

APPENDIX GA36d

LEVEL 7 ASSESSMENT SPECIFICATION

Student name:	Maximilian Wohlrab	Student ID number:	2327285
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Research Portfolio as homework for the class:

Advancing to Doctoral Research Stage

Maximilian Wohlrab, CIA, ACCA

Max_Wohlrab@gmx.de

+41/78/3204082

Title of the underlying research proposal:

Corporate Governance, Corporate Social Responsibility and Sustainability Risk Disclosures as Framework for the Assessment of Performance, Risk, and Fraud Detection - A Quantitative Analysis Based on Selected Key Principles Supported by Qualitative Market Characteristics

1. Summary of my research proposal

My research proposal prepared for the class “Converting Research into Practice” focuses on the change in the European Corporate Social Responsibility (CSR) regulations, specifically the implementation of the Corporate Sustainability Reporting Directive (CSRD) by the European Union. This directive got effective on January 5, 2023. It requires companies to disclose their social and environmental impact and the related risks on themselves as well as society, enhancing the CSR reporting standard for companies affiliated with the European Union.

The key objective of the proposed research is to assess the impact of the new CSR disclosures on various aspects of companies concerned by the new directive, such as corporate governance, market performance, profitability, risk management, and financing costs. The research will combine a qualitative approach (through interviews with senior employees of concerned companies) with a quantitative method (by reviewing the financial statements of concerned companies) to assess how the performance of these companies has developed considering the impact of the sustainability risks disclosed in their financial statements. Additionally, the relation between a company’s sustainability behaviour and its ethical conduct will also be explored. This could enrich previous studies which examined connections between CSR, ethical management, and financial stability.

It is planned to leverage existing models from previous studies, for example, those developed after the implementation of the Sarbanes-Oxley (SOX) Act to assess the data newly available due to CSRD. As a side topic, the research should also challenge the current understanding of Environmental, Social und Governance (ESG) and CSR metrics, such as ESG scores and CSR disclosures, and evaluate and challenge these measures in a more critical and detailed way.

There is a longstanding historical background of CSR literature. It developed over time from a pure profit maximisation focus of the companies to the focus on stakeholder interests nowadays (Carroll, 1999). The pressure on companies to consider all their stakeholders including society and environmental questions has become significant during the last decades. The new CSRD imposed by the European Regulation Directive (EU) 2022/2464 (effective since 5 Jan 2023) (Keegan, 2023) will provide a new research opportunity to contribute to the existing research, because of the high volume of new data available in the market.

The nature of regulatory change requires the disclosure of environmental and social risks in a specific paragraph and format in the financial statements (Keegan, 2023). This is a similar change as required by the SOX Act in 2002. SOX made it mandatory to disclose key internal control weaknesses (Beneish et. al., 2007 & Zhang, Y et al., 2007) in the financial statements,

which led to a significant high volume of new data available and, therefore, an increase in research based on this data. A similar development regarding the increase in research could be expected for CSRD.

As a mixed research method is proposed, quantitative data on sustainability risks disclosed will be collected by analysing the disclosures in the firm's annual reports (Wohlrab, 2024). On the other hand, the qualitative details and correctness of the CSR risk disclosures will be analysed and the degree of quality of the disclosures will be assessed by interviewing middle and senior managers of the companies, who are required to disclose this information. The mixed approach also provides the opportunity to investigate potential discrepancies between the written disclosures and other risks which might be disclosed through interviews process and, therefore, control for the accuracy and completeness of the disclosures.

As stated in my homework for the "Converting Research into Practice" class, Wohlrab, M. (2024). p. 4 "The main research objective is to identify the correlation between CSRD risk disclosures and their impact on classical key performance indicators (KPIs), such as:

- "(1) The corporate governance structures of these companies,
- (2) Their impact on the market performance (share price),
- (3) Profitability,
- (4) Risk management, and
- (5) Financing costs"

This leads to the following research questions as stated in the presentation for the class

"Advancing to Doctoral Research Stage" Wohlrab, M. (2024). p.7:

- "Are sustainable companies performing better than their competitors?
- Do these mandatory risk disclosures have an impact the earnings (e.g. revenue growth) or a negative impact on the costs (e.g. financing costs)
- How reliable and detailed are the information provided within the financial statements (e.g. use of standard wording)
- Is a sustainable company also an ethical company? (E.g. business practises or fraud detection)"

Overall, this research could offer valuable insights into the effectiveness and impact of CSR practices in the current economic climate, which is especially relevant given the economic slowdown in Europe. The findings could potentially affirm the benefits of sustainable and

ethical business practices, encouraging more robust CSR engagement among European and international companies.

