ACCOUNTING FOR PLANET, PEOPLE & PROFIT
Centre for Critical Accounting and Auditing Research
VOLUME 8
Issue 1 / 2023

Combined Assurance

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This report explores the different types of assurance which companies are using to bolster the credibility of their integrated and sustainability reports and provides evidence on how combined assurance quality varies among firms

Components and quality elements of combined assurance for integrated and sustainability reports in a South African context

Purpose of this report

Integrated and sustainability reporting are principles-driven processes which explain how an organisation relies on and impacts multiple types of capitals at the strategic, risk-management and operational levels to create value for multiple stakeholders[1]. Adopting an integrated thinking mindset leads to more effective decision-making focusing on long-term sustainability[2]. While the quality of financial statement audits has been studied in detail, relatively little is known about the assurance of integrated and sustainability reports[3].

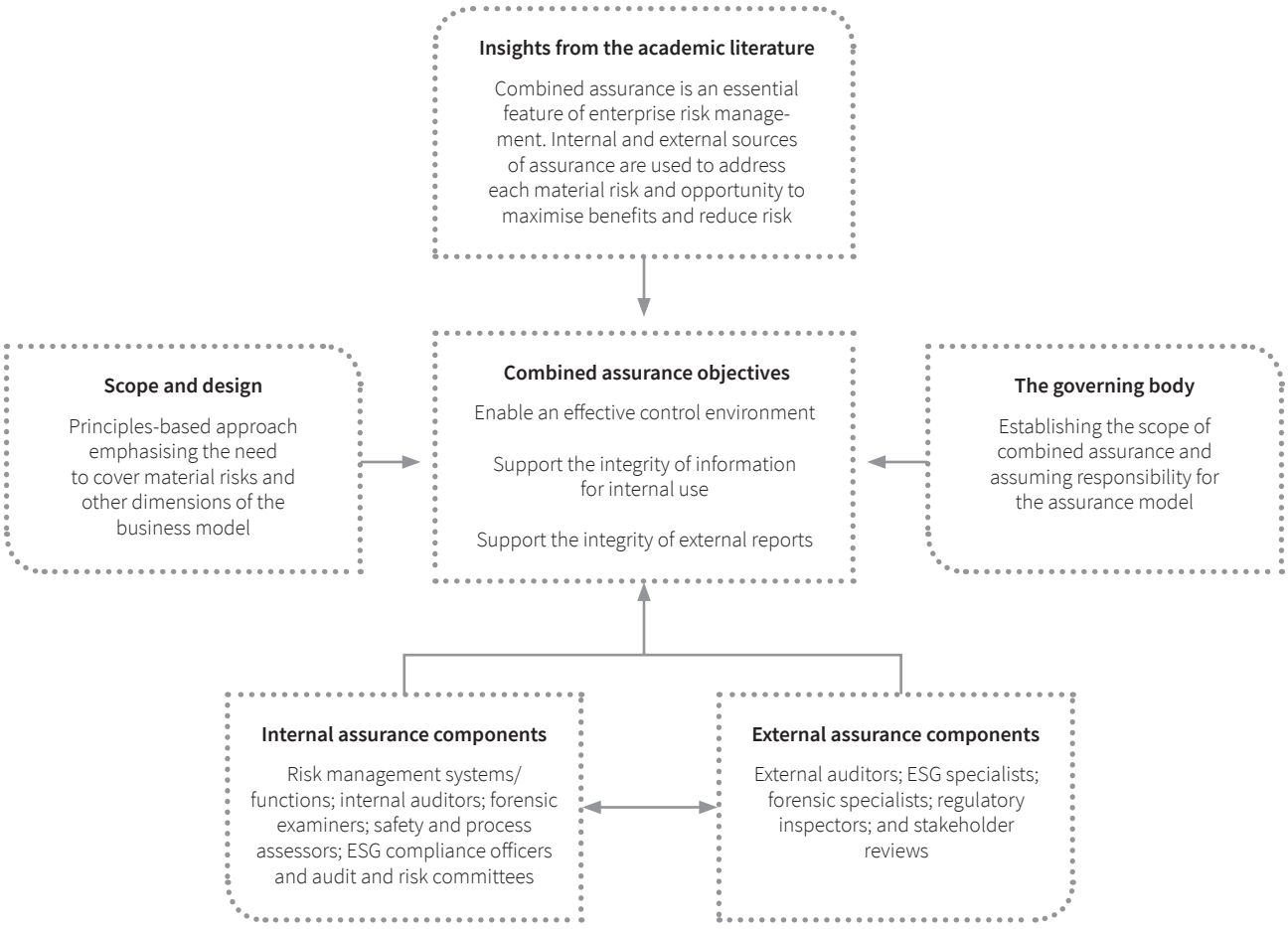
South Africa is regarded as a leader in sustainability and integrated reporting[4] and the country's codes on corporate governance are regarded as world-class[5]. A key feature of these codes is the role played by different types of assurance in supporting the monitoring and strategic functions of the governing body[6]. King-IV refers specifically to the importance of using multiple services and functions as part of a coordinated combined assurance model (CAM). CAMs create an effective control environment and support relevant and reliable reporting to stakeholders and those charged with an organisation's governance. This enhances internal decision making and external reporting[7-9].

