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Corporate social responsibility assurance and reporting quality: Evidence from restatements☆

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ABSTRACT

Previous research has shown that obtaining independent assurance of corporate social responsibility (CSR) reporting has capital market benefits and that these benefits are amplified when accountants provide the assurance. Yet, little is known about whether and the manner in which CSR assurance improves the quality of CSR reporting, and whether accounting providers improve reporting quality to a greater extent than non-accounting providers. This study uses the unique setting of CSR restatements to examine these issues. We present theoretical and empirical evidence supporting a competitive advantage of using accounting firms as assurance providers as they not only identify inaccuracies in previous reports earlier than non-accounting providers, but also prevent future reporting inaccuracies. CSR assurance, from either type of provider, also leads to improved reporting definitions, scopes, and methodologies that require restatements for comparability. Results also indicate that CSR reporting frameworks (e.g., GRI) are not a substitute for obtaining CSR assurance as the latter has incremental benefits over GRI usage in terms of identifying errors and reporting improvements. These results have implications for public policy makers considering the merits of mandating CSR assurance and for organizations assessing the relative benefits and costs of preparing GRI-based CSR reports, obtaining CSR assurance, and choosing between accounting vs. non-accounting CSR assurance providers.

1. Introduction

Independent assurance of corporate social responsibility (CSR) reports has become a standard business practice with nearly two-thirds of the largest 250 global companies having their CSR reports independently assured (KPMG, 2015). This demand for CSR assurance is driven by a need to convince stakeholders that the firm is appropriately managing its environmental and social risks (Simnett et al., 2009). CSR assurance appears to be effective in this respect as it reduces firms' cost of capital and reduces analyst forecast errors and dispersion, especially when accounting firms provide the assurance (Casey and Grenier, 2015). Yet, there is only scant empirical evidence on how CSR assurance achieves these capital market benefits. Do capital market participants simply have more confidence in firms' reported CSR performance due to the CSR assurance report or is the reporting also of higher quality? Further, if the reporting is of higher quality, what are the competitive advantages of accountants in improving reporting quality? This study uses the unique setting of restatements of CSR reports to shed light on these important questions.

KPMG (2011) reports that approximately one-third of the largest 250 global companies and approximately one-fifth of 3400

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companies across 34 countries have restated previously-issued CSR reports.[1] A CSR report is deemed to be "restated" when a subsequent CSR report indicates that the previous report had an error or omission (i.e., errors) or was otherwise updated to improve or enhance definitions, scopes, and/or estimation/calculation methodologies (i.e., non-errors), necessitating previously-issued metrics to be restated for comparability (KPMG, 2011). See Appendix A for examples of both types of restatements. Consistent with KPMG (2011), we consider CSR restatements as "good," and a positive step forward for improving CSR quality and effectiveness (i.e., part of the maturation process of CSR reporting). That is, in contrast to the mature financial reporting setting where restatements can be indicative of management incompetence (or in some cases fraud), CSR reporting is still in its relative infancy where errors are somewhat expected and where definitions, scopes and methodologies should be significantly improving over time.[2]

Leveraging and extending previous literature on the internal and external benefits of obtaining CSR assurance (e.g., Chua, 2006; Casey and Grenier, 2015), we predict that obtaining CSR assurance is positively associated with both error and non-error CSR restatements, and having an accounting firm provide the assurance amplifies this association. As CSR assurance is a verification exercise, identified inaccuracies in current reporting lead to error restatements to fix similar inaccuracies in prior periods. CSR assurance providers also recommend improvements to CSR reporting (O'Dwyer and Owen, 2005, 2007) resulting in non-error CSR restatements where previous reports have to be restated for comparability. We expect accountants to be more likely (than non-accounting providers) to identify each type of restatement due to their superior assurance expertise (cf. Power, 1997; Gray, 2000; Wallage, 2000; Pflugrath et al., 2011). We also pose a research question to examine whether accounting providers are not only more likely to identify CSR restatements, but also do so in a timelier manner. Importantly, we expect to find these associations after controlling for use of CSR reporting frameworks such as GRI's (2013) *G4 Sustainability Reporting Standards*, indicating that reporting frameworks are not a substitute for obtaining CSR assurance in terms of improving reporting quality, let alone in terms of increasing user confidence in the reporting.