2. Critical evaluation of the research proposal (strengths & limitations)

After a critical evaluation of the original research proposal for the class “Converting Research into Practice”, the following strengths and opportunities, as well as several weaknesses and limitations have been identified.

Strengths

The research proposal suggested shows the following strengths. There will be a large amount of new quantitative data in the market and these quantitative data will be publicly available in the financial statements. This provides new opportunities to further develop existing theories with new data sets and new theories based on new information, which has not been available before.

Further, this newly added information in the financial statement must be audited by the external audit firms. This should provide a certain level of quality because the external audit firms must critically challenge the disclosures in systematic way. In addition, usually the external audit firms (especially the “Big Four”) audit firms audit several companies of the same industry. Therefore, they would detect industry specific risk omissions of companies operating in the same industry. This should ensure a certain level of quality for the published data.

The mixed method chosen and the additional qualitative data available by following that approach can further contribute to a better understanding of the qualitative landscape. Especially, considering that the data are new in the market and analysed the first time by all researchers, it could contribute to broad assessment of the status quo and identify areas for improvement.

Opportunities

In addition, the approach would also have the following long-term opportunities for a continues research. Since there will be new data available every year, a trend analysis can be conducted.

The regulatory change will be implemented in different waves and detailed as below (Watershed, 2024).

Reports in 2025 based on 2024 financial information will include CSR disclosures for companies that are already concerned by the Financial Reporting Directive (NFRD) and includes listed large firms with more than 500 employees, public interest entities (PIEs), banks,

and insurance firms. These companies will then have to apply the full European Sustainability Reporting Standards (ESRS).

Further, Reports in 2026 based on 2025 financial information will have to include CSR disclosures also for companies that are Non-Small Medium Size Enterprises (SMEs) and micro-listed companies as well as large private companies showing two or more of the following criteria:

- 250 or more employees
- 50 million EUR or more revenue (net turnover)
- 25 million EUR or more as balance sheet assets

These companies will then have to apply the full ESRS.

Reports in 2027 based on 2026 financial information will have to include corporate social responsibility disclosures also for companies that are listed SMEs. These companies will then have to apply the Simplified ESRS.

Reports in 2029 based on 2028 financial information will have to include CSR disclosures also for companies that are Non-EU companies with the following criteria:

- 150 million EUR (or equivalent) revenue (net turnover) (in each of the last 2 years),
- and either a large or listed subsidiary, meaning two or more criteria out of:
 - 250 or more employees;
 - 50 million EUR or more revenue (net turnover);
 - 25 million EUR or more assets
- or a significant EU branch generating €50m in revenue (net turnover)

These companies will then have to apply the Simplified ESRS.

This successive implementation provides several opportunities for analysis. Trends in the quality of the disclosures can be identified and controlled over the upcoming years. As part of the trend analysis, the data quality can be checked by comparing recent disclosures to the years before. Data published in the first year might not be in a very high quality yet due to a lack of understanding and routine by the preparing companies. Therefore, it could be assumed that the quality may be improved over time when the concerned companies develop a certain expertise for the matter. Using this time component in the research might bring additional challenges from an operational angle, because it will be time consuming to collect the data every year. Hence, not all data would be available at the same time and some data will be just available at

the very end of the research project. However, the benefit of developing consistency and analysing quality improvement may outweigh these challenges.

Weaknesses

Qualitative data might be difficult to obtain, because middle and senior managers might not be willing to be interviewed regarding hot topics such as corporate and social risks of the firms they are working for. Moreover, it might even be prohibited for some managers to talk about such topics by company policy depending on the confidentiality classifications within the firms.

Another problem, which could make the research difficult is that the implement of this new regulations might go at a very slow pace and some delays might occur in the process. In some cases, the deadline for the implementation will be postponed, because it can be seen by the authorities that the market practitioners cannot implement the guidelines according to the expected timeframe.

Further, since it is a completely new disclosure requirements, the data quality might be rather low in the beginning and the firms might require time to adapt the proper way of disclosing. The reason behind this assumption is that firms will also have to build up expertise regarding this new regulation.

