
Assurance and third-party comment in sustainability reporting in Japan: a descriptive study

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Abstract: This paper provides an overview of assurance and third-party comment in sustainability reporting (SR) of Japanese companies. The paper discusses issues concerning these third-party services such as reporting frequency, frequency of assurance and third-party comment in SR; changing patterns in these practices; characteristics of companies that adopt assurance and third-party comment; and types of assessor and commentator. While most leading Japanese companies have adopted SR, the number of those adopting assurance in SR has been decreasing in recent years. However, approximately 50% of companies have adopted third-party comment in SR, which is a unique practice in Japan. Assurance and third-party comment are used predominantly by large companies and environmentally sensitive industries. Consistent with global practice, accounting firms dominate the assurance market followed by nongovernmental organisations and certification firms. This is the first known study to examine this emerging audit practice in Japanese context where majority of large companies publish sustainability reports.

Keywords: sustainability reporting; assurance; third-party comment; Japan.

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1 Introduction

The number of companies issuing standalone sustainability reporting (SR) has increased significantly in recent years (KPMG, 2011). However, this voluntary and unregulated reporting is frequently criticised for its lack of credibility and completeness (O'Dwyer and Owen, 2005; Adams, 2004; Adams and Evans, 2004). Certain researchers argue that management is more concerned with the business opportunity that can be gained from such reporting rather than ensuring transparency and accountability to stakeholders (O'Dwyer and Owen, 2005). In this context, assurance¹ serves to enhance the credibility of reporting and to ensure accountability and transparency to external stakeholders (Dando and Swift, 2003). In fact, third-party assurance in SR has increased steadily in the last ten years (KPMG, 2011, 2013). More than half (59%) of the world's largest companies have adopted assurance in their SR in 2013, up from 30% in 2005. Similarly, CorporateRegister.com, a private company that specialises in tracking SR, also observes an average growth rate of 20% in assurance practices from 1997 to 2007 (CorporateRegister.com, 2008).

Academic observers from social and environmental accounting have examined this emerging auditing practice (O'Dwyer et al., 2011; O'Dwyer, 2011; Jones and Solomon, 2010; Edgley et al., 2010; Kolk and Perego, 2010; Owen et al., 2000; O'Dwyer and Owen, 2005, 2007; Deegan et al., 2006; Ball et al., 2000). However, the first wave of research concerning assurance in SR was critical in nature and questioned the value added by contemporary assurance practices for external stakeholders. Observing wide variations in current assurance services in Perego and Kolk (2012) conclude that companies usually project a decoupled or symbolic image of accountability from such practices and thereby undermine the credibility of these verification processes.

Recent studies contribute to an in-depth understanding of this voluntary audit practice (Jones and Solomon, 2010; O'Dwyer, 2011; O'Dwyer et al., 2011). The studies of Edgley et al. (2010), O'Dwyer et al. (2011) and O'Dwyer (2011) focus on the views and perceptions of the assurator with respect to this practice. Whereas O'Dwyer et al. (2011) explain accounting firm efforts to gain legitimacy of new assurance practices among the key stakeholder groups, O'Dwyer (2011) documents the development of this practice within accounting firms. Using the dialogic theory, Edgley et al. (2010) note that stakeholders are now increasingly included in the assurance process as the practice matures. In contrast to the assurator perspective, Jones and Solomon (2010) and Park and Brorson (2005) examine managerial perceptions on the assurance of SR in the UK and Sweden, respectively. Kolk and Perego (2010) and Simnett et al. (2009) explain the influence of country-level institutional factors on the decision to adopt assurance in SR in two international comparative studies. The descriptive study of Perego and Kolk (2012) emphasises the external institutional pressures in addition to the internal resources and capabilities as drivers of assurance adoption in SR. Recent studies by Sierra et al. (2013) and Zorio et al. (2013) investigate the relationship between corporate characteristics and the adoption and quality of sustainability assurance in Spain.

The extant literature focuses predominantly on European practices. Japan offers an opportunity to investigate assurance practices in a context where the majority of large companies publish sustainability reports. The Japanese rate of assurance adoption in SR was 26% in 2002 and increased to 31% in 2005 before declining to 24% and 23% in 2008 and 2011, respectively (KPMG, 2011, 2008). An additional significant characteristic of Japanese companies is the adoption of 'third-party comment'² in SR in place of, or in

addition to, formal assurance. In 2008, more than 54% of companies have issued SR with such commentaries. This study reveals the assurance and third-party comment practices attached to Japanese SR. This is the first known study to examine assurance and third-party comment practices in a Japanese context.

This article is part of a broader research project. Related studies of this project include Haider (2012), Haider et al. (2012), Haider and Kokubu (2013), Haider and Kokubu (forthcoming). While there are similarities in the context and definition of concepts such as 'assurance' and 'third-party comment', the focus of each paper is different. For example, Haider et al. (2012) provide an overview of the sustainability reporting and assurance practices. It defines the key concepts and explains historical development and global practice of such voluntary initiatives. The questionnaire survey of Haider and Kokubu (2013) examines the managerial views on assurance and third-party comment in SR in Japan. In another study, Haider and Kokubu (forthcoming) evaluate the quality of assurance statements in Japan. The objective of this descriptive analysis is to provide an overview of assurance and third-party comment in SR of the Nikkei 225 companies for the period 2006 to 2010. This paper discusses the issues concerning third-party services in SR, such as the frequency of reporting, the frequency of assurance and third-party comment, changing patterns in these practices, the characteristics of the companies that adopt assurance and third-party comment and the types of assessor and commentator.

2 The Japanese external audit environment

Certain research argues that independent auditing in Japan was imported from the USA following World War II and that it was not generated by internal demand (McKinnon, 1984; Nakajima, 1973). Specific laws such as the Securities and Exchange Law (SEL) and the Certified Public Accountants Law were enacted and the Japanese Institute of Certified Public Accountants (JICPA) was established during a two-year period from 1947 to 1949 as part of the reform policy led by the US forces. The SEL mandated CPA audits for publicly listed companies (Matsumoto and Previts, 2010). However, under the Companies Act, only large companies (each with a stated capital of 500 million yen or more or total liabilities of 20 billion yen or more) are required to undergo a CPA audit. Consequently, only 0.5% of all stock companies in Japan are required by law to conduct a CPA audit on their financial statements. As of 31 December 2009, the total number of qualified Japanese CPAs was only 19,935, which is low by western standards (JICPA, 2013). It is estimated that more than half of Japanese CPAs are engaged in auditing. Prior to 1966, auditing was conducted exclusively by individual CPAs. The first audit corporation was formed in 1967 in accordance with the amended CPA Law of 1966. In 2009, the number of corporations conducting audits was 195, an increase from 24 corporations in 1970. The Big Four accounting firms dominate the audit market in Japan, as they do globally, possessing over 75% of the market share (Pong and Kita, 2006; JICPA, 2008). The remaining market is shared by small audit corporations (16.7%) and individual CPAs (6.9%).

