Research Article

Effect of Accounting and ESG Controversies on Financial Performance: Moderating Effect of ESG

Kemal ÇEK[1]

[1] Cyprus International University, kcek@ciu.edu.tr, ORCID: 0000-0001-5380-4860

Abstract: This study unveils the crucial impact of ESG (Environmental, Social and Governance) performance on controversies and the firm performance nexus for companies listed in S&P1500. We measure firm performance regarding market-based (Tobin's Q) and profitability-based (ROA) performance, while controversies are gauged by accounting and ESG-related issues. To achieve the highest level of accuracy, we employ the System Generalized Method of Moments (GMM) estimation to address for endogeneity. The key findings reveal a positive interaction effect between lagged ESG and controversies about market-based performance. However, lagged ESG does not significantly impact profitability-based performance measures in the context of controversies.

Keywords: Accounting Controversies, ESG Controversies, ESG, Market Based Performance, Profitability Based Performance
Jel Codes: M41, Q56, G32

Muhasebe ve ESG Tartışmalarının Finansal Performans Üzerindeki Etkisi: ESG'nin Düzenleyici Rolü

Öz: Bu çalışma, S&P1500'de listelenen şirketler için ESG performansının tartışmalar ve şirket performansı bağlantısı üzerindeki etkisini ölçmektedir. Şirket performansı, piyasa bazlı (Tobin's Q) ve karlılık bazlı (ROA) performans olarak ölçülmekte, tartışmalar ise muhasebe ve ESG ile ilgili tartışmalar olarak değerlendirilmektedir. Endojeniteyi kontrol etmek için Sistem Genelleştirilmiş Momentler Metodu (GMM) tahmini kullanılmaktadır. Sonuçlar, gecikmeli ESG'nin tartışmalar ve piyasa bazlı performans arasında pozitif bir etkileşim etkisi gösterdiğini kanıtlamaktadır. Gecikmeli ESG, tartışmalar ve karlılık bazlı performans ölçümleri arasında önemli bir etki gösterememiştir.

Anahtar Kelimeler: Muhasebe Tartışmaları, ESG Tartışmaları, Çevresel, Sosyal ve Yönetişim (ESG), Piyasa Bazlı Performans, Karlılık Bazlı Performans
Jel Kodları: M41, Q56, G32

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1. Introduction

Controversies can damage a company's reputation and, as a result, negatively influence performance (Walsh et al., 2009). As a result, the 2008 financial crisis and the questionable actions of certain banks and credit institutions painted a bleak image of the financial industry and its operators. The United States was not the only place accounting fraud led to firm bankruptcy and significant shareholder losses. Accounting scandals have consumed several well-known public corporations in Europe. Such accidents frequently result in unfavorable publicity and put the company's image in danger (Aguilera et al., 2007). In this regard, Bae et al. (2018) proposed that a company's sustainable practices boost its reputation and performance by demonstrating its dedication to future generations' well-being. Controversy emerges when a company engages in acts or situations that hurt its stakeholders and the environment (Li et al., 2019). Controversies frequently jeopardize a company's reputation, necessitating swift and efficient responses by the company to mitigate the negative impacts of the controversies. In addition, companies worldwide look for new strategic moves when financial performance falls short of expectations. Equity analysts and market participants may use ESG performance as a proxy for key performance indicators, making it an essential facet of business strategy (Eccles et al., 2011). Enhanced ESG performance can improve company value, according to empirical studies on the link between ESG performance and firm value performance (Duque-Grisales & Aguilera-Caracuel, 2021; Fatemi et al., 2018; Huang, 2021). Furthermore, when a company takes proactive steps to improve its ESG performance, it enhances its image among its many stakeholders (Kim et al., 2018).

Nonetheless, the literature overlooks the idea of corporate controversies, such as accounting and ESG controversies and their connection to the related issue of CSR (Corporate Social Responsibility). Furthermore, there is a discrepancy in the impact of corporate scandals on a company's success. The study by Li et al. (2019) is an exception, as it implies that a corporation adopts new CSR initiatives in a disagreement or during a controversy to restore the connection with stakeholders to pre-controversy levels. As a result, firms utilize ESG tactics to lessen the negative impact of an occurrence in the short term. However, Nirino et al. (2021) conclude that ESG did not reduce the adverse effects of controversies. To date, no studies have explored or looked at the influence of both accounting and ESG controversies on the financial performance of firms and the moderating role of ESG. This study contributes to the literature on corporate controversies and economic performance by showing that lagged ESG showed a positive interaction effect between controversies and market-based performance. Furthermore, lagged ESG failed to show a significant impact between controversies and profitability-based performance measures. The study adds to the body of knowledge on CSR and stakeholder theory by highlighting the detrimental effects of controversies and showing that ESG practices are crucial for meeting stakeholders' needs.