The biggest challenge in the suggested research will be that the data basis will be completely new, and no previous research has been conducted on these data sets. Therefore, it might be challenging to work with the newly available quantitative data, because it is a completely new set of information, which has not been in the market before. Furthermore, the models used during SOX implementation might be not a good fit for the analysis of sustainability risk and thus completely new models must be developed. This might be time intense and not easy within the timeframe given for the DBA program.

Limitations

The data for the qualitative analysis might be confidential and might not be obtained. This can lead to a situation where neither qualitative data through the interviews nor off-record information is available for the analysis. This then only provides a weak basis for further analysis without having collected enough data in the first place by conducting meaningful number of sample interviews. Moreover, if the number of interviews is too little, the information obtained in the process might not be objective and lack any valuable insights, because the less interviews conducted, the higher the risk that the counterparties interviewed are representing outliers in the market.

Moreover, some firms may also refuse to disclose the correct information and breach of regulation, which might lead to a strong bias in the data. The reasons why the firms refuse to provide accurate information are that the firms do not have the right expertise and they do it by mistake due to incompetency or the management of the firm perpetrates fraud and does not disclose this information on purpose, because they are afraid of negative consequences on the performance and their compensation.

The identified weaknesses and limitations will be addressed in the next paragraph and some mitigating steps will be discussed in order to improve the execution of the planned research.

3. Alternative approach in the research design and potential shortcomings

In this session, several improvements of the approach developed in the original research proposal will be discussed.

The potential unwillingness of middle and senior management to be interviewed could require a change in addresses of the qualitative interviews. After longer reconsideration, I would suggest replacing the interviews with people of the concerned firms by surveys and selective interviews among external auditors instead of going to the responsible managers in the firms directly. This has the advantage that external auditors see different companies as part of their yearly audit portfolio and can speak more generally about trends within whole industries and not only about specific companies. This can be deemed more discreet and may lead to better insights and a greater willingness to participate in the survey or interviews, because it is more difficult to trace which company in the portfolio an external auditor might talk about when being interviewed, compared to the very clear connection of senior executives of companies and their statements in the interviews. Further, my background of having been an external auditor at a “Big Four” audit firm at the beginning of my career provides me with a network in this field. It will be easier for me to reach out to old colleagues, who I personally know well, compared to other senior managers who I do not have connections with.

The problem that the new regulation might be introduced slowly, and potential delays may occur can be tackled by focusing on specific countries or industries which are known for their fast implementation of European regulations. For example, the small country of Luxembourg in Central Europe, which is very well known for implementing European legislation and regulation in a very fast speed in general and especially for the financial service sector. Focusing the analysis on the financial service sector in Luxembourg would have a few additional benefits. Luxembourg is the biggest hub for domiciling investment funds in Europe and second biggest

in the world (The Financial Centre Development Agency of Luxembourg, 2024). Therefore, Luxembourgish funds are invested in a broad range of industries and used as investment vehicles globally to structure investment tax efficiently with a European distribution license. However, this also means that listed Luxembourgish private equity funds under the CSRD will have to disclose the CSR risks for the investment in their portfolios. Thus, these funds could provide a good source of information, because they are invested in a broad range of European companies. Further, since I have worked and lived in Luxembourg, I could utilize my network there and leverage my good understanding of the market, which can positively contribute to efficient execution of my research.

The potentially lower data quality after the new disclosures are introduced for the first time can be addressed by controlling it over a longer period with a consistency analysis over several years. For example, the first-year disclosures can be assessed against the data published in the two years afterwards to show if significant corrections had to be made or if disclosures should have already been made the year before. For example, a risk disclosure which has been added in year 2 of the disclosure requirement, could have already existed in year 1 due to its systemic risk nature. Thus, a consistency check can be performed over time. Also, a consistency check within industries should be performed. Companies operating in the same industry might face at least similar external risks or will have a similar positive or negative impact on society depending on the supply chain, production facilities and distribution networks they use. For example, a steel producing company will have similar environmental risk disclosures as another steel manufacturing company due to the nature of the production process and regardless of other company specifics. However, if these companies disclose very different risks in their financial statements, it would be an indication to further investigate the underlying data quality before continuing with the research.

The fact that this research is based on completely new data in the market, which has not been analyzed before, is one of the biggest challenges. Therefore, a very structured approach to analyze the data must be followed to ensure the thesis can be finalized within the timeframe provided by the University of Wales Trinity Saint David for the DBA program. As a starting point, a small number of analytical models used for research conducted after the implementation of the SOX Act in 2002 will be analyzed and verified if these models can be used as the basis for this research as well. Key areas with strong areas of similarity should be identified and used to pick specific concepts and models that can be reused with reasonable adaptations in a timely manner. Especially, the statistical impact calculation of risks on the performance of a company could show similar attributes for both cases. This upstream analysis of the models before the

actual research will start can smooth the time pressure in the end by ensuring only feasible parts of the analytical models are considered.