A well-functioning corporate reporting ecosystem is premised on the foundation of a high-quality CAM. The components and quality elements of a combined assurance model can bolster the credibility of the reporting process. In this context, the objective of this report is to examine the different types of assurance being used by companies to ensure accurate, complete and reliable reporting to stakeholders.

Background

As the prominence and importance of integrated and sustainability reports continue to grow so too do the demands for these reports to be subject to, at least, some form of assurance[3]. Combined assurance represents a co-ordinated approach to addressing risks and ensuring that that data and extra-financial information used in the organisation's decision-making processes and disclosed in integrated and other sustainability reports is valid, accurate and complete. The features and objectives of combined assurance are summarised in Figure 1 which draws on King-IV and the academic literature.

Figure 1: Core elements / features of a combined assurance model



Source: adapted from [3, 6, 10]

Components of a combined assurance model

Combined assurance is a key element for an organisation to manage its risks. A principles-based approach to risk management, informed by integrated thinking, needs to be implemented by the governing body to assess the underlying risks and business model[3]. This is supported by both internal and external assurance components to achieve the CAM objectives.

A well-functioning CAM can bolster the effectiveness of an organisation's internal controls and, in turn, contribute to improved operating efficiency and the realisation of business objectives[7]. A more comprehensive review of and response to material risks can inform management's decision-making processes and provide stakeholders with greater confidence in the information included in external reports[11].

It is often assumed that "assurance" is only provided by an independent expert who expresses an opinion on defined subject matter. External assurance is only a part of a more co-ordinated approach to overseeing operations, internal processes, and risks. Assurance should be considered more broadly. Different internal sources of assurance must also be used to mitigate adverse economic, environmental and social impacts, enhance the quality of reporting to stakeholders and safeguard long-term value creation[3]. Examples include risk management functions, internal auditors, verifications by environmental, social and governance (ESG) specialists and audit and risk committees' monitoring functions.

For the combined assurance process to operate effectively, assurance providers must have the necessary expertise, resources and standing in the organisation[6]. A carefully designed management and control framework must be in place, enabling communication among assurance providers and allowing those charged with governance to coordinate the use of different types of assurance to achieve monitoring and control objectives. Factors to consider when designing a CAM include the level of risk, the efficiency with which assurance providers can mitigate risk and materiality of the affected systems, processes and data[9].

There is no generally accepted basis for observing and quantifying the quality of CAMs. Researchers have, however, identified different quality indicators which are summarised in Table 1. These indicators are used to assess the combined assurance quality among South African listed companies.

Table 1: Combined assurance quality indicators

Combined assurance quality (CAQ) indicator	Summary
INDICATOR 1 - RESPONSIBILITY Responsibility for the CAM by those charged with governance, including compliance with existing frameworks or guidelines.	Boards of directors take responsibility for the design and operation of the CAM with a clear statement of application. This statement includes compliance with codes of best and/ or existing professional standards/ guidelines practice.
INDICATOR 2 - SOURCES The use of multiple assurance providers to ensure accurate, complete and reliable reporting.	A mix of internal and external sources of assurance – see Figure 1 for examples.
INDICATOR 3 - LEVEL The level of assurance provided to stakeholders.	This includes the scope and objective of the engagement, the subject matter used to collect and assess evidence and a conclusion or opinion on the extent to which the subject matter conforms to the specified criteria.
INDICATOR 4 - COVERAGE The extent to which assurance addresses different disclosures and underlying systems and controls (coverage).	A CAM should cover the guiding principles of integrated reporting and the content elements of an integrated report including the use of multiple capitals to provide sustainable value creation[1].
INDICATOR 5 - PROCEDURES The type of test procedures used in internal and external assurance engagements.	The extent to which tests of controls, analytical procedures and substantive tests are used by internal and external assurance providers.
INDICATOR 6 - ADDRESSEE The addressee of any assurance opinions/conclusions, including any restrictions on use.	The number of stakeholders to whom any assurance opinions/ conclusions are addressed. The absence of restrictions on the use of an assurance opinion.

Methodology applied to this study

The quality indicators presented in **Table 1** are applied to the largest 50 companies listed on the JSE based on market capitalisation over a 5-year period. The companies selected applied King-IV over the study period. The study only deals with companies which have consistently prepared an integrated report for the full period under review. These companies also publish sustainability reports. References to internal and external sources of assurance in integrated and sustainability were evaluated collectively. Financial statements were excluded from the analysis.

