CSR Assurance as a Signal of CSR Disclosure Quality

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Over the past several decades, considerable attention has been paid within the environmental literature narrowly, and the CSR literature more broadly, to the relationships among 3 core constructs

CSR Disclosure
(environmental)

Economic Performance

CSR Performance
(environmental)

Al-Tuwaijri *et al.* (*AOS*, 2004) argue that –

> **"any exploration of environmental strategy, financial performance, and environmental reporting transparency must all be examined simultaneously, and that an analysis of a subset of any two of these measures is incomplete"**

Notwithstanding the “imperative” from Al-Tuwaijri *et al*. **and echoed by others**, much of the literature has focused on pairwise relationships

Thus, starting with the ***CSR Performance – Economic Performance*** relation as the perhaps the least contentious

CSR Disclosure
(environmental)

Economic Performance

CSR Performance
(environmental)

- Cash Flow / Earnings
- COEC
- Valuation

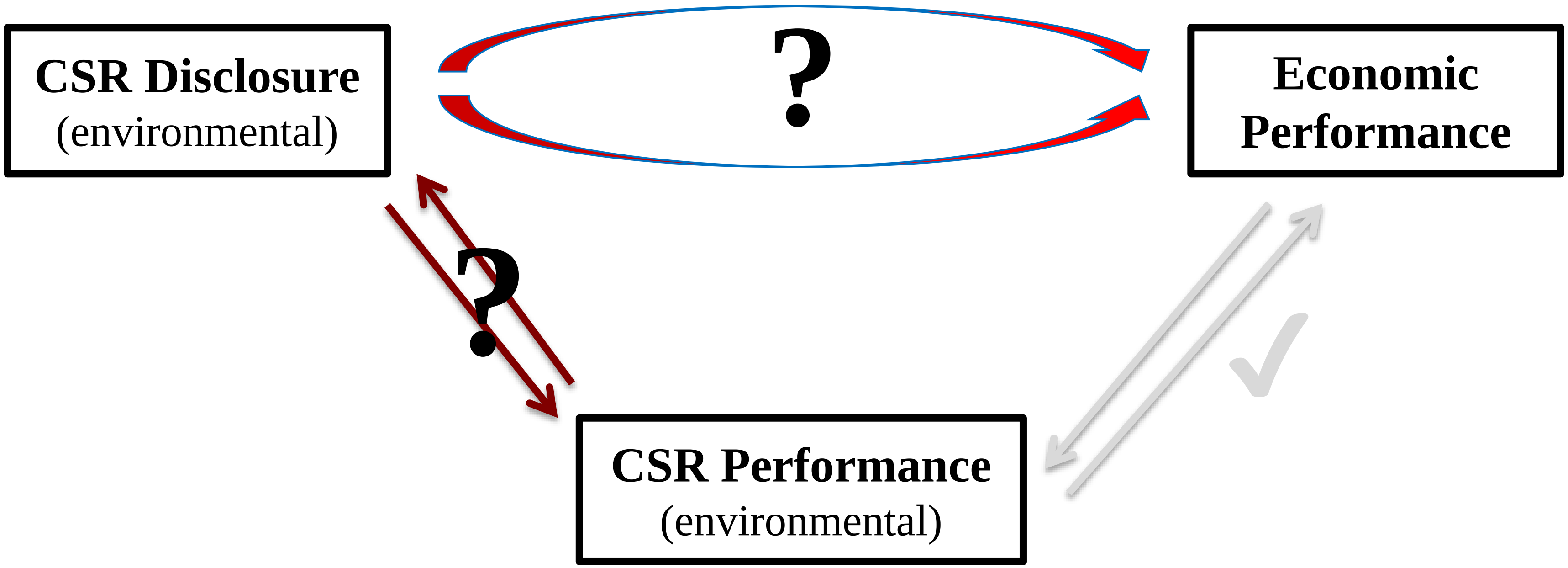
- - - - - - - - -

- analyst forecast properties
- F/S quality
- investment decisions

- cross-sectional, correlational studies
- Hart & Ahuja (*BSE*, 1996) $\Delta EP \rightarrow \Delta FP$
- Clarkson *et al*. (*JAPP*, 2011) $\Delta EP \Leftrightarrow \Delta FP$

