ENSAIO

AUDITORIA INDEPENDENTE E DIVULGAÇÃO ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

INDEPENDENT AUDIT AND ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) DISCLOSURE

ABSTRACT

A divulgação de informações de environmental, social and governance (ESG), por um lado, reduz as incertezas, contribuindo para minimizar os custos de agência. Por outro, pode disfarçar comportamentos oportunistas dos gerentes, que podem investir, excessivamente, nessas práticas em prol de benefícios pessoais. Assim, podem-se observar impactos positivos ou negativos das informações de ESG, a depender dos interesses dos agentes envolvidos na sua evidenciação. Uma das formas de minimizar esses conflitos é por meio do trabalho de auditoria. Dessa forma, o ensaio tem como objetivo discutir o papel da auditoria independente nas informações ESG, evidenciadas pelas entidades à luz da Teoria da Agência.

Palavras-chave: ESG; auditoria independente; teoria da agência.

RESUMO

Disclosure of environmental, social, and governance (ESG) information, on the one hand, reduces certainties and certainly minimizes agency costs. On the other hand, it can disguise opportunistic behaviors by managers, who may start to escape these practices for personal benefits. Thus, one can observe the positive or negative effects of ESG information depending on the interests of the agents involved in its disclosure. One way to minimize these conflicts is through audit work. Thus, the essay aims to discuss the role of independent auditing in ESG information evidenced by entities in the light of Agency Theory.

Keywords: ESG; agency theory; independent audit.
1 INTRODUCTION

The topic of *Environmental, Social and Governance (ESG)*, regarding the recognition, measurement and disclosure of environmental, social and governance impacts, has received much attention from various *stakeholders* (YU; GUO; LUU, 2018). Stemming from this attention is a growing pressure for transparency in relation to corporate sustainability (BRAVO; REGUERA-ALVARADO, 2019).

Since the signing of the Paris Agreement, the concept of *ESG* has attracted attention from academia and society (SERAFEIM; YOON, 2022). Basic corporate quality information is most valued by investors, especially *ESG* scores that reflect the long-term investment value of the organization (ZHANG *et al.*, 2023).

By reducing uncertainties, improving access to finance and firm valuation, *ESG* disclosure contributes to reducing agency costs between the firm and its stakeholders (CHENG; IOANNOU; SERAFEIM, 2014; YU; GUO; LUU, 2018) and effectively constraining management behavior (LEE; KIM, 2020).

Nevertheless, managers may adopt this disclosure in a strategic manner to compensate for an *ESG* weakness (CHAMPAGNE; COGGINS; SODJAHIN, 2021) or to disguise their opportunistic behavior for personal benefits (APPUHAMI; TASHAKOR, 2017) by investing in Corporate Social Responsibility (CSR) practices. It is emphasized that the conceptual basis of CSR relates, directly, to the discussion on shareholders’ and *stakeholders’* rights (SILVA; SILVA; TEIXEIRA, 2022).

One way to inhibit these behaviors and align the interests of the principal with those of the agent is through the monitoring of managers (JENSEN; MECKLING, 1976). One of these performance monitoring tools is independent auditing, crucial to the development of firms (WATTS; ZIMMERMAN, 1983). In this sense, Xiao and Shailer (2022) identified that assured sustainability reports increase the credibility of the information evidenced therein. Assured sustainability reports have higher *ESG* scores (DEL GIUDICE; RIGAMNOTI, 2020).

In the assurance work, the independent auditor analyzes the information, seeking to obtain sufficient evidence to issue an opinion on the content in order to increase the degree of confidence perceived by its users (CONSELHO FEDERAL DE CONTABILIDADE, 2015). In auditing financial statements, the auditor aims to analyze whether the financial statements comply with the applicable financial reporting framework, as well as whether they adhere to laws and regulations (CONSELHO FEDERAL DE CONTABILIDADE, 2016).

Regarding non-financial information, due to discrepancies in the disclosure of *ESG* information and the volume of entities that prepare this information, a more restricted limited assurance work is indicated, for non-financial information contained in the Integrated Report (CONSELHO FEDERAL DE CONTABILIDADE 2022). This assurance is in line with what is proposed by the Securities and Exchange Commission (CVM) for this type of report (CVM, 2020). Hammami and Zadeh (2020) identified that audit quality is a key determinant of *ESG* transparency.

