

Promoting ESG Principles through Audit Committees in New Chinese Company Law Framework

Chunhao YIN¹

Abstract

This article conducts an in-depth analysis of the role of audit committees in promoting ESG (Environmental, Social and Governance) practices under Chinese new Company Law framework. It explores the theoretical and practical foundations for audit committees to undertake ESG functions, focusing on director's fiduciary duty theory and risk management theory, and argues that audit committees, as an important part of corporate governance, have the legitimacy and feasibility to participate in ESG governance. Against the backdrop of ESG's global development and China's institutional advancement—from voluntary practice to institutional construction—the article points out that audit committees in China currently face issues such as ambiguous functional positioning, inefficient cross-governance collaboration, and inadequate ESG promotion capacity under the new Company Law. By examining the historical evolution, organisational structure, and terms of reference of audit committees, as well as comparing international experiences, the study analyses the positive significance and limitations of audit committee reform from an ESG perspective. The article further proposes targeted optimization paths: statutory recognition of audit committees' ESG functions through legislative and regulatory improvements; clarification of their responsibilities in scenarios with or without dedicated ESG committees; and enhancement of performance effectiveness through measures such as introducing ESG professionals, strengthening training, establishing incentive mechanisms, and extending the business judgment rule to ESG decisions. Ultimately, the research aims to provide recommendations for improving China's corporate governance framework, facilitating enterprises' ESG development, and promoting a balance between economic and social benefits in sustainable development.

Key words New Chinese Company Law · Audit committee · ESG · Corporate governance

¹ Guangdong University of Finance and Economics. China.

Introduction

ESG (Environmental, Social and Governance) is a framework for assessing the non-financial performance of a company, covering environmental responsibility, social responsibility and corporate governance. This concept was first formally proposed by the United Nations Global Compact in the report *Who Cares Wins* in 2004. Its core lies in integrating environmental, social and governance factors into corporate decision-making to achieve long-term sustainable development.² In the context of corporate law, corporate governance within ESG has injected new connotations and requirements into corporate law and its related theories. In terms of corporate objectives, while traditional corporate governance focuses on financial performance and maximising shareholders' interests, ESG requires boards of directors to take on broader social responsibilities and focus on the overall well-being of stakeholders. This shift not only requires conceptual updating, but also involves adjusting the governance structure and improving the monitoring mechanism.³ In corporate governance, ESG emphasises the systematic integration of environmental, social and governance factors into corporate strategies and operations. Whether under US Board-Centric or Chinese Shareholders-Centric, ESG's special emphasis on corporate governance is conducive to the further improvement of the corporate governance mechanism and the quality of corporate governance, which will be more conducive to the sustainable development of the company, and this is the proper meaning of ESG.⁴

ESG has been widely stipulated in the laws of various countries around the world, typical laws include the EU Corporate Sustainability Reporting Directive (CSRD) and the US SEC's Climate Disclosure Rule, etc. China's ESG practice began with policy exploration in the late 2000s, in 2006, the Shenzhen Stock Exchange (SZSE) issued the Guidelines on Social Responsibility of Listed Companies, which for the first time put forward the requirements for CSR disclosure. In 2018, the Guidelines on Governance of Listed Companies formally established the framework for ESG disclosure, which requires listed companies to disclose information on the environment, social

² World Bank Group, 'Who cares wins' (World Bank Group, August 2004),

<https://documents.worldbank.org/en/publication/documents-reports/documentdetail/444801491483640669/who-cares-wins-2004-08>, accessed 8 August 2025.

³ Bani-Khaled, S., Azevedo, G. & Oliveira, J. Environmental, social, and governance (ESG) factors and firm value: A systematic literature review of theories and empirical evidence. *AMS Rev* (2025). <https://doi.org/10.1007/s13162-025-00303-2>.

⁴ Zhu Ciyun and Lv Chenglong, 'The Rise of ESG and the Dynamic Response of Modern Corporate Law (ESG 的兴起与现代公司法的能动回应)' (2022) 5 *Chinese and foreign law* (中外法学) 1241, 1248.

responsibility, and governance. In 2022, the Ministry of Finance and four other departments jointly issued the Fourteenth Five-Year Plan for Financial Standardisation. In 2022, four departments, including the Ministry of Finance, jointly issued the “14th Five-Year Plan for Financial Standardisation”, which explicitly establishes a system of ESG evaluation standards, marking the shift of ESG from voluntary practice to institutional construction.⁵ Overall, the development of ESG is moving towards globalisation, refinement and mandatory development.

At a time when the process of global sustainable development is accelerating, the concept of ESG has become a core guideline for enterprises to achieve sustainable development and enhance long-term competitiveness. However, the development of ESG is still facing many practical challenges. On the one hand, fraudulent practices such as “greenwashing” occur frequently. Although Chinese listed companies have a fairly high ESG report disclosure rate, most lack key quantitative indicators, making it difficult to truly reflect their actual performance in ESG aspects. This directly undermines the market’s trust in ESG information.⁶ On the other hand, the pressure on companies to promote ESG practices is increasing - financially, organisational restructuring, manpower costs, data audits and so on are imposing a heavy economic burden. In terms of legal compliance, foreign-related companies need to follow different standards at home and abroad, which significantly increases the difficulty and cost of compliance.⁷ Under Chinese Company law framework, although the new Company Law and the Code of Corporate Governance for Listed Companies have initially established an ESG governance framework, and changes in the corporate governance structure have provided an institutional foundation for the refinement of ESG governance, the audit committee—an important part of corporate governance—still faces issues such as ambiguous functional positioning, inefficient cross-governance collaboration mechanisms, and inadequate performance in promoting ESG development.

⁵ The Guidelines on Social Responsibility of Listed Companies of Shenzhen Stock Exchange (2006), Article 5; The Code of Corporate Governance for Listed Companies (2018), Articles 95 - 96; The Financial Standardization 14th Five - Year Development Plan, Section 5, Article 1.

⁶ Liu Siqi, ‘ESG Greenwashing: Theoretical Tracing and Practical Correction of ESG Conceptual Alienation’ (2025) 7 *Academic Journal of Business & Management* 45 <<https://doi.org/10.25236/AJBM.2025.070106>>.

⁷ Matteo Tonello, ‘Regulatory Shifts in ESG: What Comes Next for Companies?’ (Harvard Law School Forum on Corporate Governance, 7 August 2025), <https://corpgov.law.harvard.edu/2025/04/12/regulatory-shifts-in-esg-what-comes-next-for-companies/>, accessed 8 August 2025.