The empirical findings of this research extend the literature on signaling theory (Lys et al., 2015) and resource-based theory (McWilliams & Siegel, 2001) by providing evidence that ESG performance can help mitigate the adverse effects of controversies on financial performance. A sample of firms in the S&P 1500 index was obtained from the Thomson Reuters database to test the proposed hypotheses. This study aims to investigate the influence of accounting and ESG controversies on financial performance and the ability of ESG performance to mitigate the adverse effects of controversies.

2. Hypothesis Development

Corporate controversies emerge when a corporation is involved in acts or situations that may have a detrimental influence on its stakeholders and the environment. This aspect of CSR appears to be disregarded in the literature (Li et al., 2019). Controversies frequently jeopardize a company's reputation, requiring prompt and effective responses to mitigate their negative impact. Litigation, revenue losses, higher financial risk, and a rise in the cost of debt can all result from stakeholders' wrong view of the organization (Lange & Washburn, 2012). As a result, corporate scandals (such as downsizing and corporate crime) can harm a company's image and reputation. Love & Kraatz (2009) state that a downsizing event harms employees. The signaling theory, which originated from Akerlof (1970) and is based on information asymmetries between insiders and outsiders, may be used to explain the value significance of business reputation from CSR. Furthermore, the emergence of negative ESG media coverage will likely have detrimental signaling effects on the company's reputation with investors (as it denotes non-conformity with societal expectations). This could result in excessive costs, such as limitations on business functions, monetary losses, or adverse publicity that lowers demand for the company's underlying product lines.

Furthermore, as Pierce (2018) points out, unlawful activities hurt shareholders by increasing the agency cost, which can be a disincentive to engaging in illegal or unethical behavior. In addition, accounting controversies include nontransparent or threatening accounting issues published in the media. When a corporation is involved in several issues, it is realistic to expect a drop in its financial performance due to stakeholder responses. In the case of publicly traded enterprises, the market might overreact to such occurrences, exacerbating their impact. A loss of reputation due to business scandals leads to a loss of confidence. As a result, stakeholders may decide to take legal action against the corporation. Customers may stop buying the company's products, suppliers may stop supplying them, governments may levy fines and penalties, and shareholders may sell their stocks due to the loss of confidence.

Accounting controversies typically involve disputes or scandals related to a company's financial reporting, such as earnings manipulation, fraudulent financial statements, or misrepresentation of financial data. These controversies can include using aggressive accounting techniques that violate generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS). High-profile cases like Enron and Parmalat illustrate how accounting scandals can lead to severe consequences, including loss of investor trust, legal penalties, and significant damage to financial performance (Li et al., 2019; Aouadi & Marsat, 2018). ESG controversies involve incidents where a company's practices negatively impact its environmental, social, or governance dimensions. These could include environmental degradation, poor labour practices, human rights violations, or corrupt governance. For example, companies involved in pollution, unethical supply chain practices, or executive misconduct often face backlash from stakeholders. ESG controversies can damage corporate reputations, lead to legal actions, and negatively influence financial performance as firms struggle to manage stakeholder relations and maintain investor confidence (Nirino et al., 2021; Aouadi & Marsat, 2018).

The ESG and accounting controversies allow institutional investors to assess significant social, environmental, and corporate governance and accounting issues impacts by identifying company participation in the controversies, enforcement of international standards and practices, and firm performance about these standards and practices (Melinda & Wardhani, 2020). Increased controversies will likely be interpreted by stakeholders, especially investors, as a sign of lowered ability to seize revenue-generating opportunities, achieve cost savings, and amplify the negative consequences of failures, financial penalties, and litigation. These will likely imply economic uncertainty, unpredictable earnings, and higher risk, which makes related firms appealing to investors (Brooks & Oikonomou, 2018).

H_1: ESG controversies have a negative influence on financial performance.

H_2: Accounting controversies have a negative influence on financial performance.

