

University of Graz



10. IWP-WISSENSCHAFTSFORUM

CREDIBILITY OF CSR REPORTS, AUDITING AND CORPORATE GOVERNANCE

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OUTLINE



1 Introduction

Why is it relevant?

2 Essays

What are the findings?

3 Conclusion

What do we learn?

- » Growing demand for reliable information on Corporate Social Responsibility (CSR)
 - Uncertainty about climate change risks
 - Use of CSR information in executive compensation contracts
 - Credibility issues such as "greenwashing"

- » Corporate Sustainability Reporting Directive (CSRD) in EU
 - Reporting Standards: European Sustainability Reporting Standards (ESRS)
 - **Assurance requirement:** "The CSRD also requires **assurance** on the sustainability information that companies report." *European Commission (2024)*

QUESTIONS



- » Limited understanding and research on effects of CSR audit mandate
 - Concerns regarding market concentration and audit quality
 - Impact on financial audit quality
 - So far mainly voluntary CSR audits (= little empirical research available)
- » If data is unavailable economic models can enhance our understanding
- » Broad body of analytical literature on financial audits

Analytical Auditing Models might offer insights

- What can we learn from (financial) analytical audit literature about mandatory CSR audits?
- How can auditing models be used to make predictions about effects of a CSR audit mandate?

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Essay

CSR Assurance: Insights from Analytical Audit Research

- » **Question:** What do we learn from analytical audit literature about mandatory CSR audits?
- » Literature Review based on 154 analytical auditing papers

SELECTED FINDINGS



(If applicable to CSR audits, literature suggests that ...)

» Non-Audit Service Literature

- Sourcing from one auditor advantageous
- Knowledge spillovers might increase financial, CSR, and overall audit quality, and decrease audit fees (e.g. *Simunic, 1984; Beck and Wu, 2006; Wu, 2006*)
- Partially confirmed by empirical literature, e.g. *Dal Maso et al. (2020)*

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» Auditor Size Literature

- Established audit firms have market advantage and provide better CSR reports (e.g. *Bar-Yosef and Sarath, 2005*)
- Some empirical findings support this prediction (e.g. *Ackers and Eccles, 2015; Dhaliwal et al., 2011; Casey and Grenier, 2015*), others disagree

» Research gap on CSR assurance (analytically and empirically)

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An architectural rendering of a modern building with a glass facade and a courtyard. The building has a prominent glass section on the left and a courtyard in the center. The courtyard is paved with large tiles and has a few people walking around. The building is surrounded by trees and other buildings in the background.

Essay

The Impact of Non-Financial Audits on Audit Effort Choices

» **Question:** How can auditing models be used to make predictions about effects of CSR audit mandate?

- » Extension of Analytical Auditor Liability Models such as *Dye (1995)* and *Laux and Newman (2010)* (one-auditor and one-firm models)
- » We introduce a second audit task for the auditor next to "standard" audit
 - Auditor chooses financial (a) and CSR (q) audit effort (= quality)
 - Audit errors occur in financial (L_f), CSR (L_n), or both dimensions (L_t)
 - Higher efforts a and q reduce likelihood of errors
- » How do audit quality decisions change in cost parameters?

$$\min C^A(a, q) = P_{\text{err}}(a)L_f + P_{\text{err}}(q)L_n + P_{\text{err}}(a, q)L_t + c(a, q)$$

- » As auditor chooses efforts a and q to minimize overall cost ...
 - ... CSR audit effort q decreases in higher CSR audit cost $c(q)$ and lower CSR litigation L_n
 - ... while financial audit effort a increases

= *substitutive effect*

SELECTED FINDINGS



Effects of parameters

- » Changes in direct cost parameters (e.g. cost per hour) cause expected *substitutive effect*
- » Changes in litigation for audit errors ($L_t(L_f, L_n) = L_f + L_n$) might cause unintended reactions
 - We either observe *substitutive or complementary effect*
 - Expected *substitutive effect* only observable for certain cost parameter constellations
 - Increasing litigation for CSR audit L_n can decrease quality of CSR audit q
 - Increasing L_n can increase not only q but also a (same is true for L_f) (= *complementary effect*)

Intuition for complementary effect

If CSR audit errors are priced higher (but not too high relative to financial audit errors), a more cautious assessment of both the financial and sustainability report is beneficial to reduce the overall cost of the audit.

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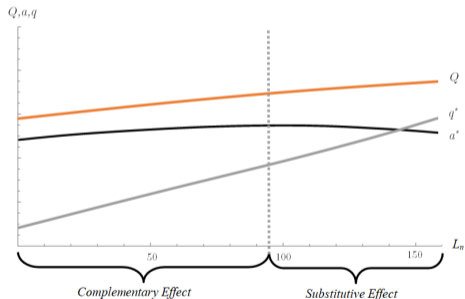
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Overall-audit quality

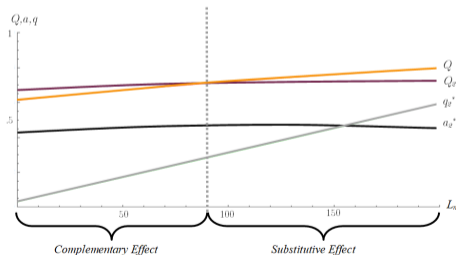
One-provider case

- » Overall-audit quality increases in litigation



Two-provider case

- » Results structurally similar for two different audit providers if a sharing rule is introduced (subcontracting)



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CONCLUSION



Economic impact of mandatory CSR audits:

- » Incentive structure on audit market might change severely
- » Connectivity of financial and CSR audits might lead to unexpected reactions to changes in litigation
- » Large research gap on the impact of CSR audits

