The Demand for Corporate Sustainability Reports Assurance By Companies Close to violating their Debt Covenants An Empirical study

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Abstract

This study examines whether assurance on sustainability reports affects users' decisions. An experiment was conducted where participants were provided with a case study containing condensed financial statements for a hypothetical highly leveraged company, a sustainability report including a Green House Gas Emissions Statement and an assurance report on this statement. Assurance was manipulated (assurance versus no assurance) between the two groups of sample participants. After reading the case materials, participants were asked to select the best choice regarding the value of the loan they would agree to grant to the company, the interest rate charged on the granted loan, and the percentage of assets acting as collateral on the loan. As expected, results of statistical analysis found that the inclusion of an assurance report had a significant impact on providing credibility to the associated sustainability report resulting in increasing the value of the loan, reducing interest rate charged on the loan and reducing the percentage of fixed assets acting as collateral on this loan and accordingly accepting the study hypothesis that the assurance of sustainability reports can greatly help in reducing the company's cost of debt especially for those companies close to violating their debt covenants. This research contributes to the literature on the value of expanded assurance services and on the value of enhanced corporate disclosure.

Key words: assurance, sustainability, cost of debt

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الطلب علي توكيد تقارير الإستدامة بواسطة الشركات التي أوشكت علي الإقتراب من خرق شروط الدين دراسة تجريبية

ملخص البحث:

تهدف هذه الدراسة إلي اختبار دور التوكيد علي تقارير الإستدامة في التأثير علي متخذي القرار. وقد قام الباحث باجراء تجربة تم من خلالها اعطاء حالة عملية للمشاركين في الدراسة تشتمل علي قوائم مالية مكثفة لشركة افتراضية ذات درجة عالية من الرافع المالي، تقرير استدامة يحتوي علي قائمة انبعاثات غازات الإحتباس الحراري بالإضافة إلي تقرير توكيد للتنمية المستدامة. وقد تراوحت الحالات في الدراسة بين وجود تقرير الوكيد علي التنمية المستدامة من عدمه للعينتيـــن المشاركتين في الدراسة. وبعد الإطلاع علي الحالة العملية، تم توجيه الأفراد المشاركين في الدراسة لإختيار أفضل الإجابات المتعلقة بقيمة القرض الذي يمكن منحه للشركة محل الدراسة، معدل الفائدة الذي يمكن تحميله علي القرض الممنوح للشركة وأخيرا نسبة الأصول المتداولة التي يمكن أن تعمل كضمان للقرض الممنوح. وكما هو متوقع، أوضحت نتائج التحليل الإحصائي أن وجود تقرير التوكيد علي بيانات التنمية المستدامة كان له أثر جوهري في حث المشاركين في الدراسة علي زيادة قيمة القرض الذي يمكن منحه للشركة، تخفيض معدل الفائدة علي القرض الممنوح وتخفيض نسبة الأصول المتداولة التي يمكن أن تعمل كضمان للقرض وبالتالي قبول الفرض الأساسي للدراسة والمتعلق بالأثر الإيجابي للتوكيد علي تقرير التنمية المستدامة في خفض تكلفة الدين وخاصة للشركات ذات الرافع المالي المرتفع التي أوشكت علي خرق شروط الدين. ويساهم هذا البحث بشكل فعال للدراسات السابقة التي تناولت القيمة المضافة لخدمات التوكيد بالإضافة إلي تحسين جودة الإفصاح لدي الشركات.

الكلمات المفتاحية: التوكيد، التنمية المستدامة، شروط الدين

I. Introduction

Corporate reporting and financial transparency received great attention by policy makers, regulators and users of the reports especially after the financial crisis of 2007-2009 (Ng and Rezaee, 2014) and the several high profile corporate scandals (Ioannou and Serafeim, 2014). Traditional financial reports had been accused that they do not adequately represent the multiple dimensions of the business value at the date they are issued (Simnett et al 2009). This has resulted in a search for new financial measures (Rappaport 1998; Simnett et al 2009) and; or additional nonfinancial measures of performance (Kaplan and Norton 1992 cited in Simnett et al 2009) and motivated stakeholders to demand more transparent, accurate, reliable and relevant financial and non-financial information on key performance indicators related to corporate governance, risk assessment, corporate social responsibility (CSR) and environmental performance (Ng and Rezaee, 2014).

These indicators comprise business's policy for sustainability reporting which encompasses five dimensions: the economic, legal, ethical, governance and environmental performance (Caroll 1979, 500 cited in Kim et al 2012, and Brockett and Rezaee cited in Ng and Rezaee 2014). The fourth generation (G4) of Sustainability Reporting Guidelines (published in 2000, 2002, 2006 and 2011 respectively) by the Global Reporting Initiative (GRI) will also cover economic, governance, social and environmental performance (Ng and Rezaee 2014). Investors and information intermediaries are increasingly using the data related to economic, social and governmental dimensions in their valuation models which create a demand for sustainability reporting (Ioannou and Serafeim 2014).

Sustainability reporting provides clear financial and nonfinancial information to stakeholders (Srivastava et al 2013). It provides a structured way through which the entity reports on its economic, environmental and social performance. This allows the company to show how nonfinancial metrics affect the financial figures and how those factors contribute in deriving the entities' values (Mock et al. 2007, Slater and Gilbert 2004; Deegaan et al. 2006 cited in Srivastava et al 2013). Many companies are recognizing the potential comparative advantages of publicly disclosing their goals related to non financial and financial performance measures and then reporting on how well they achieve those goals (Ballou et al 2006 cited in Srivastava et al 2013: 109)

Corporate social responsibility has been an object of interest for academicians for several decades (Heald 1957; Ultmann 1985; Moir 2001; cited in Srivastava et al 2013). Empirical evidence suggests that corporate social reporting is value relevant (Margolis and Walsh 2003 cited in Casey and Grenier 2015) and has capital market benefits such as reduced cost of capital, increased analyst coverage, lower analyst forecast errors, and lower analyst forecast dispersion (Dhaliwal et al 2011, 2012). The information content in corporate social responsibility reports not only benefit investors but could also operate through other stakeholders as it could result in better financial performance by improving the firm's reputation with customers and increase sales accordingly, improves the firm's reputation with regulators to receive more favorable treatment and attracting and motivating employees (Dhaliwal et al 2012 and Moser and Martin 2012).

