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Abstract: Corporate social responsibility (CSR) assurance rates continue to lag behind corporate reporting of CSR activity (Blasco and King 2017), suggesting managers question whether the benefits of purchasing assurance outweigh the costs. This article summarizes a recent study by Stuart, Bedard, and Clark (2020) investigating the value of CSR assurance when a company experiences a negative event by examining how prior disclosure of management’s CSR intentions, and the decision to purchase independent assurance, influence investors’ judgments. Findings suggest investors react more favorably to management’s intention to engage in activities that increase expected future financial returns when economic times are good. In contrast, in difficult times investor preference shifts to management’s intent for activities done solely for social good as a signal of ethical culture. However, this preference disappears when disclosures are assured. Findings suggest the decision to purchase CSR assurance plays an important role in signaling management’s ethical culture.
PRACTITIONER SUMMARY:

The Value of Assurance and Ethics in Difficult Times: Corporate Social Responsibility Disclosures and Investor Decisions

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The Value of Assurance and Ethics in Difficult Times: Corporate Social Responsibility Disclosures and Investor Decisions

SUMMARY: Corporate social responsibility (CSR) assurance lags behind corporate reporting of CSR activities, suggesting managers question whether the benefits of purchasing assurance outweigh costs. We summarize our recent study (Stuart, Bedard & Clark, 2020) investigating how prior disclosure of management’s CSR intentions, and purchase of independent assurance on those disclosures, influence investors’ judgments following a negative event (i.e., a product recall). Absent the recall, investment judgments are higher when company management discloses that CSR activities are intended to increase financial returns; CSR assurance does not alter that response. In contrast, investment judgments in the product recall scenario are higher when CSR activities are intended solely to achieve social good, signaling the company’s ethical culture. However, the purchase of CSR assurance serves as an alternative signal of ethical culture when management’s CSR intention is increasing financial returns, thus also protecting the company from negative investor reaction in that scenario.

Keywords: Investor judgments, Negative event; Corporate Social Responsibility; CSR disclosure; CSR assurance.
I. INTRODUCTION

This article summarizes our recent study (Stuart, Bedard, and Clark 2020) investigating how corporate social responsibility (CSR) disclosures, and independent assurance on those disclosures, affect investor response when a company-specific negative event occurs. Specifically, we study the situation of a product recall due to customers’ foodborne illness, in which it is not clear whether management is responsible for the contamination causing the recall. We ask whether the company’s stated intention to engage in CSR, and its willingness to voluntarily purchase assurance on its CSR disclosures, can mitigate the potential damage from such an event. In this summary, we review the study’s motivation, background, methods and results and discuss the practical implications of our findings.

II. MOTIVATION

Negative events (e.g., safety or health issues) with significant financial consequences are commonly reported in the business press and represent significant risk to firms.¹ The motivation of our study is to examine whether and how management’s prior CSR disclosure choices (i.e., signaling of CSR intent and the purchase of assurance) provide protection if a company later experiences a negative event with an ambiguous cause.² In such cases, there is often a period of uncertainty about how responsibility should be attributed to the company, other parties, or accidental causes. During this period, investors may seek information about prior activities in order to judge whether the company is at fault for the current event. Positive signals of the company’s ethics could influence investors to not hold the company responsible for the event. In sum, we

¹ Recent examples include recent reports of foodborne illnesses at Chipotle and contamination of romaine lettuce.
² The timeline of events in our study is important. Our interest is not in how a company responds to a negative event, but rather how CSR disclosure and assurance choices made before a negative event influence investor reactions when difficulty later occurs.
examine whether a company’s prior CSR disclosure choices influence investors’ perceptions of the company’s ethical culture, and thus provide protection against negative investor reactions.

We examine two possible signals of ethical culture in the context of CSR disclosures. First, we compare investor reaction to two possible intentions for firms undertaking CSR commonly found in practice: (1) CSR as a means for businesses to benefit society, an altruistic motive; and (2) CSR as a means for businesses to benefit both society and their own financial performance, combining altruistic and self-serving motives (Vogel 2005). The second possible signal of ethical culture that we study is assurance of CSR disclosures by an independent public accounting firm. Unlike financial statement auditing, purchase of assurance on non-financial disclosures such as CSR reports by public companies is voluntary. Despite increased CSR reporting by large, global companies over recent years, assurance rates continue to lag (Blasco and King 2017), suggesting that many companies remain skeptical about its net benefit.