This paper aims to explore the role positioning, functional roles, and optimization paths of audit committees in the ESG governance system, based on Chinese Company law framework. Firstly, it analyzes the theoretical and practical basis for audit committees to promote corporate ESG practices; secondly, it puts forward targeted strategic suggestions in light of the institutional updates of the new Company Law. Through these efforts, it seeks to facilitate the ESG development of Chinese companies, improve their corporate governance mechanisms, and promote companies to achieve a balance between economic and social benefits on the path of sustainable development.

2. Audit Committee With ESG-Compatible Functions

2.1 Perspective of Director's Fiduciary Duty Theory

Audit committees, whose main members are directors, are subject to fiduciary duties concerning ESG issues. Directors are required to fulfil their fiduciary duties as stipulated in the Company Law, including the duty of loyalty and the duty of diligence. The development of ESG is injecting new dimensions into directors' fiduciary duties. The duty of loyalty requires directors to act in the best interests of the company and avoid conflicts of interest. In the ESG context, corporate governance emphasizes "stakeholder centrality", with the scope of stakeholders expanding. Moreover, the protection of rights and interests of stakeholders such as communities and the environment may conflict with the company's interests. For example, Shell shareholders sued directors for failing to respond effectively to climate change, arguing that they had breached their duty of loyalty to "promote the success of the company". Although the lawsuit was ultimately dismissed, it reveals the dilemma of adapting the traditional duty of loyalty to the ESG era.⁸ The duty of diligence requires directors to exercise "reasonable care, skill and diligence" in the performance of their duties, and is centred on the Business Judgment Rule, where the determination of whether a director has breached his or her duty of diligence is primarily a matter of business judgement.⁹ However, the complexity and externality of ESG issues go beyond the scope of traditional business judgment, and the traditional duty of diligence can hardly meet the diversified needs of ESG governance. In the ESG era, the duty of diligence has shifted

⁸ Climatecasechart, ClientEarth v Shell's Board of Directors (Climate Change Litigation Databases, 2023) <https://climatecasechart.com/non-us-case/clientearth-v-shells-board-of-directors/>, accessed 26 April 2025.

⁹ The Business Judgment Rule is an important principle of company law designed to protect directors and audit committee members from improper legal action in the performance of their duties, see Delaware General Corporation Law Section 141(a).

towards “social judgment”, requiring directors to incorporate social value considerations into their decision-making and form dual criteria of “business judgment + social judgment”. Business judgment and social judgment together constitute an indispensable core criterion for the legitimacy of directors’ performance of duties, and they are in an interdependent relationship where each contains elements of the other.¹⁰

For directors serving on the audit committee, there is an expansion of their oversight duty when addressing ESG issues. Historically, it has been argued that the primary function of audit committees is to oversee financial statement disclosure and fraud prevention, and their membership places greater emphasis on business knowledge and experience, making it difficult to address other non-financial social factors and technical issues.¹¹ The main types of risks covered by directors’ oversight duties include compliance risks and key business risks. Since most ESG risks can be categorised as either compliance risks or key business risks, directors should bear ESG oversight duties. Specifically, directors have an oversight duty regarding ESG matters that have been incorporated into compliance requirements, as well as those characterised by key business risks. The reasons for defining such matters as having key business risk characteristics are twofold: first, the larger the company, the more complex its ESG matters, making it impossible for directors to be personally involved in every matter; second, some ESG risks have minimal impact on the company’s operations and reputation, so non-critical risks are not included in the scope of oversight.¹²

2.2 Perspective of Risk Management Theory

Since the birth of risk management theory in the 1950s, its development has always been closely linked to changes in the business environment. It has evolved from

¹⁰ See Jiang Daxing, ‘ESG’s transformation of directors’ obligations: the evolution from business to social judgement (ESG 对董事义务的改造: 从商业判断到社会判断的进化)’ (2024) 4 China Legal Science (中国法学) 88, 103.

¹¹ See Mo Zhi, ‘Directors’ Compliance Obligations under the Integration of Social Risks into Corporate Governance - Dilemma, Reinterpretation and Balance (社会风险融入公司治理下的董事合规义务——困境、重释与平衡)’ (2025) 1 Journal of Hainan University (Humanities and Social Sciences Edition) (海南大学学报(人文社会科学版)) 162, 169.

¹² See Peng Yuchen, ‘Jurisprudential Logic and Normative Construction of Directors’ ESG Monitoring Obligations (董事 ESG 监督义务的法理逻辑与规范构造)’ (2023) 6 Finance and Economics Law (财经法学) 48, 55.

traditional risk management to comprehensive risk management.¹³ Traditional risk management mainly focuses on managing individual risk events and adopts an insurance-based approach to risk response. With the implementation of the Sarbanes-Oxley Act and the establishment of the COSO (The Committee of Sponsoring Organizations of the Treadway Commission) framework, risk management has shifted to systematic governance at the company's strategic level, emphasising the identification, assessment, and control of the company's overall risks, as well as the dynamic balance between risk and return. According to COSO's definition, comprehensive risk management is a dynamic process that runs through a company's strategy formulation and daily operations, aimed at identifying potential events that may affect the company and achieving its objectives by managing risks.¹⁴

Since the start of the 21st century, challenges such as climate change and supply chain globalisation have given rise to new dimensions of ESG risks. Phenomena like rising environmental compliance costs, labour disputes impacting brands, and governance deficiencies incurring penalties have shown that ESG risks go beyond traditional financial risks. PwC research indicates that corporate ESG performance is directly linked to financial performance and market reputation, making it a key area of modern risk management.¹⁵ Against this backdrop, audit committees are transitioning from purely financial oversight to integrated governance.¹⁶ By integrating ESG indicators into audit plans, audit committees can not only leverage existing governance structures to avoid duplicate positions but also utilise their financial expertise to capture opportunities for risk transformation. This functional upgrade not only aligns with the COSO framework's requirements for dynamic risk management but also balances governance cost control and value creation. The financial transmission mechanism of ESG risks requires audit committees to restructure their risk response strategies. The financialisation pathways of environmental risks include regulatory compliance costs, asset impairment risks, and supply chain resilience costs. For example, the Gulf of Mexico oil spill led BP to pay hundreds of millions of dollars in compensation over

¹³ Gen Goto, 'Risk Management: History, Definition, and Critique' (2013) 16 Risk Management International Journal 147 <<https://doi.org/10.1111/rmir.12016>>.

¹⁴ KPMG, COSO Internal Control-Integrated Framework (KPMG, 2023) <https://assets.kpmg.com/content/dam/kpmg/pdf/2016/05/2750-New-COSO-2013-Framework-WHITEPAPER-V4.pdf>, accessed 26 April 2025.

¹⁵ PwC, The Economic Realities of ESG (PwC, 2021) <https://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting/esg-investor-survey.html>, accessed 26 April 2025.

