

The Discrepancy in ESG Ratings and Audit Quality

Yaxuan Lin*

School of Economics and Management, Shanxi University, Taiyuan, China.

18634921724@163.com

Abstract. The ESG rating system serves as an important reference for assessing corporate sustainability. However, due to discrepancies between rating agencies, the evaluation results exhibit significant variations, which severely undermine the external users' ability to make comprehensive and objective assessments of companies. In this context, this paper examines the intrinsic relationship between ESG rating discrepancies and audit quality from the perspective of auditors. Using a sample of A-share listed companies from the Shanghai and Shenzhen stock exchanges from 2009 to 2023, the study systematically investigates the impact of ESG rating discrepancies on audit quality and the underlying mechanisms. The findings reveal that ESG rating discrepancies significantly enhance audit quality, primarily through two mechanisms: increased analyst attention and improved internal controls. Heterogeneity analysis shows that the positive relationship between ESG rating discrepancies and audit quality is more pronounced when analysts' earnings forecast abilities are stronger and when market competition is higher. This study provides empirical evidence on the economic consequences of ESG rating discrepancies, offering decision-making insights for audit firms in developing risk assessment frameworks, and supplying empirical support for regulators in constructing a standardized evaluation system for corporate sustainability criteria.

Keywords: ESG Rating Discrepancies; Audit Quality; Analyst Attention; Internal Control.

1. Introduction

Corporate ESG ratings are a critical criterion for the strategic decision-making of stakeholders and an important reference for evaluating corporate sustainability. However, due to discrepancies in the information collected by different ESG rating agencies and variations in their evaluation frameworks, the ratings for the same company can differ significantly across agencies. Existing literature suggests that such discrepancies can produce two distinct effects: on the one hand, ESG rating discrepancies can have an “empowering” effect on corporate development by enhancing the company’s voluntary information disclosure (He Taoming et al., 2023)^{错误!未找到引用源。} and reduce the cost of debt financing for the company (Li Fengyu and Zhai Xinyue, 2024; Chen Pengcheng et al., 2024)^{错误!未找到引用源。} [1]. On the other hand, ESG rating discrepancies also have a “negative” effect. An increase in these discrepancies can not only diminish the effectiveness of corporate information disclosure but also reduce the accuracy of analysts’ predictions regarding expected stock returns (Serafeim and Yoon, 2023)^[2]. The China Securities Regulatory Commission (CSRC) issued “The Guidelines for Investor Relations Management of Listed Companies”, which outlined the requirements for ESG information disclosure. Subsequently, in February 2023, the Supreme People’s Court released “The Opinions on Fully and Accurately Implementing the New Development Philosophy and Providing Judicial Services to Actively and Steadily Promote Carbon Peak and Carbon Neutrality”, explicitly elevating the disclosure of corporate ESG reports as one of the key strategic measures to support the country’s economic transformation. In 2024, the Ministry of Finance issued “The Corporate Sustainability Disclosure Standards-Basic Guidelines (Trial)”, providing clear regulations on corporate sustainability information disclosure to progressively advance the development of China’s sustainability disclosure standards system. Therefore, investigating the causes and economic consequences of ESG rating discrepancies, as well as improving the construction of corporate sustainability disclosure standards, is a core task in building a modern capital market with Chinese characteristics, and is of significant importance for promoting high-quality corporate development.

The discrepancies in ESG rating systems not only increase the complexity of information verification but may also result in additional audit resource allocation, consequently raising audit risk

(Zhou Zejiang et al., 2023)^{错误!未找到引用源。}. As audit risk is closely linked to audit quality, discrepancies in corporate ESG ratings may further influence auditors' perception of risk and their accumulation of experience, thereby impacting the quality of the audit (Han Weifang, 2017)^[5]. However, there is a lack of literature that deeply explores the impact of ESG rating discrepancies on audit quality. In light of this, this paper aims to examine the relationship between ESG rating discrepancies and corporate audit quality from the perspective of auditors, and attempts to answer the following questions: Does a greater discrepancy in ESG ratings enhance or inhibit audit quality? If such an effect exists, what is the underlying mechanism? Is there heterogeneity under different conditions?