The need for sustainability reports disclosure had been also made obvious with the potential economic, social, and environmental impacts of climate change that raised interest in carbon emissions' disclosure through the world (Simnett et al 2009b). This had made a proliferation of national and regional Green House Gas GHG reporting regulations and Emissions Trading Schemes (ETS) followed by a range of voluntary initiatives for emissions' reporting (Huggins et al 2011) either as GHG stand-alone reports or GHG information presented as part of a broader sustainability report (ISAE 3410, IFAC 2012) .

The sustainability report that covers a broader set of environmental accountabilities includes a Green House Gas (GHG) Statement (Huggins et al 2011). The statement is defined in (ISAE 3410) as "a statement setting out constituent elements and quantifying an entity's GHG emissions for a period, and, where applicable, comparative information and explanatory notes including a summary of significant quantification and reporting policies (ISAE 3410, IFAC 2012). The statement is divided into three sections according to the types of emissions: Direct emissions (also known as Scope 1 emissions), which are emissions from sources that are owned or controlled by the entity. Indirect emissions are emissions that are a consequence of the activities of the entity, but which occur at sources that are owned or controlled by another entity. Indirect emissions can be further categorized as: Scope 2 emissions, which are emissions associated with energy that is transferred to and consumed by the entity. Scope 3 emissions, which are all other indirect emissions (ISAE 3410 p.8). According to the standard, the statement usually quantify the GHG emissions in CO_2 or CO_{2-e} and the GHG statement is the subject matter information of the engagement (Huggins et al 2011)

However, financial scandals and the recent global financial crisis caused a general feeling of distrust in the company's reports and a belief that these current disclosures made by companies provide information about the company's past performance rather than the future aspects of the business (Kaplan and Norton 1992 cited in Simnet et al 2009 and Ioannou and Serafeim, 2014) creating a valuable need for the assurance of corporate sustainability reports (Casey and Grenier 2015). The analysis in the 2002 KPMG survey of Corporate Responsibility Reporting (KPMG/Uvf 2002,p.18) suggested that the increased adoption of sustainability assurance arises from "…the demand for reliable and credible information for management, managing the company's environmental and social risks, and from stakeholders who want assurance that the report truly represents the company's efforts and achievements".

Accordingly, this study contributes to prior literature by providing empirical evidence on the economic value of assurance services provided by external auditors on company's sustainability report by analyzing whether auditors' association to corporate sustainability reports leads to reduction of lending costs. This is done using a sample of bank officers from Egyptian's banks to study the effect of the presence of an assurance report to the sustainability statement on their decision to provide a loan to a company and whether this report will help in reducing the cost of debts of the associated company.

2. Research Objectives

The research aims to study the effect of assurance of sustainability reports on reducing the cost of debt to the reporting company. This is done by examining the effect of including an assurance report to the company's sustainability report on increasing the value of the loan required by the issuing company, reducing the interest rate charged to this loan, and finally on increasing the percentage of current assets acting as collateral on this loan.

3. Research Problem

The problem of the research stems from companies' need to reduce their cost of debt raised due to the information asymmetry. According to the information hypothesis, independently audited information reduces information asymmetry and decreases uncertainty (Wallace 1987 cited in Coram et al 2009). Different arguments suggest that auditing increases

information credibility whether this information is financial and nonfinancial. Accordingly, companies can benefit from the assurance of their nonfinancial information contained in their sustainability reports to add credibility to those reports and reduce uncertainty and thereby help the company to reduce its cost of debt.
Accordingly, the research problem could be formulated in the form of the following question:
Can the assurance of sustainability reports help a highly leveraged company close to violating its debt covenants to:

- Increase the value of a loan required by this company?
- Reduce the interest rate charged on the granted loan?
- Reduce the percentage of current assets acting as collateral to the loan?

4. Research Hypothesis

The study aims to investigate the effect of the independent assurance of the company's sustainability report on its cost of debt especially for those companies close to violating their debt covenants. Accordingly the research hypothesis could be formulated as follows:
H: For companies close to violating their debt covenants, the independent assurance of their sustainability reports reduces their cost of debt.
This hypothesis could further be divided into three sub hypotheses:
Ha: For companies close to violating their debt covenants, the independent assurance of their sustainability reports increases the magnitude of the loan granted to these companies.
Hb: For companies close to violating their debt covenants, the independent assurance of their sustainability reports reduces the interest rate charged on granted loans.
Hc: For companies close to violating their debt covenants, the independent assurance of their sustainability reports reduces the value of collaterals provided on granted loans

5. Research Limitations

The study has limitations, the most important of which is concern regarding the degree to which experimental results generalize to the field. Because not all participants have high experience in credit granting decisions in banks, the degree to which the decision of all participants can be generalized to the whole field is questioning. Another important limitation of the study is that it aims to measure the impact of providing assurance on sustainability reports on reducing the firm's cost of debt only not equity capital. Finally, the study is limited to providing assurance to the company's sustainability activities including its Green House Gas Emissions to professional external auditors to the exclusion of other types of service providers such as internal auditors or third party consultants.

6. Research Plan

The study is organized as follows. It starts by a literature review that can be divided into three main parts; the first is concerned with factors affecting the demand for sustainability assurance from a preparer point of view, the second discusses the different types of assurance providers and the relevance of each of them and the third and last part in the literature review involves the demand for sustainability assurance but from a user's point of view. This section ends with the formulation of research hypothesis. Section II is an explanation of the experimental study used to study the research hypothesis, it provides information about the sample, variables' definition, the statistical analysis and the results.

II. Literature Review and Hypothesis Development

Audit theory suggests that an audit is valuable in decision making due to its ability to enhance the perceived reliability of information (Mautz and Sharaf 1961 cited in Coram et al 2009). Kolk and Perego 2010 argued that recent surveys reported rising demand for sustainability assurance facilitated by the increased availability of auditing guidelines or guidance statements issued by bodies such as AccountAbility, the European Federation of Accountants and the Global Reporting Initiative (CPA Australia, 2004; Deegan et al., 2006; FEE, 2002, 2004, 2005; NIVRA, 2004; Zadek and Raynard, 2004 cited in Kolk and Perego 2010). Manetti and Becatti (2009) reported the presence of a credibility gap that renders sustainability reports an instrument seldom used by traditional target users such as shareholders, lenders, customers, employees, and local communities. Assurance services provided by qualified auditors had a strategic role in bridging this credibility gap. Accordingly, the number of organizations that started to rely on assurance to improve the credibility and transparency of disclosed environmental and social information (KPMG 2005) is growing. Academic research on this form of non assurance service had taken different paths.