Qualitative content analysis is used to collect and analyse the data[12]. Parts of the integrated reports, which dealt directly or indirectly with combined assurance were identified and recorded in a summary table. A search for key words was also performed. Examples included "assurance", "combined", "control" and "test". The identified content was then analysed several times and coded according to the CAQ indicator per **Table 1**. Individual paragraphs and sub-sections of the integrated reports, sustainability reports and webpage content served as the unit of analysis. Words or sentences were not used as recording units because this ran the risk of overlooking the context in which disclosures were provided and made it difficult to control for repetition.

Each unit of data was labelled with one or more quality elements. To limit subjectivity, quality elements were treated as having equal importance. The coding was based only on the presence or absence of disclosures dealing with the respective quality feature. No inferences were drawn about the appropriateness of any information based on factors such as tone, layout or the use of infographics. To ensure further the validity of the data, data were coded by the lead researcher and then re-examined three weeks after all companies had been reviewed. Any differences were flagged and corrected by the lead researcher. A research assistant then reviewed the coded reports. Variations from the lead researcher's results were highlighted, discussed and resolved before a final set of data was generated. Descriptive statistics are used to present and analyse the data [refer to 3].

Results

The results across each of the six quality indicators are presented below. This is followed by an overall assessment of the combined assurance quality scores and an analysis of the score in the context of industries on the JSE.

Indicator 1: Responsibility

In most cases, companies include express statements about their directors' responsibilities in connection with integrated and sustainability reports (96% of cases) and a clear indication that the reports have been subject to, at least, some form of assurance (92% of cases). External and internal service providers account for 64% and 36%, respectively, of the formal assurance provided in an integrated or a sustainability report.

With regards to compliance with governance, sustainability or integrated reporting frameworks,

- 92% of the companies make an express statement of compliance with King,
- 73% of the companies comply with GRI principles and
- 63% of companies prepared integrated reports in accordance with the IIRC Framework.

Indicator 2: Sources

Assurance is provided predominantly by engagements executed by the Big 4 or monitoring and review by audit committees. Verification agencies (51%) are the most prevalent external assurance providers, with most of this relating to compliance with codes of practice and statute dealing with black economic empowerment. Audit committees (64%) are providing most internal assurance. This is in keeping with the fact that King-IV vests responsibility for an organisation's internal controls with the audit committee. The South African Companies Act (2008) also imposes specific statutory duties concerning the integrity of an organisation's financial controls and reporting on audit committees. **Figure 2** provides detail on the types of assurance providers

