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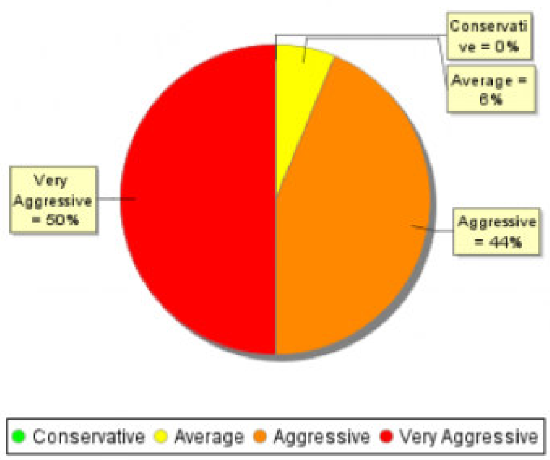
The Money Game

Audit Integrity: 'Socially Responsible' Companies Have Worse Accounting Practices Than Normal Ones

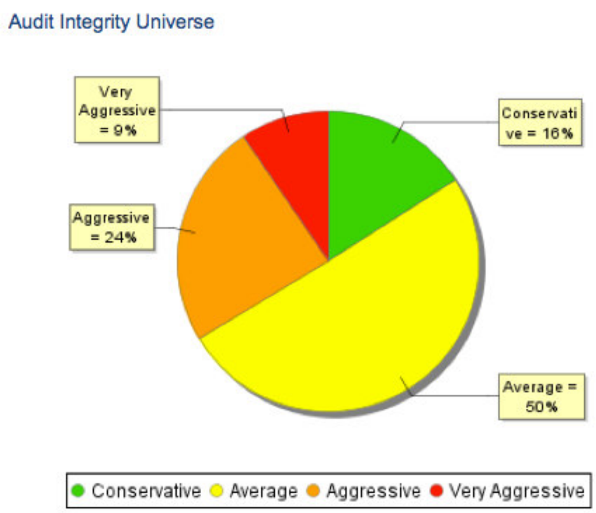
Vincent Fernando | Dec. 28, 2009, 3:55 PM |

So-called socially responsible funds may actually be higher risk than their plain vanilla brethren. According to the firm Audit Integrity, if you take two socially responsible funds as an example it appears that their 'socially responsible' holdings contain companies who practice some pretty risky companies from an aggressive accounting or corporate governance perspective.

For the Domini Social Equity Fund and the FTSE KLD 400 Social Index, 50% of their holdings have been ranked as 'Very Aggressive' by Audit Integrity's metrics, as shown below.



This is a pretty substantial shift in governance risk when compared to Audit Integrity's entire universe of stocks under coverage, for which only 9% are bad enough to receive 'Very Aggressive' ratings.



Obviously any such accounting or corporate governance ratings system is only as good as the methods employed. Maybe one has to look closer at how Audit Integrity actually scores companies. Yet given the wide divergence between the two charts above, the relationship likely still stands even after accommodating some room for error.

The larger question we feel is why some socially responsible funds might inadvertently be exposing investors to higher governance risk. Perhaps it's because the socially responsible label makes people less skeptical. Or perhaps socially responsible funds are less diligent in checking companies beyond their standard social criteria. Yet you'd expect that good governance was part of being a socially responsible investment. Thus our message is that socially responsible investing, as a label, might be pretty misleading.

http://www.businessinsider.com/audit-integrity-socially-responsible-funds-actually-contain-massive-governance-concerns-2009-12