ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CONTROVERSIES AND INTEGRATED REPORTING ASSURANCE: AN EVENT STUDY OF TOP 100 JOHANNESBURG STOCK EXCHANGE (JSE) LISTED COMPANIES

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Background

- Integrated reporting (IR) – an innovative reporting approach that combines both financial and nonfinancial information into a stand-alone report.
- Concern for the credibility of qualitative and forward-looking information in the report.
- Reporting quality – high IR quality (IRQ) is positively associated with firm value and negatively associated with information asymmetry and financial analysts' forecast errors and dispersions (Barth et al., 2017; Zhou et al., 2017).
- IR assurance – the combined assurance (CA) model is improving the firm value and reducing information asymmetry (Zhou et al., 2019). Conventional CSR assurance are attenuating the textual complexity and readability difficulties of annual integrated reports (Caglo, et al., 2019).
- Not sufficient evidence to supporting the substantial audit outcomes (such as reduction of litigation risks and improving the investors' perception) for assurance services for nonfinancial information (Maroun, 2020).

Motivation and objectives of the study

- Motivation of the study:

a. Insurance hypothesis (Wallace, 1980) – auditor's responsibility for audit failures in the financial statement audit. Buffer role of CSR assurance in the case of negative stakeholder responses.

b. Insurance value of Corporate Social Performance (CSP) (Godfrey et al., 2009) – firms engaged with CSPs are in a better position to deal with adverse investors responses following negative news events.

- Objectives of the study:

a. To investigate the potential insurance benefits of IR quality in dealing with ESG controversies.

b. To examine to what extent the innovative CA model generates the insurance benefits for the reporting firms following ESG controversies.

c. To explore the incremental insurance value of conventional CSR assurance over the CA model in dealing with ESG controversies.

ESG controversies and their effects on CSR reporting and assurance

- Negative news associated with ESG issues often gets news media exposures, hence, leading to adverse stakeholder reactions (Aouadi & Marsat, 2018; Cai et al., 2012; Carroll, 1979; Klein & Dawar, 2004).

- Empirical CSR studies document mixed outcomes regarding relationship between CSR and firm value (Aouadi & Marsat, 2018).

- Cahan et al. (2015) - a positive interaction effect between high CSR performance and favourable media coverage would increase (decrease) the reporting firms' equity valuation (cost of capital).

- Du and Wu (2019) - CSR assurance can protect firm value against negative stock market reactions for first-time offenders. However, such insurance benefits can not be carried forward for reporting firms with a repeated history of ESG related misconduct.

Research Hypotheses

IR quality

H1: *Investors react less severely to the ESG controversies of firms with high IR quality following negative news events.*

IR assurance

H2: *Investors react less severely to the ESG controversies of firms implementing the innovative CA model.*

H2a: *Conventional CSR assurance can bring incremental economic benefits in dealing with adverse investors reactions for firms implementing the CA model*

Methodology

- Sample – Top 100 JSE listed firms based on EY's excellence in the integrated reporting ranking from 2011 to 2017.
- Negative corporate ESG events (South African media and International media sources)– FACTIVA, Google, BBC news, and Reuters.
- Initial sample 208 negative ESG news events – final sample 154 observations.
- Sample coding Schema:

a. FACTIVA (both South African and International Media): <Company Name> AND <Keyword>
b. FACTIVA (South African Media only): <Company Name> AND <Keyword> AND <South Africa>

Methodology (contd.)

Table 2 (continued):

Panel C: Events categories and observations

Event Categories	General event types	Observations (%)
Health and Safety	Accidents, pollution and spills, wastage	24 (13.11%)
Anti-trust and breach	Breaches, anti-trust	22 (12.02%)
Carbon tax announcement	South Africa carbon tax announcement	92 (50.27%)
Litigations	Lawsuits, sued, litigation, class action, shareholders' activism	21 (11.48%)
Other	Poor performance, CEO resign, selling majority stock, pollution, winding up costs, restructuring, termination of auditor, sell of key business unit, negative campaigning	24 (13.11%)
Total		**183 (100%)**

Research models

- Ordinary Least Square (OLS) regression models (Caglio et al, 2019; Godfrey et al., 2009; Zhou et al., 2019):

$$CAR_{it}\,[-5, +5] = B_0 + B_1 IRQ_{it} + Controls + Year\ fixed\ effects + Industry\ fixed\ effects + \varepsilon_{it} \quad (1)$$

$$CAR_{it}\,[-5, +5] = B_0 + B_1 IRQ_{it} + B_2 CA_{it} + Controls + Year\ fixed\ effects + Industry\ fixed\ effects + \varepsilon_{it} \quad (2)$$

$$CAR_{it}\,[-5, +5] = B_0 + B_1 IRQ_{it} + B_2 CA_{it} + B_3 CSRA_{it} + Controls + Year\ fixed\ effects + Industry\ fixed\ effects + \varepsilon_{it} \quad (3)$$

- The coefficients of *IRQ*, *CA*, and *CSRA* are representing the research hypotheses, *H1*, *H2*, and *H2a* respectively.
- Fama and French (2015) five factors models - the abnormal return from 90 days before to 10 days after the negative ESG news events
- *CAR [-5, +5]* - Cumulative Abnormal Return calculated from 5 days before to 5 days after the ESG controversies dates.

