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Audit Committee Effectiveness and Environmental, Social and Governance Rating in Malaysia

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ABSTRACT

The purpose of this research is to ascertain the impact of audit committee effectiveness and the environmental, social and governance (ESG) rating for public listed firms in Malaysia. This paper aims to understand how AC effectiveness (ACEF) such as size, independence, meeting and expertise influence the ESG rating. Given that ESG rating is part of corporate reporting, the reporting practice of ESG should therefore be part of the AC's effectiveness. The study uses a sample of 237 listed companies for the year 2023 that discloses ESG rating based on the FTSE Russel rating model. The rating model consists of 3 individual pillars and 14 themes. The collected data was then analyzed through regression analyses. The disclosure of ESG rating was regressed against the AC effectiveness, controlling for firm size, return on asset (ROA) and leverage. The results show a significant positive effect of AC effectiveness on ESG rating for the firms in Malaysia. Individually, AC independence, firm size, ROA and leverage also indicate a positive and significant relationship with the ESG rating. The paper validates the significant of the AC control mechanism in improving the ESG rating hence offering a potential answer to reduce agency and legitimacy issues of firms in Malaysia. This study deepened the understanding about the functions of AC beyond the traditional and compulsory roles to oversee the financial reporting process. Empirical evidence that AC effectiveness leads to a better corporate disclosure practice had also been presented.

Keywords: Audit Committee Effectiveness, Environmental, Social, and Governance Rating, Malaysia
JEL Classification: M1

1. INTRODUCTION

On October 25, 2023, the European Securities and Markets Authority (ESMA) released a report focused on the disclosure of climate-related issues in financial statements. The report is designed to help issuers improve their disclosures and foster greater consistency in the accounting of climate-related matters in IFRS-compliant financial statements. ESMA encourages issuers, including their management, supervisory boards, audit committees, and auditors, to integrate climate-related considerations into the preparation and auditing processes of financial statements.

The role of audit committees has become increasingly complex and vital. As financial scandals, cybersecurity risks, and regulatory demands grow, audit committees serve as key guardians of corporate governance. According to the Wall Street Journal and industry experts, audit committees are tasked not only with ensuring accurate financial reporting but also with overseeing critical risk areas such as environmental, social, and governance (ESG) disclosures, data privacy, and operational risks. In this new environment, audit committees must enhance their expertise, build more robust oversight frameworks, and engage more proactively with independent auditors and legal counsel. By doing so, they protect shareholder value, maintain investor confidence, and ensure regulatory compliance.

High-quality corporate reporting requires relevant, consistent, and trustworthy ESG data. In order to guarantee that data is accurately represented in ESG reporting, the audit committee is essential (Darnall et al., 2022; Darsono et al., 2024; Sukmadilaga et al.,

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2023). Since the board of directors is in charge of authorizing and monitoring management systems, corporate culture, and strategic goals, they have a major impact on the company's success. Corporate responsibility and business ethics are also given top priority by a successful board. A growing body of data indicates a strong positive relationship between a business's profitability and its ESG sustainability performance.

Businesses that have high sustainability ratings typically beat their competitors in terms of market value and financial success. To put it simply, implementing sound ESG policies can give an organization a sustained competitive advantage. Companies understand that reaching one or more of the Sustainable Development Goals (SDGs) is essential to their existence and that doing so will help ensure their long-term viability, especially with regard to climate change (Celone et al., 2022; Pratama et al., 2022).

Thirty-six percent (36%) of director's report that their boards have assigned ESG oversight to the entire board (Darnall et al., 2022). As boards increasingly focus on sustainability issues, directors should consider delegating oversight of specific sustainability components to dedicated committees. It is essential for companies to ensure that the sustainability information they disclose is of high quality, regardless of the medium of disclosure. This necessitates the development of policies, systems, processes, controls, and governance similar to those used for financial reporting. Given its experience in overseeing these matters, the audit committee is ideally positioned to manage sustainability disclosures, as well as the controls and processes needed to ensure consistency in their generation. The audit committee's expertise in financial reporting enables it to evaluate the soundness of the methodologies and policies used by management to develop metrics and other sustainability disclosures.

The remainder of this study is organized as follows. The next section provides a literature review and formulates the hypotheses. This is followed by a section detailing data collection, variables, and methodology. The penultimate section presents the analyses and findings, while the final section concludes the paper.