Drawing on the signaling theory, firms increase their ESG disclosures in yearly or sustainability reports as a signal to stakeholders. According to the signal theory, increasing ESG disclosure can help stakeholders make better decisions by decreasing the disadvantages of information asymmetry (He et al., 2019; Spence, 1974; Wong & Zhang, 2022). Given the advantages of ESG standards, specific organizations may rely on reckless behavior. When a firm is found to be engaged in a controversy, it begins to implement programs aimed at protecting the environment, local communities, and human rights (Livesey & Kearins, 2002). These initiatives are characterized by "reacting to societal changes" in reaction to harmful behaviors to lessen their consequences. Li et al. (2019) stated that CSR participation has an "insurance-like impact" on future occurrences. Thus, a company experiencing unfavorable events may be motivated to participate in CSR to restore its reputation. There is, nevertheless, "proactive social transformation." Companies that have never been involved in issues or scandals adopt efforts to build a corporate culture based on ethical and sustainable values. Consequently, this leads to improved social, environmental, and financial performance (Hart & Milstein, 2003). Therefore, firms are more inclined to participate in CSR under such circumstances to regain their reputation (Becker-Olsen et al., 2006).

In line with the resource-based theory, a firm's strong CSR reputation is an intangible resource that may raise the market value of net income, lower the unpredictability of its cash flows, and improve the value of its forecast cash flows (Hussainey & Salama, 2010; Wong & Zhang, 2022). As a result, when a firm is more involved in environmental and social activities, stakeholders are more likely to trust the company and respond to unpleasant occurrences less negatively. However, if these activities are symbolic, they cannot minimize stakeholder distrust. According to Klein & Dawar (2004), companies that have implemented sustainability policies in the past are less likely to lose their reputation following a disastrous occurrence. Sustainable initiatives, in particular, can improve a company's reputation among stakeholders and financial performance (Park et al., 2014). In addition, the release of value-relevant materials to investors, such as information on corporate social performance and how a firm's organizational effectiveness compares to that of rival firms, can minimize information asymmetry for investors, which in turn reduces uncertainty and affects the financial performance (Hussainey & Salama, 2010; Ramchander et al., 2012). As a result, it is plausible to suppose that enterprises' long-term efforts enable them to mitigate the harmful consequences of conflicts.

H_3: ESG practices moderate the relationship between ESG controversy and financial performance.

H_4: ESG practices moderate the relationship between accounting controversy and financial performance.

3. Methodology

The study has two objectives: (1) to investigate the impact of accounting and ESG controversies on financial performance and (2) to examine whether the firms' ESG performance moderates the negative influence of controversies on financial performance. The study sample consists of firms listed on the S&P 1500 index. ESG, accounting controversies, ESG controversies and financial performance data are collected from the Thomson Reuters Asset4 database. Similar studies have used the Thomson Reuters Asset4 database to test the proposed relationships (Nirino et al., 2019; Nirino et al., 2021). It is suggested that financials and insurance firms should be excluded from the sample as they can have different financial information, and comparison with other firms would be misleading (Doni et al., 2019; Nirino et al., 2021). In addition, all firm-year observations with missing variables and less than five firm-year observations are removed. Thus, these firms are excluded from the sample, leaving 7,070 observations between 2013 and 2020.

Both company-specific and corporate governance factors have been chosen as control variables for the study. Following previous studies, this study included control variables such as firm size (Nirino et al., 2021; Shaukat et al., 2016), firm age (Wong & Zhang, 2022), board size (Hafsi & Turgut, 2013) and firms' leverage (Limkriangkrai et al., 2017). Firm size, as measured by total assets, has been selected because of the potential for economies of scale in socially and ecologically conscious investing (Elsayed & Paton, 2009). As a dependent variable, Tobin's Q is selected as a market-based value, which also reflects investors' expectations (Awaysheh et al., 2020). Tobin's Q represents the firm's market value ratio to its value in the accounting record and the cost of replacing firm assets. Tobin's Q is used as a proxy for financial performance as it is more durable against earnings management and is extensively used in the ESG literature (Azmi et al., 2021; Bennouri et al., 2018; Nekhili et al., 2021). Table 1 below provides descriptions of each variable.