Numerous studies have discussed the factors that affect the demand for assurance of sustainability reports from the preparer's point of view. Some studies had attributed such a demand to the strength of the legal environment in which the firm operates arguing that companies operating in a weak legal environment are more likely to require the assurance of their reports to increase user confidence in the credibility of the information contained in their sustainability reports. In contrast, companies operating in stronger legal environments will experience less demand for assurance which is compensated by country level protection mechanisms in these environments (Choi and Wong 2007 cited in Simnett et al 2009). Kolk and Perego (2010) found that the voluntary demand for assurance services is greater in countries with weaker legal regimes because auditing serves as a substitute for the absence of other institutions that facilitate private contracting. In the case where country level institutional mechanisms are weak, the probability of adopting assurance services will increase as they will become more affordable.

Other studies associated the demand for sustainability assurance to the industry specifically the level of environmental and social risks claiming that countries belonging to industries having a greater environmental or social impact are more exposed to more social or environmental risks and so will have a greater need to manage those risks through the assurance of their sustainability reports to increase user confidence in the credibility of those reports (Simnett et al 2009).

A third factor that could influence the demand for assurance services is the business culture of the company and in particular whether the company is more stakeholder or shareholder oriented (Williams and Aguilera 2008 cited in Dhaliwal et al 2012). A stakeholder oriented culture is one in which a wide range of stakeholders are believed by the society to have a legitimate interest in business activities. Accordingly, stakeholders in these countries will have a considerable influence on companies' activities. In contrast, in a shareholder oriented culture, companies are seen as tools for the creation of shareholders value and other stakeholder groups have less legitimate right and therefore less influence on corporate activities (Simnett et al 2009).

Accordingly, in countries that are more stakeholder oriented, stakeholder groups have greater influence on firms' operations and financial performance compared to other countries that are shareholder oriented, this will cause corporate sustainability disclosure which is supposed to contain information on how well firms handle issues related to stakeholders, is more useful to analysts in assessing firms' financial performance. This has caused Dhaliwal et al (2012) to provide evidence concerning the existence of a more pronounced positive association between CSR disclosure and analyst forecast accuracy in countries that are stakeholder oriented compared to other countries that are shareholder oriented. Simnett et al (2009) also suggested that companies located in countries that are more stakeholder oriented are more likely to demand assurance on sustainability reports and to choose the assurance from outside the profession compared with their counterparts located in countries that are more shareholder oriented (Simnett et al 2009 and Srivastava et al 2013). That's why Smith Adhikari and Tondkar (2005) provided evidence that firms from countries with a stakeholder orientation show higher levels and quality of their sustainability reports than firms from countries with a weaker emphasis on social issues and thus a shareholder orientation.

Studies also differentiated between the types of assurance providers and the relevance of each provider differentiating between companies that choose assurance from outside the auditing profession as consultants and companies that choose assurance from the auditing profession as either external or internal auditors (Simnett et al 2009, Peters and Romi 2014). Professional accountants are independent and follow the requirements of professional conduct, well developed global standards, and quality control mechanisms which promotes the quality of assurance reports and thus makes them an important contributor to the reporting about sustainability (Simnett et al 2009 and O'Dwyer 2011, Huggins et al 2011 cited in Peters and Romi 2014) although such quality requires significantly greater costs from the company requiring the assurance service (Peters and Romi 2014).

The accounting profession also has strict education and experience requirements for entry into the profession, ongoing professional development requirements to maintain certification, and competency. The auditing profession follows the quality assurance policies and procedures at both the engagement and audit firm levels developed by IFAC, performance standards for particular types of engagements such as ISAE 3410, in addition to the strong and detailed code of ethics which well places the accounting profession in a position that enables it to enhance the credibility of sustainability reports through the assurance process (Huggins et al 2011).

Practitioners from the accounting profession are well placed to deliver GHG assurance services as they are well trained to deal with the risk model for the audits of financial statements, which involves understanding the entity, and assessing the risk of material misstatement, and then appropriately responding to assessed risks. Such a model translates well into the GHG reporting domain (ISAE 3410, IFAC 2011). The assessment of the risk of material misstatement can be at both the GHG statement level as well as the assertion level for each GHG statement line item. The GHG statement is a statement of GHG emissions for a period, so is similar to the income statement in nature; thus, the use of similar assertions (e.g. occurrence, completeness, accuracy, cut-off classification) and assertions concerning presentation and disclosure of the GHG emission inventory (e.g. rights and occurrence, completeness, classification and understandability, accuracy and valuation) are considered. In terms of reporting, the assurance report on GHG statement is similar in structure to audit reports for audits of financial statements (ISAE 3410, A78 cited in Huggins et al 2011).

In case specialized experience is needed, the profession has developed the auditing standards that address the situations in which the work of a specialist in a field other than accounting, such as valuation, IT, actuary and fraud is required to assist the auditor in obtaining sufficient appropriate audit evidence and work as part of the auditing team or engaged as outside experts (Manetti and Becatti 2009 and Huggins et al. 2011). Ballou et al (2011) suggests in this respect that independent review assurance can foster strategic integration of sustainability initiatives by serving as "an organizational control mechanism for effective strategic decision making and resource allocation decisions creating long term value for shareholders and other stakeholders" (Ballou et al 2012 :3).