2. LITERATURE REVIEW

As global markets increasingly prioritize sustainability and responsible practices, growing businesses must adopt ESG factors to survive and thrive. Companies that genuinely commit to reducing their environmental impact, fostering positive stakeholder relationships, and enhancing their operations are more likely to attract investors and secure long-term success. Innovative methods for measuring and showcasing corporate ESG actions are emerging across the Asia-Pacific region. In Malaysia, the Bursa Malaysia stock exchange promotes ESG initiatives through the FTSE4Good Bursa Malaysia (F4GBM) Index, an ESG rating system developed in collaboration with FTSE Russell. This index aims to guide investor decisions, elevate the profiles of high-performing companies, enhance transparency, and support the transition to a sustainable economy. ESG reporting requirements vary across the APAC region, and in Malaysia, publicly listed companies are adapting to stricter rules imposed by Bursa Malaysia. Since ESG reporting became mandatory for listed companies in 2016, firms have had the flexibility to choose their reporting frameworks. However, Bursa Malaysia is now implementing more rigorous reporting requirements in a phased, multi-year approach to strengthen the resilience of listed companies and attract greater investment.

2.1. ESG Rating

To determine a company's ESG rating, FTSE Russell has established itself as a global index providing benchmarks, analytics, and information for investors worldwide. In April 2016, FTSE Russell introduced the FTSE4Good ASEAN 5 Index, developed in collaboration with the Association of Southeast Asian Nations (ASEAN) Exchanges, to evaluate companies against the standards required for inclusion in the FTSE4Good Index.

The ESG rating created by FTSE Russell measures risks and performance across various ESG dimensions using a transparent and reliable methodology. This involves a relative scoring procedure that assesses each theme's impact and relevance to a company's exposure, rather than applying a generic sector-wide approach. The ESG rating consists of a comprehensive score that breaks down into fundamental pillars and thematic evaluations, based on over three hundred individual indicators tailored to each company's unique circumstances.

An ESG rating can highlight the implications of ESG issues on a company's reputation, brand, competitive advantage, and investment decision-making, thereby underscoring the importance of comprehensive ESG disclosures. Furthermore, according to Alam et al. (2022), these measures are crucial for managers who must integrate sufficient ESG considerations into strategic decisions.

Currently, many international and domestic public companies are evaluated on their ESG performance by various third-party reporting and rating providers. The primary users of these reports include financial institutions, asset managers, and other stakeholders. Consequently, sustainable reporting can serve as an effective communication platform between companies and stakeholders, reflecting a company's commitment to sustainability.

A substantial body of literature indicates that strong ESG performance can contribute to a company's financial value over the medium to long term (Chen et al., 2023; Weber, 2023; Xie et al., 2019). Companies excelling in ESG areas are more likely to attract investors focused on sustainability and long-term growth. Characteristics of audit committees, such as board diversity, independence and financially expert and stakeholder engagement, are key drivers of ESG performance and can help companies create long-term value for their stakeholders. Based on these insights, this study aims to identify the characteristics of audit committees that enhance the effectiveness of ESG ratings and has developed a research hypothesis grounded in the premise that audit committee effectiveness influences corporate disclosure.

2.2. Audit Committee Effectiveness and ESG Reporting

In recent years, companies have paid significant attention to non-financial information and found out a way to report their ESG

practices through sustainability reports (Hammami and Hendijani Zadeh, 2020). Accurate sustainability statements have also been emphasized in the literature. As part of the overall implementation of the reporting system, a company's internal auditors collaborate with independent auditors, and the AC keeps tabs on how they are doing (Čular et al., 2020). In an attempt to offer improved non-financial reporting, the AC function has also been examined from several viewpoints.

ESG quality reporting can promote sustainable innovation by providing companies with valuable information and incentives to improve their performance in these areas. By regularly reporting on their ESG performance, companies can identify areas where they need to improve and develop strategies to address them. Audit committee plays a crucial role in enhancing the quality of disclosure practices by providing guidance, oversight, and assurance on the effectiveness of such disclosures. Previous studies highlighted that audit committee helps in enhancing risk disclosure by encouraging the culture of transparency, accountability, and responsibility within an entity.

Furthermore, effective communication and alliance between audit committee and the management enhances the relevance and reliability of disclosures. Furthermore, some studies investigated the attributes of audit committee such as size, meeting frequency, and expertise in developing and improving the quality of disclosures and resultingly, ensuring stakeholders trust and confidence (Bédard and Gendron, 2010).