This paper focuses on the intrinsic relationship between ESG rating discrepancies and corporate audit quality, selecting A-share listed companies on the Shanghai and Shenzhen Stock Exchanges from 2009 to 2023 as the research sample. It systematically examines the impact of ESG rating discrepancies on audit quality and the underlying mechanisms. The study confirms that ESG rating discrepancies significantly improve corporate audit quality, with this effect primarily operating through two channels: increased analyst attention and improved internal corporate quality. Heterogeneity analysis reveals that when companies possess strong analyst earnings forecasting capabilities or face higher market competition pressure, the positive relationship between ESG rating discrepancies and audit quality becomes more pronounced.

The contributions of this study are primarily as follows: First, it expands the understanding of the economic consequences of ESG rating discrepancies. Existing research has predominantly focused on exploring the relationship between ESG rating discrepancies and corporate development (Jiang Yuanyuan et al., 2024)^[6], with relatively less attention given to the role of other market participants. This study adopts an audit perspective to systematically expand and deepen the theoretical exploration of the economic effects of ESG rating discrepancies. Second, it contributes to the understanding of factors influencing audit quality. Innovatively, this research analyzes the impact of ESG rating discrepancies on audit quality through the lenses of analyst earnings forecasts and market competition, providing an in-depth examination of the underlying mechanisms. Third, it offers empirical evidence to inform the development of relevant policies. From the standpoint of auditors, this study investigates the mechanisms through which ESG rating discrepancies affect audit quality, aiming to uncover the intrinsic relationship between the two. This research not only provides theoretical guidance for auditors in addressing ESG rating discrepancies, but also offers valuable insights for policymakers to better promote the establishment of corporate ESG disclosure standards.

2. Theoretical Analysis and Research Hypotheses

This paper argues that, based on the principle of accounting conservatism, the impact of ESG rating discrepancies on corporate audit quality primarily operates through two mechanisms: First, ESG rating discrepancies enhance analyst attention, which in turn improves audit quality. According to signaling theory, increased analyst attention can subject firms to stricter external supervision, maximizing the effectiveness of monitoring and improving governance standards, making it more difficult for corporate executives to engage in opportunistic behavior. The quality of audits conducted by accounting firms is also significantly related to external supervisory mechanisms. As key information intermediaries, analysts, through their market oversight function and media exposure effects, create reputational risks for accounting firms. These risks can have profound negative implications for the future business development of the firms, prompting them to invest more in audit costs, provide higher-quality audit reports, and fulfill their audit responsibilities (Yan Huahong et al., 2021)^{错误!未找到引用源。}. Second, ESG rating discrepancies improve audit quality by enhancing internal control. When there is a significant divergence in a company's ESG ratings, executives are likely to implement measures to strengthen the internal control system in order to safeguard their interests. They actively work to improve the internal governance environment, thereby establishing high-quality internal controls. This not only enhances auditors' confidence in the financial statements but also reduces the need for unnecessary substantive testing procedures. Given the limited availability

of audit resources, this allows auditors to issue more informed audit opinions, ultimately improving audit quality. Based on this reasoning, the following hypothesis is proposed:

H1: The greater the divergence in a company's ESG ratings, the higher the audit quality.

3. Research Design

3.1 Data Sources and Sample Selection

The subject of this study consists of Chinese A-share listed companies that received ESG ratings from at least one rating agency between 2009 and 2023. Basic information and financial data for these companies were collected from the CSMAR database. The analysis is based on data from nine rating agencies: Huazheng, Bloomberg, Wind, ShenDao Ronglv, MengLang, Zhongzheng, Runling Global, FTSE Russell, and MSCI. The sample was refined by excluding companies in the financial sector and those designated with special treatment (ST and *ST). After applying these filters, the final sample includes 10,144 annual observations from the selected companies. To mitigate the potential impact of outliers on the sample data, all continuous variables were winsorized at the 1% and 99% levels.