The auditing profession through (ISAE 3410) permits either of two levels of assurance to be provided. A "reasonable assurance" engagement requires that assurors collect sufficient appropriate evidence to reduce engagement risk to an acceptably low level, enabling them to state in the assurance report whether in their opinion the information is materially misstated. A "limited assurance" engagement provides a lower, but still meaningful, level of assurance and involves reducing engagement risk to a level that is acceptable within the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement. This permits assurance providers to state whether anything has come to their attention which indicates that the information is materially misstated. Recognition of these two levels of assurance has now become widespread in the assurance community and appears to becoming generally understood and accepted (Huggins et al 2011, Pflugrath et al 2011b, ISAE 3410: IAASB 2013)

Alternatively, many firms use third party sustainability consultants (such as environmental consultancies) to provide the assurance service (Simnett et al 2009). These individuals possess significant experience in the subject matter being assured and they commonly claim a competitive edge because of their skill sets and extensive knowledge of the subject matter (Corporate Register 2008 cited in Huggins et al 2011). According to ISAE 3410 in late 2009, specific engineering and chemical expertise needs to be appropriately applied for scope 1 emissions in the assurance process. In contrast, for scope 2 and scope 3 emissions, different areas of expertise may be required (IFAC 2010, cited in Huggins et al 2011). On the other hand, third party consultants do not depend on the auditing standards of professional conduct, procedures and reporting neither they are independent as required by the accounting profession (Huggins et al 2011 cited in Peters and Romi 2014).

Outside the auditing and assurance profession, at the international level, the International Organization for Standardization (2006b) has produced a standard, ISO 14064-3:2006, which specifies principles and requirements and provides guidance for those conducting or managing the verification of carbon assertions. It can be applied to organizational quantification, monitoring and reporting carried out in accordance with ISO 14064-1:2006. ISO 14064-3:2006 specifies requirements for selecting carbon emission verifiers, establishing the level of assurance, objectives, criteria and scope, determining the verification approach, assessing carbon emissions data, information, information systems and controls, evaluating carbon emissions assertions and preparing verification statements. This standard is complemented by ISO 14065:2007, which specifies principles and requirements for bodies that undertake verification of GHG assertions (Huggins et al 2011, Pflugrath et al 2011b)

Internal auditors represent an alternative source of assurance services because they are able to add reliability to reported information at a lower cost (Abbott et al 2011 and Peters and Romi 2014). They occasionally provide internal auditor's assurance letters accompanying public sustainability reports (Peters and Romi 2014). The choice among the three types of providers depends on the type of data being audited, the level of quality required, and the audit fees (Huggins et al 2011).

The third stream of studies had taken a user perspective and approached the demand for sustainability reporting assurance from their effect on investors and creditors. Ng and Rezaee (2014) studied the differential effect of business sustainability information on cost of debt versus equity. They found that debt and equity investors pay special attention to corporation's business sustainability that they demand lower debt and equity returns for corporations with strong sustainability disclosure. Dhaliwal et al (2011) provided evidence that corporate sustainability disclosure combined with superior corporate sustainability performance is associated with a reduction in the cost of equity capital.

Chow (1982) investigated the voluntary assurance of voluntarily produced sustainability report from the agency theory perspective. He argued that the agency costs are associated with the voluntary adoption of financial statement audits to reduce the information asymmetry between the company and the market. He also documented that surrogates for agency costs related to shareholders and creditors, such as leverage, the extent to which accounting numbers are used in debt covenants and company size are positively related with the voluntary adoption of financial statement audits. Accordingly, a growing number of archival studies that the market views the reporting of corporate social responsibility information in a sustainability report in a positive manner and negatively associated with cost of capital and analyst forecast errors (Green and Wako 2015).

Inconsistent with Simnett et al. 2009, Casey and Grenier 2015 argue that highly leveraged firms are less likely to obtain corporate sustainability reporting assurance. Nini et al. 2011 attributed this to strong bank monitoring in the USA that could reduce the demand for corporate reporting assurance to avoid violating debt covenants. Blackwell et al. (1998) approached the association between the need for assurance and lack of control from a different approach. He argues that the demand for assurance stems from the need to reduce information asymmetry with institutional creditors.

Consistent with Chow (1982), Carey et al (2000) found that the demand for assurance is also associated with higher levels of debt. Such an assurance enhances the firm credibility regarding the way it manages its social and environmental risks (Simnett et al 2009; Casey and Grenier 2015) and this in turn improves the firm reputation and makes it easier to acquire resources (Hall 1992, Suchman 1995, O'Dawyer et all 2011; cited in Casey and Grenier 2015) in addition to enhancing the credibility of external reporting (Simnet et al 2009 and Pflugrath et al 2011). A study made on private firms that could choose one of four levels of auditor association (low, medium, high levels and no assurance) found that audited firms paid significantly lower interest rates than non audited firms (Blackwell et al 1998) due to the ability of assurance to reduce information asymmetry between the company and its lenders and thereby enhances the credibility of information being assured (Green and Wako 2015).

Accordingly the study hypothesis could be formulated as follows:

H: For companies close to violating their debt covenants, the independent assurance of their sustainability reports reduces their cost of debt.

This hypothesis could further be divided into three sub hypotheses:

Ha: For companies close to violating their debt covenants, the independent assurance of their sustainability reports increases the magnitude of the loan granted to these companies.

Hb: For companies close to violating their debt covenants, the independent assurance of their sustainability reports reduces the interest rate charged on granted loans.
Hc: For companies close to violating their debt covenants, the independent assurance of their sustainability reports reduces the value of collaterals provided on granted loans

III. Research Methodology

Sample Selection

The sample consists of bank officers from bank credit departments who are responsible for studying companies' requests for credit services (Blackwell et al 1998).

Research Instrument

Participants were provided with a case study requiring them to estimate the value of the loan they would grant to the company being studied, the interest rate for a new loan required by the company compared to the interest rate announced by the Central Bank of Egypt, and the value of the collateral they would approve to grant the loan. The case contains data from the company's annual report (a condensed balance sheet and a condensed income statement), a sustainability report containing environmental, social data about the company including a Green House Gas Emissions Statement classified according to the three scopes of emissions (Scope 1 refers to direct emissions that "occur from sources that are owned or controlled by the company, for example, emissions from combustion in owned or controlled boilers, furnaces, vehicles, etc.; emissions from chemical production in owned or controlled process equipment". Scope 2 refers to indirect emissions from consumption of purchased electricity, heat or steam, and scope 3 refers to other indirect emissions generated in the wider economy as a consequence of a facility's activities but which are physically produced by others (Huggins et al 2011) and an assurance report on the company's sustainability report assured by a professional accounting firm (Green and Wako 2014).

