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Original Paper

An Audit Governance Study of Green Financial Subsidies on ESG Greenwashing Behavior

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Abstract

Green financial subsidies are an important policy tool to drive enterprises' green transformation, but while incentivizing enterprises to increase environmental protection investment, they may also induce ESG "greenwashing" behaviors - enterprises create a green image through false or exaggerated ESG information disclosure In order to maintain the subsidy eligibility or obtain more resources. This paradox constitutes an important pitfall in the performance of green subsidy policies. From the perspective of audit governance, this paper systematically analyzes the theoretical logic of ESG "greening" induced by green subsidies, explains the logical basis of audit governance embedded in the relationship between green subsidies and ESG "greening", and reveals the three major audit governance mechanisms: information authentication, supervision and accountability, and strategic orientation. The study explains the logical foundation of audit governance embedded in the relationship between green subsidies and ESG, reveals three audit governance mechanisms: information verification, supervision, accountability and strategic orientation, and constructs a full-chain audit governance framework from four aspects: audit of policy design, audit of subsidy allocation, audit of corporate behavior and audit of performance results. The study concludes that the audit governance of green financial subsidies should not be limited to the traditional review of *financial compliance, but should be extended to the independent verification of the truthfulness of corporate ESG information disclosure and the dynamic assessment of the effectiveness of subsidy policies, so as to realize the paradigm upgrade from money management to efficiency management.*

Keywords

green financial subsidies, ESG bleaching green, audit governance, information forensics, oversight accountability

1. Introduction

With the in-depth promotion of the "dual-carbon" goal and the widespread dissemination of the ESG concept, green financial subsidies have become a core policy tool for governments at all levels to guide enterprises in green transformation. From energy-saving and environmental protection special subsidies to green technology innovation subsidies, from carbon emission reduction incentive funds to new energy industry support funds, the scale and coverage of green financial subsidies continue to expand. At the same time, the ESG information disclosure system is also accelerating. Green financial subsidies and ESG disclosure have formed an increasingly close linkage, i.e., the performance of corporate ESG not only affects its market reputation and financing ability, but also becomes an important basis for whether it can obtain and maintain green financial subsidies. However, this association has given rise to a real problem that cannot be ignored. Instead of improving ESG performance through substantial environmental investment, some enterprises create a "green image" through false or exaggerated ESG disclosure in order to meet the screening criteria of subsidy policy and maintain the subsidy eligibility. According to Chen Xiaoshan (2023), ESG greenwashing refers to the behavior of enterprises that exaggerate their efforts and achievements in environmental, social and governance aspects through misleading disclosure, which not only misleads investors' judgment on the real ESG performance of enterprises, but also undermines the allocation efficiency of the green investment market, and fundamentally hinders the substantive process of enterprise sustainable development.

It is a matter of concern that subsidies, which are supposed to provide incentives for enterprises to "go green", may induce enterprises to "go green". International studies have shown that while environmental subsidies have incentive effects in theory, in practice they may trigger policy compliance and rent-seeking behaviors by enterprises, i.e., enterprises maintain subsidy eligibility or obtain additional resources through greenwashing. In addition, government environmental subsidies in general may promote greenwashing in ESG disclosure, and the pandering effect outweighs the incentive effect. This finding reveals a deep-seated pitfall in the design of green subsidy policies: in the absence of effective monitoring and governance mechanisms, subsidies, instead of promoting substantial emission reductions by firms, may become a catalyst for greenwashing behavior. In the face of this dilemma, audit governance provides a possible path to break the deadlock. Audit, as an independent monitoring mechanism, naturally assumes the functions of information authentication, monitoring accountability and strategic orientation. It has been pointed out that, as an important supervisory body of environmental governance, audit can effectively prevent and manage the greening behavior of ESG reports by utilizing its preventive, supervisory, evaluative and forensic functions. Embedding audit governance in the relationship between green subsidies and ESG “greening” is not only a realistic choice to respond to the demand for subsidy policy performance management, but also a theoretical exploration to expand the boundaries of audit functions.