3.2 Model Specification and Variable Definition

The explanatory variable, ESG rating divergence, is defined following the methodology of Avramov et al. (2022)^[7]. First, the ratings or score data provided by each rating agency are standardized. For each agency, the ESG scores of all companies rated by that agency are ranked annually, and these rankings are subsequently standardized. Next, for each company, a "rating pair" is formed by selecting any two rating agencies that rated the company in the same year (companies rated by only one agency are excluded, as they cannot form an effective pair). The standard deviation of the standardized rankings provided by the two agencies in each "rating pair" is then calculated and defined as the "rating divergence". Finally, the average "rating divergence" across all "rating pairs" for a company is used as the company's ESG rating divergence indicator for the year, denoted as *Divergence*.

The dependent variable, audit quality: This study develops a measure of audit quality following the research approaches proposed by Xu Yahui et al. (2018)^[9] and Dong Xiaohong and Sun Wenxiang (2021)^[10], developing a measure of audit quality. First, based on relevant methodological models, the probability of auditors issuing a standard unqualified opinion is predicted. Next, the actual audit opinion received by the firm is compared with the predicted probability, and the difference between the two is calculated. Finally, the absolute value of the negative difference is used as a proxy for audit quality, with a larger value indicating higher audit quality. This approach effectively captures the deviation between the actual audit opinion and the expected outcome, thereby providing a more accurate assessment of audit quality.

$$Mao_{i,t} = \alpha_0 + \alpha_1 QuickR_{i,t} + \alpha_2 AR_{i,t} + \alpha_3 Other_{i,t} + \alpha_4 Inv_{i,t} + \alpha_5 Roa_{i,t} + \alpha_6 Loss_{i,t} + \alpha_7 Lev_{i,t} + \alpha_8 Size_{i,t} + \alpha_9 Age + \alpha_{10} Industry + \alpha_{11} Year + \varepsilon_{i,t} \quad (1)$$

$$Aquality_{i,t} = -|Opinion_{i,t} - Mao_{i,t}| \quad (2)$$

In Model 1, *QuickR* represents the conservative quick ratio, *AR* indicates the proportion of accounts receivable to total assets, *Other* refers to the proportion of other receivables to total assets, *Inv* is the ratio of inventory to total assets, *Roa* denotes the return on total assets, *Loss* reflects whether the firm incurred a loss during the year, *Lev* represents the debt-to-equity ratio, *Size* measures the company's size, and *Age* denotes the number of years since the company went public. Additionally, *Opinion* describes the type of audit opinion actually issued by the auditor.

Selection of Control Variables: To mitigate the impact of endogeneity, this study adopts the approach of ELIWA et al. (2023), Luo Ling and Cao Qingqing (2023), and Li Xiuli et al. (2023)^[12]. The control variables selected include company size (*Size*), profitability (*Roa*), debt-to-equity ratio (*Lev*), firm growth potential (*Growth*), years since listing (*Age*), proportion of independent directors (*Indep*), ownership structure (*Owner*), dual role of CEO and chairman (*Dual*),

ownership stake of the largest shareholder (*Top1*), whether the firm is audited by one of the Big Four (*Big4*), and operating cash flow (*Cash*).

Table 1 Definitions of Variables

| Variable Name | Variable Symbol | Variable Definition |
|---|-------------------|---|
| Audit Quality | <i>Aquality</i> | Calculated from Model 1 |
| ESG Rating Discrepancy | <i>Divergence</i> | The average value of “rating disagreement” across all “raters” |
| Firm Size | <i>Size</i> | Natural logarithm of total assets |
| Total Assets | <i>Asset</i> | Total assets of the firm |
| Profitability | <i>Roa</i> | Net profit / average total assets |
| Debt-to-Equity Ratio | <i>Lev</i> | Total liabilities / total assets |
| Growth Potential | <i>Growth</i> | (Current year revenue - Previous year revenue) / Previous year revenue |
| Years Since Listing | <i>Age</i> | The difference between the sample year and the year of the company’s listing + 1, then the natural logarithm is taken |
| Proportion of Independent Directors | <i>Indep</i> | Number of independent directors / total number of board members |
| Ownership Structure | <i>Owner</i> | State-owned = 1, Non-state-owned = 0 |
| Dual Role | <i>Dual</i> | If the Chairman and CEO are the same person, the value is 1; otherwise, it is 0 |
| Ownership Proportion of the Largest Shareholder | <i>Top1</i> | Ownership stake of the largest shareholder |
| Big Four Audit | <i>Big4</i> | If the company’s annual report is audited by one of the “Big Four” accounting firms, the value is 1; otherwise, it is 0 |
| Operating Cash Flow Year | <i>Cash Year</i> | Net cash flow from operating activities / total assets Annual dummy variable |
| Industry | <i>Ind</i> | Industry dummy variable |

