspective, disclosures made by management related to ESG aim to reduce information asymmetry that occurs between investors and management. By presenting information related to ESG, management provides information to investors regarding how management manages the environment, social and governance. Management expects that investors can assess whether management policies and decisions related to ESG will be in line with investors' interests. ESG-related policies and decisions that are in line with investors' interests will be able to reduce idiosyncratic risks and vice versa if investors judge that these policies and decisions are not in line with investors' interests. Thus, with the results obtained, it can be seen that investors are considering how management manages its ESG, which is reflected in the decrease in idiosyncratic risk.

This outcome is consistent with studies carried out by Reber et al (2021). The impact of ESG disclosure on the idiosyncratic risks associated with companies making initial public

offerings was examined by Reber et al. (2021). Reber et al. (2021) see that the initial stock offering is a time when information asymmetry is very large. Reber et al. (2021) found that voluntary ESG disclosure was able to reduce a company's idiosyncratic risk. The same thing was also concluded by Izcan & Bektas (2022) who found that ESG disclosure can reduce risk in banking companies in Europe. Similar results were also obtained by Giese et al. (2019) and Murata & Hamori (2021) for Japanese and European companies. Reber et al. (2021) provides an explanation of how the role of ESG disclosure can reduce idiosyncratic risk. ESG disclosure is a way for management to respond to requests from stakeholders to balance corporate power by making corporations more accountable for material aspects in order to keep the public's approval to continue operating (Reber et al., 2021). Apart from that, ESG disclosure is a strong instrument to strategically prevent damage to the company, for example, in the form of loss of reputation, sustainability risks. and risks of financial distress and litigation (Reber et al., 2021).

This research shows that risk disclosure does not have a negative effect on idiosyncratic risk. This research shows that risk disclosure made by management is not seen as a factor that reduces information asymmetry between management and owners. If we look at the descriptive statistics of the data. The average value of risk disclosure made by companies in Indonesia is 0.34 on a scale of 1. So the disclosure presented is very minimal compared to the indicators that are expected to be disclosed based on the 2017 COSO Framework. The lack of disclosure made by management could be one of the factors that influences whether the owner consider risk disclosures in assessing the company's idiosyncratic risks.

This research shows empirical evidence that audit quality is able to reduce idiosyncratic risk. Thus, investors consider the role of auditors in reducing information asymmetry between management and investors. Investors consider audit quality in determining idiosyncratic risk. The outcomes are consistent with Chen et al. (2017) research, which found that a quality audit can lessen shareholders' motivation to look for more information to lower idiosyncratic risk. Likewise, research conducted by Houqe et al. (2017) and Thu et al. (2017) where both of them also concluded that a quality audit is able to reduce the cost of equity due to reduced company risk.

Regarding the role of audit quality as a moderator that strengthens the negative influence of financial report quality, this research fails to prove this hypothesis. This condition is in line with research conducted by Chen et al. (2011) on a sub-sample of state-owned companies in China. In his research, Chen found that the quality of audit did not affect the cost of equity capital of state-owned companies. When viewed from an idiosyncratic risk perspective, the lack of influence on the cost of equity capital indicates that idiosyncratic risk are not influenced by the quality of the audit.

Moreover, this study is unable to demonstrate that audit quality can amplify the detrimental impact of ESG disclosure on idiosyncratic risks. The primary goal of the auditor in this study's audit context—a general audit of financial reports—is to express a judgment regarding the propriety of the financial reports that management has given to shareholders. A company's financial report isn't, however, released separately. The financial report will be included in the annual report, which will also contain other information, such as ESG, in addition to financial data.

In this regard, the auditor's obligations with regard to other data included in financial report-containing documents are governed by ISA 720. The auditor is required by ISA 720, paragraph 6, to review additional information included in documents that contain financial statements in order to determine whether there are any discrepancies between the information included in the financial statements and information not included in them (IAASB, 2015). When it comes to ESG disclosure, the auditor is required to review and make sure that the data released is in line with the data shown in the financial statements. Accordingly, the auditor has verified the information in the ESG disclosure, provided it has relevance to the financial report. The auditor's function in verifying ESG-related information in the annual report appears to go unnoticed by shareholders, meaning that it has no effect on idiosyncratic risk reduction.

Lastly, the study is unable to demonstrate how audit quality contributes to the negative impact that risk disclosure has on idiosyncratic risks. According to ISA 720, in order to determine whether there are any discrepancies between the information included in the financial statements and information outside of them, the auditor must review additional material included in documents containing financial statements (IAASB, 2015). When it comes to risk disclosure, the auditor has to read it and make sure the information shared about the risks is in line with what's shown in the financial statements. As a result, the auditor has verified the information in the risk disclosure, provided that it has anything to do with the financial statements. Nevertheless, as shareholders are unaware of this function, the auditor's verification of risk-related data in the yearly report has no bearing on lowering idiosyncratic risks.

5. CONCLUSION

This research tries to analyze how financial, non-financial information and audit quality influences the idiosyncratic risks faced by investors. This is important because idiosyncratic risks are not easy for small investors to avoid. Apart from that, this research also tries to analyze how a quality audit moderates the influence of financial and non-financial information on idiosyncratic risk.

It can be concluded that non-financial information particularly ESG disclosure is able to reduce the company's idiosyncratic risk. The role of presenting information by management to owners as a mechanism to reduce asymmetric information is able to carry out its role. Investors, in this case owners, use information provided by management in adjusting idiosyncratic risks. Investors see that this information is able to reduce the company's idiosyncratic risk. This research presents empirical evidence that in emerging markets investors' attention is not only related to financial information, but also includes non-financial information such as ESG disclosure. This research also proves that the role of quality audits is also considered by investors in decision making so that it can influence idiosyncratic risks.

However, this research fails to prove the role of a quality audit in increasing the negative influence of financial and non-financial information on idiosyncratic risks as expected by ISA 720 regarding the auditor's responsibility for other information presented in documents containing financial reports.

This research also fails to prove that quality financial reports can reduce idiosyncratic risk. Even though this has also happened in several other studies, the results obtained indicate that investors actually become more worried if the financial reports become clearer.

Based on this, it is recommended that further research be able to solve issues related to how the quality of financial reports influences idiosyncratic risk by using time series data or by using different measurements. Apart from that, it is recommended that further research can also identify the role of audit quality as intended in ISA 720 by using more precise audit quality measurements.

This research has a theoretical contribution by providing empirical evidence of how information related to ESG disclosure can reduce idiosyncratic risk. Practically, this research can be used as a reference for the regulator in issuing regulations related to the disclosure of non-financial information that needs to be carried out by issuers and also for standard setters in developing ESG-related reporting standards.

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