$\Rightarrow$ evidence on the ***CSR Performance – Economic Performance*** relationship, while perhaps not definitive, is relatively less contentious

Alternatively, the natures of the relationships involving ***CSR Disclosure*** are much less clear



for example, ***CSR Disclosure – CSR Performance*** relationship

Conceptually, two opposing perspectives / arguments –

voluntary disclosure (economic) theory	positive association
socio-political theories	negative association

Empirically, results mixed with support for both perspectives

Conceptually –

Voluntary disclosure theory predicts a **positive association** between *CSR performance* and *discretionary CSR disclosure* – superior performers will convey their "type" by pointing to objective indicators that are difficult to mimic by inferior type firms

Socio-political theories alternatively predict a **negative association**; to the extent that poor CSR performers face more political and social pressures and threatened legitimacy, they will attempt to increase discretionary CSR disclosures to change stakeholder perceptions about their actual performance.

Empirically – studies <u>include</u>

- **insignificant association**
  - Ingram & Fraser (*JAR*, 1980)
  - Wiseman (*AOS*, 1982)
  - Freedman & Wasley (1990)
- **negative association**
  - Bewley & Li (2000)
  - Hughes *et al*. (*JAPP*, 2001)
- **positive association**
  - Patten (*AOS*, 2002)
  - Al-Tuwaijri *et al*. (*AOS*, 2004)
  - Clarkson *et al*. (*AOS*, 2008)

<u>note</u>: importantly, Patten (2002) also raises / identifies design issues with prior studies

Clarkson, Li, Richardson, Vasvari (AOS, 2008)

environmental disclosure – GRI-based index developed in conjunction with a GRI steering committee member: 95 items

- **Hard disclosure items ⇒ verifiable** (79 items)
  - **A1 - Governance Structure & Management Systems**
  - **A2 - Credibility**
  - **A3 - Environmental Performance Indicators**
  - **A4 - Environmental Spending**

- **Soft disclosure items ⇒ non-verifiable** (16 items)
  - **A5 - Vision and Strategy Claims**
  - **A6 - Environmental Profile**
  - **A7 - Environmental Initiatives**

Table 5: Intra-Industry Rank Regressions

	Total	Hard	Soft
% Recycled (+/-)	0.15***	0.14***	0.11**
	(3.19)	(2.98)	(2.24)
- TRI/Sales (+/-)	0.14***	0.16***	0.09*
	(2.93)	(3.42)	(1.73)

$\Rightarrow$ **positive association**

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⇒ positive association

Table 6: Comparisons of Soft to Total Disclosure Scores

	Average Score		Difference
	Good EP	Poor EP	(t-stat)
Soft / Total (%)	34.23%	50.95%	-16.72%***

"preliminary evidence that socio-political theories are robust in predicting <u>what is being said</u>; in particular, firms whose environmental legitimacy is threatened put greater emphasis on soft claims to be committed to the environment."

alternatively, the ***CSR Disclosure – Financial Performance*** relation

e.g., ***Plumlee, Brown, Hayes, Marshall (JAPP, 2015)***

$$\textbf{Valuation} = \textbf{PV}\left\{ \frac{\textbf{E(cash flows)}}{\textbf{Discount rate (risk)}} \right.$$

role for disclosure incremental to historical ED? (prospective)

valuation $\xleftrightarrow{?}$ VEDQ

future cash flows $\xleftrightarrow{?}$ VEDQ

cost of equity capital $\xleftrightarrow{?}$ VEDQ

"Our results suggest that partitioning the disclosures increases our ability to detect the associations between VEDQ and firm value, by allowing the associations to differ across firm value components (e.g., cash flow and COEC) and across variation in VEDQ for **hard/soft** and **positive/neutral/negative** environmental issues"

