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Executive Summary

The Demand and Consequences of Assurance of Mandatory Extended External Reporting



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We recognise and pay respect to the Elders and communities – past, present, and emerging – of the lands that the University of Sydney's campuses stand on. For thousands of years they have shared and exchanged knowledges across innumerable generations for the benefit of all.

The Demand and Consequences of Assurance of Mandatory Extended External Reporting

Key conclusions

Mandatory sustainability assurance results in more harmonized assurance practices and provider choices across different types of firms.

Abstract

Regulators worldwide have mandated or are considering mandating sustainability assurance in response to the growing demand for reliable sustainability information. While such a mandate can improve the credibility and standardization of sustainability information, it also introduces significant costs. Given the limited empirical evidence on mandatory sustainability assurance, we investigate this issue using the European context, where the Non-Financial Reporting Directive required sustainability reporting, but only a few countries mandated sustainability assurance. We find that the assurance mandate is associated with increased assurance timeliness, particularly for firms that combine financial and sustainability information in one report, firms with lower sustainability performance, and smaller firms. The mandate is also associated with an expanded assurance scope and a higher likelihood of the same auditor being used for both financial and sustainability reports in firms with combined reporting. In firms with lower sustainability performance, it is linked to an expanded assurance scope and a reduced likelihood of using a Big 4 assurance provider. For smaller firms, the mandate is associated with an expanded assurance scope. Overall, our results show that mandatory sustainability assurance results in more harmonized assurance practices and provider choices across different types of firms.



Introduction

With many investors relying on sustainability information to make informed investment decisions (IFAC & AICPA, 2024; IFRS, 2023a & b; Krasodomska, Simnett & Street, 2021; SEC 2024), the demand for credible and robust sustainability information is more critical than ever. In line with this demand, regulators have started to mandate reporting of sustainability information, along with considering or implementing mandatory assurance of that information. While voluntary assurance on sustainability information, including assurance practices, the choice of assurance providers, and the consequences for information use—has been extensively studied, little is known about how mandating assurance would affect these outcomes. Prior research demonstrates a diversity in voluntary assurance practices and providers and suggests that this variation may be correlated with differences in the quality of the underlying assurance services (e.g., Fuhrmann et al., 2017; Hummel et al., 2019; O'Dwyer & Owen, 2005). Combined with a lack of standardisation in the assurance report, this can at times make it difficult for stakeholders to assess the nature of the assurance service, and thus the reliability of the assured information (IAASB, 2021, SEC 2024).

Like all regulations, mandating assurance provides a base of what constitutes acceptable assurance practices and standardises the minimum level of assurance services. This can result in entities (and assurance providers) assessing (or reassessing) the assurance service provided, to ensure that it is fit for purpose and provides the appropriate signals for commitment to quality of sustainability reporting in the mandatory reporting environment. Thus, mandatory assurance has the potential to harmonize assurance practices by reducing laggards to a base level and levelling the playing field, incentivizing those that wish to be seen as leaders to further improve and distinguish their assurance service, or both. Given the move to assurance mandates, and the competing incentives and possible wide-ranging societal outcomes, it is imperative to investigate whether mandating assurance results in improved assurance practices or fosters the harmonization of such practices.



Objectives

In this study, we examine the most suitable setting for empirically examining the impact of the introduction of mandatory assurance: the assurance mandate by certain European Union (EU) countries under the Non-Financial Reporting Directive (NFRD; Directive 2014/95/EU) introduced by the EU in 2014. While the NFRD did not require an assurance mandate, individual EU member countries could transpose the NFRD into national laws, with substantial options related to extending the scope of the regulation, including imposing an assurance mandate. Two EU countries of interest to us, Italy (assurance mandate effective for financial years starting on or after 1 January 2017) and Spain (assurance mandate effective for financial years beginning on or after 1 January 2018) mandated independent assurance of the non-financial information under the NFRD. Overall, this setting allows us to explore and compare the assurance practices under voluntary and mandatory assurance in a setting where the reporting of sustainability information is both mandatory and standardized across jurisdictions, effectively addressing the selection biases encountered in previous studies focused on voluntary reporting environments.