¹⁶ Lisa K. Meulbroek, 'Integrated Risk Management for the Firm: A Senior Manager's Guide' (Harvard Business School, 2002) <https://www.hbs.edu/faculty/Pages/item.aspx?num=12463>, accessed 26 April 2025.

four years and caused its share price to plummet by half.¹⁷ The financial impacts of social risks include litigation and compensation risks, human capital volatility, and brand value depreciation. A class-action lawsuit by former Uber employees resulted in legal fees consuming 15% of its annual net profit.¹⁸ The financial consequences of governance risks include regulatory penalties, governance structural deficiencies, and loss of merger and acquisition premiums. For example, Luckin Coffee's financial fraud incident not only triggered a massive fine from the SEC but also led to a 300-basis-point increase in equity financing costs after its delisting.¹⁹ These challenges make it feasible to build a "prevention-identification-disposal" closed-loop mechanism through audit committees. Their tasks may include overseeing the entire enterprise risk management (ERM) process, or such tasks may be handled by a separate committee or the full board of directors.²⁰

3. ESG Governance under Chinese Company Law Framework

The "G" in ESG stands for Corporate Governance, a core dimension for measuring the effectiveness and standardisation of a company's internal management mechanisms. It focuses on whether institutional arrangements for decision-making, supervision, and incentives are scientific and transparent—factors directly linked to a company's sustainable operational capacity. ESG governance within a company, as a refinement of "G" in ESG, refers to actively integrating the concept of sustainable development into various systems and processes of corporate governance in light of the company's actual situation and relevant requirements. This further enhances and optimises corporate governance mechanisms to drive the company's sustainable development.²¹ Modern countries require companies to establish ESG governance frameworks.

¹⁷ Jack Brook, '15 Years After Deepwater Horizon Oil Spill, Lawsuits Stall and Restoration Is Incomplete' (U.S. News, 2025) <https://apnews.com/article/deepwater-horizon-oil-spill-bp-offshore-01247f5b76c028b09c4ef80d9f982a50>, accessed 26 April 2025.

¹⁸ Leah Shepherd, 'Uber Signs \$8.4 Million Settlement Over Driver Misclassification' (SHRM, 2022) <https://www.shrm.org/topics-tools/employment-law-compliance/uber-signs-8-4-million-settlement-driver-misclassification>, accessed 26 April 2025.

¹⁹ Wang Zhuoqiong, 'Luckin Coffee Agrees to \$180m Fine' (China Daily, 2020) <https://www.chinadaily.com.cn/a/202012/17/WS5fdb241ca31024ad0ba9c764.html>, accessed 26 April 2025.

²⁰ KPMG, ESG Guide for Audit Committees (KPMG, 2023) <https://assets.kpmg.com/content/dam/kpmg/ca/pdf/2023/08/kpmg-blc-esg-guide-for-audit-committees-en.pdf>, accessed 26 April 2025.

²¹ Self-Regulatory Guidelines for Listed Companies of the Shanghai Stock Exchange No. 14-Sustainability Reporting (for Trial Implementation), Article 51.

However, such frameworks are not mandatory norms for corporate governance, and there is no uniform model for companies to advance their ESG governance frameworks. ESG governance frameworks consist of multiple layers of elements. Under Chinese Company law framework, ESG governance can be categorised mainly in terms of governance subjects, structures, and mechanisms.

3.1 ESG Governance Subjects

The main subjects of ESG governance within Chinese Company law framework include directors, employee directors, Specialized committees and so on. Directors are primarily involved in decision-making on ESG-related matters, and directors' duties in the ESG era have also taken on new connotations. With the development from "shareholder primacy" to "stakeholder theory", the company's goal orientation has shifted from short-term interests under the perspective of one-off or limited games to long-term interests under the paradigm of infinite repeated games. There is thus normative space for embedding corporate ESG into directors' fiduciary duties.²² A company's interests are an aggregate of shareholders' interests, stakeholders' interests, and public interests, though there is still a hierarchy of priorities within this aggregate. Article 180 of China's Company Law stipulates directors' fiduciary duties. The obligation to avoid conflicts of interest, as part of directors' duty of loyalty, corresponds to and aligns with the mandatory regulatory requirements for corporate governance under ESG principles. Directors should therefore focus on balancing and coordinating the interests of multiple parties.²³ The duty of diligence requires directors to make decisions in the best interests of the company and to establish the necessary monitoring mechanisms for ESG matters.

Specialised committees are the most common choice for companies to advance ESG matters. As early as the period when social responsibility was the primary advocacy goal, scholars proposed that establishing a social responsibility committee could advance the implementation of corporate social responsibility. Such a committee could routinize and professionalize the assessment of social impacts of a company's business decisions, and provide an important basis for exempting directors from liability

²² See Chen Jingshan and He Tianxiang, 'Corporate ESG hierarchical governance paradigm: the choice of chimerical model for directors' fiduciary obligations(公司 ESG 分层治理范式: 董事信义义务的嵌合模式选择)' (2023) 3 Journal of Zhengzhou University (Philosophy and Social Science Edition) (郑州大学学报(哲学社会科学版)) 43, 45.

²³ See Liu Xiaomeng, 'ESG guidelines for directors' behavioural change: rationale and path (ESG 指引董事行为变革: 理据及路径)' (2024) 9 Southern Finance (南方金融) 52, 59.

regarding their duty of care when acting on social responsibility.²⁴ Indeed, in terms of ESG development, the introduction of specialised committees dedicated to addressing social responsibility objectives is appropriate and feasible, regardless of their name or composition.²⁵

After being elected as employee directors through necessary procedures, employees can enhance listed companies' credibility in protecting employees' interests and managing human capital risks, and improve their ESG performance, by participating in the ESG committee or the human capital and compensation committee.²⁶ Companies should protect employees' rights and interests and enable their participation in democratic management through trade unions and employee congresses. For companies of a certain size, there must be employee representatives on the board of directors, and these representatives may join specialized committees to participate in corporate governance.²⁷

As "outsiders" to the company, independent directors can use their professionalism and independence to help the company identify risky market information and effectively respond to the company's potential crises.²⁸ At the corporate governance level, independent directors can act as gatekeepers in determining the substantive legality of fiduciary matters such as related-party transactions, which involve the duty of loyalty. At the environmental and social governance level, their performance of duties can reduce corporate operating costs and boost returns from the perspective of shareholders' long-term interests and sustainable enterprise development.²⁹ At the same time, independent directors are also important members of specialized committees.

²⁴ See Jiang Daxing, 'How Corporate Social Responsibility Becomes a "Tiger with Teeth"-The Design of Board Social Responsibility Committees (公司社会责任如何成为“有牙的老虎”——董事会社会责任委员会之设计)' (2009) 4 *Tsinghua Law (清华法学)* 21, 31.