An AC improves the quality of reporting, risk management and monitoring the operating activities of an organization and therefore helps in improving the overall performance of the firms. Previous studies have shown that reporting quality positively influences the market returns. Likewise, an AC improves the quality of reporting and hence, have a favourable influence on the value of the firm. AC assists in identifying and solving potential issues in corporate reporting practices. AC supervises the affairs of the company independently and closely and it perceives the unethical and fraudulent practices and behaviours in a timely manner. AC protects the interest of the stakeholders by ensuring the accuracy and transparency of corporate reporting. AC is helpful in improving the internal corporate governance mechanism.

In different study, AC attributes were also looked at in relation to how Australian firms disclose their CSR (Appuhami and Tashakor, 2017). Corporate governance frameworks are said to foster practices of corporate transparency, according to the literature (Agnese et al., 2024). If the audit committee is large enough, it may be possible to give more accurate and comprehensive financial information (Rochmah Ika and Ghazali, 2012). In the past, several audit committees' features have been studied in terms of non-financial openness, but the findings have been uneven (Bédard and Gendron, 2010). Audit committee knowledge and neutrality have a favourable impact on Malaysian companies' voluntary disclosure levels (Ghazalia and Shafie, 2019). Audit committee's frequency and their financial knowledge had no effect on how much information was readily available (Bédard and Gendron, 2010).

The independent or non-executive directors' oversight and supervise the functioning and business and have no personal or economic relationship with the firm. Additionally, non-executive directors have diverse experience and backgrounds and are more attentive to environmental and social concerns. Independent directors enhance the firm's value by ensuring that companies are undertaking sustainable actions for its long-term survival (Pisani and Russo, 2021). Also, independent directors enhance the effectiveness of corporate disclosures, especially the ESG reporting to communicate their sustainable actions to the large audience of stakeholders and protect their professional reputation by communicating that company is not just focused on financial performance.

Hence, voluntary ESG reporting helps in improving the social profile of an entity and fosters trust among the stakeholders and shareholders (Chen et al., 2023). According to the assessment of the relevant literature, the contribution of the audit committee to the enhancement of ESG reporting of listed firms in Malaysia has received little attention.

2.2.1. Theoretical framework

Extant literature shows that organizations report ESG issues to address shareholder and legitimacy concerns. However, there can be opposing motives behind ESG reporting.

2.2.2. Agency theory

Agency theory advocates that management acts as an agent to communicate financial and non-financial information between the entity and its stakeholders. Hence, it is important for the management to avoid information asymmetry and AC is responsible to protect the interests of stakeholders (Husted and De Sousa-Filho, 2019). Hence, the existence of independent directors safeguards the interest of the shareholders, making a corporate governance structure an integral component of agency theory. Research in the past has shown that ESG reporting is helpful in addressing the legitimacy concerns of shareholders (Michelon and Rodrigue, 2015).

Agency theory highlights that association between the agent and principle may result in moral issues that could lead to agency costs. Effective ESG reporting lowers the agency costs and consequently, helps in lowering the finance cost for reporting (Meckling and Jensen, 1976). Also, with an integration of financial and non-financial information in one report, the chances of information asymmetry have reduced, resultingly, it helps in reducing the borrowing costs and improving the risk profiles of an organization (Cheng et al., 2014). Further, presence of AC's independence is positively correlated with the quality of ESG reporting and helps in reducing the agency issues within an organization (Zampone et al., 2024). The research in the past has shown that the more independence of the AC is more sensitive to ESG information and give more attention to the details and enhance the overall quality of ESG reporting (Manita et al., 2018).

On the other hand, the Agnese et al. (2024) state that superior performance on the ESG dimension issues is related to reduced agency costs that, in return lower the finance costs for reporting

organization. Similarly, the voluntary preparation of integrated report lowers the information asymmetry, which simplifies lender's assessment of default risk and results in a lower cost of debt.

2.2.3. Legitimacy theory

Using ESG disclosure as a corporate cover, corporate executives may explain their activities and evade full scrutiny (Chen et al., 2023). Hopwood and Unerman (2010) contends voluntary social and environmental disclosures might limit the amount of information about a corporation and its environmental activities that is known. If these approaches are successful, "it is possible that fewer inquiries may be asked of the legitimate organisation, and hence less may be known about it."