2. The Mechanism of Green Financial Subsidies and ESG Bleaching Green

From the perspective of manifestation, corporate ESG bleaching behavior presents diversified characteristics. Li Jiangfeng (2024) summarizes the typical ways of corporate greenwashing, including blatant deception, double standards, blank check, blurred vision and counterproductive. At the operational level, ESG greenwashing is mainly manifested in selective disclosure, ambiguity, false claims, and symbolic actions. These behaviors point to a common essence, i.e., the disconnection between ESG information disclosure and actual ESG performance of enterprises. The impact of green subsidies on ESG “greening” is not a simple linear relationship, but works through multiple mechanisms. Zhang Qia (2024) argues that there is no single, definitive relationship between green subsidies and ESG “greening”, and that their actual effects depend on the quality of the subsidy policy design, the effectiveness of the monitoring mechanism, and the institutional environment in which the firms operate. It is this uncertainty that constitutes the reasonableness and necessity of the intervention of auditing governance, that is, the core function of auditing lies in bridging the information asymmetry and suppressing opportunistic behavior, so that the incentive effect of subsidies can be manifested rather than being drowned out by the catering effect. In the light of existing studies, this mechanism can be summarized as two core dimensions, namely, the “policy pandering effect” and the “resource rent-seeking effect”.

2.1 Policy Pandering Effects

The allocation of green financial subsidies is usually based on the green performance of enterprises - enterprises need to meet certain environmental standards, disclose corresponding environmental information, and commit to specific emission reduction targets. Under this screening mechanism, ESG disclosure becomes a key channel for enterprises to transmit green signals to the government. However, when the cost of substantial environmental investment is higher than the cost of greenwashing, some companies will make strategic choices. Instead of investing a large amount of money in real green transformation, they would rather “create” a green image by embellishing their ESG reports, so as to satisfy the conditions for obtaining subsidies at a lower cost. Some scholars summarize this effect as the “pandering effect” of environmental subsidies, i.e., the manipulation of information by enterprises in order to meet the policy orientation.

2.2 Rent-seeking Effects of Resources

Green subsidies are a scarce public resource in themselves, and obtaining subsidies means obtaining direct financial support, implicit government endorsement, and the resulting market advantage. Under the temptation of such resources, firms have strong incentives to maintain or expand their subsidy share through information manipulation. Su Jialu (2023) argues that such rent-seeking behavior is not only manifested in the declaration of fraud, but also in the “symbolic green action” to cope with the assessment after obtaining the subsidy, and the diversion of the subsidy funds for other purposes. Based on the perspective of resource dependence theory, a study has empirically examined the relationship between government environmental protection subsidies and green governance deviation behavior, and found that government environmental protection subsidies have a significant positive impact on green governance deviation behavior. This effect is more significant in private enterprises with stronger government dependence and enterprises with high financing constraints.

2.3 The Catalytic Role of Information Asymmetry

The realization of the above two effects depends on a common precondition - information asymmetry. In the process of allocating and managing green subsidies, there is a significant information asymmetry between the government and enterprises. Enterprises have sufficient information about their own carbon emission level, environmental protection investment, ESG practices, etc., while the government mainly relies on the information disclosed by enterprises to make judgments and decisions. This information asymmetry exists not only in the process of subsidy approval, but also throughout the whole process of subsidy utilization and effectiveness evaluation. When enterprises realize that the probability of their “greenwashing” behavior being detected is low and the cost of being punished is low, “greenwashing” becomes a rational choice.

3. Audit the Logical Basis for the Embedding of Governance

3.1 Information Asymmetry and the Information Forensic Function of Auditing

The root cause of green subsidies inducing ESG bleaching is information asymmetry. The government is unable to accurately identify the true ESG performance of an enterprise, and enterprises therefore have the opportunity to obtain undue benefits through information manipulation. One of the core functions of auditing is precisely information authentication.

Information assurance refers to the auditing body through independent verification procedures to verify the truthfulness, accuracy and completeness of the information disclosed by the information provider, and to issue an assurance opinion to the information user. ESG report assurance is an important means to measure the quality of ESG information disclosure. However, China’s ESG report forensics is still in its infancy, the relevant institutional system is not yet sound, lack of unified forensic standards, the low rate of forensics, and at the same time, the phenomenon of “greenwash” in the ESG report has increased the difficulty of forensic practice. In order to effectively solve the problem of greenwash in ESG reports, the introduction of ESG assurance mechanism to improve the reliability of information disclosure has become a hot issue for scholars. This situation highlights the urgency of strengthening the forensic function of audit information.