4. Empirical Results Analysis

4.1 Descriptive Analysis

Table 2 presents the descriptive statistics. Based on the analysis and in accordance with the calculation method of Avramov et al. (2022)^[7], there is a significant difference between the maximum value of 0.530 and the minimum value of ESG rating disagreement. Moreover, the mean value of 0.184 is higher than the median of 0.164, indicating a right-skewed distribution. This suggests that ESG rating disagreement is not evenly distributed across firms, with notable variation, and that certain firms exhibit a higher level of rating disagreement. Overall, these findings indicate that ESG rating disagreement is a common phenomenon in the Chinese capital market. This result is consistent with the findings of Zhou Zejiang et al. (2023)^{错误!未找到引用源。}. The mean value of audit quality (*Aquality*) is -0.052, with a median of -0.013, indicating a small difference between the actual audit opinions issued by auditors and the predicted probability of issuing an unqualified opinion. This suggests, to some extent, that the overall audit quality is relatively high. This finding is in broad agreement with the conclusions of Dong Xiaohong et al. (2021)^[10].

Table 2 Descriptive Statistics of Key Variables

| Variable | Sample Size | Mean | Median | Standard Deviation | Minimum | Maximum |
|-----------------|-------------|--------|--------|--------------------|---------|---------|
| <i>Aquality</i> | 24571 | -0.052 | -0.013 | 0.153 | -0.967 | -0.003 |

| | | | | | | |
|-------------------|-------|--------|--------|-------|--------|--------|
| <i>Divergence</i> | 10144 | 0.184 | 0.164 | 0.127 | 0.000 | 0.530 |
| <i>Size</i> | 24571 | 22.507 | 22.330 | 1.299 | 20.004 | 26.438 |
| <i>Roa</i> | 24571 | 0.031 | 0.031 | 0.063 | -0.240 | 0.197 |
| <i>Lev</i> | 24571 | 0.461 | 0.461 | 0.199 | 0.070 | 0.912 |
| <i>Growth</i> | 24570 | 0.134 | 0.083 | 0.359 | -0.540 | 2.166 |
| <i>Age</i> | 24571 | 2.513 | 2.565 | 0.517 | 1.609 | 3.401 |
| <i>Indep</i> | 24571 | 0.375 | 0.357 | 0.053 | 0.333 | 0.571 |
| <i>Owner</i> | 24571 | 0.442 | 0.000 | 0.497 | 0.000 | 1.000 |
| <i>Dual</i> | 24571 | 0.238 | 0.000 | 0.426 | 0.000 | 1.000 |
| <i>Top1</i> | 24571 | 0.336 | 0.311 | 0.146 | 0.087 | 0.736 |
| <i>Big4</i> | 24571 | 1.930 | 2.000 | 0.256 | 1.000 | 2.000 |
| <i>Cash</i> | 24571 | 0.050 | 0.048 | 0.068 | -0.152 | 0.246 |

4.2 Benchmark Regression Results

Table 3 presents the benchmark regression results for the relationship between corporate ESG rating divergence and audit quality. Column (1) examines the relationship between ESG rating divergence and audit quality without including control variables. Column (2) includes control variables but does not account for year and industry fixed effects. Column (3) includes both control variables and accounts for year and industry fixed effects. As shown in the results of Table 3, the coefficient for *Divergence* is positive and statistically significant at the 1% level, indicating a significant positive relationship between ESG rating divergence and audit quality. Specifically, greater divergence in ESG ratings is associated with higher audit quality. This finding supports Hypothesis H1, which suggests that ESG rating divergence positively influences audit quality.