Table 1. Variable Descriptions

Independent Variable	Description
ESG controversies	ESG related controversies
Accounting controversies	Accounting related controversies
ESG Performance	Weighted average of the ESG scores
Environmental Performance	The relative sum of category weights for three dimensions: resource use, emissions and waste reduction, and innovation
Social Performance	The relative sum of category weights for four dimensions: Workforce, Human rights, Community, and Product Responsibility
Governance Performance	The relative sum of category weights for three dimensions: Management and oversight, Shareholders rights, and CSR strategy
Dependent Variables	
Tobin's Q	Market value divided by the total assets
ROA	Net profit divided by average total assets.
Control Variables	
Leverage	Debt to equity
Size	The natural logarithm of total assets
Board Size	The natural logarithm of the number of directors
Firm Age	Incorporation year

In order to account for endogeneity caused by omitted variables, we employ the System Generalized technique of Moments (GMM) technique introduced by Blundell & Bond (1998). This technique was used previously by similar studies (Azmi et al., 2021; Chen & Xie, 2022) and has previously been employed in studies of ESG and financial performance. This approach integrates the level form with the initial differences in our regression equation. The first difference between GMM's biases and imprecision is reduced by using this technique. Instead of using two-stage least squares, we employ System GMM, as incorrect instrument selection may distort the results. The System GMM method is preferred over other techniques, such as Fixed and Random Effects models, because it is better suited for dynamic modeling. In terms of variables, Fixed Effects and Random Effects models fall short of being extensive. Therefore, estimations are vulnerable to bias caused by missing variables. This bias caused by the missing variable may be addressed by the dynamic panel definition of the System GMM (Ibrahim & Rizvi, 2017). The Sargan/Hansen test is used to examine whether constraints are overidentified. Additionally, we look for first- and second-order autocorrelation. The diagnostics (Sargan/Hansen test and AR (2)) meet the criteria for instrument validity. These analyses show that the lag values are suitable instruments. There are no endogeneity problems with the results in any tables. Furthermore, employing dynamic GMM enabled researchers to adjust for persistence.

4. Results

The descriptive statistics of the sample are presented in Table 2 below. The findings showed that firms had moderate environmental, social and governance performance (34.86%, 49.44% and 55.60%). Firms showed a lower environmental performance compared to social and governance performance. The ESG performance score was 47.50%, indicating a moderate level of performanceIn terms of ESG controversies, the performance of 79% of the firms exceeded the 50% threshold. The mean value of accounting controversies was 52.32%. Findings indicated that most of the observed firms had been involved in a controversy. The average number of board members is 9.81 for the sample, which shows the board size. The average ROA is 5.66%, whereas the average ROE is

14.33%. The companies' size is found by taking the logarithm of total assets, which is 22.52. The debt-to-equity ratio measures the leverage at 91%. Lastly, the average Tobin's Q for the firms is 1.51%. In addition, the variance inflation factor (VIF) analysis yielded values below the upper limit of 3, and multicollinearity is not an obstacle in this research (O'Brien, 2007).

Table 2. Descriptive Statistics

Variables	Observations	Mean	Std. Dev.	Min	Max
Year	7,070	2016.9	2.14	2013	2020
ROA	7,070	5.66	5.72	-5.25	18.02
SIZE	7,070	22.52	1.47	19.54	26.30
Leverage	7,070	0.91	0.76	0.02	2.51
Age	7,070	3.11	0.91	0	4.93
ESG	7,070	47.50	17.07	23.17	73.91
ENV	7,070	34.86	27.31	0	79.84
SOC	7,070	49.44	19.11	22.65	79.77
GOV	7,070	55.60	18.22	26.43	81.43
ESG Controversy	7,070	0.79	0.41	0	1
Accounting Controversy	7,070	52.32	0.80	50.95	53.51
Tobin's Q	7,070	1.51	1.04	0.41	3.65

The research model is the following:

Model1 $Tobin's\ Q_{i,t} = \beta_0 + \beta_1\ ESG_{i,t-1} + \beta_2 Accounting\ Controversy_{i,t-1} + \beta_3 ESG\ Controversy_{i,t-1} + \beta_4\ Leverage_{i,t} + \beta_5 Size_{i,t} + \beta_6 Age_{i,t}$

Model2: $Tobin's\ Q_{i,t} = \beta_0 + \beta_1\ ENV_{i,t-1} + \beta_2 SOC_{i,t-1} + \beta_3 GOV_{i,t-1} + \beta_4 Accounting\ Controversy_{i,t-1} + \beta_5 ESG\ Controversy_{i,t-1} + \beta_6\ Leverage_{i,t} + \beta_7 Size_{i,t} + \beta_8 Age_{i,t}$