Clarkson et al. (AOS, 2008) & Plumlee et al. (JAPP, 2015)

introduce notion of ***verification*** into the debate i.e.,

hard ≡ **objective, verifiable measures, not easily mimicked**

soft ≡ **claims, difficult to verify**

➡ **potential role for CSR Assurance (?)**

re-iteration ('step back')

- evidence that a positive CSR image has capital market benefits

  e.g., Dhaliwal et al. (2011, 2012) - COEC, analyst coverage, forecast error & dispersion

  ⇨ increasingly, firms are voluntarily providing information about their CSR initiatives with the apparent objective of signalling that they are meeting stakeholder demands for sustainable / responsible practices

  e.g., Simnett *et al.* (2009); Cohen and Simnett (2015); Dhaliwal *et al*. (2012)

- however, a lack of common CSR reporting standards and the diversity of the scope of CSR disclosure provides managers with considerable opportunities to disclose CSR information strategically

  e.g., Peters and Romi (2015); Cho and Patten(2007, 2014)

- Cohen and Simnett (2015) –

  argue that building reputation through voluntary CSR disclosures depends on the perceived reliability and credibility of the disclosures

  and further, that

  one way to enhance the credibility of corporate social responsibility (CSR) disclosure is to have CSR disclosure assured by an external third party

- arguably, assurance of CSR disclosure could provide both external stakeholders and management with increased confidence in the credibility of CSR information voluntarily disclosed by firms (GRI 2013)

- **empirical evidence** on whether external assurance of CSR disclosure is beneficial and can provide a credible signal to stakeholders on how the firm is managing its social and environmental risks is **mixed** – for example,

  - ✓ Dhaliwal *et al*. (2011) find that CSR reports with assurance tend to have a greater effect on reducing CSR reporting firms' cost of equity capital
  - ✓ Casey and Grenier (2014) find results consistent with Dhaliwal *et al*. (2011), and further that the reduction in the cost of equity capital is significantly greater when an *accounting firm* serves as the CSR assurance provider

  - X Cho *et al*. (2014) find that a CSR report with assurance is not associated with higher market value than a CSR report without assurance

Regulatory / institutional setting

Fuhrmann *et al*. (2017)

- **prominent prevailing assurance standards**
  - AccountAbility 1000 Assurance Standard (AA1000)
  - International Standard on Assurance Engagements 3000 (ISAE3000)
- 2 basic assurance levels: reasonable (high) vs limited (moderate)
- both recognize breadth of possible providers
- similar requirements regarding CSR report content
- ISAE3000 – focuses mainly on procedural details and integrity in data compilation
- AA1000 – focuses on the materiality aspects of CSR performance and meeting the expectations of stakeholders

CSR Assurance ‘Decision Tree’ – core decisions

No ← CSR Report ?

No ← YES ⇨ 3rd party assurance ?

YES

decisions include –

⇨ ***Assurance Provider ?***

accounting firm *vs*
specialist consultant

⇨ ***Scope of Assurance ?***

partial ⟶ full

Choice of assurance provider –

Big4 accounting firm *versus* **Specialist consulting firm –**

Cohen & Simnett (2015)

"unlike the audits of financial statements, the accounting profession does not have a monopoly on assurance services related to CSR"

"in this voluntary and competitive market, there will not be a demand for assurance unless the benefits to those paying are seen to exceed the costs, and the value-proposition of using assurers from either within or outside the accounting profession may be different."

Cohen & Simnett (2015)

"practitioners from the accounting profession are well placed to deliver CSR assurance services for a number of reasons

- Huggins *et al*. (2011) argue that the risk model used for F/S audits translates well when assuring other reporting domains
- assurance practitioners from accounting backgrounds have the assurance competencies to undertake these engagements, and are supported by a detailed code of ethics that emphasizes the importance, independence, objectivity and other core ethical concepts
- Pflugrath *et al*. (2011) argue that it is much easier to acquire subject matter expertise than assurance expertise
- public confidence in assured CSR information may further be enhanced by the reputational capital associated with the purchase of assurance from leading accounting firms"

Casey and Grenier (2015)