²⁵ Tang Lin Yao, 'New quality productivity facilitated by the new Company Law (新质生产力的新《公司法》促动)' (2024) 10 *Business Economics and Management (商业经济与管理)* 85, 90.

²⁶ See Liu Donghui, 'Institutional Positioning and Functional Reconstruction of Employee Directors of Listed Companies under ESG Perspective (ESG 视角下上市公司职工董事的制度定位与职能重构)' (2023) 6 *Yunnan Social Science (云南社会科学)* 114, 121.

²⁷ *Company Law of the People's Republic of China 2023*, Articles 16-17, 68-69.

²⁸ Gu Gongwei and Luo Peixin, 'On Several Legal Issues of Establishing Independent Director System in China (论我国建立独立董事制度的几个法律问题)' (2001) 6 *China Legal Science (中国法学)* 65, 66.

²⁹ Zhu Qiaochu, 'The systematic reengineering of independent director system under the perspective of environment, society and governance development (环境、社会及治理发展视阈下独立董事制度的体系化再造)' (2025) 2 *Tsinghua Law (清华法学)* 191, 201.

3.2 ESG Governance Structure

In April 2024, the three major stock exchanges in Beijing, Shanghai and Shenzhen jointly issued guidelines related to Sustainability Reporting for Listed Companies, aiming to implement the new development concept, promote high-quality development, and guide listed companies to practice the concept of sustainable development and standardise information disclosure.³⁰ In January 2025, the three exchanges issued a guideline for the Preparation of Sustainability Reporting for Listed Companies at the same time, which provides practical guidance for listed companies.³¹ In view of the consistency of the core contents of the documents issued by the three exchanges, we focus on the Shanghai Stock Exchange's Guidelines for the Preparation of Sustainability Reports (hereinafter referred to as the "Guidelines") for analysis.

According to the Guidelines, The sustainability governance structure is generally divided into three levels: decision-making, management, and executive. The setup of the management and executive levels is more diversified—for instance, an ESG management committee may be established at the management level, while an ESG executive team, special department, or full-time position may be set up at the executive level. Companies can design their sustainability governance structures in light of internal management conditions, with the management and executive levels primarily responsible for proposing, planning, and executing ESG matters.³²

The decision-making level is responsible for decision-making and supervision of ESG matters and consists of members of the company's board of directors. Specific duties include: keeping abreast of domestic and international industry and sustainable development policies, understanding the overall picture of the company's operations; guiding and reviewing sustainable development strategies; supervising and assessing relevant impacts, risks and opportunities; following up on goal progress; and approving sustainable development reports.³³ The first two duties require the board of directors to have professional competence and make recommendations, while the last three

³⁰ Self-Regulatory Guidelines for Listed Companies of the Shanghai Stock Exchange No. 14 - Sustainability Report (for trial implementation), Article 1.

³¹ Shanghai Stock Exchange Self-Regulatory Guidelines for Listed Companies No. 4 - Preparation of Sustainability Report, Article 1.

³² Shanghai Stock Exchange Self-Regulatory Guidelines for Listed Companies No. 4 - Preparation of Sustainability Reports, Annex I "General Requirements and Disclosure Framework", Chapter 3, Section 1, Part I, Paragraph 3.

³³ Shanghai Stock Exchange Self-Regulatory Guidelines for Listed Companies No. 4 - Preparation of Sustainability Reports, Annex I, General Requirements and Disclosure Framework, Chapter 3, Section 1, Table 13.

specify the direction of supervision. The Guide emphasises that companies should strengthen the board's integration and oversight of ESG strategies and highlight its core role.

There are three main modes for establishing the decision-making level: first, establishing a dedicated ESG committee, newly formed under the board of directors. With due consideration to members' ESG backgrounds and diversity, this committee assists the board in ESG governance independently or in collaboration with other committees to improve decision-making efficiency; second, the board directly oversees sustainable development or ESG governance efforts while maintaining the structure and responsibilities of existing specialised committees; third, optimising the structure of existing specialised committees, where the board authorises specific committees to take charge of sustainable development matters. For example, restructuring the "Strategy Committee" into the "Strategy and Sustainable Development Committee" ensures members have both strategic and ESG backgrounds, thereby promoting integration between the company's strategy and ESG governance.³⁴ The latter two options, based on the existing corporate governance structure, achieve ESG management by strengthening the functions of directors or specialised committees.

3.3 The Main Governance Mechanisms of ESG

The information disclosure mechanism is one of the key elements of corporate governance in ESG. It includes not only external disclosure, but also information flow and supervision in the internal ESG governance process. ESG information disclosure has multiple positive impacts on companies.³⁵ Currently, over 30 exchanges across countries and regions worldwide have imposed requirements for ESG disclosure. Voluntary disclosure is the primary approach, while some exchanges mandate the disclosure of ESG information.³⁶ Although the international community lacks the scope to include ESG disclosure in statutory requirements through means such as *jus cogens*, as sovereign states do, there is a growing consensus that ESG disclosure should

³⁴ Shanghai Stock Exchange Self-Regulatory Guidelines for Listed Companies No. 4 - Preparation of Sustainability Reports, Annex I, General Requirements and Disclosure Framework, Chapter 3, Section I (i) (1-3).

³⁵ See Liu Jiangwei, 'Research on Corporate Sustainability and ESG Disclosure Construction (公司可持续性与 ESG 披露构建研究)', (2022) 5 Journal of Northeastern University (Social Science Edition) (东北大学学报(社会科学版)) 104, 105.

³⁶ Bernhard Frey, 'Reporting on the SDGs' (United Nations Global Compact, 2020), <https://unglobalcompact.org/take-action/action-platforms/sdg-reporting>, accessed 26 April 2025.

be incorporated into the institutional framework for companies to follow via comprehensive social regulatory tools.³⁷ The section on “governance” in the Guidelines provides references based on a company’s internal reporting mechanisms and oversight mechanisms for sustainability-related information.

Many corporate governance issues under company law are also issues of information flow governance.³⁸ The internal reporting mechanism for sustainability information should include clear reporting methods and frequency to ensure that personnel at all levels of the governance structure have timely access to relevant information.³⁹ The boardroom makes decisions based on effective access to information. This is an inherent requirement under corporate law for directors,⁴⁰ and can also clarify the responsibilities of directors, supervisors, and other senior personnel in advance from the perspective of internal compliance.⁴¹

The construction of the ESG multi-stakeholder regulatory system requires the co-governance and cooperation of the government, enterprises, and society, and enterprises should consciously establish internal regulatory frameworks.⁴² In the sustainable development oversight mechanism, the Guidelines require disclosure of how relevant institutions and personnel oversee and manage matters related to sustainable development—such as goal-setting, strategy implementation, and progress toward goal achievement—including details of the internal control system, oversight procedures, oversight measures, and appraisal results. The prerequisites for the proper functioning of the oversight mechanism are: establishing the company’s ESG governance structure; assessing, discussing, and identifying opportunities and risks in sustainability matters; and establishing internal mechanisms to monitor sustainability issues (for example, the

³⁷ Yuan Liping, ‘Research on soft law construction of corporate social responsibility information disclosure (公司社会责任信息披露的软法构建研究)’ (2020) 2 *Politics and Law (政法论丛)* 149, 151.