Indicator 2: Sources

Figure 2: Internal and external assurance providers

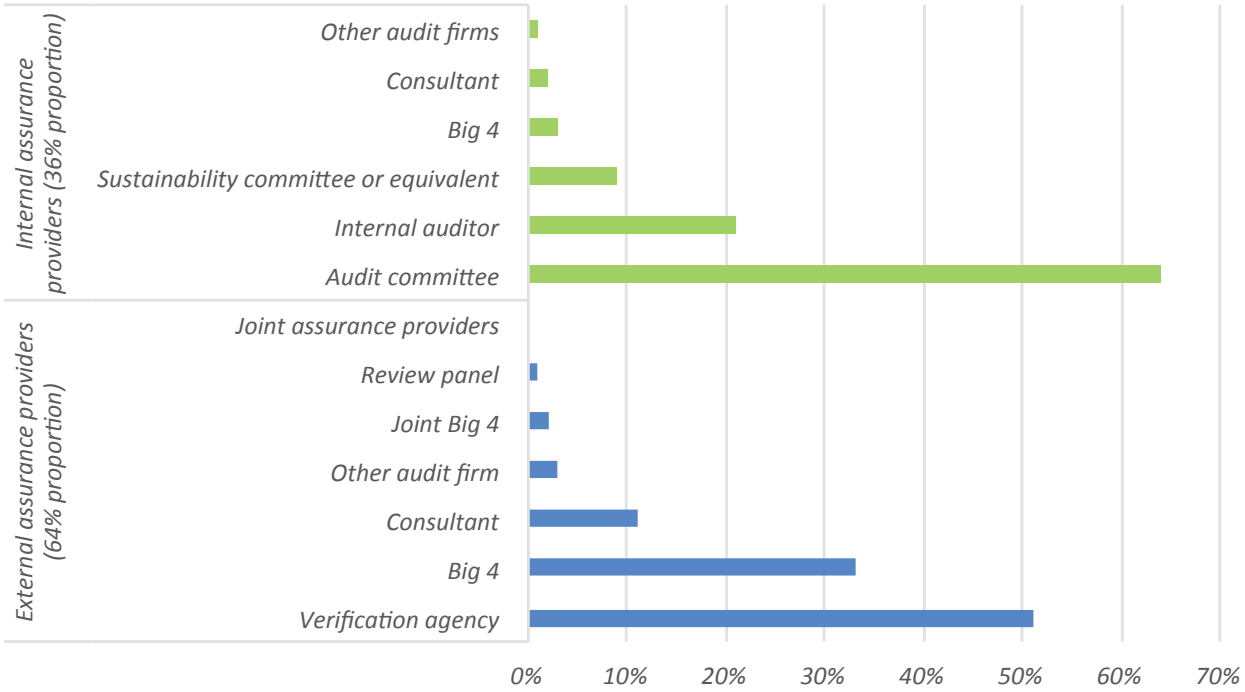
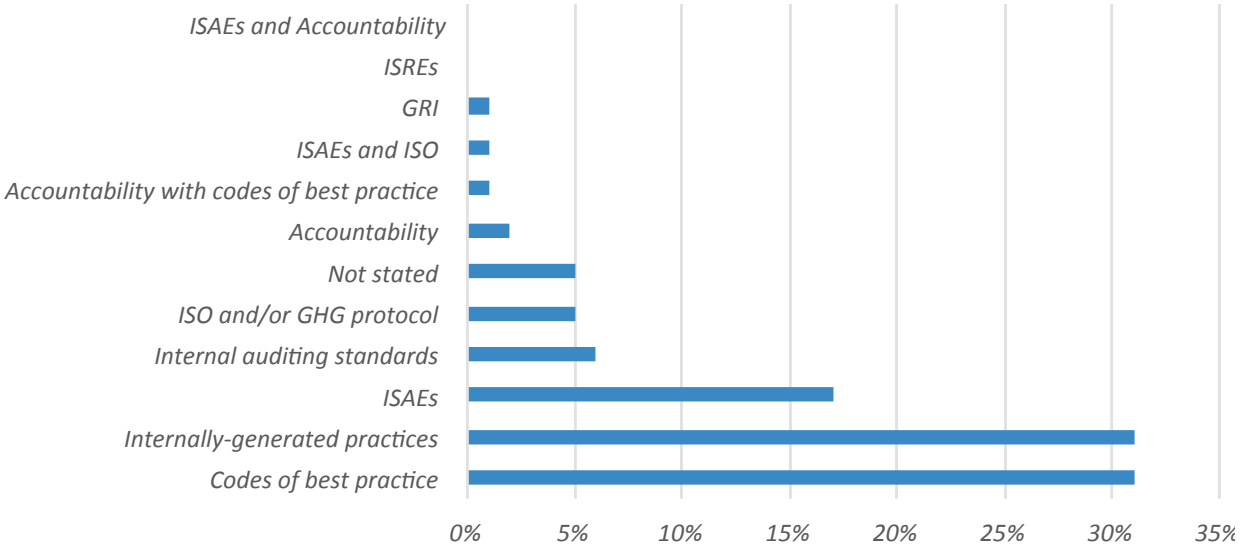


Figure 3 deals with the assurance frameworks being used. Codes of best practice (31%) dealing with specific social or environmental issues and internally generated policies (31%) are, by far, the most commonly applied frameworks. The former is typically used to execute engagements dealing with different aspects of black economic empowerment. These are followed by the use of the ISAEs. Standards/guidelines issued by AccountAbility, the ISO or the GRI are used and reported on less often.

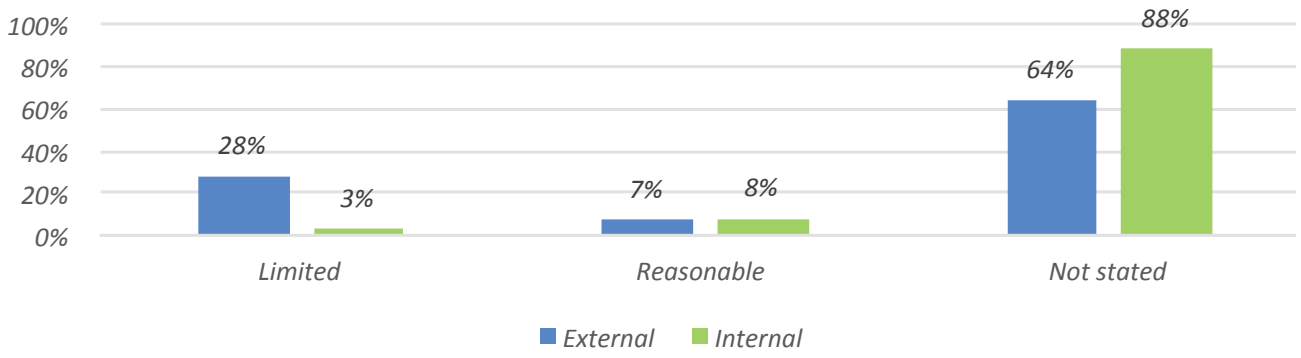
Figure 3: Level of assurance provided by external and internal assurance engagements



Indicator 3: Level

The level of assurance provided by external and internal assurance engagements is presented in **Figure 4**. For external engagements, the provision of moderate/limited assurance (28% of cases) is more common than reasonable/high assurance (7% of cases). No clear opinion was provided in 64% of cases, typically the situation when verification agencies report on aspects of black economic empowerment. Internal assurance providers do not state the level of assurance provided in 88% of the cases. This is probably because there are no specific standards dealing with how internal assurance providers report the results of their monitoring, control implementation and other testing activities to stakeholders.