In addition to CPA audits, all of the Japanese joint stock companies are required to conduct a statutory audit. This audit is governed by the Commercial Code (CC), which was enacted in 1890 and has a long history (Sakagami et al., 1999; Matsumoto and Previts, 2010). Statutory auditors are not required to be CPAs and are usually employees

of the audited corporation (Cooke and Kikuya, 1992; McKinnon, 1984). The auditors, therefore, often share the same interests as the companies, which results in ineffective and informal internal control even in large corporations. Statutory audits resemble western society internal audits (Sakagami et al., 1999).

The situation is changing as a result of globalisation; however, audits and auditors currently play a limited role in the Japanese economy and society (Yoshimi, 2002). Auditing practices in Japan are frequently criticised by the international community for their lack of rigor and quality. The literature has identified a number of socioeconomic factors that contribute to the marginalised role and status of auditing in Japan such as a cultural emphasis on interdependence, integrated internal corporate governance and the composition of corporate ownership (Komori, 2012; McKinnon, 1984; Sakagami et al., 1999).

Unlike social relationships in western societies, which typically emphasise independence and individualism, Japanese social relationships are based on interdependence and group consciousness. Japanese people emphasise the “maintenance of harmony in interpersonal and inter-group relationships rather than on confrontation and recourse to public manifestation and third-party settlement of disputation” [McKinnon, (1984), p.23]. This cultural emphasis significantly influences the Japanese auditor-client relationship, which is based on mutual loyalty, protection of mutual interests and internal settlement of disputes. For example, following the introduction of the SEL, management perceived professional auditors as their employees and assumed that they would protect the interests of management and group affiliates. Thus, qualified audit opinion that might damage a client’s reputation has been rare in Japan (Komori, 2008).

A cultural emphasis on interdependence also has significant influence on Japanese corporate governance practices (McKinnon, 1984; Dore, 2005). Whereas corporate governance in western countries is based on a notion of external surveillance, corporate governance in Japan follows the principle of internalism (Buchanan, 2007). For example, boards are often comprised of a majority of internally appointed executive directors who have worked in the company for many years (Jackson and Miyajima, 2008). Although two types of audits are required, auditors traditionally cooperate with management in the pursuit of goals rather than in monitoring activities.

Corporate ownership in Japan is dominated by stable shareholders with reciprocally held cross-shareholdings among corporations and banks (Jackson and Miyajima, 2008). This type of ownership structure is another frequently cited reason for the weakness in accounting and auditing practices (Gordon, 1999). Major businesses in Japan operate through a series of complex corporate networks known as ‘Keiretsu’ in which one main bank serves as the focal point. The companies in a typical Keiretsu group have close relationships with one another through cross-shareholdings, interlocking directorates, sharing of a common main bank and financing of fellow companies in the group. The companies in a Keiretsu, including the banks, usually have access to the private accounting information of the member companies, which effectively reduces the demand for external financial reporting and external auditing (Gordon, 1999).

After the bubble economy burst in the early 1990s, Japan experienced an unprecedented economic depression (Aggarwal, 1994). A series of bankruptcies and financial scandals questioned the effectiveness of the unique Japanese financial system. In response to various financial system weaknesses and international pressure, in 1996 the government announced a number of financial reforms that included improvements in

accounting and reporting regulations to ensure greater transparency in corporate financial reporting. For example, auditing standards were largely modified based on the International Standards on Auditing of International Auditing and Assurance Standards Board (IAASB). In order to respond to the clarity project of the IAASB, JICPA completed redrafting and rewriting the auditing standards under the clarity convention in 2012 (JICPA, 2013). One of the objectives of such reforms was “to transform the Japanese audit profession from its traditional role supportive of management to a monitoring function more similar to those of western countries” [Skinner and Srinivasan, (2010), p.41]. However, given the particularities of the Japanese audit environment, it is difficult to determine how quickly audit practices have changed.

3 Defining assurance and third-party comment in SR

‘Assurance in SR’ is not clearly defined in the literature (Al-Hamadeen, 2007). As a result a number of alternative definitions are available in academic and professional literature (Wilson, 2003; IFAC, 2013; GRI, 2006). However, efforts to define the term are highly influenced by the language and principles of the financial accounting profession to ensure rigor (Zadek et al., 2004). The definition in this study is in consistent with our broader research project (Haider, 2012; Haider et al., 2012; Haider and Kokubu, 2013; Haider et al., 2013).

Table 1 The relationship between assurance as a process and an outcome

<i>Assurance as an outcome audience centred</i>	<i>What assures?</i>	<i>Assurance as a process organisation centred</i>
Stakeholder confidence that the information they have is accurate and complete enough for them to make an informed decision (e.g., based on an organisation’s values, commitments, policies, actions, or performance)		Formal assurance services
		“an evaluation method that uses a specified set of principles and standards to assess the quality of an organisation’s subject matter and the underlying systems, processes and competencies that underpin its performance” (AA1000AS)
		Other means of assurance
		Gossip, word-of-mouth
		Personal statements from those responsible
		Demonstration, see for yourself
		Guarantees
		Quality marks, certification
		Membership of professional bodies and multi-sector initiatives
		Expert authority
		Brand reputation
		Legal liability
		Peer review

Source: Adopted from Zadek et al. (2006)

Although there are differences in meaning of terminologies like assurance, audit, verification and validation; in SR these third party services are often used

interchangeably (Deegan et al., 2006). In this regard, assurance encompasses a broader notion (Gray and Gray, 2000) and “auditing, verification and validation are some of the tools and processes by which assurance is obtained” [Zadek et al., (2004), p.7].

Zadek et al. (2006) explain assurance from both a process and an outcome perspective, as presented in Table 1. An organisation can adopt both formal and informal methods to provide assurance on a particular subject matter. In the context of SR, third party certification issued by the accounting firms can be considered as formal assurance. IFAC (2013, p.13) defines such ‘assurance engagement’ as “an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria”. To engage in sustainability assurance, all accounting firms must be guided by the International Standard on Assurance Engagements (ISAE) 3000 namely ‘Assurance engagements other than audits or reviews of historical financial information’. In contrast to formal assurance, a number of companies are seen to evaluate their SR by individual experts, NGOs, or other influential stakeholder groups (KPMG, 2008; Haider, 2012). Al-Hamadeen (2007) observes a number of limitations of such evaluation statements including inadequate systematic approach, an absence of a specific set of standards and unclear opinions/conclusions. This kind of ‘third-party comment’ can be considered as informal assurance in SR. However, from the audience perspective, the basic purpose of both formal and other types of assurance is to enhance the reliability and credibility of the reported information.