³⁸ Yuan, Chonglin, ‘The legal construction of inter-director disclosure obligations (董事间披露义务的法律构造)’ (2024) 5 *Legal Studies (法学研究)* 114, 132.

³⁹ Shanghai Stock Exchange Self-Regulatory Guidelines for Listed Companies No. 4 - Preparation of Sustainability Reports, Annex I, General Requirements and Disclosure Framework, Chapter 3, Section II (I).

⁴⁰ See Stephen M. Bainbridge, *Corporate Law*, 4th Edition (Foundation Press, 2015), 129.

⁴¹ Liu Jiangwei, ‘Research on Corporate Sustainability and ESG Disclosure Construction (公司可持续性 & ESG 披露构建研究)’ (2022) 5 *Journal of Northeastern University (Social Science Edition) (东北大学学报(社会科学版))* 104, 109.

⁴² See Li Chuanxuan and Zhang Yedong, ‘Jurisprudential Basis and Institutional Construction of ESG Disclosure Regulation of Listed Companies (上市公司 ESG 信息披露监管的法理基础与制度构建)’ (2024) 9 *Jiangnan Forum (江汉论坛)* 140, 143.

board's oversight responsibilities may be specified in the company's articles of association).⁴³

4. The ESG Role of the Audit Committee in China's New Company Law

4.1 The Historical Evolution of the Audit Committee

Audit committees first originated from the institutional design of the U.S. Securities and Exchange Commission (SEC) under the Investment Company Act of 1940. Their initial function focused on safeguarding the independence of external audits, with institutional practices during this period centered on ensuring the truthfulness of financial information. The Enron scandal led to the Sarbanes-Oxley Act (SOX), which triggered changes in global governance. This marked the first qualitative shift in the functions of audit committees: their oversight expanded from financial statements to internal control systems, and their statutory responsibilities extended to areas such as reviewing related-party transactions and anti-money laundering mechanisms for operational risk prevention and control.⁴⁴ The Act explicitly endowed audit committees with the authority to oversee financial reporting and safeguard the independence of external audits, laying the institutional groundwork for their subsequent financial and reporting oversight of ESG and other matters.⁴⁵ Subsequently, the SEC gradually incorporated ESG disclosure into its regulatory scope through a progressive regulatory strategy. The ESG Reporting Guidelines 2.0 issued by Nasdaq in 2019 further required audit committees to review the correlation between ESG data and financial risks, actively participate in corporate ESG strategy decision-making, and promote the in-depth integration of ESG management and financial governance.⁴⁶ To date, the U.S. securities market has established a framework where audit committees are involved in, oversee, and review ESG matters.

⁴³ Shanghai Stock Exchange Self-Regulatory Guidelines for Listed Companies No. 4 - Preparation of Sustainability Reports, Annex I, General Requirements and Disclosure Framework, Chapter 3, Section II (ii).

⁴⁴ The Sarbanes-Oxley Act: A Turning Point Triggered by Enron' (The Enron Saga,2003) <https://enron.net/the-sarbanes-oxley-act> accessed 26 April 2025.

⁴⁵ Paul S. Atkins, 'Speech by SEC Commissioner: The Sarbanes-Oxley Act of 2002: Goals, Content, and Status of Implementation' (U.S. Securities and Exchange Commission, 2003), <http://www.sec.gov/news/speech/spch020503psa.htm>, accessed 26 April 2025.

⁴⁶ MarketInsite, 'Introducing Nasdaq's ESG Reporting Guide 2.0' (Nasdaq, 2019), <https://www.nasdaq.com/articles/introducing-nasdaqs-esg-reporting-guide-2.0-2019-05-15>, accessed 26 April 2025.

The audit committee of Chinese companies is a product of institutional transplantation. The 2002 Code of Corporate Governance for Listed Companies specifies that the board of directors may establish an audit committee in accordance with resolutions of the general meeting of shareholders, endowing it with functions such as proposing changes to external auditors, supervising internal audits, communicating with internal and external auditors, reviewing the disclosure of financial information, and examining internal control systems. Its aim is to strengthen corporate supervision through the introduction of the U.S. independent director system.⁴⁷ The 2018 revision of the Company Law and the substantial adjustment to the Code of Corporate Governance for Listed Companies stipulated that listed companies "shall" establish audit committees, and added a catch-all clause specifying that their authority may derive from authorisation—marking the audit committee as a statutorily mandatory body. At this stage, the supervisory board remained the company's primary supervisory body, with independent directors providing professional support, while the audit committee focused on specialised financial supervision. The 2023 introduction of the new Company Law brought substantial changes to the audit committee: for limited liability companies and joint-stock limited companies, it adopted a binary choice model between the audit committee and the supervisory board, meaning companies could freely choose to establish either a supervisory board or an audit committee to exercise supervisory functions. Subsequently, the China Securities Regulatory Commission (CSRC) revised a number of regulatory documents in a focused manner, explicitly stating that supervisory boards would be abolished in listed companies and establishing the audit committee's comprehensive supervisory role.⁴⁸ At this point, the audit committee formally became a comprehensive supervisory body for listed companies, and corporate governance of China's listed companies officially moved toward a board-centered unitary structure. A key reason for this change is to facilitate domestic enterprises' "going global" and the introduction of foreign investment, align with the development direction of international corporate governance rules, and make corporate

⁴⁷ Peng Zhenming and Jiang Hua, 'A Comparison of the American Independent Director System and the German Supervisory Board System--Also on the Choice of Chinese Corporate Governance Structure Mode (美国独立董事制度与德国监事会制度之比较——也论中国公司治理结构模式的选择)' (2032) 1 Law Review (法学评论) 36, 40.