Figure 4: Level of assurance provided by external and internal assurance engagements

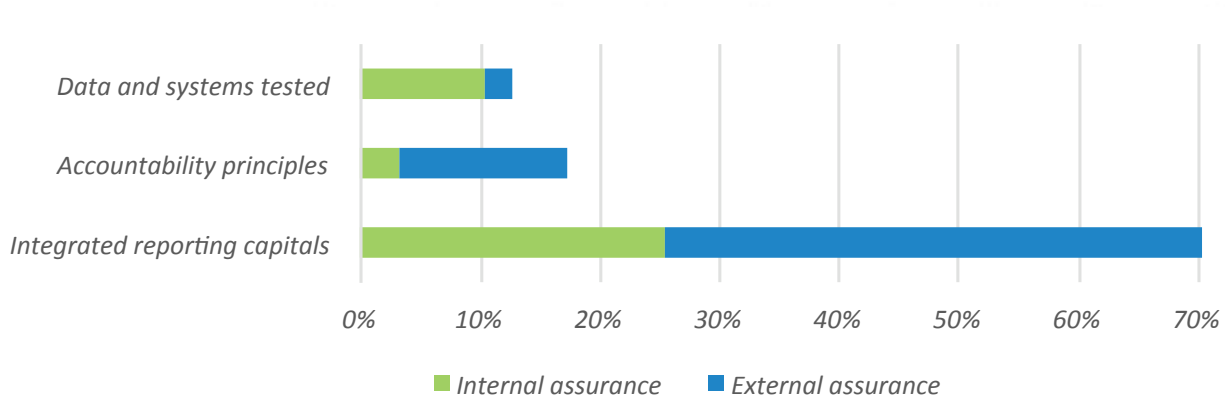


Indicator 4: Coverage

Figure 5 illustrates that the focus of the CAMs is on specific disclosures rather than the underlying processes, systems and controls which support the preparation of integrated and sustainability reports. This stands in contrast with the innovative conceptualisations of assurance which enable rigorous verification of integrated and sustainability reports based on data and systems[8, 13]. Most of the assurance over data and systems comes from internal sources.

External assurance providers focus on the AccountAbility principles more than internal assurance providers. The principles are materiality, stakeholder engagement and inclusivity[3]. Excluding financial statements, CAMs deal most often with integrated reporting capitals. External and internal sources account for 45% and 25% of the assurance over these capitals respectively.

Figure 5: Assurance coverage



Indicator 4: Coverage

Figure 6 provides additional detail on the matters being covered by assurance providers.

For the integrated reporting capitals, assurance deals primarily with intellectual and human capital (22%). Examples of the subject matter information include verification of procurement policies, training initiatives and regulatory features forming part of the broader black economic empowerment agenda. Social and relationship capital (18%) is the second highest assured capital focusing on engagements to verify corporate social responsibility expenditure and results of training programmes. Assurance of financial capital (16%) (which specifically excludes matters already assured as part of the financial statement audit) covers matters such as the number of customers, specified financial ratios and compliance with debt covenants.

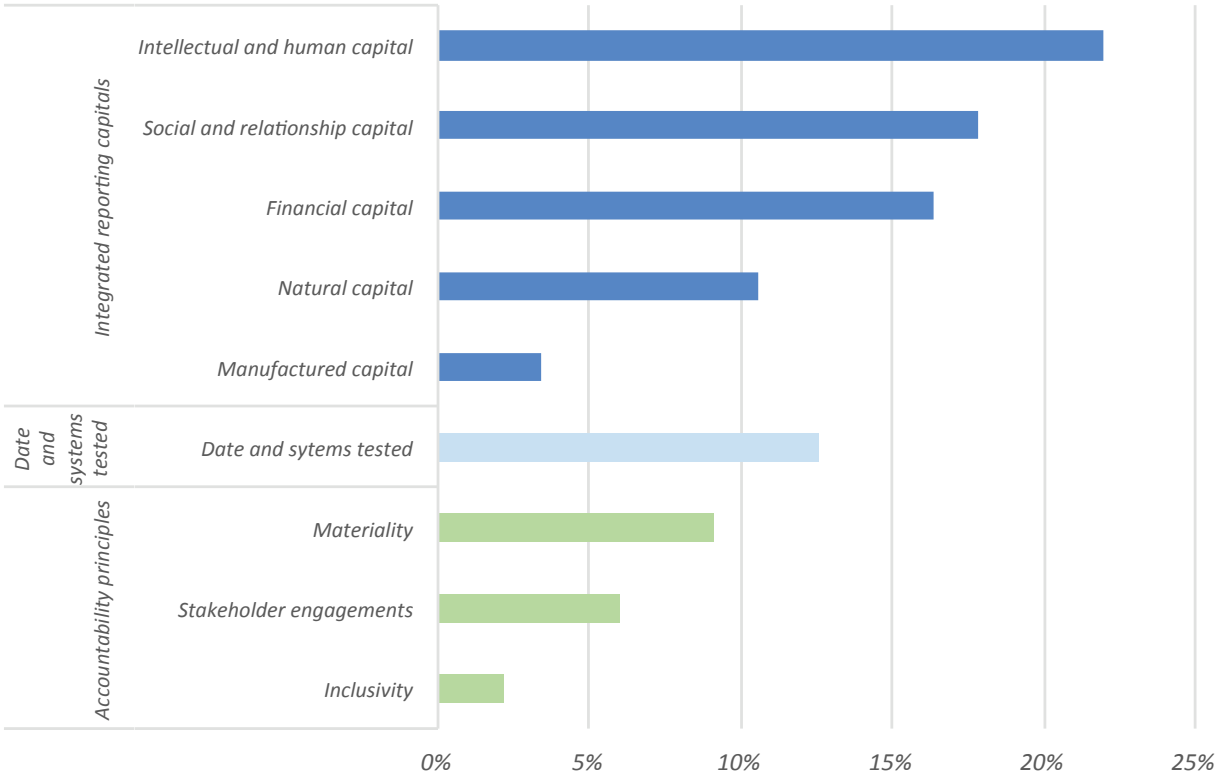
Natural (11%) and manufactured capital (3%) were least often addressed. Assurance of natural capital information includes specific environmental disclosures, carbon emissions and water usage. The fact that the GRI framework is only used in 1% of cases (**Figure 3**) affirms that the use of assurance over natural capital may be underdeveloped among South African corporates.

