

SUSTAINABILITY ASSURANCE: EXAMINING THE IMPACT OF ASSURANCE DISCLOSURE CREDIBILITY



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 and integrated reports, also referred to as sustainability assurance. This third article examines whether sustainability assurance actually enhances disclosure credibility and if so how and to what extent.

DOES EXTERNAL ASSURANCE IMPROVE DISCLOSURE CREDIBILITY?

To answer this question I break up credibility into reliability and balance. Reliability refers to content which is verifiable. Balance refers to disclosures which provide coverage of material good news (areas of good performance) and material bad news (areas of poor performance).

To answer the question “does external assurance improve disclosure credibility” we must first understand that sustainability assurance engagements are voluntary in nature and the scope of such engagements are set by assurers and assurees. The lack of regulation gives rise to a range of engagements where scope varies from narrow to broad. In narrow scope engagements practitioners provide assurance over the reliability of disclosures but not the

overall balance. In comparison, in broad scoped engagements practitioners provide assurance over disclosure reliability and balance. Importantly, users of sustainability reports cannot tell the difference between the two.

NARROW SCOPE ENGAGEMENTS

Narrow scope engagements tend to be popular as they are cheaper and less risky for assurers. In my research I found that in narrow scope engagements the reliability of non-financial disclosures (information/content/claims are supported by evidence) did improve and was achieved in three ways. First, assurers play an important role in improving underlying systems and processes. Managers narrate that an external assurance provider's recommendation's carry weight and boards (at least those committed to sustainability reporting) are more willing to approve the allocation of resources to improve their systems and processes. Second, assurers ask for evidence to support claims. As a result, some claims are either removed or alternatively edited to reflect the evidence that is available. This transforms non-financial reports which then resemble less like marketing documents and more like non-financial reports designed to promote transparency and accountability to corporate stakeholders. Finally, external assurance raises the profile of non-financial reporting within the reporting organisation. As a consequence, content owners (managers responsible for contributing material to the sustainability or integrated report) take greater care when preparing data and information as they know that their work will be independently reviewed.

BROAD SCOPE ENGAGEMENTS

In broad scoped engagements, external assurance does promote balance. However, this is more difficult to achieve, and success is incremental, i.e. gradual improvement over successive assurance engagements. Assurance providers attempt to promote balance at three levels. First, assurers put pressure on reporters to disclose material issues both good and bad. This requires assurers to carry out their own materiality assessment and identify issues material to the reporter and its industry. Additionally, the management report will be used to highlight weaknesses in the assurees materiality assessment process. If the underlying process improves there is a greater chance that material issues will be identified and reported on. Second, assurers will push reporters to provide greater disclosure over material bad news or at least provide the same amount of coverage as that given to material good news within the same report. Finally, assurers will press reporters to present material bad news in the same style (i.e. font type, size etc.) as used elsewhere in their report. However, reporting managers and assurers accept that promoting balance remains challenging as there is high degree of subjectivity involved in a materiality assessment. Also, getting reporters to publish balanced reports requires changing the mindsets of boards and senior managers who remain reluctant to disclosing bad news to stakeholders.

CONCLUSION

Sustainability assurance engagements can play a positive role in improving disclosure credibility. However, this requires broad scoped engagements and the benefits will take time to accrue. With regulatory backing assurance providers will be able to press boards to disclose higher quality sustainability reports. The next article in this series will explore the nuanced differences in the scope and objectives of sustainability assurance engagements.



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For more information on sustainability assurance please read:

- Farooq, M.B. and de Villiers, C. (2020), "How sustainability assurance engagement scopes are determined, and its impact on capture and credibility enhancement", *Accounting, Auditing & Accountability Journal*, Vol. 33 No. 2, pp. 417-445. <https://doi.org/10.1108/AAAJ-11-2018-3727>
- Farooq, M.B. and de Villiers, C. (2017), "The market for sustainability assurance services: A comprehensive literature review and future avenues for research", *Pacific Accounting Review*, Vol. 29 No. 1, pp. 79-106. <https://doi.org/10.1108/PAR-10-2016-0093>
- Farooq, M.B. and de Villiers, C. (2019), "The shaping of sustainability assurance through the competition between accounting and non-accounting providers", *Accounting, Auditing & Accountability Journal*, Vol. 32 No. 1, pp. 307-336. <https://doi.org/10.1108/AAAJ-10-2016-2756>
- Zaman, R., Farooq, M.B., Khalid, F., and Mahmood, Z. (2021), Examining the extent of and determinants for sustainability assurance quality: The role of audit committees. *Business Strategy and the Environment*. Vol. 30 No. 7, pp. 2887-2906. <https://doi.org/10.1002/bse.2777>