3.2 Delegation of Authority and the Oversight Accountability Function of Auditing

The allocation and management of green financial subsidies involves a multi-layer principal-agent relationship, whereby the public entrusts the government with the allocation of public resources, and the government entrusts the subsidized funds to enterprises for green transformation. In each layer of the principal-agent relationship, there exists the risk of opportunism of the agent, the government may relax the subsidy audit standards due to the “performance impulse”, and the enterprise may implement greening due to the temptation of resources. The supervisory and accountability function of auditing is precisely designed to address this agency problem. Through independent and objective examination, the audit can reveal the irregularities of the agents in the allocation, use and management of subsidies, and hold them accountable. State auditing institutions not only need to supervise whether the distribution of subsidies by the authorities is in line with the central government’s policy deployment, but also need to review the authenticity and compliance of financial subsidies declared by enterprises. In the ESG audit of state-owned enterprises, studies have proposed the construction of a tripartite synergistic mechanism led by the state audit, supplemented by the social audit and assisted by the internal audit, in order to effectively curb the occurrence of enterprises’ greenwashing behavior. Li Silei (2024) argues that state audit is responsible for compliance review and macro performance assessment of subsidy policies, social audit (accounting firms) is responsible for independent verification of ESG information, and internal audit is responsible for internal control and self-supervision of subsidized fund use.

3.3 Policy Objectives and the Strategic Orientation Function of the Audit

The ultimate goal of green financial subsidies is not to send out money, but to promote green transformation. However, in the actual operation of the policy, due to the lack of a dynamic evaluation and feedback mechanism for the policy effect, the subsidy is often reduced to an administrative task that is “completed when issued”, and the deviation between the policy objective and the policy effect is difficult to be detected and corrected in a timely manner. The strategy-oriented function of audit responds to this need. In the audit governance of green financial subsidies, the strategic orientation function is reflected in the systematic assessment of subsidy policy objectives. Are the subsidies targeted at the key areas of carbon emission reduction? Does the incentive effect of subsidies translate into improved ESG performance? Does the subsidy policy need to be adjusted and optimized according to the actual situation? ESG audits constitute a dynamic closed-loop system through the interconnection of three mechanisms: information verification, monitoring and accountability, and strategic orientation. Among them, strategic orientation is the key leap from “after-the-fact supervision” to “before-the-fact guidance”.

4. Audit governance Framework for Greening Financial Subsidies for ESG “Greening”

Based on the above logical analysis, this paper constructs a “four-end integrated” framework for ESG audit governance of green subsidies. From the policy design end, subsidy distribution end, enterprise behavior end to the performance result end, a closed loop of audit governance covering the whole life cycle of subsidy policy is formed.

4.1 Audit of the Design Side of the Policy

The occurrence of ESG "greenwash" is, to a large extent, due to the loopholes in the policy design itself. When the application criteria for subsidies are vague, the auditing procedures are loose, and the information disclosure requirements are unclear, the "greenwash" will have a systematic room for survival. Therefore, the first line of defense in audit governance should be at the policy design end.

Audit of clarity of policy objectives. The audit should assess whether the policy objectives of green fiscal subsidies are specific, measurable and verifiable. If the policy objective only stays at the level of promoting green transformation and other macro-expressions, without setting clear carbon emission reduction targets, ESG improvement standards and other quantitative requirements, then it will be difficult to assess the effect of policy implementation, and it will be difficult to identify and pursue "greenwashing" behaviors. Audit practice shows that unreasonable design of policy thresholds and untimely formulation of allocation programs often lead to the ineffectiveness of subsidy policies. Audit of the scientific nature of subsidy standards. The audit should examine whether the selection criteria for subsidy recipients are scientific and reasonable, and whether the real ESG performance of enterprises is taken as the core basis? Has a mechanism been established to prevent "recognizing only the report but not the actual effect"? Have the differences between different industries and sizes of enterprises been taken into account? The audit should also pay attention to the coordination between different green policy tools to avoid overlapping or conflicting policies that may provide opportunities for enterprises to "go green". Audit of the stringency of disclosure requirements. The audit should assess whether the ESG disclosure requirements of subsidy policies are sufficiently stringent, and whether enterprises are required to disclose ESG data certified by third parties. Has a standardized template for disclosure been established? Are there clear penalties for non-compliance with the truthfulness of the disclosure?

4.2 Audit of the Distribution of Subsidies

The subsidy allocation process is a high incidence area for "greenwashing" behavior. Firms have a strong incentive to embellish their ESG disclosures in order to qualify for subsidies. The core task of auditing in this process is to block the access of "greenwash" firms.

Audits should independently verify the ESG information, carbon emission data, proof of environmental protection inputs and other materials submitted by enterprises when declaring subsidies, and verify whether they are consistent with the actual operating conditions of the enterprises. Such verification should not stop at the paper audit level, but should be extended to field verification, data cross-checking and other in-depth reviews. Auditors should focus on the key aspects of fund allocation, disbursement, utilization and efficiency, and implement all-round and penetrating supervision. Substantive audit of ESG performance of enterprises. In addition to verifying the authenticity of the declaration materials, the audit should also assess the materiality of the ESG performance of the enterprise, whether the ESG disclosure of the enterprise matches its actual environmental management, social responsibility fulfillment and governance level? Is there any suspicion of "greenwashing", that is, "talking a good game but doing a bad one"? Audit can use the three dimensions of compliance, matching and verifiability to identify "greenwash" behavior. Audit should also pay attention to whether the subsidy distribution process is open, fair and just - is there a phenomenon that "related households" get subsidies while green enterprises that really need support are marginalized? Have local governments relaxed their auditing standards in order to achieve "green performance"?