The experiment held constant all the information except for all information related directly to the independent variable examined in the study which is the assurance of the sustainability report. The balance sheet was prepared at a high debt/asset ratio of 47% as an indicator that the company is highly leveraged and close to violating its debt covenants. General information about the company and the industry in which it operated are provided in the sustainability report, as well as the average and range of interest rates for the industry. The financial information was accompanied by an unqualified audit opinion (Coram et al 2009).

Independent variable:

The independent variable was the presence or absence of an assurance report on the firm's sustainability report (Coram et al 2009 and Simnett et al, 2009). The assurance report provided is related to a high level of assurance provided by the external auditor based on the guidance in the International Standard on Auditing (ISA) No. 100 Assurance Engagements (IFAC 2002) (Coram et al 2009 p.143) and in accordance with ISAE (3410) (نمير ٢٠١٣). This variable is manipulated by providing study participants with either "an assurance" or "no assurance" condition on the company's sustainability report. This assurance report was shown in the Appendix as part of the study questionnaire used to collect data.

Dependent Variables:

The dependent variable would be the effect of non assured (control group) or assured sustainability report on the users' lending decision regarding the value of the loan, the interest rate charged to the loan and the percentage of current assets acting as collaterals on this loan. This variable is measured by two ways; the first is providing participants with a list of five nonfinancial questions measuring the degree to which participants agree or disagree to the important role of the assurance of financial statements in general and sustainability reports in particular in affecting credit decisions and on increasing the value of loans granted by the bank, reducing interest rates charged on these loans and reducing the value of collaterals suggested by bank officers (Blackwell et al 1998). Participants were asked to answer these questions using a five point scale starting from totally agree to totally disagree. Second, the dependent variable was measured financially by asking participants to choose the desired answer from three multiple choice questions where the first is concerned with the choosing the value of the loan that the participant as a bank officer can approve to the client based on financial statement data. Three options were provided: (1) L.E. 4-6 million, (2) L.E.6-8 million and (3) L.E. 8 -10 million. The second is determining the interest rate they agree to be charged to the granted loan where three options are also provided (1) less than 9.75[2] percent (2) 9.75 percent and (3) more than 9.75 percent and the finally the third question is concerned with choosing the percentage of current assets that the participant thinks can act as a collateral to the granted loan. Four options were provided (1) 70 percent (2) 80 percent (3) 90 percent and (4) 120 percent.

Participants

Participants were bank officers; the professional experience of those officers who participated in the study was as follows: 21 percent has less than five years, 26 percent had five to ten years, and 53 percent had more than ten years. In relation to their main area of professional experience, over half worked in corporate banking and the others worked across the various areas of banking departments including relationship management and senior management positions indicating that members who participated in the study had the appropriate experience needed to complete the task[3]0.

Descriptive Statistics and results

For the nonfinancial questions, both the "no assurance" and "assurance" conditions totally agreed that the assurance of financial statements represents one of the most important factors affecting credit decisions. Results also showed a significant difference between expected and observed frequencies for the no assurance case (x^2 = 27.250[4], p=0.00). Similarly, participants in the two conditions agreed but to a lesser extent compared to the previous case on the important role of professional assurance of sustainability reports in influencing credit granting decisions Results also showed a significant difference between expected and observed frequencies for the no assurance condition (x^2 = 6.75, p=0.034). Participants in the assurance condition agreed to a great extent on the effect of assurance of sustainability reports in increasing the value of the loan granted to the company while the no assurance condition was neutral with respect to the effect of sustainability assurance in influencing the value of the loan. Distribution of participants' answers in each of the two

[2] Interest rate on the loan was chosen at 9.75% based on the Central Bank of Egypt rate on the date the study was carried.

[3] Kruskal Wallis test was used to examine the effect of Experience on participants' responses. Results showed that tears of experience did not significantly affect participants' choices between the given options. Therefore, these factors are not included In the analysis reported later (p-value >0.05 for all answers)

[4] The Chi square test is a nonparametric test used to determine whether there is a significant difference between the expected frequencies and observed frequencies in each category.

conditions did not show any significant differences than was estimated. On the other hand, the assurance condition disagreed to a certain extent on the importance of sustainability assurance in reducing interest rates charged to a loan granted by the bank while the no assurance case was neutral with respect to this factor. Finally, concerning the effect of sustainability assurance in reducing the percentage of assets acting as collaterals on the granted loan, participants in both conditions disagreed to a great extent on the influence of this factor. Results also showed a significant difference between expected and observed frequencies for the assurance condition (x^2 = 11.526, p=0.009).

With respect to the second part of the questionnaire concerned with financial questions measuring cost of the debt: the following three tables presents the results of proportionality test related to participants answers to the research questions:

Value of the loan	No Assurance condition	Assurance condition	z-statistic	p-value
L.E. 4-6 million	37%	5%	2.90	0.004
L.E. 6-8 million	50 %	16%	2.59	0.010
L.E.8-10 million	13%	79%	-5.76	0.000

Table 1

Concerning participants' responses to financial questions, descriptive statistics results showed most of sample participants in the "no assurance" condition (50%) selected the second option of granting a loan ranging from L.E. 6-8 million (Median =2) compared to a higher value of the loan L.E. 8-10 million in the assurance condition (Median =3) where Chi square statistical analysis shows that frequency distribution of participants' answers for the assurance condition showed a significant difference than estimated (X^2 = 18.105, p=0.000). A test of proportionality was used to compare the percentage of those participants from each condition who selected each option shows that for the first option with lowest loan value (L.E. 4-6 million), the percentage of participants in the no assurance condition who selected this option was significantly higher compared to their counterparts in the assurance condition (z=2.90 and p= 0.04 <0.05) (table 1). The same applies to the second option (L.E. 6-8 million) where a significantly higher percentage from the no assurance condition had selected this value compared to the assurance condition (z= 2.59 and p=0.01 <0.05). Finally, for the third option with the highest loan value (L.E. 8-10 million), the percentage of those participants who selected this option was significantly higher for the assurance condition compared to the no assurance condition (z=-5.76 and p=0.000 < 0.05), there by completely supporting Ha.