The prevalence of this type of third-party comment is higher in Japan than in any other country. Whereas only 27% and 18% of Global Fortune 250 (G250) and National 100 (N100) companies, respectively, have adopted third-party comment in SR, more than 50% of Japanese companies have done so in 2008 (KPMG, 2008). In a related study Haider and Kokubu (forthcoming) investigate the quality of the assurance statement and third-party comment in SR in Japan. The authors find that the assurance statements provided by the accounting or certification firms are of high quality when evaluated based on the requirements of assurance standards/guidelines such as the International Standard on Assurance Engagements 3000 (ISAE 3000) or Account Ability 1000 Assurance Standard (AA1000AS). Contrastingly, almost all of the cases’ third-party comments are based only on reading the sustainability reports instead of collecting substantive evidence and following guidelines or standards. For example, the first sentence of the third-party comment in the ‘Toyota Sustainability Report 2012’ that was provided by an individual expert stated “I have been granted the opportunity to read through Toyota Motor Corporation’s Sustainability Report (http://www.toyota-global.com/sustainability/report/sr/12/pdf/sr12_p63.pdf) for the second year in a row”. Similarly, an academic who provided a third-party comment in the ‘NTT Data CSR Report 2012’ clearly stated that his opinion was based on his experience as a researcher in CSR (http://www.nttdata.com/global/en/csr/report/pdf/rep2012_all.pdf). Without providing a specific conclusion, over 90% of the sample statements (third-party comments) praise the sustainability performance of the respective companies and identify areas for future improvement (Haider and Kokubu, 2013). There is no significant difference among the third-party comments provided by academics, NGOs/NPOs, individual experts and stakeholder panels. For example, the third-party comment in the ‘Denso CSR Report 2007’ that was provided by an NPO (<http://www.globaldenso.com/en/csr/report/2007/pdf/e21.pdf>) emphasised two points: ‘highly recognised points’ and ‘points that require more work’. ‘What I evaluate highly’ and ‘expectation for future

efforts' were the two headlines used by a professor in his comment on the (http://www.nttdocomo.co.jp/english/corporate/csr/report/third_party/evaluation/index.html) 'NTT DoCoMo CSR Report 2012'. A comparison of the previous and current years' CSR performance was highlighted by an individual expert's third-party comment in the Kobe Steel Group's (http://www.kobelco.co.jp/english/about_kobelco/csr/environment/2012/36.html) Sustainability Report of 2012.

This study defines assurance as "a systematic, documented, and evidence-based process in which a responsible party appoints an independent third party to evaluate and give an opinion on the assertions related to environment, social, and/or economic performance or management against criteria with the objective to improve the credibility of the reporting to intended users". A typical example of assurance is the Independent Assurance Statement provided by KPMG in the 'eco ideas Report 2010' of Panasonic (http://panasonic.net/sustainability/en/downloads/back_number/pdf/2010/review2010e.pdf). This study defines third-party comment as "a general statement of a third party engaged by the responsible party that evaluates or interprets the company's social, economic or environmental performances, underlying management processes, and related disclosures in the sustainability report based on his/her subjective judgment rather than objective evaluation". For example, the third-party opinion attached to the 'KDDI CSR Report 2010' is considered third-party comment (http://www.kddi.com/english/corporate/csr/csr_report/2010/pdf/csr_report_2010_16.pdf) in this current study.

4 The research method

4.1 Sample selection

This descriptive study is based on the Nikkei 225 companies. The Nikkei Stock Average, commonly known as the Nikkei 225, is Japan's most widely watched index of stock market activity. The index is maintained by the Nihon Keizai Shimbun and has been calculated continuously since 7 September 1950. It is a simple, price-weighted arithmetic average of the 225 component stocks that are among the most actively traded issues in the first section of the Tokyo Stock Exchange (TSE). The Nihon Keizai Shimbun periodically reviews the performance of component stocks to ensure that they are representative of Japan's changing economic and industrial structure (Liu, 2006). Thus, the sample adequately represents the industries in the Japanese economy. The study will observe the trends in assurance and third-party comment practices. Therefore, with availability of data, the analysis is conducted for a period of five years from 2006 to 2010.

4.2 The collection of sustainability reports

The sustainability reports of the sample companies were collected primarily from individual company websites. The list of Nikkei companies was obtained from the Nikkei needs financial quest³. All Company web pages were searched to determine whether they issued a sustainability report during the period 2006 to 2010. Additionally, sustainability reports for certain companies were collected from the website CorporateRegister.com if they were unavailable on the proprietary website. Both Japanese and English versions of the reports were investigated. The study then identified whether the reports contained

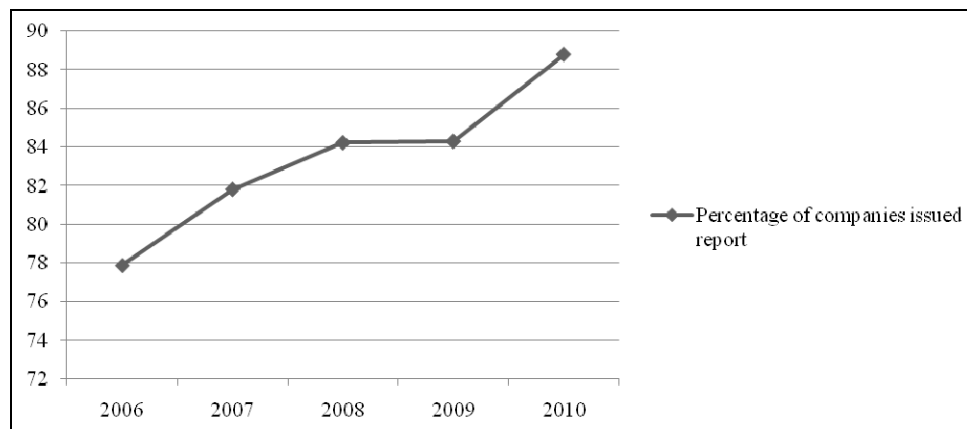
assurance or third-party comment. The study chose two operational definitions to distinguish the practices (see the discussion in Section 3). For the study's purposes, independent third-party engagement of systematic, documented and evidenced-based approach is treated as assurance. Contrastingly, "third-party engagement based on subjective judgment rather than objective evaluation is treated as third-party comment". Based on the criteria, the study classified the assurance and third-party comment statements. The statements were then cross-checked with the CorporateRegister.com database, which is widely used in academic literature (O'Dwyer et al., 2011). The results were fully consistent.

5 The findings

5.1 The frequency of SR

The trend in SR with respect to the Nikkei 225 companies is shown in Figure 1. The figure shows that the publication of a sustainability report has been increasing over the years. In 2006, approximately 78% of the surveyed companies published a sustainability report and in the last year (2010), approximately 89% did so, an increase of approximately 11% in five years. On a yearly basis, the maximum percentage increase for recent years was recorded in 2010, whereas the minimum was recorded in 2009.