However, it also possible that CSR assurance does not improve reporting quality, and the capital market benefits are solely attributable to increased, but perhaps misplaced, confidence in CSR reporting. This possibility is consistent with the extensive criticism of CSR assurance (cf. Gray, 2000). Critics argue that CSR assurance (1) is often unduly influenced by management and hence fails to challenge reporting completeness or relevance (Ball et al., 2000; O'Dwyer and Owen, 2007; Smith et al., 2011), (2) often fails to engage stakeholders in identifying concerns (Adams and Evans, 2004; O'Dwyer and Owen, 2005, 2007), and (3) exhibits high variation in scope, independence of provider, use of external criteria (Kamp-Roelands, 2002; Deegan et al., 2006; Manetti and Becatti, 2009). Further, most CSR assurance engagements provide limited assurance (O'Dwyer and Owen, 2005, 2007), a lower level than the reasonable level of assurance provided on financial statement audits that may not be sufficient to improve reporting quality. Finding a significant association of CSR assurance and restatements would help refute such criticisms by suggesting that CSR assurance is serving its primary role of improving the relevance and reliability of CSR reporting.

Our sample includes 2339 of the 7540 firms surveyed by KPMG in their 2011 and 2013 surveys. Within the sample, 36.3 percent obtained CSR assurance and 20.2 percent restated a previously issued CSR report. To address self-selection and endogeneity, we utilize Heckman's two-stage estimation approach in our empirical models. In the first stage, CSR assurance is the dependent variable in a probit regression using the determinants of CSR assurance decisions from prior research (Simnett et al,. 2009; Casey and Grenier, 2015) as independent variables. We use a probit regression in the second stage with CSR restatements serving as the dependent variable (error and non-error restatements separately estimated) and CSR assurance, provider type (accounting vs. non-accounting) and several control variables for other factors that may be associated with CSR restatements as independent variables. The most notable control variable is the use of GRI reporting standards to examine whether CSR assurance has an incremental effect over use of reporting frameworks.

Results support our predictions as CSR assurance and use of accounting providers are both significantly positively associated with both types of CSR restatements (errors and non-errors). Importantly, these results are obtained when controlling for use of GRI reporting standards, indicating that such frameworks are not a substitute for independent assurance. In fact, GRI standards are only significantly associated with non-error restatements (i.e., definitions, scopes, and/or methodologies); whereas, CSR assurance is significantly associated with both error and non-error restatements. Supplemental analyses examining the time series dynamics of CSR assurance/provider elucidate one of the argued competitive advantages of accounting providers insofar as they are able to detect errors relatively better than non-accounting providers and prevent future errors during early engagement periods; whereas, non-accounting providers detect errors more gradually across engagement periods. CSR assurance has a constant effect on non-error CSR restatements, however, illustrating the importance of repeated CSR engagements in improving CSR reporting quality.

This study makes several contributions to the literature. First, we extend previous archival and experimental research that documents capital market benefits of CSR assurance (Pflugrath et al., 2011; Casey and Grenier, 2015; Cheng et al., 2015) by providing empirical evidence on whether and the manner in which CSR assurance improves the quality of CSR reporting, and whether

[1] Although KPMG (2011) describes its report as a survey and it technically meets the definition, its research procedures are different from typical academic conceptions of surveys. Rather than sending questionnaires to the companies, KPMG professionals complete a questionnaire based on the publicly available CSR reports (or lack thereof) of the top 250 companies listed on the Fortune Global 500 for 2010 and the 100 largest firms by revenue in each of 34 countries. As such, our study examines standalone CSR reporting, and does not examine CSR-related disclosures in annual reports or through other channels such as the CSRwire newswire service (cf. Griffin and Sun, 2013). See De Villiers and Van Staden (2011) for a discussion of factors that affect the choice of CSR disclosure medium.

[2] The notion that CSR restatements are a positive step forward for improving CSR quality and effectiveness distinguishes CSR restatements from earnings restatements that are usually treated as indicators of reduced credibility and quality of financial reporting. Nevertheless, the implications of CSR restatements could change over time, as KPMG (2011, 27) notes that, "In the long-run however, restatements, errors and omissions in CR reporting will begin to erode investor confidence in not only the data presented, but potentially also the quality of the wider governance structure and internal controls with the organization."

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