Percentage of interest rate charged to the loan	No Assurance condition	Assurance condition	z-statistic	p-value
Less than 9.75%	4%	26%	-2.03	0.042
9.75%	17 %	26%	-0.76	0.445
More than 9.75%	79%	47%	2.25	0.025

Table 2

With respect to the second question concerned with the percentage of interest rate charged on the granted loan, analysis of sample results showed that all participants in both conditions tended to select the highest interest rate option which is greater than 9.75% where there is a significant difference in the frequency distribution of participants' answers than estimated (X^2 = 23.250, p=0.000) in the no assurance condition compared to the assurance condition. Results of proportionality test showed that for the first option with lowest interest rate (less than 9.75%), the percentage of participants in the assurance condition who selected this option was significantly higher compared to their counterparts in the no assurance condition (z = -2.03 and p =0.042 <0.05) (table 2). Concerning the second option (interest rate = 9.75%), participants responses with respect to this option did not differ significantly in both conditions (z =2.25, p=0.445>0.05). Finally, for the third option with the highest interest rate (more than 9.75%), the percentage of those participants who selected this option was significantly higher for the no assurance condition compared to the assurance condition (z=2.25 and p=0.025 < 0.05), there by completely supporting Hb.

Percentage of current assets acting as a collateral to the loan	No Assurance condition	Assurance condition	z-statistic	p-value
70%	8%	21%	-1.16	0.244
80%	25 %	37%	-0.84	0.403
90%	29%	37%	-0.53	0.595
120%	38%	5%	2.90	0.004

Table 3

Finally, with respect to the percentage of current assets acting as collaterals on the loan, the highest percentage of participants in the no assurance condition had selected to set the collateral at 90% of current assets. On the other hand, participants' responses in the assurance condition were more highly concentrated between the second and third options of 80% and 90% of current assets.

Results of proportionality test showed that for the first three options (70%, 80% and 90% of current assets), participants responses did not differ significantly in both conditions (p >0.05) (table 3). With respect to the last option where the percentage of current assets acting as collateral represent 120%, the percentage of participants in the no assurance condition who selected this option was significantly higher compared to the corresponding percentage selected by those participants in the assurance condition (z=2.90 and p=0.004 < 0.05), which could thereby give high support to Hc.

Conclusion and Implications for Future Research

Results showed that there was a high level of acceptance by all samples' participants to the effect of assurance of financial statements in general and the assurance of sustainability reports in particular regarding their effect on granting credit decisions. Combining the two sets of questions (nonfinancial and financial) together can further explains participants' reactions in both cases. For the first option results showed that participants in the assurance condition had agreed to the effect of sustainability assurance on increasing the magnitude of loans compared to the neutral position of their counterparts in the no assurance condition. This result was supported by the higher value of the loan selected by the assurance condition compared to the no assurance group. With respect of the interest rate charged to the loan, although participants' responses in both conditions showed that they refused the effect of sustainability assurance in reducing interest rates on bank loans in general but when they were provided with three interest rates options, the percentage of those participants in the assurance condition who selected the highest interest rates was significantly lower compared to the corresponding percentage of participants in the no assurance condition showing that when participants were provided with numbers and were asked to give a decision, the presence of an assurance statement prepared by a professional audit firm can greatly influence their choice and induce them to lower the interest rate they would charge to the loan. Similarly, participants' answers when they were directly asked about the effect of the loan on reducing collaterals showed that both groups didn't recognize the effect of assurance on enhancing this value. However, when they were provided with numerical options, a significantly lower percentage of group participants in the assurance condition had selected the highest collateral percentage compared to their corresponding counterparts in the no assurance condition. Accordingly, the study hypotheses could be greatly accepted and thus the study can provide evidence that the assurance of sustainability report can have a positive impact to companies issuing these reports through reducing their cost of debts.

Further studies could be performed to examine the effect of type of assurance (limited versus reasonable assurance) on bank officers' decisions and the effect of changing preparers views on users' decisions. Further studies could also be performed to measure the tradeoff between additional costs charged by the company due to additional sustainability disclosures and associated assurance versus cost savings arising from reduction in cost of debts.

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Appendix
Research Questionnaire

بسم الله الرحمن الرحيم

Dear Sir

You are invited to participate in a research study concerned with the Effect of Assurance on Sustainable Development Report on Credit Granting Decisions.

In this study, you will be asked to read the attached case study and complete the attached questions. There are no risks associated with participating in this study. The survey collects no identifying information of any respondent. All of the response in the survey will be recorded anonymously.

Kindly reply to the questions accurately as information collected from the study might have a greatly benefit the profession and the research in the mentioned field of study.

Regards
Researcher
Dr. Maha Ramadan
Lecturer of accounting and auditing
Faculty of Commerce, Alexandria University

SUSTAINABILITY REPORT FOR ELALAMAL CO. FOR PETROCHEMICAL INDUSTRIES
FOR THE YEAR ENDED DECEMBER 2014

ELAMAL is a leading joint venture set up for the purposes of manufacturing fertilizers and petrochemicals. In developing our sustainability strategy, we ensure a close knit integration between the stakeholders' interest, important environmental concerns and our core business. Our business model is based on principles of sustainable development as we appreciate that all our operations and activities impact, either directly or indirectly, the welfare of all our stakeholders, as well as the environment.

Vision: Our vision sees our economic prosperity built on a firm foundation and economic growth must never come at the expense of the environment and the long term wellbeing of our people. The three interrelated principles that guide our ambitions are sustainability, competitiveness and fairness to ensure that every person has the means to live a secure and fulfilling live and reach his full potential.

ELAMAL's sustainability strategy is centered on pillars of sustainable development: people, planet and profit. We measure our success on social responsibility, care for the environment and profitability.

Economic Performance As a prime producer of ammonia, methanol and granular urea, Egypt petrochemicals business growth and financial performance are essential to its continued sustainability, and creating long term value for our shareholders. The financial and operational results for the years depict that the Company operates in a continually evolving market with ample opportunities for future growth.