Model3: $Tobin's\ Q_{i,t} = \beta_0 + \beta_1\ ESG_{i,t-1} + \beta_2 Accounting\ Controversy_{i,t-1} + \beta_3 ESG\ Controversy_{i,t-1} + \beta_4 ESG_{i,t-1} *\ Accounting\ Controversy_{i,t-1} + \beta_5 ESG_{i,t-1} * ESG\ Controversy_{i,t-1} + \beta_6\ Leverage_{i,t} + \beta_7 Size_{i,t} + \beta_8 Age_{i,t}$

Model4: $ROA_{i,t} = \beta_0 + \beta_1\ ESG_{i,t-1} + \beta_2 Accounting\ Controversy_{i,t-1} + \beta_3 ESG\ Controversy_{i,t-1} + \beta_4\ Leverage_{i,t} + \beta_5 Size_{i,t} + \beta_6 Age_{i,t}$

Model5: $ROA_{i,t} = \beta_0 + \beta_1\ ENV_{i,t-1} + \beta_2 SOC_{i,t-1} + \beta_3 GOV_{i,t-1} + \beta_4 Accounting\ Controversy_{i,t-1} + \beta_5 ESG\ Controversy_{i,t-1} + \beta_6\ Leverage_{i,t} + \beta_7 Size_{i,t} + \beta_8 Age_{i,t}$

Model6: $ROA_{i,t} = \beta_0 + \beta_1\ ESG_{i,t-1} + \beta_2 Accounting\ Controversy_{i,t-1} + \beta_3 ESG\ Controversy_{i,t-1} + \beta_4 ESG_{i,t-1} *\ Accounting\ Controversy_{i,t-1} + \beta_5 ESG_{i,t-1} * ESG\ Controversy_{i,t-1} + \beta_6\ Leverage_{i,t} + \beta_7 Size_{i,t} + \beta_8 Age_{i,t}$.

Where I index firms and index time. All variables are defined in table 1.

Table 3 below presents models 1-3, which are the system GMM results of Tobin's Q. ESG was found to have a negative effect on Tobin's Q in model 1. However, lagged ESG was found to have a significant positive impact on Tobin's Q. Surprisingly, current-year ESG controversies were determined to have a positive impact on Tobin's Q, whereas lagged ESG controversies did not show a significant effect. Model 2 ESG is separated into environmental, social and governance performance, and no significant effect has been found. Model 3 tested the moderating effect of ESG performance on the relationship between controversies and financial performance. The results showed that lagged ESG controversies significantly negatively influenced Tobin's Q. In addition, lagged ESG performance substantially moderates the relationship between lagged ESG controversies and Tobin's Q. Lastly, the firms' age positively affects Tobin's Q in all three models.

Table 3. Dependent Variable Tobin's Q

	(Model 1)	(Model 2)	(Model 3)
	Tobin's Q	Tobin's Q	Tobin's Q
L.tobin	0.8643***	0.7712***	0.8818***
	(0.0386)	(0.0852)	(0.0350)
ESG	-0.0253**		-0.0086
	(0.0114)		(0.0124)
Acc. Cont.	-0.0416	-0.0271	0.0016
	(0.1163)	(0.1311)	(0.0330)
L.ESG	0.0227**		-0.0623
	(0.0102)		(0.0474)
L.ESG Cont.	-0.0332	-0.0300	-0.5716*
	(0.0282)	(0.0338)	(0.3140)
L. Acc. Cont.	-0.0085	-0.0144	-0.0710
	(0.0286)	(0.0368)	(0.0483)
ESG Cont.	0.3895**	0.3131	0.1373
	(0.1515)	(0.2160)	(0.1530)
Leverage	0.0261	-0.0261	0.0388
	(0.0510)	(0.0779)	(0.0462)
SIZE	-0.0102	-0.0258	-0.0250
	(0.0276)	(0.0569)	(0.0233)
AGE	0.0093**	0.0259*	0.0067**
	(0.0036)	(0.0150)	(0.0028)
ENV		-0.0144	
		(0.0101)	
SOV		0.0136	
		(0.0147)	
GOV		0.0103	
		(0.0125)	
L.ENV		0.0015	
		(0.0109)	
L.SOC		-0.0001	
		(0.0172)	
L.GOV		-0.0129	
		(0.0109)	
L.ESG # L.Acc. Cont.			0.0012
			(0.0007)
L.ESG # L.ESG Cont.			0.0106*
			(0.0060)
Constant	2.6750	2.0490	4.6651
	(7.0444)	(8.2185)	(3.7925)
Observations	5998	5998	5998
AR1	-10.5407	-6.0415	-13.2655
AR(1) Prob.	0.0000	0.0000	0.0000
AR(2)	1.0892	1.0794	1.5005
AR(2) Prob.	0.2761	0.2804	0.1335
Hansen Stat.	31.3575	21.7887	39.2438
Hansen Stat. Prob.	0.2152	0.1135	0.1470
# of Cross-Sections	1030.0000	1030.0000	1030.0000
# of Instruments	43.0000	36.0000	50.0000