Table 3 Benchmark Regression Results

| Variable | <i>Aquality</i> | | |
|-------------------|-----------------------|-------------------------|-------------------------|
| | (1) | (2) | (3) |
| <i>Divergence</i> | 0.1165*** (7.4271) | 0.0477*** (3.3885) | 0.0430*** (3.0676) |
| <i>Size</i> | | 0.0138*** (6.4683) | 0.0128*** (5.7694) |
| <i>Roa</i> | | 0.9076*** (20.2461) | 0.9006*** (20.1272) |
| <i>Lev</i> | | -0.0711*** (-4.0530) | -0.0830*** (-4.8784) |
| <i>Growth</i> | | 0.0154** (2.5235) | 0.0159** (2.5318) |
| <i>Age</i> | | -0.0259*** (-5.8217) | -0.0240*** (-5.2479) |
| <i>Indep</i> | | -0.0085 (-0.2742) | -0.0144 (-0.4590) |
| <i>Owner</i> | | 0.0326*** (5.9503) | 0.0311*** (5.3345) |
| <i>Dual</i> | | 0.0046 (0.9738) | 0.0044 (0.9351) |
| <i>Top1</i> | | 0.0060 (0.4222) | 0.0080 (0.5611) |
| <i>Big4</i> | | 0.0029 (0.5012) | 0.0044 (0.7313) |
| <i>Cash</i> | | -0.1585*** (-5.0263) | -0.1278*** (-3.8706) |
| Constant | -0.0777*** | -4.8315*** | -0.2770*** |

| | | | |
|-------------------------|------------|-----------|-----------|
| | (-17.4366) | (-3.8669) | (-5.1608) |
| Year | Control | Control | Control |
| Industry | Control | Control | Control |
| Sample Size | 10144 | 10144 | 10144 |
| Adjusted R ² | 0.008 | 0.206 | 0.225 |

Note: The values in parentheses are t-statistics, with ***, **, and * denoting significance at the 1%, 5%, and 10% levels, respectively. The same applies to the following tables.

4.3 Robustness Check

4.3.1 Substitution of Explanatory Variables

Building on the research design of Avramov et al. (2022)^[7], this study calculates the industry average of annual ratings for each company, and subsequently computes the overall mean. As shown in column (1) of Table 4, the regression coefficient for ESG rating divergence is statistically significant at the 1% level. This empirical result not only reinforces the findings from previous studies but also further supports the robustness of the benchmark regression results. By employing the industry average calculation method, potential systematic biases are effectively controlled, thereby strengthening the credibility of the study's conclusions.

4.3.2 Substitution of the Dependent Variable

Following the method of Wu Weirong et al. (2017)^[14], this study predicts the probability of issuing a non-standard audit opinion using a model. After regression, the predicted value is subtracted from the actual audit opinion issued. Specifically, a value of 1 is assigned when a non-standard audit opinion is issued, and 0 when a standard audit opinion is issued. This results in the audit report aggressiveness (*ARAgg*). A higher *ARAgg* value indicates lower audit quality when *ARAgg* is positive. A new regression is then performed with *ARAgg* as the dependent variable. The regression results are presented in column (2) of Table 4. The findings show that the regression coefficient for ESG rating divergence remains significant at the 1% level, and the conclusions of this study remain unchanged.

Table 4 Robustness Check

| Variable | Substitution of Explanatory and Dependent Variables | |
|-------------------------|---|----------------------|
| | <i>Aquality</i> (1) | <i>ARAgg</i> (2) |
| <i>Divergence</i> | | 0.0362** (2.3134) |
| <i>ESGrank</i> | 0.0401*** (7.9910) | |
| Constant Term | -0.3545*** (-8.4378) | 0.0567 (1.0014) |
| Control Variables | Control | Control |
| Year | Control | Control |
| Industry | Control | Control |
| Sample Size | 24,570 | 10,144 |
| Adjusted R ² | 0.193 | 0.028 |

4.3.3 Instrumental Variables Approach

This study investigates the relationship between ESG rating divergence and audit quality, while acknowledging the potential for reverse causality to influence the results. To mitigate potential endogeneity concerns, the study employs an instrumental variables (IV) approach. Given that irregularities in corporate ESG information disclosure may lead to rating divergence, and that such disclosure practices may have spillover effects on other firms within the same industry, the industry and annual mean of ESG rating divergence (*Lv*) are selected as the instrumental variable. The analysis is performed using the two-stage least squares (2SLS) method.