Organization's internal control mechanisms are vital in reducing opportunities for business executives to take advantage of ESG disclosures. ESG disclosures' conflicting aims may be resolved via a critical role for the AC, which is a critical and dependable institution among all organizational control systems. The AC's involvement and independence have also been proved to be critical in enhancing both financial as well as non-financial information (Ghazalia and Shafie, 2019). It is the responsibility of an entity to adhere to the rules and regulations and meet the social expectations of its stakeholders. This helps in building the corporate image and ensures long-term survival.

2.2.4. Hypotheses development

2.2.4.1. AC size

Since the ability of AC to effectively carry out its monitoring and regulatory obligations is directly connected to the human capital resources available, the number of persons who make up this body is an important consideration (Bédard and Gendron, 2010). Legislative requirements and past studies suggest that an audit committee should include between three and five members, with a majority of those members being independent, however there is no ideal number. With more people on the audit committee, there is a greater chance that the group will have a diverse range of perspectives, ideas, and talents. In order to strengthen enforcement and monitoring operations, a bigger audit committee discovers and rectify any faults with the reporting process (DeZoort et al., 2002). Hence, this study inferred the following hypothesis:
H1: There is positive and significant association between AC Size and ESG rating.

2.2.4.2. AC meeting

Numerous studies have demonstrated that the total number of meetings conducted each year is a good indicator of an AC's activity (Ghazalia and Shafie, 2019). Having regular meetings demonstrates the members' commitment to their roles and responsibilities and serves as a gauge of the committee's overall performance. Audit committees benefit from regular meetings because they have more time to oversee disclosure processes. The inactive audit committees are less likely to uncover financial irregularities and dishonest disclosure practises because they spend less time together and have weaker bonds among their members (Yang and Krishnan, 2005). Regular meetings proactively address the issues rising from the changes in the business environment and helps firms to responds better to the micro and macro level changes. To guarantee that high quality information is provided upon disclosure, audit committees have regular meetings. Hence the second hypothesis can be inferred is:
H2: There is positive and significant association between AC meeting and ESG rating.

2.2.4.3. AC independence

In order to effectively supervise and monitor, the audit committee's independence is an important attribute (Ghazalia and Shafie, 2019). Regulations and academic standards both call attention to the need of such autonomy. Audit committees with a high degree of independence are better able to detect and prevent fraudulent information collection and representation operations, according to the agency theory (Abbott et al., 2003). Because independent members have no links to internal administration, they are better able to supervise and oversee actions Independent members are better able to present their viewpoints and monitor the corporate operation from different angles. For both financial and non-financial company transparency to be more credible it is important to have an independent AC (Bédard and Gendron, 2010). Therefore, the third hypothesis is:
H3: There is positive and significant association between AC independence and ESG rating.

2.2.4.4. AC expertise

Recent corporate scandals have heightened concerns about the involvement of financial and accounting expertise on these panels. Financial competence is critical for audit committees (Ahmed Haji and Anifowose, 2016). In order to assist other members, understand auditor findings and identify the root of differences between independent auditors and management, it is important to require financial abilities. In order to minimise disputes between the management and statutory auditors, the financial knowledge of the audit committee promotes favourable capital market reactions and decreases vulnerabilities in internal controls (Ahmed Haji and Anifowose, 2016).

When it comes to financial and accounting competence, this body is not as effective as it may be since it does not have such skills (Raghunandan and Rama, 2007). Participation in disclosure by persons with financial expertise ensures higher-quality content (Mangena and Pike, 2005). With the addition of financial professionals, the AC's monitoring duties grow, as well as the healthy rivalry for transparent disclosure processes. Financial professionals' attitudes and abilities are critical when it comes to presenting non-financial information. Accordingly, the following hypothesis regarding audit committee expertise is formed:
H4: There is positive and significant association between AC expert and ESG rating.

In line with the idea that examining overall audit committee characteristics yields a more significant measurement effect (Bin-Ghanem and Ariff, 2016), this study suggests that audit committee effectiveness may result in a greater level of GHG emissions disclosure, as demonstrated in the following hypothesis:
H5: There is positive and significant association between AC effectiveness and ESG rating.

3. DATA AND METHODOLOGY

Using the FTSE Russell Rating Methodology, 237 Malaysian listed businesses that reveal their ESG rating were included in the sample size for this study. Transparent and well-defined ESG standards are used to screen the chosen companies. The FTSE Bursa Malaysia Index Series now offers more benchmarks for Malaysian markets thanks to this rating, which was created to identify Malaysian businesses with acknowledged CSR practices.