In light of the above, this paper aims to discuss the role of independent auditing in the *ESG* information evidenced by entities in light of the Agency Theory. To this end, it will initially discuss sustainability reports and *ESG* information. Subsequently, independent auditing will be addressed as one of the mechanisms used to reduce agency conflicts. And, finally, the role of independent auditing in sustainability reporting will be discussed.

This study differs from others in that it discusses the role of auditing in non-financial information, i.e., in the disclosure of voluntary aspects of the organization. Thus, it expands the academic debate on the importance of environmental, social, and governance information being disclosed with quality and transparency. As a result, it proposes that independent auditing in sustainability reports reduces informational asymmetry in relation to ESG disclosure.
2 RATIONALE AND DISCUSSION

2.1 SUSTAINABILITY REPORT AND ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

In the early twentieth century, some questionings arose about the damage caused by business activity in nature, aggravated by the absence or reduced contribution to society to remedy the damage caused (DIAZ-BECERRA; LEON-CHAVARRI; AMPUERO-ALFARO, 2021). In the mid-1970s, in France, society began to demand from organizations greater attention from companies regarding the importance of social responsibility and, as a result, some disclosure and certification tools emerged, such as the Social Balance Sheet (LIMA; COSTA; ALVES, 2019). Years later, in Brazil, several institutions proposed environmental and socioeconomic reporting models; among them, the Ethos Institute and the Brazilian Institute of Social and Economic Analysis (IBASE) (RÉGIO; ALENCAR; OLIVEIRA, 2022).

Another initiative that aims to help companies more adequately perform corporate responsibility disclosures is the Integrated Reporting (IR) with views to encouraging entities to adopt a reporting process that considers the connectivity and interdependence of financial and non-financial factors to demonstrate how the company generates value (ZARO, 2021). In 2020, the Federal Accounting Council (CFC) released the Brazilian Accounting Standard - General Technical Communication (CTG) 09 that deals with the Correlation to the Basic Conceptual Framework of Integrated Reporting (MARIA; D’ANGELO; BORGETH, 2022).

The sustainability report is a disclosure that brings together both economic-financial information, as well as social, environmental and performance of entities, consolidating them, in a clear and transparent way, to the most different users (RÉGIO; ALENCAR; OLIVEIRA, 2022). In general, the disclosure of sustainability reports occurs on a voluntary basis, and there is no standardization that results in a standardization of these reports (SILVA et al., 2021).

Internationally, the Global Reporting Initiative (GRI) supports companies with their impacts related to their social, environmental, and economic responsibilities by providing global guidelines for reporting these impacts (RÉGIO; ALENCAR; OLIVEIRA, 2022). GRI remains the dominant global standard for sustainability reporting or ESG reporting. When companies adopt the GRI standards, the content, format, and other requirements in their ESG reports are standardized (LUO; TANG, 2022).

By providing sensitive information to shareholders regarding potential risks to the organization, ESG disclosure is considered relevant by its users, improving the relationship between firms and their multiple stakeholders, having a positive impact on their market value (HONG; KOSTOVESTSKY, 2012; LI et al., 2018).

Thus, environmental, social and governance activities, in a multi-sector context, require consideration of the boundary of the firm, which in turn examines the informational structure of markets (SPENCE, 2002). The discussion of the integration of ESG factors beyond financial valuation is extended by reference to Agency Theory, with its concerns around moral hazard and adverse selection due to informational asymmetry arising from the decoupling of ownership and control (HUANG, 2021). In this respect, informational asymmetry may arise due to the absence of ESG standards.

2.2 INDEPENDENT AUDITING, AGENCY THEORY AND INFORMATIONAL ASYMMETRY

In the agency relationship, the informational asymmetry between the internal and external players can take the form of adverse selection, in which the internal agent has better information (JENSEN; MECKLING, 1976), and of moral hazard, in which the internal agent takes an action not
observed by the external ones. Due to both the impossibility of direct monitoring of the agent’s action by the principal, and the administrative opportunism, in which managers make their decisions aiming at an increase in their own benefit to the detriment of the increase in shareholders’ wealth, agency conflicts arise (HITT; IRELAND; HOSKISSON, 2011).