Figure 1 Sustainability reporting of Nikkei 225 companies



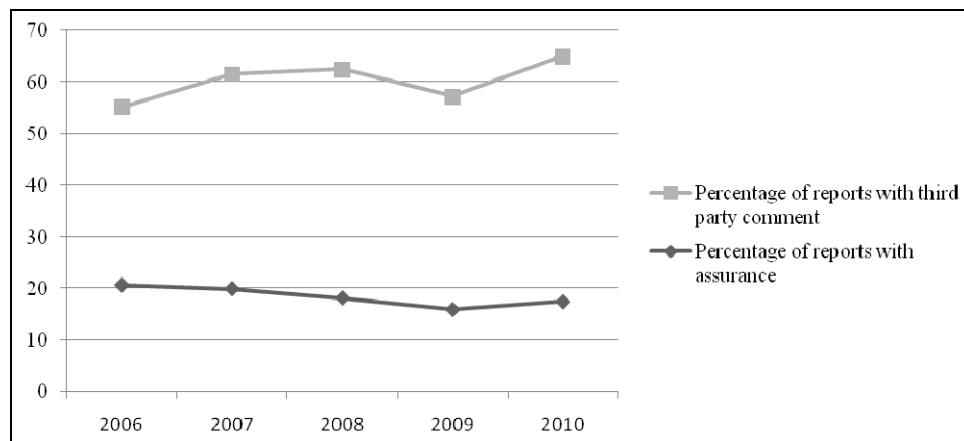
This finding is consistent with that of KPMG (2008), which observes that stand-alone SR in Japan increased from 80% in 2005 to 88% in 2008. The reporting rate of 84% for 2008 in the current study is higher than that for G250 companies (79%) as shown by KPMG (2008). KPMG (2008) argues that there is little room for improvement in Japan with respect to the number of reports. However, Yamagami and Kokubu (1991) find that there was almost no social disclosure in the mandatory annual reports of the late 1980s and minimal disclosure in the voluntary corporate reports such as operating reports, English versions of annual reports and public relation reports. Therefore, there has been significant improvement in SR in Japan in the last two decades. The Japanese government has played a pivotal role in the improvement by issuing voluntary guidelines

such as the Environmental Accounting Guidelines 2000 and the Environmental Management Accounting Workbook 2003 (Kokubu and Kurasaka, 2002). Kokubu et al. (2003) observe that there has been substantial improvement in the incidence of reporting and in the content and format of environmental disclosure since the issuance of the Ministry of Environment (MOE) guidelines. Additionally, increased social awareness concerning public health and the environment, initiatives by the top business association Nippon Keidanren (the Japan Federation of Economic Organizations), adoption of ISO 14001 or international reporting codes and strong commitment to the Kyoto Protocol and the impact of globalisation are also significant improvements in Japanese SR (Fukukawa and Moon, 2004; Tanimoto and Suzuki, 2005).

5.2 The frequency of assurance and third-party comment in SR

Figure 2 presents the frequency of assurance and third-party comment in SR during the period 2006 to 2010. The adoption of assurance decreased from 2006 to 2009 but slightly increased in the last year (2010). The highest incidence of assurance was in 2006 (approximately 21%) and the lowest incidence of assurance was in 2009 (approximately 16%). In 2010, the incidence of assurance was approximately 17.5%.

Figure 2 Assurance and third-party comment in sustainability reporting



KPMG (2008) shows that in 2002, 26% of Japanese N100 companies possessed a formal assurance statement; this percentage increased to 31% in 2005 and then decreased to 24% in 2008. In the current sample, only 18.23% of the reports were assured in 2008. The low adoption rate in the current sample compared to that in KPMG (2008) may be a result of an increased sample size because the study is based on Nikkei 225 rather than N100 companies. The low level of assurance adoption may be a result of the particularities of the general audit/assurance context in Japan. Historically, assurance was not expected by Japanese society and was imposed by the USA after World War II (Yoshimi, 2002). Japanese cultural emphasis on interdependence, internal mode of corporate governance, cooperation among the 'Keiretsu' member companies, dominance of banks and other institutional investors in the corporate ownership are some frequently cited reasons for the marginalised role and position of auditing in Japan (Komori, 2009).

Japan is far behind Europe in this emerging practice. More than 60% of companies in Denmark, Spain, Italy and France had adopted assurance in SR by 2011 (KPMG, 2011). The Japanese trend is aligned with Asian practices and approximately 20% of reports were externally assured in 2007 (CorporateRegister.com, 2008). Whereas an international comparative study can provide valuable insights with respect to the country differences, this is not the case in the present study because it examines only Japanese practices. Simnett et al. (2009) and Kolk and Perego (2010) have already conducted two comparative studies. Kolk and Perego (2010) find that companies operating in stakeholder-oriented countries (code law countries) with weaker governance enforcement are more likely to adopt assurance in SR. Similarly, Simnett et al. (2009) document that voluntary demand for assurance is higher in countries with weaker legal systems. Both studies conclude that assurance can serve as a substitute in an ineffective legal environment and hence, the demand is higher in countries with an ineffective legal system. The findings of these studies, that demand for assurance in SR is higher in stakeholder-oriented (code law) countries, is also supported by KPMG (2011), Sierra et al. (2013) and Zorio et al. (2013). Although Japan is a code law country, the low adoption levels of assurance in SR reiterates the unique audit culture of Japan.

However, Figure 2 also shows that the adoption of third-party comment has been increasing in recent years. In 2010, 65% of reports were issued with third-party comments. For G250 and N100 companies, the commentary rates were 27% and 18%, respectively, whereas for the UK, the rate was only 8% (KPMG, 2008). A high rate of adoption of third-party comment is a unique practice in Japan and implies that companies are using this service as an alternative to assurance because only a small number of companies have both assurance and third-party comment in SR (Herda and Taylor, 2010; KPMG, 2008). Zadek et al. (2004, 2006) consider these civil society or opinion leader commentaries to be an informal form of assurance. They suggest the need for the integration of formal assurance with these informal information flows and networks. Herda and Taylor (2010) also term these individual third-party commentaries as casual progress reports rather than assurance. However, none of the studies analyse this practice in detail.

5.3 The changes in assurance and third-party comment practices in SR

Once adopted, companies typically consistently employ assurance in SR. However, certain companies have changed the practice from assurance to third-party comment; these companies are presented in Table 2.

Certain companies have also changed third-party comment practice in SR. The majority of such companies utilised the service for several years before abandoning it. For example, Tokyo Gas has included third-party comment in its 2006 to 2008 SRs and has abandoned the practice since 2009. Similarly, Terumo (for three years), Toray Industries (for three years), Nippon Sheet Glass (for two years) and Oji Paper (for three years) have also used the service. Sumitomo Metal Mining adopted third-party comment in 2007 and added formal assurance in 2009. Yokohama Rubber changed their policy in 2007 from third-party comment to assurance and reverted to third-party comment in 2009.

In some instances, companies that have adopted assurance and third-party comment also changed the assessor and third-party commentator; these companies are presented in Tables 3a and 3b respectively.