We are aware that our operations have major direct and indirect impacts, and are taking steps to increase the positive impacts whilst reducing any negative impacts. Our direct impacts include shareholder returns in the shape of dividend or payment to investors in shape of return on loans, payment of taxes to the Government, payment of salaries and benefits to employees, payment to

suppliers etc. while our indirect impact includes the economic betterment of local communities through improvements in business environment and investments.
Our profits amounted to 87 million Egyptian pounds in 2014. The future of our industry looks positive and we are well positioned for continued earnings growth in 2014 and beyond. For a full account of EPIC financial performance, please see the 2014 ELAMAL's Annual Reports.
Our financial statements not only provide a look at the current state of the Company, but also at future growth potential. They also provide information on the economic impact for our stakeholders.
Environment ELAMAL has committed itself to some of the most stringent standards of environmental management because it believes that the way any organization manages environmental issues is a crucial measure of its standards of corporate social responsibility, competitiveness and vision.
ELAMAL has consistently demonstrated that a rapidly growing company in a highly competitive emerging market can, not only meet its environmental responsibilities, but also dramatically reduce its carbon footprint whilst simultaneously improving profitability.

Safeguarding the Environment
Compliance to the Environmental legislations, reducing energy consumption and emissions, resource conservation, energy efficiency, hazardous waste management and pollution prevention are some of our main priorities towards the environmental challenges we face at ELAMAL.
GHG emissions
Manufacturing of fertilizers is a relatively clean but highly energy intensive process. In a global context, the greatest environmental impact is from Green House Gases GHGs emitted during the production of ammonia and methanol along with the emissions from fossil fuel fired boilers and gas turbines.
We have reduced our GHG emissions significantly by capturing and recycling CO_2 through our urea plant (commissioned 1998) and the carbon dioxide recovery unit (commissioned 2009)
Strict Compliance to Legislative and regulatory requirements
We ensure regulatory compliance to applicable environmental laws and legislations. This important aspect is embedded in our policies.
Regular Audits
In addition to internal audits our facilities are frequently audited by professional third party organizations to ensure that we are holding ourselves to the standards we have committed ourselves to.
Environmental awareness
We are also actively engaged in inculcating a culture of environmental responsibility amongst our people and the community. We train our employees and provide them with skills, competencies and empowerment to continuously improve in their professional and personal lives.
Climate Change Commitments
In an era of global climate change, EPC greenhouse gas emissions, as well as its carbon footprint, are one of the biggest challenges we face when trying to invest in environmental sustainability. ELAMAL has been able to implement some projects such as the urea plant and the carbon dioxide recovery plant that have reduced the company's carbon footprint and greenhouse gas emissions, thereby helping to reduce our impact towards climate change.
People and Society We aim to maintain good labor management relations through implementation of good labor practices. ELAMAL values human resources as an important capital and believes in treating employees fairly, promoting diversity and inclusion, providing open feedback and ensuring compliance with laws, regulations and Company's own code of conduct. We also endeavor to educate employees and ensure their health and safety. At ELAMAL we have well-defined HR

policies to manage HR priorities that are based on Egypt's Labor Law. Succession planning, development of local talent, recognizing and rewarding the prestigious talent and leadership development are part of our HR development vision.

Our Human Resources Strategy: The training and development of our employees is a main priority for our management. The periodic organizational review is a process carried out by our senior management, to assess our strengths and weaknesses in people's competencies and capabilities across the business. Our leadership's capabilities and succession plans are also reviewed periodically. Our investments in training and development continue to grow.

The following are condensed balance sheets and income statement for El Amal Co. for the year ended December 31, 2014

Balance Sheet
December 31, 2014

Total long term assets (1)	129,966,967
Total current assets	282,178,382
Total current liabilities	128,843,909
Working capital(2)	153,334,473
Total investments and financed as follows (1) +(2)	283,301,440
Total stockholders' equity	218,437,035
Non- Current Liabilities	64,864,405

Income Statement
For the period January/February 2014

Net Sales	308, 108,500
Cost of Sales	138,880,300
Gross Profit	169,228, 200
Sales and Administrative Expenses	60,311,000
Operating Income	108,917,200
Deduct: Interest expenses	1,100,000
Add: Other Revenues	6,342,700
Net Income	114,159,900
Deduct: Income Taxes	27,194,400
Net income after taxes	86,965,500

The company has obtained an unqualified report from the firm's auditor who provided an opinion that the financial statements fairly and obviously represent in all material aspects the company's financial position on December 31, 2014, results of operations and cash flows for the year ended December 31,2014 according to Egyptian standards of Accounting and related laws and procedures

ElAmal Co.
GHG Emissions Statement for the Year Ended December 31, 2014

Emissions according to their scope	Carbon Dioxide Emissions	Nitrous Oxide Emissions	Methane Gas Emissions	Total Emissions
Scope 1 Emissions				
Steam Generators	86000	800	3200	90000
Fire Pumps	78000	500	1500	80000
Well Drilling	9500	100	400	10000
Burners	44000	200	800	45000
Heaters	54200	50	250	54500
Diesel Pump Engines	36000	1000	3000	40000
Steam Combustion Units	14200	200	600	15000
Thermal Conduction Units	14500	150	350	15000
Electric Turbine Generators	88700	100	300	89100

Press Engines	**49000**	**200**	**800**	**50000**
Excavation Equipment	**98300**	**1000**	**700**	**100000**
Sulfer recovery units	**47000**			**47000**
Hydrogen plants	**8000**			**8000**
Chemical Injection pumps	**62000**		**3000**	**65000**
Equipment and pipe line leakage	**87000**		**3000**	**90000**
Leakage from the fuel gas system			**10000**	**10000**
Production storage and crude oil tanks	**87000**		**3000**	**90000**
Thermal cracking process	**80000**			**80000**
Total scope 1 Emissions	**943400**	**4300**	**30900**	**978600**
Scope 2 Emissions				
Transformed Electricity	**180000**	**3000**	**2000**	**18500**
Transformed Steam	**5000**	**300**	**200**	**550Press Engines0**
Heat Transformed	**26000**	**1000**	**3000**	**30000**
Total scope 2 emissions	**211000**	**4300**	**5200**	**220500**
Scope 3 Emissions				
Company employees' travel using public transportation	**13400**	**100**	**500**	**14000**
Helicopters	**17000**	**1000**	**2000**	**20000**
Oil tanks and marine tankers	**27000**	**800**	**2200**	**30000**
Buildings	**11600**	**100**	**300**	**12000**
Boilers	**17000**	**1000**	**2000**	**20000**
Marine carriers	**37500**	**100**	**400**	**38000**
Transportation of company products and raw materials	**6600**	**100**	**300**	**7000**
Usage of Company products	**60000**	**1000**	**4000**	**65000**
Total scope 3 emissions	**190100**	**4200**	**11700**	**206000**
Total scopes emissions	**1344500**	**12800**	**47800**	**14051000**