Research method

We employ a difference-in-differences (DiD) design to examine the impact of adopting an assurance mandate on assurance practices, including assurance provider choice, for a sample period spanning from 2014 to 2019. Our treatment sample consists of all large, listed entities in Spain and Italy that fall under the scope of the NFRD and have complete data. Our control sample is drawn from the population of large, listed entities subject to the NFRD reporting requirements but incorporated in EU countries where sustainability assurance is not mandatory. We focus our examination on the following assurance practices, based on prior literature: the assurance scope (entire sustainability report or a part of the report), the level of assurance (reasonable or limited), the assurance standards that are referenced (ISAE 3000 or other), the timeliness of assurance (the natural logarithm of assurance report lag in days), whether the assurance provider is a Big 4 audit firm, and whether the assurance provider is from the same firm as the financial statement auditor.



Main findings and implications for practice

Based on our Difference-in-Differences (DiD) analysis, we find that mandatory assurance, compared to voluntary assurance, is significantly associated with a reduction in assurance report lag, suggesting that the implementation of mandatory assurance improves the assurance practices in terms of enhancing assurance timeliness.

Nonetheless, for our full sample, we do not find evidence that mandatory assurance has resulted in significant changes in the other aspects of sustainability assurance practices examined, being the choice of Big4 assurance provider, the use of the same provider, assurance scope, assurance level and assurance standard.

We then examine whether conditional on key sustainability reporting and entity characteristics—specifically the nature of sustainability reporting practices, sustainability performance, and entity size—the introduction of mandatory assurance has a differential impact on assurance practices and provider choice. Using the same DiD analyses, we partition the sample on the basis of these characteristics. For sustainability reporting practices, we partition the sample by whether entities combine their sustainability and financial information or present their sustainability information in a stand-alone sustainability report. We find that mandatory assurance has no discernible impact on sustainability assurance practices for firms that prepare a standalone sustainability report, but that for entities without a sustainability report mandatory assurance is significantly associated with an expanded assurance scope, a reduced assurance report lag and is marginally significantly associated with a higher likelihood of using the same firm as the financial statement auditor.

For sustainability performance, we partition the sample based on reporting firms' median ESG score. We find that for firms with low ESG scores, mandatory assurance is significantly associated with changes in sustainability assurance practices and providers, including a lower likelihood of engaging a Big 4 audit firm, a shorter assurance report lag, and marginally significant associated with an expanded assurance scope. However, these relationships are insignificant for firms with high ESG scores.

Finally, we examine whether the impact of mandatory assurance is dependent upon entity size, which is commonly used by regulators to restrict the impact of regulation. We partition the sample based on firms' median size. While we find no significant association between mandatory assurance and the variables of interest for larger firms, mandatory assurance results in a significantly reduced assurance lag, and is marginally significantly associated with an expanded assurance scope for smaller firms.

Conclusions

We contribute from both a literature and theoretical perspective by examining how mandatory assurance impacts sustainability assurance practices and assurance provider choice in a mandatory sustainability reporting setting.

We show that mandating assurance has had the effect of harmonizing certain assurance practices across client firms, as evidenced by the fact that mandating assurance has improved the assurance practices of entities that are generally considered to have lower quality assurance practices and has thus led to a leveling of the playing field. Since assurance practices are informative about the underlying assurance quality (e.g., Hummel et al., 2019), this harmonization should ultimately enhance consistency, standardization and comparability of sustainability information (Ackers & Eccles, 2015; Christensen et al., 2021)

Our findings are also expected to contribute to the ongoing discussions in practice, standard-setting, and regulation regarding how to enhance the credibility of disclosed sustainability information, and in particular regarding the discussions about mandating assurance over sustainability reporting in various jurisdictions. In comment letters in response to attempts to mandate assurance, various actors have expressed doubts about the benefits, or even whether it is possible, to mandate assurance, given the lack of expertise available to conduct assurance in a new, specialized, and complex field; the costs of the assurance process, particularly for small players; and the lack of control over the reliability of the ESG data used (Boiral et al., 2024). By showing evidence of harmonization, by the improvements in assurance practices for those entities that, our study sheds light on the impact of mandatory assurance on sustainability assurance practices.





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