Table 2 Companies that changed type of assurance practice

<i>Corporations</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
Obayashi ^a	Assurance	Assurance	Third-party comment	Third-party comment	Third-party comment
Ricoh ^b	Assurance	Assurance	Assurance	Third-party comment	Third-party comment
Sanyo	Assurance	Assurance	Assurance	None	None
Kirin Holdings ^c	Assurance	Assurance	Third-party comment	Third-party comment	Third-party comment
Yokohama Rubber	Third-party comment	Assurance	Assurance	Third-party comment	Third-party comment
Olympus ^d	Assurance	Third-party comment	Third-party comment	Third-party comment	Third-party comment
Fuji Heavy Industries	Assurance	Third-party comment	Third-party comment	Third-party comment	Third-party comment
Mizuho Financial Group	Third-party comment	Both assurance and third-party comment	Third-party comment	Third-party comment	Third-party comment
Mitsubishi Estate	Assurance	Assurance	Assurance	Third-party comment	Third-party comment
Mitsubishi	None	Third-party comment	None	Assurance	Third-party comment

Notes: ^aAdopted assurance from 2000 to 2007,
^bAdopted assurance from 2000 to 2008,
^cAdopted assurance from 2005 to 2007,
^dAdopted assurance from 2005 to 2006

Table 3a Companies that changed assurance providers

<i>Corporations</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
Fujifilm	Accounting firm	Accounting firm*	Certification firm	Certification firm*	Accounting firm
Kao	Accounting firm	Accounting firm**	NGO	NGO**	NGO**
Showa Denko	NGO	NGO**	NGO**	Certification firm	Certification firm**
Toshiba	Accounting firm	-***	Certification firm	Certification firm**	Certification firm**

Notes: *Indicates that assurator is the same accounting firm/certification firm/NGO as it was in the previous year,
**Indicates a change in the assurator compared to that in the previous year,
***Toshiba did not adopt assurance in 2007

Table 3b Companies that changed third-party commentators

<i>Corporations</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
Kobe Steel	Academic	Academic*	Academic*	Academic*	Others
Asahi Glass	NGO/NPO	Academic	Academic*	Academic*	Ind. expt.
Fujikura	***	***	Academic	Ind. expt.	Ind. expt.*
Furukawa Electric	***	***	Ind. expt.	Ind. expt.*	NGO/NPO
Toyo Seikan Kaisha	Ind. expt.	Academic	Academic*	Academic*	Academic**
Daikin	Ind. expt.	NGO/NPO	NGO/NPO**	Academic	Academic**
Kubota	Ind. expt.	Ind. expt.**	Ind. expt.**	Academic	Academic*
NSK	Academic	Academic	Ind. expt.	Ind. expt.*	Ind. expt.*
NTN	***	NGO/NPO	NGO/NPO*	Academic	Academic*
K Line	***	***	Academic	Academic**	Academic**
MOL	Ind. expt.	Academic	Academic**	Academic**	Academic**
NYK Line	***	***	NGO/NPO	Ind. Expt.	NGO/NPO
Yamato Holdings	***	Academic	Academic**	Academic**	Academic**
KDDI	***	Academic	Ind. expt.	Ind. expt.*	Ind. expt.*
NTT	***	Academic	Academic*	Academic**	Academic*
Kansai Electric	Academic	Academic**	Academic*	Academic*	Academic*
Dainippon Screen	Ind. expt.	Ind. expt.*	Academic	Ind. expt.	***
Tokyo Electron	Others	Others**	Others**	Ind. expt.	Academic
Ricoh	Ind. expt.	Academic	SP	***	Academic
ITOCHU	***	Academic	Academic*	Academic**	Academic*
Shimizu	***	***	Others	Others**	NGO/NPO
INPEX Holdings	***	Ind. expt.	Ind. expt.**	Academic	NGO/NPO
Mitsubishi Chemical	NGO/NPO	NGO/NPO*	NGO/NPO*	Academic	Academic*
UBE	Academic	Academic**	Others	Others*	Others*
Kyowa Hakko Kirin	Academic	Academic*	Academic*	Academic*	SP
SMFG	Academic	Academic*	Academic*	Academic*	Ind. expt.
Mizuho Financial	Academic	Academic*	Academic*	Academic**	Academic*
Nomura Holdings	Academic	Academic*	NGO/NPO	NGO/NPO*	NGO/NPO*
Daiwa Securities	Academic	Academic**	Academic	Academic**	NGO/NPO
Tokio Marine Group	Ind. expt.	Ind. expt.*	Ind. expt.*	Ind. expt.**	Ind. expt.*
AEON	Ind. expt.	Ind. expt.*	NGO/NPO	***	***
Kikkoman	Academic	Academic**	Academic*	NGO/NPO	NGO/NPO*

Notes: Ind. expt. = individual experts,

SP = stakeholder panel,

*Indicates that third-party commentator was the same academic/individual expert/NGO/NPO/stakeholder panel/other as it was in the respective previous year,

**Indicates change in third-party commentator compared to that in the previous year,

***Indicates companies that did not adopt third-party comment in the particular year

Table 3b Companies that changed third-party commentators (continued)

<i>Corporations</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
Keio	Others	Others*	Academic	Academic*	Academic*
Mazda	Ind. expt.	Ind. expt.*	Ind. expt.*	Ind. expt.**	Ind. expt.*
Nissan	-***	NGO/NPO	NGO/NPO*	Ind. expt.	Ind. expt.**
Honda	Academic	Academic**	Ind. expt.	Ind. expt.*	Ind. expt.*

Notes: Ind. expt. = individual experts,

SP = stakeholder panel,

*Indicates that third-party commentator was the same academic/individual expert/NGO/NPO/stakeholder panel/other as it was in the respective previous year,

**Indicates change in third-party commentator compared to that in the previous year,

***Indicates companies that did not adopt third-party comment in the particular year

The changes in assurance and third-party comment practice require further investigation. The present study is concerned with overall assurance and third-party comment practices and therefore, future research should examine changes in adoption of these practices. However, certain inferences can be obtained from the existing literature. Studies observe wide variations and ambiguities in current assurance forms (Ball et al., 2000; Perego and Kolk, 2012). Although expensive, the benefits from assurance provision are not straightforward (Jones and Solomon, 2010). The lower level of demand for assurance in Japan (Haider, 2012) may cause management to consider third-party comment as an alternative to formal assurance.

The cases of Ricoh and Obayashi are different because these companies utilised the assurance service for many years and abandoned the practice in 2008 and 2007, respectively. It appears that sustainability assurance has achieved only 'pragmatic legitimacy'⁴ for these companies (O'Dwyer et al., 2011). When companies achieve a desired level of improvement in the reporting system, they become unwilling to continue the assurance provision.

Sustainability and its reporting encompass diverse fields. Some researchers argue that reporting is insufficiently developed to merit assurance (Jones and Solomon, 2010). There are many industry- and company-specific issues with respect to SR that an assessor must understand. The stable relationship between company and assessor can be viewed from the perspective that an assessor's familiarity with a client will render simpler future audits (Park and Brorson, 2005). This may reduce the assurance fees if the company remains a client of that assessor. Rotation of assessors and the associated additional cost can explain the change in assurance practice to third-party comment. For example, Fujifilm Holdings adopted accounting firms for seven years and then used a certification firm for two years before reverting again to an accounting firm in 2010.