Audit Assurance Report

On Green House Gas Emissions Statement as attached

TO: Management of El Amal Company
Egyptian Financial Supervisory Authority
Company Stakeholders
Environmental Impact Assessment

Introductory Paragraph

We have been engaged to provide reasonable assurance towards the three scopes of emissions mentioned in the attached Green House Gas Emissions' Statement of the ELAmal Petroleum Company for the year ended December 31, 2014. This statement has been prepared in accordance to Corporate Accounting and Reporting protocol for GHG at issued by the World Business Council on Sustainable Development and World Resources Institute on 2004, and the Compendium of Greenhouse Gas Emissions Estimation Methodologies for the Oil and Natural Gas Industry issued by the American Petroleum Institute (API) on 2009. The engagement has been performed using a multidisciplinary Assurance team composed of auditors, engineers, and environment specialists.

Management Responsibility towards Green House Gas Emissions Statement

Management of ElAmal Co. is responsible for the preparation and presentation of the Statement in accordance with applied measurement standards and guidelines, including the design, implementation, and maintenance of internal control structure over the preparation of a GHG Emissions Statement free of material misstatements whether due to error or fraud.

Independence and Quality Control Paragraph

To perform this assurance engagement, we complied with the ethical requirements relevant to accounting and auditing profession issued by Egyptian Financial Supervisory Authority comprising independence and other requirements inherent in the basic principles of professional ethical requirements which comprise honesty and integrity, objectivity, professional efficiency and exercising due professional care, confidentiality, and professional conduct. According to the Egyptian Standard of Quality Control on CPAs registered in Egyptian Financial Supervisory Authority, ElShoruq office maintains a comprehensive system of Quality Control that includes documented policies and procedures concerning compliance with ethical requirements, standards of professional conduct, and the related legal requirements.

Auditor's Responsibility

Our responsibility is to express a conclusion on the GHG Report based on the evidence obtained. We conducted our engagement to provide reasonable assurance in accordance to Egyptian Assurance Standard 3000 concerning Assurance Engagements other than Audits or Reviews of Historical Financial Information, and International Standard on Assurance Engagements 3410 concerning Assurance Engagements on Green House Gas Statements issued by International Auditing and Assurance Standard Board and related technical standards issued by international non-accounting bodies. These standards require us to plan and implement the engagement to obtain reasonable assurance on whether GHG Emissions Statement free of material misstatements.

Obtaining a reasonable assurance engagement in accordance to these standards implies performing the assurance procedures for gathering evidence on the quantitative measurement of GHG emissions and related information. The timing, nature and extent of selected procedures depends on our professional judgment, this includes assessment of the risk of material misstatements in GHG emission statement whether due to error or fraud. When assessing those risks, internal controls over the preparation of GHG report by company management are considered. Obtaining a reasonable assurance also includes:

- Evaluating the acceptability of measurement standards in accordance to current conditions for El Amal Co. as a base for the preparation of GHG statement.
- Evaluating the acceptability of the measurement and quantification methods, accounting policies followed in the preparation of the GHG emissions Statement, and the reasonableness of estimates prepared by management.
- Evaluating the overall presentation of GHG emissions Statement.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusion.

Limitations to using this report

This report was especially prepared to targeted users with the objective of helping them to determine whether the company had complied with applicable measurement standards. Accordingly, we are not responsible on the consequences of depending on this report, or any of the three scopes emissions related to it by other than the targeted users or for any purposes other than the purpose for which the report has been especially prepared for.

Inherent Limitations paragraph

Due to the inherent limitations of any internal control structure, it is possible that some misstatements may not be prevented or detected in the information relevant to the three scopes of emissions. Accordingly, this engagement does not aim to detect all the weak points in the internal control structure over the process of preparation and presentation of information. Also the engagement had not been performed on a continuous basis all over the period. In addition, the procedures were performed on a test basis. Finally, the quantitative measurement of greenhouse gas emissions was subject to scientific uncertainty and the uncertainty of estimates.

Opinion Paragraph

In our opinion the GHG emissions statement for the year ended December 31, 2014 has been prepared in all material aspects in accordance to applicable relevant standards

ElShorouq Office
Mohamed Mohamed Omar
Audit Partner
31/3/2015

After reading the previous case, State the degree to which you agree on each of the following statements, through using (√) in front of the answer that represents the best choice from your point of view:

Statement	Totally agree	Agree to a great extent	Neutral	Disagree to a certain extent	Totally disagree
Auditing of financial statements represents one of the most important factors affecting credit decisions					
Professional assurance on sustainability reports represents one of the most important considerations affecting credit granting decisions					
Assurance of sustainability reports by auditors results in increasing the magnitude of the loan granted to the company					
Assurance of sustainability reports by auditors results in reducing interest rate charged to the loan granted to the company					
Assurance of sustainability reports by auditors results in decreasing the value of collaterals on the loan granted to the company					

(2) Based on your analysis of the previous case and if you knew that the current interest rates on loans according to The Central Bank of Egypt is 9.75% and the company had applied for a one year loan; Please answer the following questions:

A. The value of the loan would range from:

1 .L.E. 4million – L.E. 6 million (…….)
2 .L.E. 6 million – L.E. 8 million (…….)
3. L.E. 8 million – L.E. 10 million (…….)
4. Other value ……………………

B. What is the interest rate you suggest to be charged to the granted loan compared to the interest rate charged to similar types of loans?

1. Less than 9.75% (…..)
2. 9.75% (…..)
3. More than 9.75% (…..)

C. What is the percentage of current assets that you think can represent collateral to the granted loan?

1. 70% (……)
2. 80% (……)
3. 90% (……)
4. 120% (……)

3. Personal Data

A. Academic grades achieved:

1. BSc. in Commerce……………………………...
2. Post Graduate Diploma………………………
3. Master Degree in………………………………..
4. Ph. D. in…………………………………………….
5. Any other certificates…………………

B. Current Position at the bank…………………………………

C. Number of years of Experience…………………………..

1. Less than 5 years (…..)
2. From 5 to 10 years (…..)
3. More than 10 years (…..)

Thank You