A market value-based performance (Tobin's Q) and a profit-based performance (ROA) was used to enhance comparability. Model 4-6 ROA was used as a dependent variable to test the proposed relationships. In model 4, current-year environmental performance negatively affected the same year's ROA, whereas social and governance performance did not show a significant effect. Lagged environmental, social and governance also failed to affect ROA significantly. Lagged ESG controversies showed a positive influence on the ROA. In addition, leverage was found to have a negative effect on the ROA, as expected. In Model 5, current-year accounting controversies positively influenced the current-year ROA. Surprisingly, lagged accounting controversies showed a positive influence on the ROA. Lagged ESG controversies did not show a significant effect. Lastly, in model 6, where the moderating effects were tested, no significant effect was found on the ROA. The age of the firms showed a positive influence on the ROA.

Table 4. Dependent variable ROA

	(Model 4)	(Model 5)	(Model 6)
	ROA	ROA	ROA
L.ROA	0.3047	0.2370	0.4790***
	(0.2345)	(0.2984)	(0.0395)
GOV	-0.0615		
	(0.0959)		
ENV	-0.1845*		
	(0.1120)		
SOC	0.2355		
	(0.1573)		
Acc. Cont.	1.0346	1.8441*	0.4877
	(0.9907)	(1.1048)	(0.3731)
ESG Cont.	-0.0849	-0.3838	2.0431
	(1.9600)	(1.7812)	(1.9168)
L.ENV	0.0528		
	(0.0928)		
L.SOC	0.1315		
	(0.1575)		
L.GOV	0.0164		
	(0.0486)		
L.ESG Cont.	0.5191*	0.0902	1.1625
	(0.2981)	(0.2730)	(3.6863)
L.Acc. Cont.	0.4727	0.5938**	0.5136
	(0.3074)	(0.2520)	(0.5909)
LEV	-4.5895***	-1.0059	0.3237
	(1.7286)	(1.7070)	(0.5810)
SIZE	-0.5529	-0.8141	-0.0964
	(0.7066)	(0.6106)	(0.2697)
AGE	0.0595	0.0157	0.0885***
	(0.1376)	(0.1509)	(0.0287)
ESG		-0.2063	-0.2305
		(0.1713)	(0.1670)
L.ESG		0.3117	0.6685
		(0.2629)	(0.6247)
L.ESG # L. Acc. Cont.			-0.0084
			(0.0091)
L.ESG # L.ESG Cont.			-0.0223
			(0.0715)
Constant	-70.8238	-106.4144*	-50.7518
	(62.0557)	(63.2698)	(46.6373)
Observations	5998	5998	5998
AR1	-0.5270	-1.8280	-7.8110
AR(1) Prob.	0.5982	0.0675	0.0000
AR(2)	-2.6038	-0.1758	0.8112
AR(2) Prob.	0.092	0.8605	0.4172
Hansen Stat.	14.5556	11.5974	34.9713
Hansen Stat. Prob.	0.4839	0.4785	0.2849
# of Cross-Sections	1030.0000	1030.0000	1030.0000
# of Instruments	36.0000	29.0000	50.0000