5.4 The characteristics of the companies that adopt assurance and third-party comment in SR

5.4.1 Corporate size, assurance and third-party comment in SR

Corporate size is a significant explanatory variable for SR (Adams, 2002; Fifka, 2013). Legitimacy theory considers corporate size to be an important proxy for organisational visibility (Patten, 1991; Hackston and Milne, 1996; Cormier and Magnan, 2003); larger firms are susceptible to public scrutiny. SR represents a method that firms can use to influence public pressure by creating a positive public image, deferring regulation for more disclosure and minimising government intervention (Parker, 1986).

Simnett et al. (2009) and Sierra et al. (2013) find a significant positive relationship between corporate size and assurance in SR, whereas Kolk and Perego (2010) observe company size as insignificant in determining company decisions concerning the adoption of assurance in SR. Therefore, the null hypotheses are the following:

H_{0a} There is no significant difference between large and small companies with respect to the adoption of assurance in SR.

H_{0b} There is no significant difference between large and small companies with respect to the adoption of third-party comment in SR.

Table 4 Corporate size and assurance and third-party comment

Year	Assurance				Third-party comment			
	Obs.	Large/ mean ^a	Small/ mean ^b	t-test/ t value	Obs.	Large/ mean ^c	Small/ mean ^d	t-test/ t value
2006	34	0.735	0.265	5.416***	59	0.712	0.288	6.531***
2007	36	0.722	0.278	5.292***	74	0.662	0.338	5.920***
2008	35	0.800	0.200	7.141***	85	0.635	0.365	5.582***
2009	31	0.774	0.226	6.036***	78	0.615	0.385	4.806***
2010	34	0.706	0.265	5.104***	94	0.596	0.415	4.531***

Notes: Obs. = observation,

Companies for which data are missing are excluded,

^{a+b}These two columns indicate the proportionate percentage of adoption of assurance between large and small companies,

^{c+d}These two columns indicate the proportionate percentage adoption of third-party comment between large and small companies,

***Significance at the 1% level

To understand the relationship between corporate size and adoption of assurance and third-party comment, this study divides the Nikkei 225 companies into two groups based on market capitalisation of companies. While top 112 companies are considered to be large and the remaining half of companies is measured as small. Although all these are big companies in general, however, there is significant variation among the companies. For example, in 2010 total market capitalisation of largest Toyota was 11,550,792 million yen whereas smallest Mitsubishi Paper Mills was 30,147.42 million yen. This type of industry category was also used by other studies such as Al-Hamadeen (2007). The

adoption of assurance and third-party comment based on size is presented in Table 4. The two-sample t-test was used to calculate differences in adoption of assurance and third-party comment between large and small companies.

Table 4 shows that larger companies have exhibited more interest in adopting both assurance and third-party comment in their SR compared to small companies. In each of the five years, over 70% of the total assurance was adopted by large companies, with the highest levels seen in 2008 (80%). The higher adoption level of assurance by large companies is statistically significant in all five years at the 1% level. This rejects the null hypothesis H_{0a} and implies that large companies are more likely to adopt assurance in SR. Similarly, the higher levels of third-party comment in SR by large companies are also statistically significant in all five years. This also rejects the null hypothesis H_{0b} and this study posits that larger companies are more vested in third-party comment than smaller companies. In summary, both assurance and third-party comment in SR are practices peculiar to larger companies. From the perspective of legitimacy theory, a strong presence in society by large companies provides incentive to adopt third-party services to enhance credibility with the public.

5.4.2 The sectors and assurance and third-party comment in SR

A variable often used as a proxy for public pressure in the SR literature is industry classification (Patten, 1991). Environmentally sensitive industries such as manufacturing are more visible because of their high pollution intensity, additional regulatory burden, intense media scrutiny and public concern (Brammer and Pavelin, 2006). Consequently, environmentally sensitive industries disclose social and environmental information to assure stakeholders and to project a positive social image with respect to company activity (Patten, 1991). Fifka (2013) reveals that approximately 90% of studies that utilise industry classification to explain the disclosure practice have shown that industry classification influences disclosure practice. Simnett et al. (2009) note that demand for assurance is higher among companies in mining, utilities and finance industries. Zorio et al. (2013) observe a significant positive relationship in Spain between assurance in SR and environmentally sensitive industries such as oil and energy. While the previous studies compare SR practices of 'environmental sensitive and non-sensitive industry', based on the industry classification of the TSE we focus on 'manufacturing and non-manufacturing industry'⁵. As the manufacturing industry includes environmental sensitive industry like mining, pulp and paper, chemicals, pharmaceuticals, oil and coal, rubber products, steel products, machinery, shipbuilding, automotive products and electrical machinery, the finding of this study is largely consistent with the previous studies. Therefore, we posit the following null hypotheses:

H_{0c} There is no significant difference between manufacturing and non-manufacturing industries with respect to the adoption of assurance in SR.

H_{0d} There is no significant difference between manufacturing and non-manufacturing industries with respect to the adoption of TPC in SR.

Tables 5 and 6 demonstrate the adoption of assurance and third-party comment in SR of the top ten industries respectively (based on total adoption for five years).

Table 5 Assurance by industry (top ten industries)

<i>Industry</i>	<i>2006</i>	<i>%</i>	<i>2007</i>	<i>%</i>	<i>2008</i>	<i>%</i>	<i>2009</i>	<i>%</i>	<i>2010</i>	<i>%</i>
Chemicals	7	19.44	8	21.62	8	22.86	7	22.58	8	22.22
Electrical machinery	7	19.44	7	18.92	8	22.86	6	19.35	8	22.22
Construction	2	5.56	3	8.11	3	8.57	2	6.45	3	8.33
Pharmaceuticals	3	8.33	3	8.11	3	8.57	2	6.45	1	2.78
Railway/buses	2	5.56	2	5.41	2	5.71	2	6.45	3	8.33
Other manufacturing	2	5.56	2	5.41	2	5.71	2	6.45	2	5.56
Machinery	2	5.56	2	5.41	2	5.71	2	6.45	2	5.56
Nonferrous metals	1	2.78	1	2.70	1	2.86	2	6.45	3	8.33
Automotive	2	5.56	1	2.70	1	2.86	1	3.23	1	2.78
Textiles and apparel	1	2.78	1	2.70	1	2.86	1	3.23	1	2.78

Table 6 Third-party comment by industry (top ten industries)

