Study finds firms focused on environmental, social and governance have high-quality financial reporting

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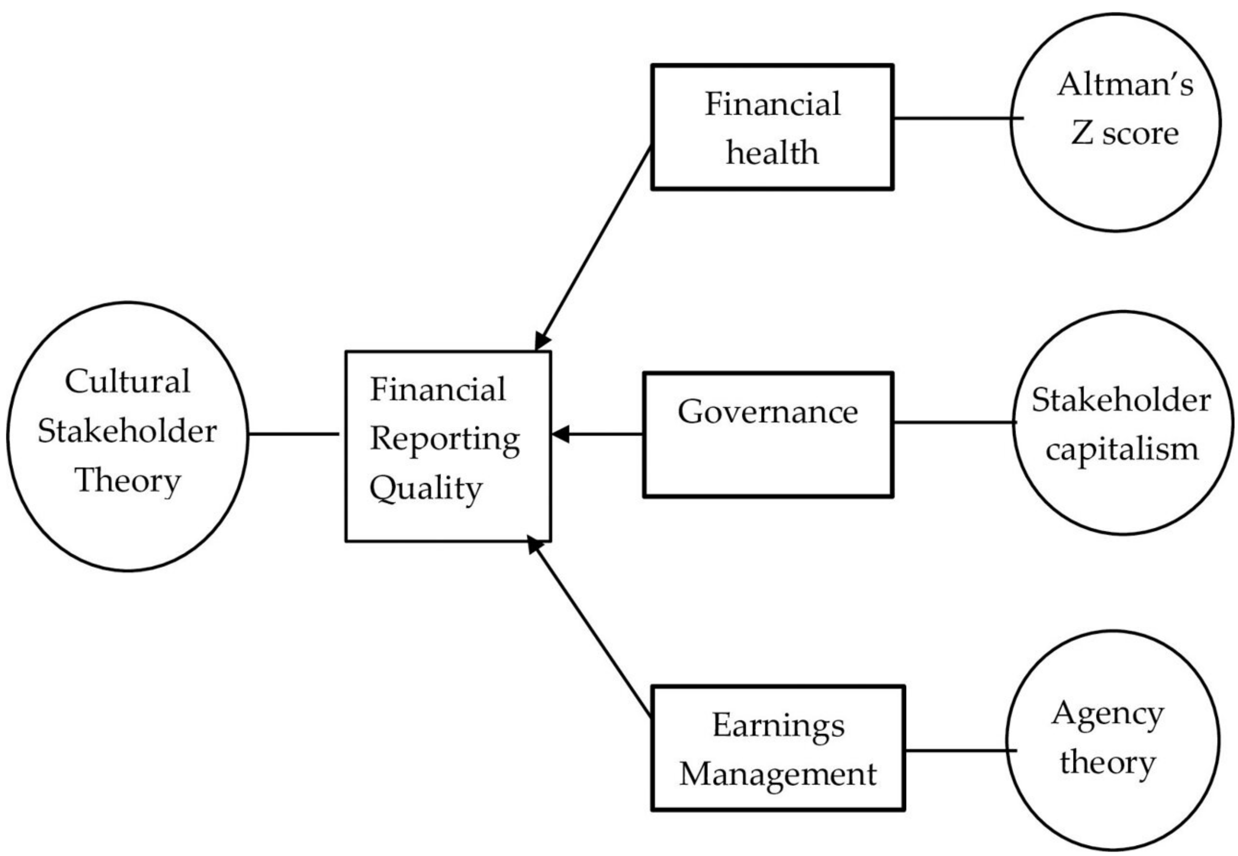

Theoretical framework. Credit: *PLOS ONE* (2023). DOI: 10.1371/journal.pone.0284684

Chinese companies that invest in environmental and socially responsible projects have high-quality financial reporting and accountability, according to a new study from Charles Darwin University (CDU) researchers.

While questions have been raised into the governance of carbon offset programs in Australia, a CDU study of 100 companies in China has revealed that governance and accounting standards are high.

CDU Professor of Accounting Indra Abeysekera and Ph.D. candidate Mengqian Wu's study was the first that contributed to understanding the financial reporting quality of environmental, social and governance (ESG) firms listed in China.

The researchers chose 100 companies at random from a 2021 list of China's top 500 environmental, social and governance (ESG) firms to analyze their accounting practices.

The results, published this month in *PLOS One*, showed that the Chinese companies did not have a culture of manipulated earning, known as earnings management.

"Businesses are under pressure to show results, but with ESG companies they are usually involved with socially responsible projects that might not show a return for a long time," Professor Abysekera said.

"This is the first study to contribute to understanding the financial reporting quality of ESG firms listed in China, and the results are quite a surprise."

Professor Abysekera said the study suggests a few reasons why Chinese ESG companies were not engaging in earnings management and have good financial reporting quality.

"The companies are attempting to attract overseas investment so there is a culture of transparency and accountability," he said.

"The ESGs in China also have good business strategies where businesses are investing in a mix of short term, medium term and long-term projects, which help to level out the earnings year on year."

Lead author on the study, Financial reporting quality of ESG firms listed in China, Wu said it should be noted that Chinese ESG firms did score lower on ESG than in other countries because there is a lack of focus on reporting on sustainability.

"Social determinants include working conditions, labor, conflicts, health and safety, employee relations, and diversity," Wu said.

"Examples of environmental impacts include climate change, waste and pollution, deforestation, and resource depletion."

"Factors that determine the quality of governance are executive pay, corruption, board composition, board diversity, board structure, political affiliations and tax strategies."

Wu said many of the 100 random companies selected were in the manufacturing and construction industries, and the good results could make the companies more open to risk.

"This study found that the increasing financial health of ESG firms is likely to encourage them to invest more in social and environmental projects," she said.

Wu said the delay between earnings becoming operating cash flows with these projects, puts pressure on companies to decreasing the financial reporting quality by smoothing out the financials.

More information: Mengqian Wu et al, Financial reporting quality of ESG firms listed in China, *PLOS ONE* (2023). DOI: 10.1371/journal.pone.0284684

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