In order to align the agents’ interests with its own, the principal incurs agency costs, such as auditing (JENSEN; MECKLING, 1976), which is a crucial performance monitoring element for the development of firms (WATTS; ZIMMERMAN, 1983).

With respect to standardized information, independent auditors act as informational intermediaries, ratifying the reliability of disclosures, reducing informational asymmetries, by revealing internal information (LOPES; MARTINS, 2017). It also minimizes the loss resulting from the opportunism of managers (PIOT, 2001), improving the quality of information (SILVA, 2010). Thus, a higher level of audit in information increases the credibility of private information that is not directly verifiable ex ante (LIU et al., 2018).

In addition to confirming evidenced financial information, whether negative or positive, this verification, independent of results, performed by the audit, has the effect of encouraging managers to be more trustworthy in evidencing private information (BALL; JAYARAMAN; SHIVAKUMAR, 2012).

The audit will be valued by the user since he believes that the auditor informs the irregularities found in the reports (WATTS; ZIMMERMAN, 1983). Thus, for the effective reduction in agency conflicts and the improvement of information in the corporate governance process, the independent audit must present quality and credibility characteristics (SILVA, 2010).

2.3 ESG REPORTING, INDEPENDENT AUDITING, AND REGULATION

Social responsibility activities can integrate stakeholders into the firm’s investment decisions and mitigate information asymmetry (CUI; JO; NA, 2018). The study of ESG in the context of informational asymmetry focuses on the information content of non-financial information and its impacts explained by Agency Theory and Signaling Theory (HUANG; 2021).

There are at least three distinct ways in which agency problems can manifest themselves in relation to ESG activities (PENG; ISA, 2020). The first is when managers engage in ESG activities out of personal interest (BROWN; HELLAND; SMITH, 2006); the second occurs when ESG practices may result in the sacrifice of more profitable projects for the organization (SCHULER; CORDING, 2006); and the third refers to managerial opportunism, which suggests that managers use company resources to engage in ESG activities in order to avoid negative aspects or justify poor financial performance (PENG; ISA, 2020), thus characterizing a personal interest.

In this context, the demand for information disclosure arises (HEALY; PALEPU, 2001), so as to reduce informational asymmetry (CUNHA; RIBEIRO, 2006). The higher the quality of this information, the greater the reduction of this asymmetry (TRAN, 2022). Factors such as regulation, accounting standards and auditing enhance the credibility of this disclosure (HEALY; PALEPU, 2001).

The improvement of ESG information disclosure is beneficial in the long run, not only for shareholders, but also for other stakeholders (GHOLAMI; SANDS; RAHMAN, 2022). As a rule, Corporate Social Responsibility (CSR) reporting is voluntary and unregulated, giving managers a high level of discretion on how to measure and evidence their CSR performance, and they may change the measurement method each year (TSANG; FROST; CAO, 2022).

In this sense, there are flaws in the preparation of the economic data of the sustainability report, according to the GRI standard, and the evidenced indexes have presented average or low accuracy (GARCIA et al., 2015). Furthermore, there is a tendency
to emphasize the social pillar over the environmental and economic one, to evidence positive, neutral and negative actions in imbalance, and not to evidence the sources used, making it impossible for the data to be auditable (DIAZ-BECERRA; LEON-CHAVARRI; AMPUERO-ALFARO, 2021).

As a result, some actions are being taken to improve the quality of ESG information as pre-financial risks are increasingly priced by investors (CFC, 2022). One example, at the international level, is the Sustainable Finance Disclosure Regulation (SFDR) which, by requiring, as of January 2023, the disclosure of sustainability risks as well as their main negative impacts, aims to provide greater transparency on environmental and social issues in financial markets while allowing comparisons of ESG investment options (BCSD, 2022).

In Brazil, the Brazilian Committee on Sustainability Pronouncements (CBPS) was created by the Federal Accounting Council (CFC) on June 9, 2022, whose purpose will be not only to study but also to issue technical reports on ESG issues to be adopted by regulatory bodies in Brazil, such as the Securities and Exchange Commission (CVM). It should also be noted that this committee will relate to the International Sustainability Standards Board (ISSB), created by the IFRS Foundation (CFC, 2022).

With this standardization in the disclosure of information, the reports may come to present characteristics of improved accounting information, such as comparability and verifiability (CFC, 2022).