<i>Sectors</i>	<i>2006</i>	<i>%</i>	<i>2007</i>	<i>%</i>	<i>2008</i>	<i>%</i>	<i>2009</i>	<i>%</i>	<i>2010</i>	<i>%</i>
Electrical machinery	11	18.33	11	14.29	10	11.76	8	10.00	13	13.27
Machinery	5	8.33	6	7.79	7	8.24	7	8.75	7	7.14
Foods	6	10.00	4	5.19	6	7.06	6	7.50	8	8.16
Automotive	3	5.00	5	6.49	6	7.06	5	6.25	4	4.08
Trading companies	3	5.00	5	6.49	5	5.88	4	5.00	6	6.12
Banking	3	5.00	3	3.90	4	4.71	5	6.25	5	5.10
Steel products	3	5.00	4	5.19	4	4.71	4	5.00	4	4.08
Nonferrous metals	1	1.67	3	3.90	5	5.88	4	5.00	4	4.08
Precision instruments	2	3.33	4	5.19	4	4.71	4	5.00	3	3.06
Chemicals	3	5.00	3	3.90	3	3.53	3	3.75	4	4.08

The notable sectors with respect to the production of assured sustainability reports are chemicals, electrical machinery, construction and pharmaceuticals. However, prior studies on assurance find that the finance and banking sectors are also active in assurance adoption, which is not apparent in the current context (Al-Hamadeen, 2007; Simnett et al., 2009). KPMG (2008) finds that mining, utilities, oil and gas are the sectors with the highest levels of companies that provide assurance. This study considers the relative contribution of the sectors in the assured sustainability reports, whereas KPMG considers the percentage of companies in a sector that provide assured reports. For example, only one mining company in the current sample adopted third-party comment in its SR. Of the two oil and coal companies in the sample, one adopted assurance and the other included third-party comment in 2010 (therefore, in 2010, 50% of the oil and coal companies provided assurance). Among the five utility companies, assurance was adopted by one company and third-party comment by another two companies, whereas the remaining two companies did not adopt any services in their sustainability reports.

The electrical machinery, machinery, foods and automotive sectors evidenced the highest number of sustainability reports with third-party comment; these sectors are presented in Table 6. The manufacturing sector was generally more likely to adopt third-party comment services than the non-manufacturing sectors are. For example, of the

top ten industries that adopt both assurance and third party comment, eight belong to a manufacturing industry. Table 7 shows the adoption of assurance and third-party comment in SR based on manufacturing and non-manufacturing categories. The two-sample t-test was used to calculate differences in adoption of assurance and third-party comment between manufacturing and non-manufacturing companies.

Table 7 Assurance and third-party comment based on manufacturing and non-manufacturing industries

Year	Assurance				Third-party comment			
	Obs.	Mfg./ mean ^a	Non-mfg./ mean ^b	t-test/ t value	Obs.	Mfg./ mean ^c	Non-mfg./ mean ^c	t-test/ t value
2006	36	0.778	0.222	6.614***	60	0.650	0.350	5.029***
2007	37	0.757	0.243	6.164***	77	0.623	0.377	4.990***
2008	35	0.771	0.229	6.354***	85	0.635	0.365	5.582***
2009	31	0.742	0.258	5.303***	80	0.638	0.375	5.303***
2010	36	0.806	0.194	7.416***	98	0.633	0.367	5.918***

Notes: Obs. = observation,

Mfg. = manufacturing,

^{a+b}These two columns indicate the proportionate percentage of adoption of assurance between manufacturing and non-manufacturing companies,

^{c+d}These two columns indicate the proportionate percentage adoption of

third-party comment between manufacturing and non-manufacturing companies,

***Indicates significance at the 1% level

The manufacturing firms demonstrated a higher level of adoption of assurance and third-party comment in all five years than non-manufacturing firms; this result is statistically significant (at the 1% level for all five years). This rejects hypotheses H_{0c} and H_{0d} and implies that manufacturing firms are more likely to adopt assurance and third-party comment in SR than non-manufacturing firms are. The legitimacy theory perspective would argue that because of high pollution intensity, regulatory burden and public concern, manufacturing firms have more incentive to increase the credibility of SR by adopting assurance and third-party comment than other industries.

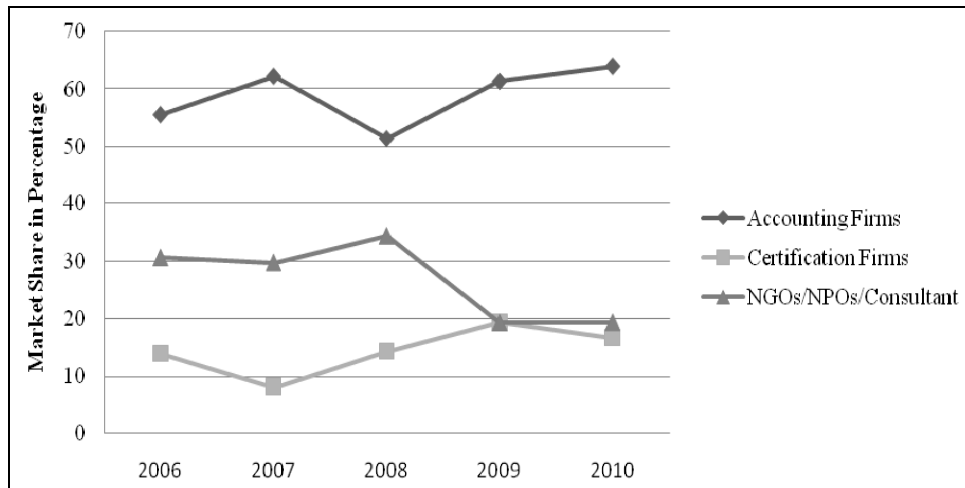
5.5 The characteristics of the assurator and third-party commentator

5.5.1 The types of assurator

Contrary to financial audit, no consensus exists as to who should perform assurance in sustainability reports and what the competencies of that person or company should be (Deegan et al., 2006). This encourages the involvement of a number of professional bodies, consulting firms, NGOs/NPOs and other organisations and individuals. The market share of different assurance providers is presented in Figure 3. Figure 3 shows that accounting firms possessed a market share of over 50%; they achieved the highest level of market share in 2010 (approximately 64%) and the lowest level in 2008 (approximately 51%). Accounting firm market share has been increasing during the study period with the exception of 2008. Whereas NGOs/NPOs/consultants' market shares ranged from 20% to 30% during the five years, those of certification firms were the lowest. The findings are consistent with global trends. KPMG (2008) observes that accounting firms represent 70% of G250 companies with assurance in SR and 65% of