4.3 Audit of the Behavioral Side of the Enterprise

The third key aspect of audit governance is whether or not substantive environmental practices are carried out as promised after the enterprise has received the subsidy. The core task of this link is to curb the continuation of "greenwashing".

Compliance audit of the use of subsidized funds. The audit should track the specific flow of green financial subsidy funds within the enterprise, and verify whether the funds have been used for the agreed green purposes, and whether they have been used for energy-saving equipment procurement, clean technology research and development, emission reduction facility construction and other substantive environmental protection projects? Is there any diversion of subsidized funds to other uses or even to affiliated enterprises? This is the core content of traditional financial auditing, but under the ESG audit perspective, its connotation needs to be expanded from whether the funds are used in a compliant manner to whether the funds generate green benefits. Substantive audit of corporate carbon management and ESG governance. The audit should assess whether the enterprise has established an effective carbon management system and ESG governance mechanism after receiving the subsidy, and whether it has set up a specialized ESG management department or position. Has it formulated a systematic carbon reduction path and timetable? Has ESG performance been incorporated into the management's assessment system? These changes in governance are an important basis for determining whether an enterprise is "truly green" or "green". Audit of the authenticity of continuous disclosure. After receiving subsidies, enterprises are usually required to submit regular ESG disclosure reports to prove the effectiveness of the use of subsidized funds. Audit should conduct dynamic tracking and independent verification of these continuous disclosures, and timely detect signs of data embellishment and other signs of greenwashing in the disclosures.ESG audits constitute a dynamic closed-loop system through the three major mechanisms of information verification, supervision and accountability, and strategy orientation, which are interrelated and progressive in order to form a dynamic closed-loop system.

4.4 Audit of the Results Side of Performance

The final effect of the subsidy policy is reflected in whether the carbon emission reduction effectiveness and ESG performance of enterprises have been substantially improved. The core task of the performance audit is to assess the overall effectiveness of "greenwash" management and provide a basis for policy optimization.

Based on verifiable data, the audit should assess whether the subsidized enterprises have achieved significant improvements in their carbon emission intensity, carbon emission reduction margin, ESG score and other outcome indicators, and compare them with the enterprises in the control group that have not received subsidies, in order to judge the true effect of the subsidies. This assessment should not only rely on the data disclosed by the enterprises themselves, but also combine third-party monitoring data, on-site verification results and other sources of information to make a comprehensive judgment. Identification and exposure of greenwash behavior. Audit should establish a systematic greenwash identification mechanism to identify and expose greenwash behaviors by analyzing the consistency between corporate ESG disclosure and actual performance. Identification methods may include in-depth analysis of report content, coherence analysis of behavioral patterns, correlation analysis of financial performance and contradiction analysis of environmental penalties. The public disclosure of audit results itself constitutes a strong deterrent mechanism - when greenwash behavior may be exposed by audits and trigger negative market reactions, the incentive for companies to greenwash will be significantly reduced. Feedback and optimization of policy effects. The ultimate value of performance auditing is to provide feedback to policy makers and promote dynamic optimization of policies. The audit should systematically feedback the assessment results to the policy makers, and put forward specific suggestions on the adjustment of subsidy targets, revision of subsidy standards, and improvement of supervision mechanisms, forming a closed loop of policy governance of “audit-feedback-optimization”.