Although the GRI establishes principles to improve the quality of environmental reports, such as transparency, auditability and accuracy (MORONEY; WINDSOR; AW, 2012), the disclosure of CSR information does not present an evidencing standard, being its content arbitrary and inconsistent (ZHENG; REN, 2019), of questionable quality (WONG; MILLINGTON, 2014), which causes concern, evidenced in the literature, regarding its quality and informational level of voluntary CSR disclosure (TSANG; FROST; CAO, 2022).

Both the CVM (CVM, 2020) and the GRI recommend that external assurance be performed in order to improve the quality of financial reports, thus increasing the credibility of the reports for their stakeholders (MORONEY; WINDSOR; AW, 2012). The assurance in this information thus plays a role in reducing informational asymmetry, which is more evident the better the characteristics of the assurer (CUADRADO-BALLESTEROS; MARTÍNEZ-FERRERO; GARCÍA-SÁNCHEZ, 2017), serving as a mechanism for monitoring managers (WONG; MILLINGTON, 2014).

Similarly to auditing financial information, assurance is perceived as essential for evaluating the social and environmental information disclosed (MARTÍNEZ-FERRERO; GARCÍA-SÁNCHEZ, 2017), with audited CSR reports being perceived as more credible (TSANG; FROST; CAO, 2022).

Assured environmental disclosures present a higher quality than those disclosures of companies whose disclosures were not assured, and this quality is improved according to the auditor’s experience (MORONEY; WINDSOR; AW, 2012). In this sense, the higher the audit quality, the higher the level of disclosure of CSR information (HANDAYATI et al., 2022). And the lower the quality of the evidenced information, the stronger the demand for small audit firms, which have a higher risk in performing the audit work (ZHENG; HEN, 2019). In short, companies usually spend a certain amount to convey non-financial information to society, which can reduce information asymmetry and facilitate investors in identifying quality companies (SPENCE, 2002).

It is noteworthy that regulations would establish a disclosure standard with verifiable criteria along the same lines as those established for financial information. In order to reduce such asymmetries and to ensure a higher quality of disclosure, in the sense that reports reliably
reflect the firm’s environmental, social and governance issues, actions such as assurance, in the absence of regulation, or independent auditing are required.

That said, under the assumption of regulation issuance, independent audit work can reduce informational asymmetry by improving the quality of reported non-financial information. As such, this study proposes that the existence of independent auditing, assuming the existence of regulation, in sustainability reporting can help improve the quality of accounting information by reducing the opportunistic behavior of agents in ESG disclosure, hence:

Proposition: independent audit in sustainability reporting reduces informational asymmetry regarding ESG disclosure G.

3 FINAL CONSIDERATIONS

This essay aimed to discuss the role of independent auditing in the ESG information disclosed by entities in the light of the Agency Theory. Considering the existence of informational asymmetry in the disclosure of ESG information, the possibility of opportunistic behavior by managers and the relevance of this information for users, it was concluded that, in the existence of regulation, independent auditing can reduce informational asymmetry, improving the quality of accounting information.

This finding is in line with the studies by Tsang, Frost and Cao (2022), Hammami and Zadeh (2020), Cuadrado-Ballesteros, Martínez-Ferrero and García-Sánchez (2017) and Moroney, Windsor and Aw (2012), which identify that assured sustainability reports are more credible, with such assurance having a role in reducing informational asymmetry.

The study contributed to highlight the discussion on Agency Theory in ESG disclosure from the perspective of informational asymmetry. Thus, while organizations are involved in an environment that takes into account economic, environmental, and social aspects and disclose ESG information in order to reduce this asymmetry, such information may not be reliable, thus undermining their credibility. Therefore, despite the benefits brought about by ESG disclosure, mediation through assurance or independent audit, in the existence of regulation, mitigates the problems of informational asymmetry.

As a limitation, it is highlighted the discussion on the role of the auditor as an element of monitoring of the organizational environment, considering only one theoretical lens: the Agency Theory. It is recommended that future studies highlight aspects supported by other theories, such as the Stakeholder Theory, the Legitimation Theory and the Voluntary Disclosure Theory, as well as studies that empirically demonstrate the impacts of independent auditing on ESG disclosure.

REFERÊNCIAS