Manufactured capital primarily deals with verification of, and implementation of, operating policies and is consistent with the fact that few engagements focus on data, systems and processes.

When analysing the AccountAbility principles, materiality (9%) is the most assured principle, focusing on the materiality determination process and presentation. This is followed by stakeholder engagements (6%) where the identification of key stakeholders and their needs are assessed.

An important aspect of coverage is how principles, capitals and systems are incorporated into an organisation's key performance indicators and performance evaluation. The value creation process needs to be understood from both financial and extra-financial perspectives and the organisation needs to be held accountable according to a broad conceptualisation of performance framed in social, economic and environmental terms[2, 14]. An integrated report should provide an "evidence-led assessment" of how well an organisation has managed its economic, environmental and social imperatives[2]. None of the assurance providers dealing with the valuation creation process in its entirety or overall sustainability of the respective organisation.

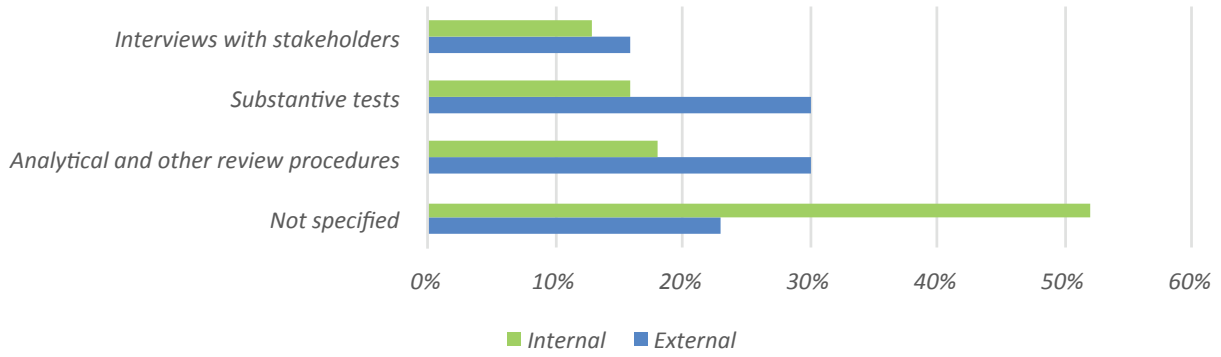
Figure 6: Granular assessment of assurance coverage



Indicator 5: Procedures

In practice, external assurors rely primarily on substantive testing and analytical reviews when executing their engagements. In most cases, the methods used and approaches followed by internal assurance providers are not stated. Refer to **Figure 7**.

