# SUSTAINABILITY ASSURANCE: EXAMINING DRIVERS AND INHIBITORS OF NON-FINANCIAL INFORMATION ASSURANCE


*The disclosure of non-financial information in the form of sustainability reports and integrated reports is now a globally established practice. Most jurisdictions across the world encourage, either through stock exchange listing requirements or through legislation, the need for companies to provide information on their non-financial performance. However, these disclosures are often criticised for failing to offer a credible account of the reporter's sustainability performance. To address this criticism many reporters voluntarily secure third-party assurance over their disclosures.*

*The ADGM Academy Research Centre is pleased to publish a series of articles by Associate Professor Muhammad Bilal Farooq on the key issues related to the assurance of non-financial reports, such as sustainability reports and integrated reports, also referred to as sustainability assurance. This first article in this series examines the drivers and inhibitors for the demand for voluntary third party non-financial information assurance.*

## DRIVERS

**Demand from users/stakeholders:** Research indicates that external assurance over non-financial information has a positive impact on stakeholder's perceptions of disclosure credibility. Further, experimental studies find that stakeholder's value non-financial information that they perceive as relevant, i.e. non-financial disclosures that are related to the corporate strategy. The external assurance of such information is then also valued and positively impacts investors decision making.

**Size of the reporter:** Larger reporters tend to receive greater attention/scrutiny from stakeholders. These companies need to ensure that their information is perceived as credible and thus they are more likely to voluntarily secure external assurance.

**Listing status of the reporter:** Listed reporters generally face greater public exposure and scrutiny. It is important for such companies to demonstrate transparency, by reporting on their financial and non-financial performance. It is also very important that this information is credible.

**Industry membership:** Companies operating in environmentally sensitive industries receive greater external scrutiny than others and must demonstrate their commitment to sustainability by publishing credible non-financial information. These companies are more likely to voluntarily secure external assurance.

**Changes in corporate governance codes and demand from corporate boards:** An increasing number of stock exchanges across the world are encouraging listed entities to provide high quality non-financial reports. Some stock exchanges now specify the need for such disclosures to conform to the requirements of international recognised reporting standards such as those published by the Global Reporting Initiative. This raises the profile of non-financial information and corporate boards voluntarily seek external assurance in an attempt to; (1) demonstrate conformance to best practice; and (2) to ensure that their sustainability claims are reliable, and thereby avoid potential legal and reputational consequences of misreporting.

**Media attention and scrutiny:** Researchers have found that companies facing negative media attention are more likely to voluntarily secure external assurance over their disclosures. Large, listed companies as well as companies operating in environmentally and socially sensitive industries tend to receive greater media coverage. Such reporters often use non-financial reporting to gain, maintain and repair their legitimacy. However, such disclosures are only effective in influencing stakeholders if the information itself is considered credible.

**Added value:** Managers demand external assurance as they perceive it to be a value-added service. Assurance providers can identify weaknesses in reporting systems, evaluate disclosures and highlight areas for improvement. Assurance providers also encourage managers to link their reporting with strategy development as well as including sustainability KPIs in their reports. The linking of these sustainability KPI’s with senior managers and boards performance appraisals and remuneration is also advised.

## INHIBITORS

**Time and cost:** Managers often complain of the time and cost of external assurance, particularly for large multinational corporations. Some complain that the assurance fee accounts for one third of their sustainability reporting budget. Others note that the assurance fee is ten times the cost of preparing their sustainability report. In the business world where decisions are often made on a cost benefit basis, these costs can be discouraging.

**No value addition:** Some managers believe that external assurance would not add value and thus the time and cost involved are simply not justifiable. Such managers are confident in their sustainability reports, which they believe are unlikely to benefit from an external experts unbiased evaluation. Importantly these managers often feel that external assurance would fail to enhance perceptions of disclosure credibility amongst stakeholders.

**External assurance is onerous:** Many managers believe that external assurance is simply too demanding, and that their systems and processes are not robust enough to withstand the rigors of external assurance. Managers complain that they do not have the level/quality of evidence required to satisfy assurers.

**Lack of regulation:** Managers and practitioners state that in the absence of regulations, external assurance rates would remain low. However, recent regulatory changes in corporate governance codes, encouraging non-financial reporting represented a step in the right direction.

**Legal and reputational risk:** Managers fear the consequences of assurance providers unearthing issues, such as breaches in environmental laws, the consequences of which may be exacerbated if boards subsequently fail to act (e.g. delays in introducing new systems due to the time and cost involved). The resulting legal and reputational risks discourage unscrupulous boards from procuring external assurance.

**Availability of cheaper substitutes:** Managers argue that they have recourse to cheaper alternatives that can assist in raising the credibility of their disclosures. For example, participating and wining (or even securing a nomination) in sustainability reporting competitions; getting disclosures assured by internal auditors; setting up a stakeholder panel to review and approve reports; and requesting commentaries from field experts and recognised scientists can all help to make disclosures appear more credible.

## CONCLUSION

To conclude, despite these barriers to adoption, the demand for external assurance is gradually increasing. Further, as regulators begin to place greater emphasis on non-financial reporting, companies are advised to start now by investing time and resources in developing systems and processes that can support sustainability reporting and the assurance thereof.

The next article in this series will discuss the approach adopted by assurance providers in overcoming some of these inhibitors to the demand for sustainability assurance.

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**For more information on sustainability assurance please read:**

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