Research models(contd.)

- Measurement of key interdependent variables of interest:

a. IRQ: five-point scores based on EY's ranking – from 1 for "improvements to be made" to 5 for "Top ten".
b. CA: 1 if a firm implemented the CA model, or 0 otherwise.
c. CSRA: 1 if a firm has separate CSR assurance statement, or 0 otherwise.

Main findings

Table 5: Regression results for *CAR [-5, +5]* models

	Dependent variable *CAR[-5,+5]*		
	(1) ***IRQ model***	**(2)** ***CA model***	**(3)** ***CSRA model***
IRQ	0.007*	0.007*	0.007*
	(1.88)	(1.88)	(1.76)
CA		0.015**	0.014**
		(2.26)	(2.05)
CSRA			0.009
			(1.10)
Intercept	-0.0001	-0.00001	0.006
	(-0.01)	(-0.00)	(0.14)
Year fixed effects	*YES*	*YES*	*YES*
Industry fixed effects	*YES*	*YES*	*YES*
Clustered by firm and year	*YES*	*YES*	*YES*
N	154	154	154
R^2	0.256	0.278	0.284
adj. R^2	0.118	0.137	0.137
chi^2	44.02	50.66	59.21
p-value	0.008	0.04	0.041

z statistics in parentheses and variable descriptions are given in Appendix A. Bootstrap standard errors are used for z stat calculation based on 1000 replications, clustered by firm and year.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Main findings (contd.)

Table 6: Regression results for *CAR [-5, +5]* models with controls for repeated ESG controversies and severity of events

	Dependent variable CAR[-5,+5]		
	(1) ***IRQ model***	**(2)** ***CA model***	**(3)** ***CSRA model***
IRQ	0.007*	0.007*	0.007*
	(1.88)	(1.88)	(1.76)
CA		0.013*	0.0124*
		(1.80)	(1.67)
CSRA			0.008
			(0.97)
REPEAT	-0.023*	-0.02*	-0.019*
	(-1.88)	(-1.78)	(-1.69)
SEVERTY	-0.001	-0.002	-0.001
	(-0.05)	(-0.14)	(-0.07)
Intercept	-0.028	-0.027	-0.023
	(-0.66)	(-0.66)	(-0.55)
Year fixed effects	*YES*	*YES*	*YES*
Industry fixed effects	*YES*	*YES*	*YES*
Clustered by firm and year	*YES*	*YES*	*YES*
N	153	153	153
R^2	0.273	0.288	0.292
adj. R^2	0.123	0.134	0.132
chi^2	59.20	50.21	61.64
p-value	0.0002	0.004	0.0003

z statistics in parentheses and variable descriptions are given in Appendix A. Bootstrap standard errors are used for z stat calculation based on 1000 replications, clustered by firm and year.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Additional Analyses

- Additional tests:

a. One-year lagged IRQ and CA.

b. First time adoption of CA model.

- Endogeneity issues:

a. Capital market participants' anticipations of the negative ESG news events and effects of price adjustments around event dates (Lee et al., 2015) – reiterate the main models using CAR[-3,-1] and CAR[+4,+10] as dependent variables.

b. Heckman's two-stage tests.

Contribution of the study

- Empirical evidence supporting potential insurance benefits of IR quality in dealing with adverse investors reactions following ESG controversies–extends the findings of Du and Wu (2019) and Godfrey et al, (2009).
- Provide comparative insights about the innovative and conventional assurance mechanisms in the presence of ESG controversies – extends the finding of CSR (Du and Wu, 2019) and IR literature (Caglio et al., 2019; Zhou et al., 2019)
- Evidence supporting the buffer role of assurance services of nonfinancial information - extends the insurance hypothesis of Wallace (1980).
- Role of innovative assurance mechanisms in dealing with adverse investors' responses for ESG controversies and choice of assurance models – key insights for the standard setting bodies such as the International Sustainability Standards Board (ISSB) and assurance providers.

Questions . . ?

Thank You