In the first-stage regression, the coefficient of the instrumental variable, *Lv*, is significant at the 1% level, and the F-statistic exceeds 10, indicating the absence of weak instruments and supporting the validity of the chosen instrument. In the second-stage regression, the coefficient for *Divergence* remains significant, providing robust empirical support for Hypothesis H1.

Table 5 Instrumental Variable Estimation Results

| Variable | First Stage | Second Stage |
|---------------------------|----------------------|-------------------|
| | (1) | (2) |
| | <i>Divergence</i> | <i>Aquality</i> |
| <i>IV</i> | 0.907*** (20.648) | |
| <i>Divergence</i> | | 0.109* (1.898) |
| Control Variables | Control | Control |
| Industry/Year | Control | Control |
| Sample Size | 10,144 | 10,144 |
| R2 | 0.123 | 0.223 |
| First-Stage F-Statistic | 14.78 | |
| Wald Chi-Square Statistic | | 2933.77 |

5. Further Analysis

5.1 Mechanism Testing

Building on the theoretical analysis presented above, corporate ESG rating divergence may enhance audit quality by increasing analyst attention and improving internal controls. To examine this mechanism, this study selects analyst attention and internal control systems as the mechanism variables. Following the research frameworks of Jiang Ting (2022) and Xu Subo et al. (2024)^{[15]-[16]}, a theoretical model is developed to explore the pathways and transmission mechanisms through which ESG rating divergence influences audit quality. In this study, analyst attention (*Analy*) is measured by the number of analysts plus one, with the natural logarithm taken. A higher level of analyst attention facilitates the faster transmission of signals regarding a company’s ESG behavior to auditors, enabling them to gather more information and obtain greater social resource support (Li Zhenjie and Kong Yu, 2025)^[17], thereby improving audit quality. A higher value of this indicator reflects greater analyst attention. Additionally, this study uses the internal control index disclosed in the Dibo database, divided by 100, to measure a company’s internal control (*IC*). Research has shown that failures in internal control increase ESG rating divergence, which adversely affects both the company and its executives. This alignment of interests helps curb management’s short-term behavioral tendencies (Li Zhenjie and Kong Yu, 2025)^[17]. By promptly detecting internal control deficiencies, management can enhance internal supervision and improve the company’s internal control system. The results in Table 6 demonstrate that corporate ESG rating divergence enhances audit quality by increasing analyst attention and improving internal controls.

$$\frac{Analy}{IC} = \mu_0 + \mu_1 Divergence_{i,t} + \mu_2 Controls_{i,t} + Industry_{i,t} + Year_{i,t} + \varepsilon_{i,t} \quad (3)$$

The dependent variables consist of two key dimensions: analyst attention (*Analy*) and internal governance level (*IC*). *Divergence* refers to the degree of corporate ESG rating divergence, while *Controls* include the relevant control variables. The model also incorporates fixed effects for both the year and industry to account for these factors. Apart from the mechanism variables, analyst attention (*Analy*) and internal governance level (*IC*), the specifications of the other variables in the model remain consistent with the baseline model to ensure the comparability and robustness of the research results.

Table 6 Mechanism Testing Variables

| Variable | Analyst Attention | Internal Control |
|----------|-------------------|------------------|
|----------|-------------------|------------------|

| | A | B |
|-------------------------|--------------------------|-------------------------|
| | (1) | (2) |
| <i>Divergence</i> | 0.2074** (2.2627) | 75.4953*** (6.5212) |
| Constant Term | -9.3815*** (-18.0072) | 296.2080*** (5.8844) |
| Control Variables | Control | Control |
| Year | Control | Control |
| Industry | Control | Control |
| Sample Size | 10,144 | 10,144 |
| Adjusted R ² | 0.537 | 0.242 |

5.2 Heterogeneity Analysis

Based on the theoretical framework outlined above, when analysts exhibit higher attention toward a company and the company operates in a highly competitive market, its audit quality is expected to improve significantly. Building on this, the present study examines the heterogeneous impact of ESG rating divergence on audit quality from two dimensions: analyst earnings forecasts and market competition.