"although non-accounting providers have more subject-matter expertise, accounting providers have a stronger reputation for integrity, independence, professional skepticisim, and assurance expertise …. accountants also must adhere to professional and organizational ethical codes of conduct

the most striking advantage of accounting providers is assurance expertise due to their unique, in-depth understanding of evidence, information systems, coordination of specialists and other third parties, and independence"

⇨ **perhaps reason to believe/expect that Big4 accounting firms are likely to provide a higher quality CSR assurance service than specialist consultants**

HOWEVER,

Simnett, Vanstraelen, Chua (*TAR*, 2009) conclude that, "in general, firms with a need to enhance credibility are not more likely to choose an accounting provider"

Scope of assurance –

Committing to a full versus partial assurance engagement, or having both of the social and environmental sections of a firm's CSR disclosure assured *versus* having only one of these sections assured (Junior *et al*., 2014)

Gürtürk and Hahn (2016)

the vast majority of the firms examined in their study assure only parts of their CSR reports instead of providing reports with full assurance

Lyon and Maxwell (2011)

intentionally committing to partial assurance instead of a full scope of assurance may indicate a firm's intention to engage in greenwashing

Voluntary External Assurance of Corporate Social Responsibility Reports and Dow Jones Sustainability Index Membership: International Evidence

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Objective –

“we investigate the impact of voluntary external assurance of CSR reports, the scope of the assurance and the choice of CSR report assurer on the likelihood of inclusion in the Dow Jones Sustainability Indices (DJSI)”

“we use the DJSI analysts as a representative user to investigate whether third-party assurance of CSR reports (i.e., existence, scope and assurer type) matters in our setting

we predict that if external assurance of CSR disclosure is perceived by the DJSI analysts to be credibility-enhancing, firms with CSR report assurance, greater assurance scope and higher quality assurance providers are more likely to be included as a DJSI component”

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DJSI – What?

- application is voluntary
- applicants evaluated by the SAM Sustainability Group
- for inclusion, firms must demonstrate leadership in sustainability, importantly including forward looking
- assessed based on economic, environmental and social criteria
  - opportunities & risks, 3 categories – strategic, management, industry-specific
- input from an extensive survey questionnaire, internal and external documents, and personal contact with SAM analysts
- successful companies are recognized as being in the top 10% of their industry in terms of corporate sustainability, and are industry leaders in best practices and superior environmental, social and economic performance
- annual review (September) and an ongoing review process

DJSI – Why?

Robinson, Kleffner and Bertels (*JBE*, 2011)

"For those firms that were the early leaders in the sustainability arena, this creates a kind of ''red queen effect'' where leading firms need to keep finding ways to differentiate themselves.

Robinson *et. al* report that there is a sustained increase in firm value following addition to the DJSI, which they attribute to successful signaling and the consequent numerator effects (green goodwill) and denominator effects (lower cost of capital)

They then conclude: ***"We have demonstrated that applying for a ''best in class'' index such as the DJSI may be an effective way to signal sustainability leadership in a credible manner."***

Thus, to re-iterate –

“we use the DJSI analysts as a representative user to investigate whether third-party assurance of CSR reports (i.e., existence, scope and assurer type) matters in our setting

we predict that if external assurance of CSR disclosure is perceived by the DJSI analysts to be credibility-enhancing, firms with CSR report assurance, greater assurance scope and higher quality assurance providers are more likely to be included as a DJSI component”

Sample Data –

- study period: 2009 – 2013

step #1 – international CSR disclosure data provided by Corporate Register

step #2 – match disclosure data with ESG metrics from Thomson Reuters ASSET4 database

step #3 – membership of DJSI – RobecoSAM DJSI’s official website

step #4 – S&P CIQ database; I/B/E/S (# analysts)

⇨ **11,333 firm-year observations from 40 countries**

Sample Data – Descriptive Profile

- Country U.S. – 3,352 Japan – 1,790 U.K. – 1,056
- **CSR 11,333 firm-year observations**

  DJSI 1,369 (12.08%)

