Universität Hamburg
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Fakultät Wirtschafts- und Sozialwissenschaften

CORPORATE SUSTAINABILITY REPORTING: RECENT DEVELOPMENTS

Challenging Statements and Debate

17/06/2021 10:30 am -15:30 pm

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Agenda

1. Third Party Assurance of the Reported Sustainability Information
2. Publication of the Reported Sustainability Information
3. Small and Medium Sized Companies
4. Standard Setting – Big Picture

1. Third Party Assurance of the Reported Sustainability Information

Upcoming Changes

- Companies **within the scope** are required to provide **limited assurance**.
- Commission has **option** to mandate **reasonable assurance** at a later date.

Levels of Assurance

Limited Assurance:

- Assurance risk is acceptable.
- Greater than the risk expressed by a "reasonable" opinion.
- Conclusions are worded negatively.

Reasonable Assurance:

- High level of verification.
- Not absolute due to some possible limitations in the internal control systems.
- Conclusions are worded positively.

Academic Research

- **Mandatory audits** of management earnings forecasts lead to less positive bias and improvement in accuracy (McConomy 1998).
- **Reasonable assurance** reduces the level of information asymmetry to a greater extent (Cuadrado-Ballesteros et al. 2017; Fuhrmann et al. 2017) and report users place more confidence in sustainability reports (Hodge et al. 2009).

Mandate of Reasonable Assurance

- **Sustainability auditor side:** Know-how and manpower required as the number of companies falling within the scope increases dramatically.
- **Business side:** Costs and time required for preparation and implementation has to be considered from a cost benefit perspective.

2. Publication of the Reported Sustainability Information

Upcoming Changes

- Sustainability information has to be **part of the management report.**
- Option of publishing the information in a **separate report is eliminated.**
- Publication of financial statements and management report **within 12 months of the balance sheet date.**
- German listed companies have a period of 4 months to release their annual report (§ 325 HGB).
- Publication together with the **independent auditor's opinion** on the sustainability reporting.

Challenges

- **Alignment** of **reporting** and **audit cycles** for financial and environmental reporting.
- Requirement of **consistency.**
- **First-time** implementation of **reporting** and **assurance** services for most of the companies.

Academic Research

- The audit reporting lag and the **timeliness of earnings** announcements is associated with the **underlying audit effort** (Knechel and Payne 2001).
- The **timeliness of annual reports** is an important determinant of their **usefulness** (Givoly and Palmon 1982) and is indeed **value relevant** (Leventis et al. 2014).
- The timeliness of earnings announcements is an accessible proxy for outsiders related to the **internal information environment** (Gallemore and Labro 2015; Huang et al. 2020).

2. Small and Medium-Sized Companies

Upcoming Changes

- SMEs within the scope of the CSRD have to adopt a **separate, proportionate and specific reporting standard**.
- Requirements will apply **three years after** they apply to other companies within scope.
- **Non-listed SMEs** (outside the scope) may decide to adopt the standards on a **voluntary basis**.

Motives for Reporting

- Possibility to **report information cost-efficiently** to requests from stakeholders (such as corporate clients or banks).
- Ability to **attract** additional **investment** and funding (such as investors).
- Contribution to the **transition** to a **sustainable economy**.

Voluntary Adoption of Disclosure and Assurance

- **Voluntary disclosure** of non-financial information reduces information asymmetry and cost of capital (Dhaliwal et al. 2011).
- Private companies that maintain **voluntary financial audits** receive higher (lower) credit scores (interest rates) (Kim et al. 2011; Minnis 2011; Dedman and Kausar 2012).

Mandatory vs. Voluntary

- Voluntary disclosure is effective in **reducing information asymmetry**, but it cannot replace mandatory disclosure in solving **information problems** (Liao and Zhang 2013).
- 35.6 % of all value added is attributable to SME companies in the EU (2018)*.
- What proportion of the emissions are attributable to SMEs?

*Source: Eurostat, National Statistical Offices, DIW Econ (2018/2019).

4. Standard Setting – Big Picture

Current Disclosure Streams

- **European Financial Reporting Advisory Group (EFRAG):** Development of EU Sustainability Reporting Standard.
- **International Accounting Standards Board (IASB):** Working on a set of IFRS Sustainability Standards.
- **Value Reporting Foundation:** Sustainability Accounting Standards Board (SASB) merged with International Integrated Reporting Council (IIRC) – US based but globally active
- **International Platform on Sustainable Finance (IPSF):** Common Ground Taxonomy.

Diversity Academic Research

- Board **gender diversity** affects **positively CSR dimensions** and women request more CSR information before taking investment decisions (Kaspereit, Lopatta and Matolcsy 2016).
- **Few firms address gender topics** throughout their annual reports. (Böttcher and Lopatta 2018).

Diversity Current Developments

- The **proportion of women in executive positions** in the EU was in 2020 **20 percent** (Germany 13.5 percent)*.
- There is a **lack of disclosure** and transparency regarding diversity for **lower management levels**.
- In addition to more women on boards, is it time for more sustainability expertise on boards?

*Source: EIGE (2021).

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