5.2.1 From the Perspective of Analyst Earnings Forecasts

In the context of ESG rating divergence, companies tend to disclose more information with higher quality, enabling analysts to access more comprehensive and accurate data, which reduces forecast discrepancies (Lang & Lundholm, 1996; Wang Xiong Yuan & Peng Xuan, 2016)^[18]. This study posits that a higher ESG rating divergence signifies greater analyst attention, and to ensure sustainable development, companies will enhance the quality of their disclosures, thereby improving audit quality. To measure analyst earnings forecasts, the study uses the industry median for each year, with values above the median assigned as 1 and those below as 0. The results in columns (1) and (2) of Table 7 show that the coefficient for *Divergence* is significantly positive at the 1% level, and the test for inter-group coefficient differences is significant. In the sample with stronger analyst earnings forecasting ability, the positive relationship between ESG rating divergence and audit quality is more pronounced.

5.2.2 From the Perspective of Market Competition

ESG rating divergence can harm a company's reputation and image. To gain a competitive advantage in a highly competitive market, companies are incentivized to proactively disclose relevant information, thereby enhancing the completeness and effectiveness of their information disclosures. This helps to reduce ESG rating divergence and protect the company's external image. This study posits that in a highly competitive market environment, a company's audit quality will improve significantly. The Lerner Index is used to measure market competition, with companies grouped based on the annual industry median—those above the median are assigned a value of 1, and those below are assigned a value of 0. The results in columns (3) and (4) of Table 7 show that the coefficient for *Divergence* is significantly positive at the 5% level, and the inter-group coefficient difference test is significant. This suggests that in samples with higher market competition, the positive relationship between ESG rating divergence and audit quality is more pronounced.

Table 7 Heterogeneity Test

| Variable | Analyst Earnings Forecast | | Market Competition | |
|-------------------|---------------------------|-------------------------|-------------------------|-------------------------|
| | High | Low | Low | High |
| | (1) | (2) | (3) | (4) |
| <i>Divergence</i> | 0.0663***(3.9191) | -0.0031 (-0.2799) | 0.0139 (1.0933) | 0.0643*** (3.3715) |
| Constant Term | -0.2679** (-2.2837) | -0.1470*** (-3.2453) | -0.1859*** (-3.1399) | -0.3264*** (-3.4975) |

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| Control Variables | Control | Control | Control | Control |
| Year | Control | Control | Control | Control |
| Industry | Control | Control | Control | Control |
| Sample Size | 6,172 | 3,972 | 5,143 | 5,001 |
| Adj_R ² | 0.248 | 0.082 | 0.100 | 0.273 |
| Difference p-value | 0.001*** | | 0.044** | |

6. Research Conclusions and Recommendations

This study, based on a sample of A-share listed companies in the Shanghai and Shenzhen stock markets from 2009 to 2023, explores the impact of ESG rating divergence on audit quality and its mechanisms. The empirical findings reveal the following: First, an increase in the degree of ESG rating divergence significantly enhances audit quality. This conclusion remains robust after conducting several tests, including instrumental variable methods, propensity score matching, and lagged variable checks. Second, mechanism analysis shows that ESG rating divergence improves audit quality through two channels: attracting analyst attention and enhancing the quality of internal controls. These factors provide auditors with richer ESG information, thereby strengthening audit quality. Finally, heterogeneity analysis indicates that the positive relationship between ESG rating divergence and audit quality is more pronounced in samples with stronger analyst earnings forecasting abilities and higher levels of market competition.

Based on these findings, the study offers the following insights:

At the external supervision level, external regulatory bodies such as the government serve as a key driving force for companies to implement ESG principles. They should develop and enhance a Chinese-specific ESG framework that aligns with the practical needs of domestic enterprises, while also establishing ESG information disclosure standards that are tailored to China's national context. At the internal governance level, despite the divergence in ESG ratings, ESG remains an important indicator for corporate management, signaling the need for greater efforts in sustainable development. As the main entities responsible for ESG information disclosure, companies should not only integrate ESG principles into their daily operations and management but also embed ESG into their corporate strategy. In addition, auditors need to maintain a professional and vigilant approach to a company's ESG evaluations, appropriately allocating audit resources based on the actual assessment. Additionally, auditors should incorporate the risks associated with ESG rating divergence into their audit risk assessment framework.

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