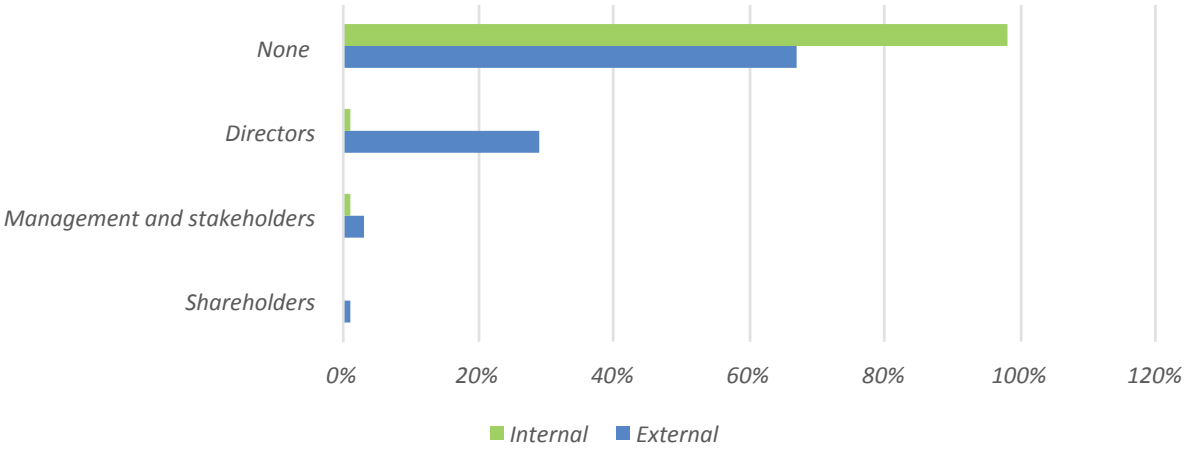
Figure 7: Use of test procedures by internal and external assurance providers



Indicator 6: Addressee

As shown in **Figure 8**, 98% of internal assurance engagements have no addressee compared to 67% of external assurance engagements. The directors are the primary addressees of external assurance engagements (29%) followed by management and stakeholders (3%) and shareholders (1%). Internal assurance engagements address management, stakeholders and directors explicitly in only 2% of all instances.

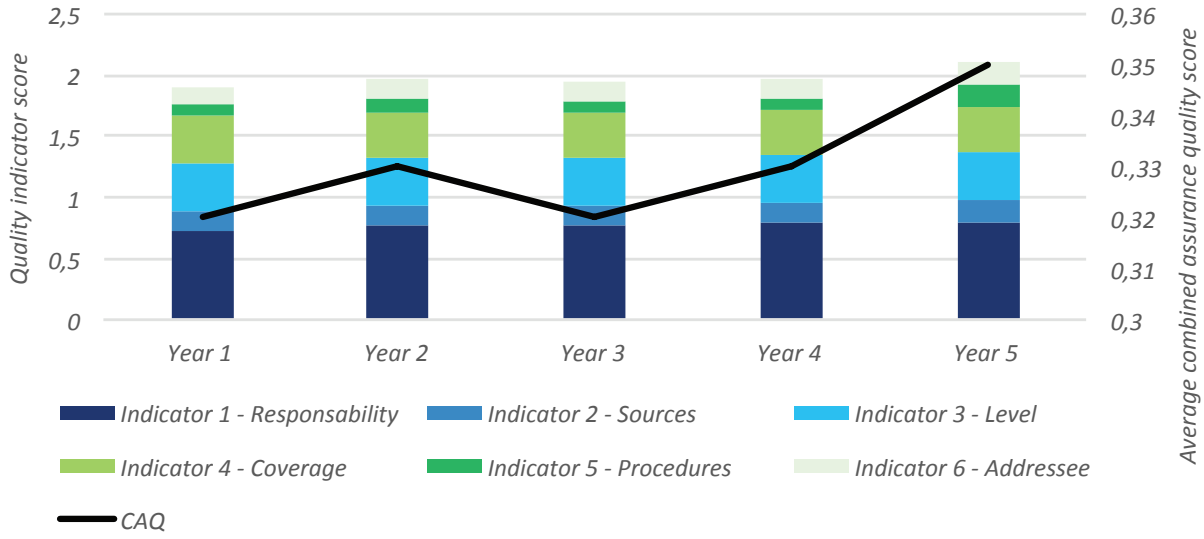
Figure 8: Addressee of assurance statements



Combined assurance quality scores

The scores per indicator were computed (with each indicator weighted equally) to obtain a combined assurance quality (CAQ) score per year. **Figure 9** shows that companies have not made significant changes to their assurance models over the period under review and the CAQ scores are relatively low at less than 50% of the maximum possible score. However, there has been a slight upward trend in the overall quality of combined assurance (0.32 average to 0.35 average CAQ score from year 1 to year 5).

Figure 9: Combined assurance quality scores



Next, the CAQ per industry is analysed. The indicator scores and overall CAQ scores are presented in **Figure 10**.

The industries present similar CAQ scores. Tests were run to confirm that the volume of information being reported is not influencing the individual components of CAQ or the total score[3]. Un-tabulated results also confirm that higher profitability (measured by return on assets) and greater leverage (measured by the ratio of debt to equity) are not associated with higher CAQ scores[3].

Larger companies tend to include more compliance-related statements in their reports and to incorporate a broader range of procedures in their combined assurance models. This does not, however, automatically result in a higher CAQ score[3]. **Figure 11** presents the top CAQ scores per company over a 5-year period and includes all companies that have scored greater than 0.4 across the six indicators with Gold Fields Ltd having the top score at 0.47.