3.1. Data Collection and Analysis

The FTSE ESG Russell Advisory Committee is an independent group of leading responsible experts and practitioners on ESG principles and criteria used to compare corporate ESG performance. It oversees the disclosure of index governance and collects information about the effectiveness of the AC, including size, meeting, independence, and expertise, through the annual report. This information is used to establish the ESG rating.

3.2. Dependent Variable

The ESG rating was chosen as the dependent variable, with scores calculated based on the disclosure report following the FTSE Russell Rating Methodology. Companies were ranked according to their ESG ratings among publicly listed companies (PLCs) in the FBM EMAS index, as assessed by FTSE Russell. This study utilized the FTSE rating model from Bursa Malaysia as the primary framework.

The FTSE rating model delivers objective ESG exposure and performance statistics, based on clear and simply applicable standards (FTSE Group, 2015). The three primary pillars of the FTSE Russell rating approach are governance, social, and environmental. These pillars are further divided into fourteen theme scores. Themes for the environmental pillar include supply chain management, pollution and resources, biodiversity, climate change, and water use. The supply chain, labor rights, human rights and community, health and safety, and customer responsibility are the five themes that make up the social pillar. Themes including risk management, tax transparency, corporate governance, and anti-corruption are all included in the governance pillar. Table 1 below is the ranking table as discussed earlier.

Table 1: Scoring FTSE Russell rating methodology

Ranking	Scoring
4	Top 25% by ESG ratings among PLCs in FBM EMAS that have been assessed by FTSE Russell
3	Top 26-50% by ESG ratings among PLCs in FBM EMAS that have been assessed by FTSE Russell
2	Top 51-75% by ESG ratings among PLCs in FBM EMAS that have been assessed by FTSE Russell
1	Bottom 25% by ESG ratings among PLCs in FBM EMAS that have been assessed by FTSE Russell

3.3. Independent Variables

Four independent variables proxying AC effectiveness are used to investigate their impact on the ESG rating. The first variable used is audit committee size (ACSIZE), measured by the total number of audit committee. Audit committee meeting (ACMEET) is the second variable, calculated as the frequency of AC meeting held for the year. The third variable is audit committee independence (ACINDEP) calculated by the total number of independent members divided by the total number of audit committee. The fourth variable is audit committee expert (ACEXPERT) measured by the percentage of AC with financial expertise background.

To calculate the composite measure of audit committee (AC) effectiveness, each non-binary variable was transformed into a binary format by assigning a value of one to variables that were greater than or equal to the median of all samples, and zero otherwise. Thus, the composite score for the AC ranged from zero to three, with higher scores indicating greater AC effectiveness. This approach has been used in previous studies by DeFond et al. (2005) and Bin-Ghanem and Ariff (2016). The control variables for this study included company size, profitability (measured by return on assets, or ROA), and leverage. Table 2 below is the summary of the variable measurement. The model for this study is as follows:

Model 1

$$ESGRating=\beta0 + \beta1\ ACSIZE + \beta2\ ACMEET + \beta3\ ACINDEP + \beta4\ ACEXPERT + \beta5\ FIRMSIZE + \beta6\ ROA + \beta7\ LEV + \varepsilon$$

Model 2

$$ESGRating=\beta0 + \beta1\ ACEF + \beta2\ FIRMSIZE + \beta3\ ROA + \beta4\ LEV + \varepsilon$$

3.4. Calculating the Audit Committee Effectiveness Score

Table 3 shows the calculation on how each of the audit committee effectiveness score is derived.

Table 2: Variables measurement

Dependent variable	Acronym	Measurement
ESG rating	ESG rating	Rating score (refer Table 1)
Independent variable		
AC effectiveness	ACEF	ACEF=Sum of the four AC effectiveness into one score
AC size	ACSIZE	Total number of audit committee
AC meeting	ACMEET	The frequency of meeting held for the year
AC independence	ACINDEP	The percentage of AC who are independent non executive directors
AC expertise	ACEXPERT	The percentage of AC who has accounting/financial expertise background
Control variable		
Company size	FIRMSIZE	Natural logarithm of total assets
Profitability	ROA	Net income divided by total assets
Leverage	LEV	Total liabilities divided by total assets

4. FINDINGS AND DISCUSSION

The sample's descriptive statistics are shown in Table 4. This study provides crucial information to improve comprehension and enable suitable data interpretation. It contains all of the study's variable values, including the maximum, minimum, standard deviation, median, and mean. A modest degree of ESG rating compliance among the organizations under study was indicated by the sample's average ESG rating score of 2.37, which ranged from 1 to 4. Based on the total of the audit committee's four dummy characteristics, the overall audit committee effectiveness (ACEF) had a mean value of 1.52 on a scale from 0 to 3.