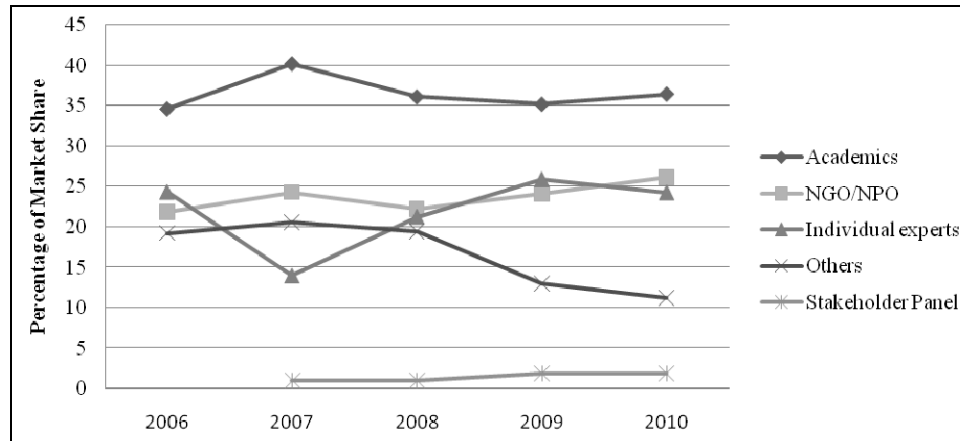
N100 companies with assurance in SR, whereas certification firms represent 13% of G250 companies with assurance in SR and 18% of N100 companies with assurance in SR. Sierra et al. (2013) recently document that the sustainability assurance market in Spain is dominated by accounting firms, especially by the Big Four accounting firms. The market share of NGOs/NPOs in Japan is mainly a result of the high market share by the chemical industry specialist organisation 'Responsible Care'. The organisation provides two types of verification, namely activity verification and report verification, through its Responsible Care Verification Centre (Responsible Care Japan, 2010). The factors that determine the choice of assurator are significant for research. The power and reputation of the Big Four accounting firms in financial and related assurance services are widely recognised in the literature (Free et al., 2009). KPMG (2008) highlights the comprehensive approach of assurance that encompasses a wide area of reporting as the reason for the high market share of accounting firms. The International Auditing and Assurance Standards Board (IAASB) is active and included the development of a sustainability assurance standard in its strategic goals for 2009 to 2011. O'Dwyer et al. (2011) explain the active role of accounting firms in creating market share for assurance provision. All of these factors may influence the substantial market share of accounting firms with respect to SR assurance.

Figure 3 Market share of assurers



5.5.2 The types of third-party commentators

Figure 4 presents the types of third-party commentators in SR. In most cases (from 35% to 40% for each of the five years), academics such as university professors offered commentaries. Individuals from NGOs/NPOs, individual experts from research organisations and consulting firms in total contributed at a similar rate over the same period. A small number of companies (from 11% to 20%) used comments from members of other stakeholder groups such as media personnel, members of local communities and consumers. In general, third-party commentators were usually individual experts in relevant fields. KPMG (2008) observes that NGOs, academics and stakeholder panels equally provided third-party comment in the SR of both national and global companies.

Figure 4 Types of third-party commentators

6 Conclusions

This study provides an overview of assurance and third-party comment in SR of Japanese companies. The results indicate that most leading Japanese companies adopt SR. Reporting increased over the sample period. In the final year (2010), approximately 89% of companies issued stand-alone sustainability reports. The percentage of reports with assurance statements decreased over the study period. Whereas 20.7% of companies included assurance statements in SR for 2006, the adoption rate in 2010 was only 17.5%. The frequency of assurance statements in Japan is significantly less than global practice; 45% of G250 companies conduct voluntary audit practices in their SR (KPMG, 2011). Third-party comment in Japan, however, demonstrated an increasing trend and in the final year (2010), more than 47% of companies adopted this service. Once adopted, companies typically utilised assurance and third-party comment consistently. However, a small number of companies changed their adoption policy from assurance to third-party comment or completely abandoning the practice altogether.

Consistent with extant literature, the results show that both assurance and third-party comment in SR are adopted by large companies and environmentally sensitive industries. From the legitimacy theory point of view, it can be argued that the high visibility of these companies provides them incentive or pressures them to enhance the credibility of SR by adopting third-party services.

Consistent with global practice, accounting firms dominate the Japanese assurance market followed by NGOs/NPOs/consultants and certification firms. Contrastingly, individual experts such as academics, professionals from NGOs/NPOs, consulting firms and a wide range of other stakeholder groups are used to provide third-party comment to SR.

This exploratory research study unveils the assurance and third-party comment practices included in SR; however, additional in-depth studies are required to understand emerging assurance practices. The following are some issues that could be addressed by future research and that could extend the research topic.

There is a lack of research that examines the assurance practice from the corporate or managerial perspective (Jones and Solomon, 2010). However, the development and expansion of this voluntary and unregulated practice is dependent on management support because demand for the service must exist (O'Dwyer et al., 2011). Therefore, studies that focus on assurance from the managerial perspective can add significant value to the existing literature. For example, managerial motivation for the adoption of assurance and third-party comment and changing from third-party comment to assurance are appropriate topics for investigation.

Future research should focus on the quality of the assurance and third-party comment statements. Certain studies have been conducted (O'Dwyer and Owen, 2005; Deegan et al., 2006; Ball et al., 2000; Perego and Kolk, 2012; Zorio et al., 2013) that use an evaluative framework developed from the international guidelines/standards of the assurance practice. An evaluation of the quality of assurance statements in Japan and a comparison with those in European counterparts would be valuable. Also valuable would be an evaluation of assurance statements or third-party commentaries with respect to providing improved credibility and accountability for external stakeholders, which are usually cited as important reasons for the adoption of such practices (O'Dwyer and Owen, 2005).

This study finds three active groups with respect to assurance service provision in Japan, which is consistent with international practice. These three groups are accounting firms, certification firms and NGOs/NPOs. Ball et al. (2000), O'Dwyer and Owen (2005) and Deegan et al. (2006) compare the assurance practices of different assurance providers. Future research could also compare the assurance practices of these three groups in Japan. This study focuses on the determinants of the adoption of assurance and third-party comment; however, it does not distinguish between the adoptions of different types of assurance providers. Additionally, the factors determining the adoption of an assessor could be investigated in future research.

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Notes

- 1 International Federation of Accountants (IFAC, 2013) defines assurance as “an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence that intended users can have about the evaluation or measurement of subject matter that is the responsibility of a party, other than the intended users or the practitioner, against criteria”.
- 2 The study defines third-party comment as “an engagement in which a third party engaged by the responsible party gives a general statement that evaluates or interprets the company’s social, economic, or environmental performances, underlying management process and related disclosure in the sustainability reports based on his/her subjective judgment rather than objective evaluation”.
- 3 Nikkei Needs Financial Quest is a comprehensive database that facilitates research by providing data that includes company financial results, stock price data, bond price data, macroeconomic data and industrial statistical data.
- 4 Pragmatic legitimacy for an organisation or a practice is achieved when the most immediate audiences believe that the organisation or the practice will bring them instrumental value or benefit (Suchman, 1995).
- 5 According to the Nikkei industry classification, manufacturing industries include mining, food, textiles and apparel, pulp and paper, chemicals, pharmaceuticals, oil and coal, rubber products, glass and ceramics, steel products, non-ferrous metals, machinery, shipbuilding, automotive products, precision instruments, electrical machinery and other manufacturing. Non-manufacturing industries are composed of fisheries, construction, real estate, electric power, securities, insurance, other financial services, railway/buses, other land transport, marine transport, air transport, warehousing, communication, gas, services, trading companies and retail.