⁴⁸ CSRC, focuses on amending and repealing some of the supporting regulations and normative documents of the new Company Law (China Securities Regulatory Commission, 2025) <http://www.csrc.gov.cn/csrc/c100028/c7547353/content.shtml>, accessed 26 April 2025.

organizational operations more resilient.⁴⁹ Taking the reform of the audit committee as an important clue, we should improve the corporate governance structure, strengthen internal supervision, and perfect the risk prevention mechanism. This is also an inherent requirement for building a modern enterprise system with Chinese characteristics.⁵⁰

4.2 Audit Committee Organisation and Terms of Reference

The new Company Law draws on international practices and, in light of the needs of state-owned enterprise reform, establishes an audit committee governance structure led by outside directors. It stipulates that the audit committee of a listed company shall consist of 3–7 non-executive directors, with a majority being independent directors and the convener being an accounting professional. This not only ensures professionalism and independence but also allows employee directors to participate. The involvement of employee directors can continue the supervisory function of employee supervisors under the former supervisory board, including reviewing the company's financial status and management performance.⁵¹ However, when employees have disputes with other stakeholders, employee representatives may easily become isolated in performing their duties, which requires supporting mechanisms to safeguard their role.⁵² Nevertheless, employee directors' participation in governance is an important manifestation of a company's fulfillment of its social responsibilities and falls within the scope of Article 20 of the Company Law.

The selection of audit committee members remains undecided, with two possibilities: selection by the shareholders' general meeting or by the board of directors. Scholars advocating selection by the shareholders' general meeting, based on their interpretative

⁴⁹ See Lin Yi-Ying, 'Legislative Improvement of Corporate Supervisory Bodies: Beyond One-Tier and Two-Tier Systems (公司监督机构的立法完善: 超越单层制与双层制)', (2022) 4 Journal of Law (法学杂志) 36, 51.

⁵⁰ Xinhua News Agency, Xi Jinping's Speech at the Forum for Private Enterprises (The Central People's Government of the People's Republic of China, 2025) https://www.gov.cn/yaowen/liebiao/202502/content_7004103.htm, accessed 26 April 2025.

⁵¹ See Guo Li, 'The corporate law path of employee rights and interests protection - a discussion centred on the new company law (职工权益保护的公司法路径——以新公司法为中心的讨论)', (2025) 1 Law Application (法律适用) 97, 103.

⁵² See Liu Junhai, 'Systematic Design of Employee Participation in Corporate Governance: The Triple Perspective of Legislative Purpose, Institutional Reconstruction and Equity Ties (职工参与公司治理的体系化设计: 立法宗旨、制度重构与股权纽带的三重视角)', (2023) 4 Northern Law Journal (北方法学) 5, 15.

stance on Article 144(3) of the Company Law,⁵³ hold that for listed companies (as joint-stock limited companies), the shareholders' general meeting is responsible for selecting audit committee members. The board of directors has no authority to replace or dismiss them, and in the selection process, a distinction should be made between the appointment of directors serving on the audit committee and that of other directors.⁵⁴ The argument in favour of selection by the board of directors is mainly that although the audit committee undertakes comprehensive supervisory functions, it is a subcommittee of the board, so appointment by the board is not inappropriate.⁵⁵ However, this may also give rise to the problem of "the supervised selecting the supervisor".⁵⁶

Within the unitary governance structure of listed companies, the audit committee does not simply take over the supervisory power of the supervisory board, but also acquires certain procedural rights to enhance the efficiency of the company's exercise of supervisory power. The introduction of the audit committee has integrated the supervisory functions of the supervisory board into the board of directors, thereby enabling the board to realise the integration of supervision and management. The scope of the audit committee's powers can be mainly categorised into operational supervision, financial supervision, decision-making participation, and special investigation

⁵³ The provision provides that class shares have the same rights as common shares in electing or replacing supervisors and audit committee members, and this juxtaposition of the provision for supervisors and audit committee members as the scope of the shareholders' meeting's authority may be legally interpreted to mean that the shareholders' meeting directly elects directors to serve on the audit committee. See Liu Bin, 'Chinese-style audit committee: organisational basis and configuration of authority and responsibility (中国式审计委员会: 组织基础与权责配置)', (2024) 4 *Legal Science (Journal of Northwestern University of Politics and Law)* (法律科学(西北政法大学学报)) 114, 118; Gao Junhui., 'The Beginning of Legal Trial and Error: The Model Positioning and Institutional Structure of Audit Committees (法律试错的开始: 审计委员会的模式定位与制度构造)', (2024) 5 *China Law Review (中国法律评论)* 51, 62.

⁵⁴ See Liu Bin, 'Chinese-style audit committee: organisational basis and configuration of authority and responsibility (中国式审计委员会: 组织基础与权责配置)', (2024) 4 *Legal Science (Journal of Northwestern University of Politics and Law)* (法律科学(西北政法大学学报)) 114, 119.

⁵⁵ See Ye Lin and Qian Cheng, 'Normative interpretation and institutional construction of audit committee under the new Company Law (新《公司法》下审计委员会的规范阐释与制度构建)', (2025) 1 *Journal of Harbin Institute of Technology (Social Science Edition)* (哈尔滨工业大学学报(社会科学版)) 25, 33.

⁵⁶ See Jiang Daxing, 'Enforcement dilemma of the audit committee rules of the board of directors in the new company law (新《公司法》董事会审计委员会规则的执行困境)', (2024) 2 *China law review (中国法律评论)* 68, 73.

rights.⁵⁷ These powers not only cover the traditional functions of the supervisory board but are also more efficient than before—especially in monitoring board decisions and improving corporate governance transparency. Compared with the previous powers of the supervisory board, the audit committee’s powers have also been adjusted and optimised in certain aspects. For example, in listed companies, audit committees have been granted pre-approval veto power over major financial decisions, such as hiring or dismissing accounting firms and appointing or removing chief financial officers. This expansion of powers has made the audit committee’s role in corporate governance more prominent, particularly in financial supervision and risk prevention and control.

4.3 Positive Significance and Limitations of Audit Committee Reform

The positive significance of Chinese audit committee reform lies in the fact that the audit committee, as a subcommittee of the board of directors, is no longer as susceptible to the influence of major shareholders or management as the supervisory board. It can thus more independently supervise and review financial reports prepared by management. This helps reduce the likelihood of management manipulating or window-dressing financial reports for its own interests, ensuring that they truly and objectively reflect the company’s financial position and operating results. The audit committee is directly accountable to the board of directors, forming an effective check on management’s power at the corporate governance level. In terms of financial reporting, it can supervise and review management’s financial decisions to ensure that the preparation and disclosure of financial reports comply with laws, regulations, the company’s articles of association, and accounting standards—preventing the quality of financial reports from being compromised by management’s improper decisions or self-dealing practices.