  CSR reports 7,083 (62.50%)

  3rd party assurance 2,055 (18.13% / 28.67% of reports)

  Big 4 assurance 1,111 (9.80% / 15.47% of reports)

Year	DJSI	CSR Report	Assurance	Big4
2009	11.65%	52.12%	28.48%	13.99%
2010	11.35%	60.79%	27.17%	12.12%
2011	11.74%	64.24%	27.86%	15.42%
2012	12.19%	67.73%	29.24%	16.69%
2013	16.63%	79.93%	33.44%	21.42%
Pooled	12.08%	62.50%	28.67%	15.47%

Econometric Model –

$$DJSI = \lambda_0 + \lambda_1\, CSR\_Report$$

$$+ \boldsymbol{\lambda_2}\, \textbf{CSR\_Assurance} + \boldsymbol{\lambda_3}\, \textbf{CSR\_Big4} + \boldsymbol{\lambda_4}\, \textbf{CSR\_Scope}$$

$$+ \lambda_5\, CSR\_Info + \lambda_6\, CSR\ Performance$$

$$+ \lambda_7\, Size + \lambda_8\, Leverage + \lambda_9\, ROA + \lambda_{10}\, Accruals + \lambda_{11}\, Auditor\_Big4$$
$$+ \lambda_{12}\, \#\, Analysts + \lambda_{13}\, CrossLising + \lambda_{14}\, VolDiscl + \lambda_{15}\, CorpGov$$
$$+ [\text{Year, Country, Industry Indicators}] + \varepsilon$$

- ***DJSI*** $= \begin{cases} 1 & \text{for years when firm is included in the DJSI} \\ 0 & \text{otherwise} \end{cases}$

- ***CSR_Report*** $= \begin{cases} 1 & \text{firm-years with standalone CSR report} \\ 0 & \text{otherwise} \end{cases}$

Treatment Measures –

- ***CSR_Assurance*** = 1 if the CSR report is assured by 3rd party; 0 otherwise

- ***CSR_Big4*** = 1 if assurance provided by Big4 firm; 0 if not

- ***CSR_Scope*** = 1 if full verification (or both environmental & social sections assured); 0 if not

Treatment Measures –

- ***CSR_Assurance*** = $\begin{cases} 1 & \text{if the CSR report is assured by 3}^{rd}\text{ party} \\ 0 & \text{otherwise} \end{cases}$
- ***CSR_Big4*** = $\begin{cases} 1 & \text{if assurance provided by Big4 firm} \\ 0 & \text{if no} \end{cases}$
- ***CSR_Scope*** = $\begin{cases} 1 & \text{if full verification (or both environmental \& social sections assured} \\ 0 & \text{if not} \end{cases}$

breakdown (<u>nested</u>)

- standalone CSR reportn = 7,083 62.50% ***(of sample)***
- third party assurance n = 2,055 29.01% ***(of reports)***
- Big4 assurance n = 1,111 54.06% ***(of assured)***
- Scope n = 294 14.31% ***(of assured)***

Primary Control Variables –

CSR_Info level of CSR information available to corporate shareholders (assessed by ASSET4)

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CSR_Drivers input measure of CSR performance
= average score of the 4 CSR drivers – CSR Policy, CSR Implementation, CSR Monitoring, CSR Improvement (assessed by ASSET4; industry-year mean adjusted)

OR

CSR_Perf output measure of CSR performance
= average of social and environmental scores *
(assessed by ASSET4; industry-year mean adjusted)

Aside: CSR Drivers

- scores for the four CSR drivers provided in the ASSET4 database
  - *Policy*
    → existence of a policy, code of conduct, procedure, compliance mechanism, or management system for
  - *Implementation*
    → the presence of a dedicated and specialized team /individuals
  - *Monitoring*
    → public disclosure of key performance indicators used by firms and regular internal or external audits on these key indicators
  - *Improvement*
    → setting specific objective to be achieved and commenting on the results of previously set objectives