5. Real Challenges and Optimization Paths for Audit Governance

5.1 Reality Challenge

Although audit governance has the significant advantage of inhibiting ESG “greenwashing” in theory, it still faces multiple challenges in practice. At present, China has not yet established unified ESG disclosure standards and ESG report assurance standards. The lack of standardization has led to the lack of a clear reference system for auditors to assess the authenticity of corporate ESG disclosure, and the lack of comparability of evaluation results between different auditing entities; the phenomenon of “greenwash” in ESG reports has further increased the difficulty of forensic practice. Carbon auditing is also faced with unsound evaluation standards and other practical difficulties. Secondly, ESG auditing puts forward higher requirements on the professional ability of auditors - not only do they need to have traditional financial auditing skills, but also need to understand multidisciplinary contents such as carbon emission accounting methods, environmental management knowledge and social responsibility assessment framework. Only with the help of a single enterprise’s internal audit work can not meet the requirements of the full coverage of the audit, bleaching green governance effect is limited. At present, professionals with ESG audit capability are still scarce, which restricts the depth and breadth of audit governance. In addition, the acquisition and quality verification of corporate ESG information is the basis of audit governance. However, the current ESG information disclosure of enterprises is still mainly voluntary, and the completeness, timeliness and comparability of information disclosure are uneven. Auditors are often faced with the dilemma of having no data to check when conducting independent assurance. Finally, the governance of ESG "greenwash" involves multiple auditing bodies such as state audit, social audit and internal audit, as well as multiple government departments such as finance, environmental protection and securities regulation. However, at present, the synergistic mechanism between various audit subjects and departments is not sound, and the phenomenon of information silo is serious, which makes it difficult to form governance synergy.

5.2 Optimization of Paths

Accelerate the construction of the standard system. The formulation of ESG information disclosure standards and ESG report assurance standards should be accelerated to provide a unified institutional reference for audit governance. The formulation of standards should take into account both international standards and China's national conditions, drawing on the useful experience of international mature frameworks such as GRI and SASB, and taking into full consideration the institutional environment and developmental stage characteristics of Chinese enterprises.

Enhancement of auditing professional capacity. The cultivation of ESG audit professionals should be strengthened, and ESG-related courses should be integrated into the education of auditing professionals to cultivate composite audit talents with both financial auditing ability and ESG assessment ability. At the same time, we should promote collaborative cooperation between auditing organizations and professional organizations in the fields of environmental protection, energy and society to make up for the shortcomings of a single auditing body in the field of ESG.

Strengthen the construction of information disclosure system. We should promote the gradual transition of ESG information disclosure from "voluntary disclosure" to "mandatory disclosure", and improve the completeness, timeliness and comparability of information disclosure. At the same time, a third-party assurance system for information disclosure should be established, requiring enterprises to hire independent auditors to certify important ESG information, so as to reduce the room for "greenwashing" at the institutional level.

Establishing a multifaceted synergistic governance mechanism. A synergistic mechanism should be established between the state audit, social audit and internal audit to form a division of labor and cooperation pattern of "state audit leading the direction, social audit providing professional support, and internal audit implementing daily supervision". At the same time, it promotes information sharing and action synergy between audit supervision and financial supervision, environmental protection supervision, securities supervision and other multi-governance bodies, and builds a mechanism covering the whole chain of "policy formulation, subsidy distribution, corporate behavior and performance evaluation". The ESG "greening" governance network has been constructed to cover the whole chain of "policy formulation, subsidy allocation, corporate behavior and performance evaluation".

6. Conclusion

There exists a deep paradox between green financial subsidies and ESG “greenwash”, i.e., subsidies are supposed to incentivize enterprises to be “truly green”, but may induce enterprises to “greenwash” due to information asymmetry and lack of supervision. This paradox reveals that green subsidies should incentivize enterprises to be “truly green” but may induce them to “drift green” due to information asymmetry and lack of supervision. This paradox reveals a key blind spot in the performance management of green financial subsidy policy - the “issuance” of subsidies is not equal to the “effectiveness” of the policy, and the “availability” of funds is not equal to the “effectiveness” of the policy. The “in place” is not equal to the “realization” of the effect. From the perspective of audit governance, this paper systematically analyzes the formation mechanism and cracking path of this paradox. The study shows that green financial subsidies induce ESG “greening” mainly through the “policy catering effect” and “resource rent-seeking effect” two paths to realize, while the information asymmetry for the “greening”. The information asymmetry provides a breeding ground for “greenwash”. Audit governance is embedded in this relationship through the three mechanisms of information authentication, supervision and accountability, and strategic orientation, and builds a full-chain audit governance framework from the policy design end, subsidy distribution end, corporate behavior end to the performance result end, realizing the “greenwash” of ESG from “access blocking” to “sustaining”. It has realized the systematic governance of ESG “greenwash” from “access blocking” to “continuous curbing” to “effect assessment”. Looking ahead, with the continuous improvement of ESG disclosure system, the accelerated introduction of ESG report assurance standards and the continuous improvement of auditing professional capacity, the role of auditing governance in curbing ESG “greenwash” will be more significant. Auditing academics and practitioners should actively respond to this trend, accelerate the construction of the standard system, strengthen the professional capacity training, and promote the multi-dimensional synergistic governance, so that auditing can really become an effective tool for the performance management of the green financial subsidy policy, and provide a solid supervisory safeguard for the realization of the goal of “dual-carbon”.

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