5. Discussion

In the literature, ESG and the associated pillars are prominent, with growing interest from managers and policymakers. Nonetheless, it is still not fully comprehended how and whether purely CSR-related corporate controversies and accounting-related controversies affect the performance of firms. In addition, the literature has ignored the topic of corporate controversies and their possible consequences on a firm's performance and reputation (Aouadi & Marsat, 2018; Li et al., 2019). Therefore, using a large sample of more than 1,000 firms listed on the S&P index from 2013 to 2020, the results of this study show that ESG controversies have a negative effect on market-based financial performance (Tobin’s Q). In Europe and the US, stocks with substantial controversies considerably underperform their benchmarks and other portfolios of stocks with minimal or no controversies (De Franco, 2020). Furthermore, ESG performance positively moderates the relationship between ESG controversies and Tobin’s Q. However, accounting controversies did not significantly affect Tobin’s Q. By highlighting the advantages of ESG practices, the study adds to the literature. In this respect, while several research discovered a favourable influence of ESG practices and CSR initiatives on various performance indicators (Liu et al., 2014), other studies also discovered a negative or neutral association (Kim & Lyon, 2015). Thus, this study suggests favourable ESG and market-based financial performance links.

ROA is a dependent variable that allows comparability between market-based and profit-based performance. The results indicated that accounting controversies positively affect the ROA, whereas ESG controversies did not show a significant effect. Moderating effects of ESG performance are not observed between controversies and ROA. It can be concluded that when a corporation engages in ESG practices, shareholders respond favorably. The company's reputation and image are enhanced as a result of this. However, as expected, controversies threaten the beneficial effects of ESG practices on financial performance. Accounting controversies have had a positive influence on profitability-based performance. Previous empirical findings concluded that accounting controversies, regardless of their negative context, increase business visibility, positively relating the ESG score to the firm market value (Aouadi & Marsat, 2018). The results extend the findings of Servaes & Tamayo (2013) and Aouadi & Marsat (2018). It has been found that advertising expenditures are a proxy for customers’ corporate social responsibility awareness (Servaes & Tamayo, 2013). Therefore, expanding on their efforts and contributing to the discussion media sources might not be completely independent of firms because media sources report accounting controversies. However, businesses easily adjust advertising budgets (Aouadi & Marsat, 2018).

6. Conclusion

This paper has explored the relationship between controversies and firm performance using market-based and profitability measures from a sample of firms listed in the S&P 1500 index. In addition, controversies were measured as accounting-related and ESG-related controversies. Using GMM models, the findings revealed that ESG positively influences the firm performance. The findings suggested that ESG performance can positively moderate the relationship between controversies and firm performance. Controversies negatively influence the reputation of firms and, therefore, are expected to influence their market values negatively. The findings of the current study confirm this expectation. As a result, it can be concluded that when a firm adopts ESG, shareholders respond favourably. This enhances the company's reputation and positively affects its brand image.

The following theoretical claims can be made in light of these findings. In the first place, the study adds to the body of knowledge on CSR and stakeholders by explaining the idea of corporate controversy in the context of CSR and offering empirical proof of the negative correlation between corporate controversy and financial performance. Business scandals and their possible detrimental effects on firm reputation and performance have received little attention in the literature. As a result, the study contributes to our understanding of the negative aspects of CSR by emphasising how S&P1500 listed firms’ performance is negatively influenced by controversies.

This study has several limitations that should be considered. First, the data used focuses on companies listed in the S&P 1500 index, which may limit the generalizability of the findings to other regions or emerging markets where ESG and accounting controversies could differ. Expanding the dataset to include firms from other geographical areas could offer more diverse insights. Additionally, the period covered, from 2013 to

2020, may not capture long-term trends in ESG performance or evolving accounting controversies. More recent data might reflect regulatory changes or emerging market dynamics. Classifying controversies into accounting and ESG categories may oversimplify these complex issues, as some controversies may overlap both domains. Lastly, while the study emphasises ESG performance as a moderating factor, it does not explore other potential moderators like corporate governance structures, market competition, or corporate culture, which may also influence the relationship between controversies and firm performance.

Future research can build on this study by examining the impact of ESG and accounting controversies across different industries. Cross-industry comparisons could reveal unique insights, as controversies in sectors like technology or energy may differ from those in finance or healthcare. Expanding the scope to include international firms could enable cross-cultural analysis, shedding light on how varying regulatory environments influence the ESG-controversy-performance nexus. Furthermore, researchers could investigate the long-term effects of controversies on firm performance, going beyond short-term market reactions. Separately analysing environmental, social, and governance factors could also highlight which elements of ESG have the most significant impact on firm value. Lastly, exploring how technological advancements, such as AI-driven reporting and blockchain, impact controversies management could offer new insights into corporate governance and transparency.

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