Although the new Company Law establishes the audit committee as a statutorily mandatory body of the board of directors, its core functions are to examine the company’s financial affairs and supervise the conduct of directors and senior management in performing their duties, with no explicit inclusion of ESG-related responsibilities. This legal positioning results in a lack of direct legal basis for the audit committee to oversee ESG matters. Meanwhile, the China Securities Regulatory Commission (CSRC)’s Measures for the Administration of Information Disclosure by Listed Companies requires listed companies to disclose sustainability reports, but the Company Law does not incorporate ESG information disclosure into the audit

⁵⁷ Guidelines for Articles of Association of Listed Companies, Article 135.

committee's scope of duties, creating a regulatory gap between regulatory rules and the Company Law. In practice, the review of ESG reports is mostly undertaken by the strategy committee or ESG leadership teams. The audit committee can only provide opinions, with no stipulation of its duty to review such reports, leaving it unable to substantially control the quality of disclosure. Finally, there is a significant mismatch between the professional backgrounds of audit committee members and ESG-related needs. Under Article 69 of the Company Law, audit committee members must possess professional knowledge in finance and accounting. However, ESG issues involve multidisciplinary fields such as environmental science, sociology, and supply chain management, inevitably leading to a mismatch in professional expertise.

5 Make A Strong Audit Committee to Promoting ESG Principles

5.1 Statutorising the ESG Functions of the Audit Committee

As mentioned above, there is a theoretical and practical basis for audit committees to undertake or share ESG functions. As directors, audit committee members have an inherent fiduciary duty. The complexity of ESG issues requires a shift in fiduciary duty from the traditional “shareholder primacy” to “stakeholder protection”—a shift that aligns with the core concept of ESG. ESG risks have transcended traditional financial risks and become a key factor affecting enterprises' sustainable development. As a comprehensive oversight body, the audit committee's integration of ESG risks into the corporate governance framework is consistent with the requirements of COSO's ERM framework. Given its extensive experience in overseeing such matters, the audit committee is widely regarded as best suited to supervise sustainability disclosures, the ongoing development and maintenance of controls and processes required for such disclosures, and related assurance activities.⁵⁸ According to agency theory, audit committees play a critical role in reducing information asymmetries and conflicts of interest between managers and stakeholders when managers make ESG decisions.⁵⁹ Currently, the ESG functions of audit committees are inferred from relevant theories, with no explicit stipulation in statutory law. Clearly defining the ESG functions of audit

⁵⁸ Stephen G. Parker et al., ‘The Audit Committee's Role in Sustainability/ESG Oversight’ (Harvard Law School Forum on Corporate Governance, 2021), <https://corpgov.law.harvard.edu/2021/10/03/the-audit-committees-role-in-sustainability-esg-oversight/>, accessed 26 April 2025.

⁵⁹ Matteo Pozzoli, Alessandra Pagani and Francesco Paolone, ‘The Impact of Audit Committee Characteristics on ESG Performance in the European Union Member States: Empirical Evidence before and during the COVID - 19 Pandemic’ (2022) 371 *Journal of Cleaner Production* <<https://doi.org/10.1016/j.jclepro.2022.133411>>.

committees is an important driver for implementing corporate social responsibility under Article 20 of the Company Law, and helps promote the concept of sustainable development embodied in the Company Law.

To achieve the statutorisation of audit committees' ESG functions, it is necessary to establish an institutional framework at both the legislative and regulatory levels. In terms of legislation, two approaches can be adopted: first, add corresponding provisions to Article 67 of the Company Law to clarify the audit committee's supervisory authority over ESG matters—including risk identification, compliance review, and information disclosure—and incorporate accountability for ESG violations into Article 188 to define liability for damages arising from inadequate performance; second, through judicial interpretation, and in accordance with the authorisation scope under Article 67 of the Company Law, endow the audit committee with temporary authority to deliberate on ESG issues, and clarify that the board of directors' authorisation scope includes ESG-related functions.

At the regulatory level, efforts can be made to promote the CSRC to formulate supporting rules requiring listed companies to specify the ESG duties of audit committees in their articles of association—such as regularly evaluating strategy implementation, reviewing information disclosure, and participating in the selection of third-party verification institutions. Meanwhile, listed companies should be required to disclose ESG key performance indicators in their annual reports, accompanied by a statement of authenticity signed by the audit committee, or subject to attestation by the audit committee. Such signatures and attestations shall serve as a basis for holding the audit committee and its members liable in cases of ESG fraud. The CSRC may impose market entry bans or fines on companies and audit committee members involved in false disclosures or major ESG incidents to encourage industry self-discipline.

5.2 Clarify the Responsibilities of the Audit Committee in Different ESG Governance Scenarios

When a dedicated ESG committee is established, the principle of collaborative governance should be adhered to. The audit committee ensures the alignment between ESG strategies and financial objectives through a “supervision + review” approach. Specialised bodies such as the ESG committee, which are responsible for decision-making and oversight of ESG matters, are subordinate to the board of directors—enjoying equal status with the audit committee. The Guidelines clearly state that establishing a board oversight mechanism requires strengthening internal ESG management supervision. In this process, the audit committee, by virtue of its

supervisory functions and leadership in internal controls, serves as a key implementing body. To this end, it is necessary to further strengthen its ESG supervisory functions, implement supervisory responsibilities, and prevent ESG non-compliance and “greenwashing”. This can be advanced through the following approaches:

In the auditing process of ESG reports, a company assumes the dual roles of principal and supervisee, posing soul-searching questions to third-party professional institutions (such as auditing firms): “Who am I? Whose trustee am I? To whom am I responsible? and Who is my boss and God?”⁶⁰ Therefore, it is necessary and feasible to strengthen the audit committee’s financial oversight and compliance supervision of ESG matters. The audit committee should regularly assess the effectiveness of the ESG committee’s strategy implementation, and incorporate the assessment results into the annual internal control evaluation report as a basis for the board of directors’ assessment. Companies may authorise the audit committee to review and appoint third-party ESG reporting institutions; this is feasible because the CSRC has long required audit committees to review the independence and professionalism of third-party institutions.⁶¹ Before an external auditor issues an ESG-related opinion, the audit committee needs to pre-assess whether its audit scope covers key ESG risk areas. Secondly, establishing an information communication and collaboration mechanism is a prerequisite for effective supervision. The audit committee should hold regular joint meetings with other relevant departments and committees, such as the ESG committee and internal audit departments, to achieve information sharing and complement each other's strengths, thereby improving the efficiency and effectiveness of supervision. In addition, the audit committee should maintain close communication with external auditors to ensure they follow relevant standards and requirements in ESG-related audit work. Studies have shown that the more oversight committees a company has (i.e., more than five), the lower the probability of it being penalised by investors.⁶²

In companies without a dedicated ESG committee, having the audit committee directly assume ESG oversight functions is a feasible option that merits in-depth exploration. From the perspective of operating costs, establishing a specialised ESG committee would require additional investment in human, physical, and financial resources to build a team and conduct related work. This not only increases a company’s operating

⁶⁰ Liu Junhai, ‘On the Institutional Design of Corporate ESG Disclosure: A New Perspective on the Protection of Consumers and Other Stakeholders’ (论公司 ESG 信息披露的制度设计:保护消费者等利益相关者的新视角)’, (2023) 5 *Law Application* (法律适用) 18, 24.