The problem that people are unwilling to be interviewed is always a risk and cannot be fully mitigated. However, there are certain mitigating steps which can be taken to increase the probability of successful interviews. This starts with a detailed planning by reaching out to the personal network first and obtain further support within the network to reach out extensively for more interviewees and increase their willingness to participate. This can already be completed early during a pilot study to ensure there will be enough time at the end of the project without having any time constraints.

Finally, the situation that a company might publish fraudulent data which could lead to bias is difficult to mitigate. However, a strong focus on consistency analysis over time and industries can provide good indication for illogical outliers. Further, not only the sample sizes for the qualitative interviews must have a presentable population, but also the data set for the quantitative analysis. This will reduce the impact of outliers and could contribute to a diversified view of the overall market. These two considerations in combination with the advantages of having a mixed approach helps to reach a reasonable level of assurance that the data basis is robust and outliers are not causing significant statistical bias in the analysis.

Changing the methodology proposed in my original research proposal to the one explained above and adding the control attributes for consistency should improve the robustness of my original plan.

4. Expected findings and overall impact

Expected findings

It could be expected that being sustainable will lead to higher profits, which would provide companies with an intrinsic motivation to act sustainable. Especially, in the current challenging global environment, it would be a significant contribution to business and society to enhance the understanding that sustainability and CSR efforts positively contributes to a company's overall success. This may be shown in the numbers as follows. A company with low CSR risks disclosed in their financials should also demonstrate lower financing costs, which then have a positive influence on the company's profit. Consequently, a higher profit should result in higher share price and therefore higher market capitalisation. This leads to a better overall performance and might also increase stability by reducing volatile due to less risk in the business model.

Further, it could be expected that a sustainable company is a more ethical company. There is a lot of research assessing this correlation. However, with this additional information in the market and the view on the relation between the two factors should be further developed.

The analysis for the relations explained above is of high importance to better explain the impact of the CSR and ESG efforts on the evolvement of enterprises. It could be assumed that a companies with a high awareness for CSR and ESG have a higher ethical foundation and a moral compass embedded in their firms culture, because the values the companies display regarding CSR could be also an indicator for the general behaviour and attitude of the people managing and working for the company. Therefore, a company who does not consider CSR as an important factor to the same extent for their decision making, would have a lower ethical standard. Consequently, this could also mean that CSR-focused firms with strong culture have an edge in the prevention and detection of fraud. That means an increased focus on a strong CSR culture within a single company and within the whole market could assist in preventing fraudulent activities from occurring. This then strengthens the stability of a market.

Particularly, considering the fact that fraud cases do not only eliminate large portion of shareholders' value at the stock market when they appear in listed companies, but also decimate the confidence in the market as well as the big audit and accounting firms which provide the market participants with a certain level of assurance for the company's financial statements. A negative recent example has been the Wirecard scanda. The German DAX 30 listed company Wirecard collapsed due to a long term and sophisticated financial statement fraud, which had been undetected by the external auditors for several years. As a result, many retail investors lost all their money invested (Wischmeyer, 2023). The auditor Ernst&Young (EY), who was appointed audit of their annual report, had been criticized for not detecting the fraud case in a timely manner (Rasch, 2023). Serious fraud cases like abovementioned one weakens the stability of the market and question quality the work of an external auditor. Therefore, a stronger market with high CSR standards could be an indicator for a good business environment and support the overall health of the business environment.

Overall impact

Research in this area will have a significant impact because every international company with a European subsidiary will be concerned by this new legislation. It could be expected that a general increase in research activities in this field will be observed as soon as the new data are available in the market, like the situation observed after the implementation of SOX Act in 2002. Therefore, being in the forefront of people analysing the data and developing an analytical

approach to better understand the impact of CSR could have a significant impact on the overall view on CSR and path the way for further research in this area. Further, these additional studies can contribute to a wide range of already existing research on sustainability and corporate social responsibility and might be able to close several gaps within the literature which could not be analysed so far due to the lack of available data. The topic Corporate Social Responsibility is more important than ever in considerations for companies' identities and will further develop in the future.

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