Combined assurance quality scores

Figure 10: CAQ indicators per industry

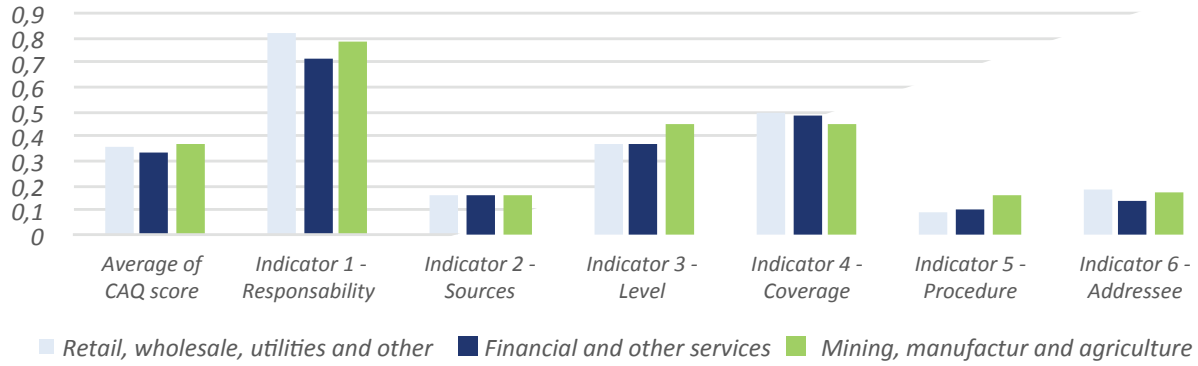
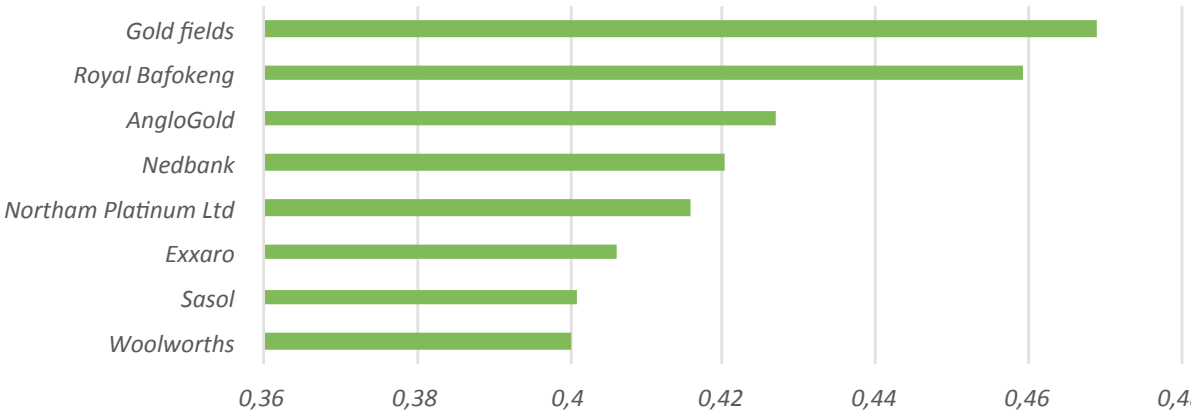


Figure 11: Top CAQ scores per company over a 5-year average



Conclusion

A well-functioning CAM is important for ensuring a sound control environment at organisations and supporting the integrity of information used for internal and external purposes. The quality indicators (**Table 1**) can be useful to those charged with an organisation's governance or with regulators/ policymakers interested in how companies are assuring their integrated and sustainability reports. The indicators can be used to identify and gauge different features of firms' CAMs and how they vary among organisations.

Results show that, in most cases, companies include express statements on their directors' responsibilities in connection with integrated and sustainability reports and a clear indication that the reports have been subject to, at least, some form of assurance. Disclosures on the level of compliance with codes on corporate governance are also common. The operation of CAMs relies on external sources of assurance to test integrated reports. The mix of internal and external assurance mechanisms being used is limited, with assurance coming predominantly from engagements executed by the Big 4 or monitoring and review by audit committees. Similarly, there is little variation in the application of standards or frameworks for guiding the assurance process. Codes of best practice dealing with specific social or environmental issues and internally generated polices are most commonly applied frameworks as part of the combined assurance process.

Areas for consideration by governing bodies include:

- **how the accounting infrastructure can be improved** and formalised to allow the systems and controls which support internal decision making and reporting to stakeholders to be formally assured;
- **ensuring that internal sources of assurance are identified clearly** in integrated and/or sustainability reports and that the methods used to provide assurance are disclosed;
- **explaining how different levels of assurance can be used** and striving to provide high rather than moderate levels of assurance for the most material subject matters and
- **considering how different frameworks, guidelines and codes of best practice can inform** a more comprehensive and innovative assurance model.

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ISBN Number for the journal is 978-1-998974-54-2