Prior research generally finds that investors prefer CSR intended to enhance financial performance, but research varies on whether CSR assurance is valued by users (Chung and Cho 2018) or how it influences investors’ judgments specifically. For instance, one study finds that in a positive information scenario, assurance is more valuable to investors when CSR is intended to improve future financial performance (Cheng, Green, and Ko 2015), while another finds that in a highly negative scenario (corporate misconduct) investors do not value CSR assurance at all (Christensen 2016). But that study does not consider more common negative events (those in which it is unclear whether management is culpable) where assurance might make a difference. Our study focuses on these situations, examining how investment judgments are made, by measuring investors’ focus on future cash flows versus ethical culture and their impact on market decisions.
Next, we discuss background and the research purpose. We then present the experimental methods used in our study, followed by a brief discussion of our results. Finally, we discuss the practical implications of our study.

III. BACKGROUND AND RESEARCH PURPOSE

Investors are increasingly using CSR information when making investment judgments (e.g., Cohen, Holder-Webb, Nath, and Wood 2011). Voluntary CSR disclosure can provide information to investors by sending a signal of management’s intent for the investment, and their projections of outcomes. In a positive information context, investors are likely to view CSR disclosure much like traditional financial disclosure by connecting the activities to future cash flows (Arnold, Hörner, Martin, and Moser 2017; Cheng et al. 2015). In contrast, heightened risk from a negative event provides a setting where investors might use CSR disclosure in ways other than the potential connection to future financial returns. In this setting, the investors’ response to a negative event likely depends on to whom they attribute responsibility. That is, if management undertook CSR initiatives solely for social good, investors might consider these as altruistic intentions, perceiving the ethical culture as stronger and management as less culpable for the negative event.

In addition, we investigate the role of assurance in investor response to CSR disclosures. Research shows companies sometimes use CSR disclosures to manage company image; i.e., “greenwashing” their reports by misrepresenting CSR activities (Lyon and Maxwell 2011). This tendency challenges the credibility of CSR disclosures and suggests investors should be cautious about relying on them. Some research finds investors’ perceptions of disclosure credibility depends on situational incentives (Mercer 2004). When information is positive, investors may perceive disclosures highlighting expectations for improved future financial performance as self-interested
and view them with greater skepticism. While assurance of CSR disclosures might logically improve their credibility, some prior research finds CSR assurance is not valued by investors (Cho, Michelon, Patten, and Roberts 2014).

When negative events occur, investors’ judgments are less impacted when they can trust management’s disclosures (Elliott, Hodge, and Sedor 2011). Thus, assurance could help build investors’ confidence and enhance perceptions of management’s ethical culture due to its willingness to make disclosures subject to an independent check. However, investors may see CSR assurance as a “frivolous luxury” (Cohen and Simnett 2015; 70) when a company experiences a negative event. Prior research in negative event settings is mixed. Pflugrath, Roebuck, and Simnett (2011) show assurance enhances credibility for CSR reports issued after a negative event, but only in certain situations. Christensen (2016) finds assurance of CSR reports issued before a negative event does not reduce negative stock price reaction to disclosure of manager malfeasance. We address this issue by studying, in a controlled experimental setting, how assurance of information in CSR disclosures alters investors’ judgments when a negative event with an ambiguous cause occurs.

**IV. METHODS**

We conduct an experiment using 459 participants taking the role of an investor in a case company (XYZ, Inc.) that procures, processes and transports branded food products sold at national grocery stores. All participants receive background information including condensed financial statements and common financial ratios, and are asked to provide initial investment judgments on their assessed valuation of the company’s stock and their willingness to invest in the

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3 The participants in our study were solicited from the Amazon Mechanical Turk, an online platform commonly used in accounting and many other disciplines. All participants passed seven screening questions to ensure they represent nonprofessional investors before completing the experiment. Refer to the full study for details on the screening criteria.
company. They then receive excerpts from XYZ’s most recent CSR report, which provides baseline information about management’s intention to use its CSR initiatives to provide societal benefit, as CSR generally involves intent to benefit society (McWilliams and Siegel 2011). The case materials also contain three items manipulated between participants. First, half of the participants read an explicit statement in the CSR report that management expects positive financial returns from its upcoming activities, while the other half are told that financial returns are not expected. Second, half of the participants received an assurance report concluding that the disclosure provides an accurate and complete description of the CSR activities, while others are told that XYZ Inc. chose not to have their CSR report independently assured. Third, half of the participants received news of a negative event, through an excerpt from a news article detailing the company’s product recall in response to customer cases of foodborne illness. The other half received no information about a negative event.