In terms of independent variable, the AC had an average of three members. Further, on a average, 90.2% of the AC's members are independent and 45% of the members possess educational background in the field of accounting/finance. Lastly, an AC meets 6 times a year.

Table 3: Audit committee effectiveness score

AC Effectiveness	Measurement
AC size	Audit committee size was coded "1" if the number of the ACS on the audit committee as higher than the sample median, and "0" if otherwise.
AC independence	Audit committee independence was coded "1" if the percentage of independent non executive directors was higher than the sample median, and "0" if otherwise (Agency theory).
AC meeting	Audit committee meetings frequency was coded "1" if the number of audit committee meetings during the year was higher than the sample median, and "0" if otherwise (Agency theory).
AC expert	Audit committee expert was coded "1" if the percentage of financial expertise was higher than the sample median, and "0" if otherwise (Agency theory).

Table 4: Descriptive analyses

Variables	Mean	Median	SD	Min	Max
ESG rating	2.37	2.00	1.054	1	4
ACEF	1.52	1.00	0.627	0	3
ACSIZE	3.40	3.00	0.678	2	6
ACMEET	5.84	5.00	2.378	1	17
ACINDEP	0.902	1	0.144	0.4	1
ACEXPERT	0.450	0.333	0.188	0	1
FIRMSIZE	6.420	6.2567	0.796	5.029	9.011
ROA	0.049	0.0387	0.127	−0.430	1.358
LEV	0.432	0.417	0.222	0.008	0.918

4.1. Correlation Analyses

Next, the data was assessed to meet the assumptions of multiple regression analysis in order to avoid misleading results. Diagnostic tests were performed to check for outliers, normality, linearity, multicollinearity, heteroscedasticity, and autocorrelation (Hair et al., 2010). Table 5 presents the correlation matrix between the variables to examine potential multicollinearity issues. The highest significant correlation coefficient observed was 0.587 between the two dependent variables. According to Hair et al. (2010), a correlation coefficient below 0.80 indicates no serious multicollinearity. The correlation matrix confirms that multicollinearity is not a concern in our models, as none of the variables have correlations exceeding 0.80.

4.2. Regression Result

In regression analysis, the variance inflation factor (VIF) measures the extent of multicollinearity between one regressor and the other regressors. For this study, all variables demonstrated a VIF value of <10. It was noted that all correlations are low, and the VIF scores remain below the recommended threshold of 10 (Gujarati, 2021). These findings indicate that there is no significant multicollinearity issue, as shown in the statistics reported in Table 6, where none of the variables exhibit high correlation. Therefore, multicollinearity is not a concern in our regression analyses.

The dependent variable, ESG rating, was analyzed in two models to assess the impact of individual audit committee characteristics and overall audit committee effectiveness (ACEF). In Model 1, the R-squared value is approximately 15.9%, indicating that the independent variables in the model explain a low portion of the ESG rating. Model 2 yields an R-squared value of around 15.5%. It's important to note that low R-squared values are common in social science studies, particularly in corporate governance research (Mohd-Saleh et al., 2012), making the R-squared values in this study acceptable for this context.

Results from Model 1 reveal that only AC independence has a positive and significant effect on the ESG rating ($t = 0.084$, $P > 0.05$). This suggests that a higher number of independent directors enhances the quality of the ESG rating, as these directors lack personal or economic ties to the firm and are better positioned to supervise and monitor the organization's functioning and reporting.