⁶¹ Guidelines on the Articles of Association of Listed Companies, Article 136.

⁶² Qin Zhang and Jin Boon Wong, ‘ESG Reputational Risks and Board Monitoring Committees’ (2022) 50 *Journal of Financial Reporting and Law* <<https://doi.org/10.1016/j.frl.2022.103325>>.

costs but may also create conflicts with other departments over resource allocation. As an important component of corporate governance, the audit committee already has certain professional resources and existing personnel. Having it take on ESG functions can, to some extent, reduce costs and improve resource utilisation efficiency.

In addition, the audit committee undertakes important supervisory and review responsibilities in corporate governance. Its members typically have strong expertise in finance, law, and other fields, giving them an advantage in assessing how ESG-related risks affect the company's financial position and reviewing the compliance of ESG information disclosures.⁶³ Therefore, the assumption of ESG functions by the audit committee enables effective integration and utilisation of resources, avoiding duplication of efforts and resource waste.

5.3 Enhancement of Audit Committee Performance Effectiveness and Guarantee

Audit committees are largely composed of independent directors with professional backgrounds in finance, auditing, and law. To deepen ESG practices, ESG professionals—such as external directors specialising in environmental engineering or social responsibility auditing—can be introduced. Leveraging their expertise, they can accurately identify ESG risks and opportunities, enhancing the audit committee's decision-making and supervisory capabilities. Meanwhile, involving employee directors in ESG management execution helps enable oversight throughout the entire process. Employee directors, from an employee perspective, provide recommendations on issues such as protecting employees' rights and interests and fulfilling social responsibilities, thereby promoting the comprehensive implementation of corporate ESG initiatives.

Audit committee members are required to receive ESG-specific training to gain an in-depth understanding of ESG concepts, relevant laws, regulations, policies, and best practice cases. Adding independent directors with ESG expertise is another important measure. As "outsiders" of the company, the independence and professionalism of independent directors are crucial to corporate governance. Historically, independent directors in corporate governance were generally required to be external individuals with legal or accounting expertise. Introducing independent directors with ESG backgrounds can, from the perspective of shareholders' long-term interests and

⁶³ Ranjith Appuhami and Shamim Tashakor, 'The Impact of Audit Committee Characteristics on CSR Disclosure: An Analysis of Australian Firms' (2017) 27 *Australian Accounting Review* 400 <<https://doi.org/10.1111/auar.12170>>.

corporate sustainable development, reduce operating costs and increase revenues when ascertaining the substantive legality of connected transactions and other matters involving fiduciary duties.

A key means of ensuring performance safeguards is the extension of the business judgment rule to ESG decision-making.⁶⁴ ESG issues often involve complex environmental, social, and governance factors, and audit committee members need to make decisions amid uncertainty and diversity—making the introduction of the business judgment rule particularly important. Based on the business judgment rule established in Section 141(a) of the Delaware General Corporation Law, it is recommended that special application rules be established in the field of ESG governance.

Specifically, if a member of the audit committee, in exercising their authority, makes a decision that is in the company's best interests based on reasonable information and prudent judgment, they may be exempt from legal liability even if the outcome falls short of expectations. The specific requirements for such exemption include: the audit committee member having obtained sufficient ESG-related information (including ESG assessment reports issued by third-party professional institutions); having conducted independent and diligent due diligence; and having made reasonable decisions based on the company's sustainable development goals. Even if such decisions later prove to have failed to achieve the expected ESG benefits, the business judgment rule may still be invoked to claim exemption. Applying the business judgment principle to ESG decisions and systematically aligning it with Article 38 of the Code of Corporate Governance for Listed Companies (which governs directors' duty of diligence) will greatly enhance the confidence and motivation of audit committee members, encouraging them to engage more proactively in ESG affairs while providing companies with greater flexibility and autonomy in ESG governance.

To motivate audit committee members to advance ESG initiatives, an incentive mechanism linking compensation to ESG performance can be established and adopted as voluntary norms.⁶⁵ Specifically, ESG performance incentives can be added to the compensation structure. Based on a scientific assessment system, the company's ESG

⁶⁴ Gen Goto, 'ESG, Externalities, and the Limits of the Business Judgment Rule: TEPCO Derivative Suit on Fukushima Nuclear Accident and the Expansion of Caremark' (2024) 12 *The Chinese Journal of Comparative Law* <<https://doi.org/10.1093/cjcl/cxae020>>.

⁶⁵ Matteo Pozzoli, Alessandra Pagani and Francesco Paolone, 'The Impact of Audit Committee Characteristics on ESG Performance in the European Union Member States: Empirical Evidence before and during the COVID - 19 Pandemic' (2022) 371 *Journal of Cleaner Production* <<https://doi.org/10.1016/j.jclepro.2022.133411>>.

performance is regularly evaluated across environmental, social, and governance dimensions. If the company achieves reduced carbon emissions, higher employee satisfaction, or enhanced governance transparency, members will receive additional bonuses based on their contributions; otherwise, their compensation will be deducted. A dedicated ESG bonus pool can also be established, with rewards distributed proportionally to improvements in the company's ESG ratings (e.g., an upgrade in MSCI ratings). By tying their interests to the company's, members are incentivized to focus more on the company's long-term sustainable development.

6. Conclusion

In conclusion, the reform to the audit committee under Chinese new Company Law framework have, to a certain extent, promoted its potential in ESG practices. These amendments help transform the audit committee from a purely financial supervision body into a comprehensive governance participant, laying the foundation for integrating environmental, social and governance factors into corporate decision-making. The emphasis on clarifying audit committees' ESG functions—rooted in director's fiduciary duty theory and risk management theory—provides a theoretical and practical basis for strengthening internal ESG supervision, which is crucial for addressing challenges such as “greenwashing” and inefficient resource allocation in ESG practice.

By adopting targeted measures—including statutorising ESG functions through legislative and regulatory improvements, clarifying responsibilities in both dedicated and non-dedicated ESG committee scenarios, and enhancing performance through professional recruitment, training, incentive mechanisms, and the extension of the business judgment rule—China can refine its corporate governance framework. This refinement is essential for ensuring that audit committees play a pivotal role in promoting ESG development, not only improving the quality of corporate governance but also facilitating a balance between economic efficiency and social responsibility. Ultimately, such efforts will contribute to a more sustainable and resilient business environment in China, boosting corporate competitiveness and stakeholder confidence in the context of global ESG integration.