After reading the case, participants provide updated assessments of the company’s valuation and their willingness to invest. We combine them into a single measure (“investment judgment”) and analyze the difference in the combined measure from before to after the manipulations. In order to assess how investors form their investment judgments, we also ask participants to rate their perceptions of the connection between management’s CSR intentions and future net cash inflows, as well as whether the disclosures provide a signal of the company’s ethical culture.

V. RESULTS

Our results show that investor responses to variation in management’s CSR intent and assurance differ based on the presence of the negative event. With no negative event (as depicted in Figure 1), investors predict greater future cash flows and increase their investment judgments
when management intends to use CSR to earn future financial rewards. Thus, investor focus in this scenario is on the prospect of financial rewards, and the presence of CSR assurance does not change this focus.

**Insert Figure 1 About Here**

When a negative event is present, results vary according to whether or not management purchased assurance for its disclosures. When assurance has not been purchased, we find that when management intends to gain future financial rewards from CSR, investors’ perceptions of management’s ethical culture are lower (as shown in Figure 2 Panel A). Thus, undertaking CSR solely for the public good (without expectation of financial gain) is viewed as a sign of management’s ethical culture, suggesting that investors are less likely to attribute the cause of the negative event to management. Higher perceptions of ethical culture are in turn associated with higher investment judgments. On the other hand, following a negative event, investors perceive that companies intending to achieve financial gain from CSR have a lower ethical culture, which in turn lowers investment judgments. However, management’s purchase of CSR assurance changes this pattern, as shown in Figure 2 Panel B. In this scenario, assurance of the CSR report has a positive influence, offsetting the relative disadvantage experienced by companies intending to gain future financial rewards from CSR. Thus, if company management undertakes CSR initiatives in order to improve future financial performance, purchasing assurance on CSR reports provides “insurance-like” protection from investor reaction to possible future negative events.

**Insert Figure 2 About Here**

**VI. DISCUSSION AND PRACTICAL IMPLICATIONS**

The results of our study provide important insights into how investors view management’s CSR disclosure choices, by examining the mechanisms influencing their reactions to information
in CSR disclosures in differing economic conditions and by providing new evidence of when companies benefit from the decision to purchase assurance. While in the full paper we note several limitations of our research design, we focus here on implications for business practice. Our results suggest that negative press received during a crisis changes how investors process management’s CSR intent and assurance when forming investment judgments. When the company has not experienced a negative event, investors focus on how management’s CSR actions affect expected future cash flows, even though this expected benefit has not yet happened. However, after a negative event occurs and investors seek information relevant to whether to attribute blame, they focus more on evidence of the company’s ethical culture. When assurance has not been purchased for CSR disclosures, management’s intent to engage in CSR solely for societal benefit is seen as altruistic. When management seeks financial gain from CSR activities, assurance itself provides a signal of a positive ethical culture and removes the disadvantage otherwise associated with management’s financial motive. These findings imply that as managers are assessing the costs and benefits of purchasing assurance on CSR disclosures, they should factor in the value of assurance sending an ethical signal if unforeseen negative events should occur.
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FIGURE 1
Negative Event Absent

CSR Assurance Present → + Perceptions of Ethical Culture → + Investment Judgment

CSR Expected to Earn Financial Rewards → + Perceptions of Future Cash Flows

FIGURE 2
Negative Event Present

Panel A. Without Assurance

CSR Expected to Earn Financial Rewards

Panel B. With Assurance

CSR Expected to Earn Financial Rewards → No difference Perceptions of Ethical Culture → + Investment Judgment

Perceptions of Future Cash Flows