Table 5: Correlation analysis

Variables	ESG rating	ACEF	ACSIZE	ACMEET	ACINDEP	ACEXPERT	FIRMSIZE	ROA	LEV
ESG rating	1	0.002**	0.054	0.203**	0.079**	0.076**	0.385**	0.014	0.234**
ACEF		1	0.499**	0.587**	−0.085**	0.073*	0.392**	−0.136**	0.202**
ACSIZE			1	0.146**	−0.198**	−0.145**	0.212**	−0.108**	0.132**
ACMEET				1	0.053	−0.015	0.492**	−0.148**	0.356**
ACINDEP					1	−0.147**	0.011	−0.022	−0.029
ACEXPERT						1	0.130**	−0.043	0.073*
FIRMSIZE							1	−0.071*	0.476**
ROA								1	−0.137
LEV									1

Table 6: Regression analysis

Variables	VIF	Model 1	Model 2
		ESG rating	ESG rating
ACSIZE	3.21	0.039 (0.251)	
ACMEET	2.09	−0.031 (0.408)	
ACINDEP	3.34	0.084*** (0.003)	
ACEXPERT	2.57	0.029 (0.310)	
ACEF	2.11		0.084** (0.035)
FIRMSIZE	4.23	0.336*** (0.000)	0.338*** (0.000)
ROA	4.68	0.054** (0.048)	0.053* (0.052)
LEV	5.16	0.081** (0.010)	0.071** (0.020)
Observations		237	237
R-squared		0.159	0.155
F-value		28.991	54.237

In Model 2, the findings indicate that ACEF is positively and significantly related to the ESG rating ($t = 0.084$, $P < 0.05$), suggesting that ACEF influences the ESG ratings of firms in Malaysia. Additionally, the overall characteristics of the audit committee, including size, independence, number of meetings, and expertise, contribute to stronger measurement effects that yield favorable outcomes. These results align with the findings of Qaderi et al. (2024) which identified a positive relationship between audit committee characteristics and sustainability reporting. Such characteristics enhance the credibility and quality of voluntary ESG disclosures, of which the ESG rating is a component.

In terms of control variables for both models, FIRMSIZE, ROA and LEV have positive influence on the ESG rating at $P < 0.05$ and $P < 0.10$ level. ESG rating is favourable influenced by FIRMSIZE at $P < 0.05$. Also, the profitability (ROA) and LEV has a positive influence on the ESG rating, with a $P < 0.10$.

5. CONCLUSION

Based on the sample of 237 public companies listed on Bursa Malaysia and employing regression analysis, the results indicate that the AC effectiveness have favorable influence on the ESG rating. This indicates that AC improves transparency, promotes accountability and fosters trusts among the stakeholders through effective ESG reports. The company's AC must be restructured to promote ethical transparency. Furthermore, ESG rating quality can also help companies to attract and retain socially responsible investors. As the demand for sustainable investing grows, companies that have good ESG rating and reporting are likely to be more attractive to these investors, which can provide additional capital and resources to innovate and grow sustainably.

Corporate audit committees should be expanded to include more people, more expertise, and more experience, all of which improve the quality of ESG reports that are disseminated as a result. Independent members should be encouraged to join audit committees, as it increases the group's ability to conduct supervision and monitoring obligations, as well as the quality of its ESG reports. A dynamic audit committee is more capable of supervising and monitoring financial reporting, thus, companies should add more members to their audit committees. This, in turn, will lead to better ESG rating.

Further, firm size, profitability and leverage also favourably influences the ESG rating quality of companies. This implies better financial performance improving the ESG rating in the annual reports of the companies. The insights from this paper are useful for policy makers, legislators, and regulators. This encourages the firms to recognize the importance of ESG rating and develop strategies that are consistent with this metric. Policymakers should suggest a standardized framework to encourage the formation of AC with large size and greater independence to promote transparency and accuracy of the information contained in the ESG reports. Also, a structured meeting schedule for AC should be in place to monitor the number of meetings to be conducted.

Moreover, the insights are also useful for academicians and practitioners, to enhance the role of audit committee in improving the quality of ESG rating of firms. Academicians could use the results of this paper to understand the effectiveness of ESG rating and its impact on financial performance, as well as on the social and environmental outcomes of companies. They can also develop new metrics and frameworks for measuring and reporting ESG rating. Additionally, academicians can provide education and training to practitioners on the importance and use of ESG rating. By providing this valuable knowledge and expertise, academicians can help to enhance the quality and credibility of ESG rating, and ultimately promote to the sustainable development of companies and the economy.

Lastly, there are limitations to this study. This sample is limited to only one developing country, Malaysia. Further study could be taken by increasing the sample size by combing the data from more developed countries. Also, due to the lack of standardized framework of calculating ESG scores, which vary among the different rating agencies and the results could vary depending upon the source of ESG scores.

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