- *CSR_Drivers* = ave score for the 4 drivers

Pooled Sample – 11,333 observations

CSR_Report	*0.404**	***0.894******
	(0.067)	***(< 0.001)***
CSR_Assurance	***0.684******	***0.844******
	(< 0.001)	***(< 0.001)***
CSR_Big4	0.115	0.106
	(0.317)	(0.355)
CSR_Scope	***0.444******	***0.417******
	(0.005)	***(0.008)***
CSR_Info	***3.548******	***7.252******
	(< 0.001)	***(< 0.001)***
CSR_Drivers_Adj	***7.502******	- - - -
	(< 0.001)	
CSR_Perf_Adj	- - - -	***2.625******
		(0.005)

CSR_Report	**0.404***	***0.894******
	(0.067)	***(< 0.001)***
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	(< 0.001)	***(< 0.001)***
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	(0.005)	***(0.008)***
CSR_Info	***3.548******	***7.252******
	(< 0.001)	***(< 0.001)***
CSR_Drivers_Adj	***7.502******	- - - -
	(< 0.001)	
CSR_Perf_Adj	- - - -	***2.625******
		(0.005)

⇨ 3rd party assurance and scope of assurance are incrementally important

⇨ no further benefit to accounting assurance

	PSM Sample (n = 4,058)	1^{st} Time DJSI
CSR_Report	0.283	***1.864*****
	(0.393)	***(0.017)***
CSR_Assurance	***0.650******	***1.284******
	(< 0.001)	***(< 0.001)***
CSR_Big4	0.121	-0.341
	(0.393)	(0.245)
CSR_Scope	***0.693******	0.071
	(< 0.001)	(0.858)
CSR_Info	***4.266******	*-2.858**
	(< 0.001)	*(0.084)*
CSR_Drivers_Adj	***6.928******	***6.869******
	(< 0.001)	***(< 0.001)***

	U.S.	Japan	U.K.	Canada	Valuation Model
CSR_Assurance	***p* = 0.008**	***p* = 0.002**	***p* < 0.001**	*p* = 0.065	***p* = 0.003**
CSR_Big4	*p* = 0.792	*p* = 0.350	*p* = 0.931	*p* = 0.143	*p* = 0.719
CSR_Scope	*p = 0.071*	***p* = 0.044**	*p = 0.075*	*p = 0.099*	*p = 0.088*

by year –

CSR_Assurance	***p* < 0.001 uniformly**
CSR_Big4	*p* > 0.100 uniformly
CSR_Scope	**2010, 2013 *p* < 0.050** *2009, 2011 p < 0.100* 2012 *p* > 0.100

Summary –

results ***consistently*** indicate that incremental to CSR performance (***CSR_Info; CSR_Drivers; CSR_Perf***)

- ✓ **CSR disclosure 'matters' (*CSR_Report* = 1)**
- ✓ **third party assurance of CSR disclosure 'matters' incrementally (*CSR_Assurance* = 1)**
- ✓ **scope of assurance 'matters' incrementally (*CSR_Scope* =1)**

BUT

- **X type of assurer (Big4 accounting versus specialist consultant) does not incrementally 'matter' further (*CSR_Big4* = 1)**

➔ results **consistent with a signaling role** to the voluntary adoption of external CSR report assurance, **but do not extend to the decision to seek assurance by the accounting profession**

Conclusions –

- In describing the future research agenda for CSR Assurance , Cohen and Simnett (*AJPT*, 2015) state that: " This setting has provided a suitable platform for examining the benefits of assurance, and the signaling effects of the type of assurance provider. A logical **next step** is to examine whether organizations obtain a benefit from having their CSR reports assured. For example, what will be the effects of assurance on CSR reports on changes in share price, types of investors on share registers."

- We take the next step and show that CSR assurance plays an incrementally important role in the firm's inclusion in the DJSI. The DJSI literature has established firm valuation benefits arising from DJSI inclusion.

- Future research can address the puzzle in our data that the type of assurer does not appear to matter for DJSI inclusion…does this imply that there is no difference in assurance quality across accounting firms and other types of assurance providers …and why might this be so ??