Integrated reporting and board features

Rareș Hurghiș

Abstract

In the last two decades the concept of sustainability reporting gained more field in the companies annual reports, a trend which is embedded also in integrated reporting. Issuing an integrated report became a necessity, because it explains to the investors how the organization creates value over time. The governance structure, more exactly the board of directors, decides whether or not the company will issue an integrated report. Thus, are there certain features of the board that might influence the issue of an integrated report? The companies which issue an integrated report have certain features of the governance structure? Looking for an answer at these questions, we seek for any possible correlation between a Disclosure Index and the corporate governance structure characteristics, on a sample from the companies participating at IIRC Examples Database. The results highlight that only the size of the board influences the extent to which the issued integrated report is in accordance with the IIRC Framework.

Key words: integrated reporting, sustainability reporting, corporate reporting, financial reporting

1. Introduction, motivation and importance

The reporting package, evolved from financial statements to financial statements, management commentary, environmental reporting, governance and remuneration. But, nevertheless, the information in these reports was not interconnected, and it did not shown hot environmental issues may affect the company’s performance.

Thus a new trend was born in the reporting field: integrated reporting. In 2011 the International Integrated Reporting Council (IIRC) - a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs, lunched a pilot programme regarding the issue of an integrated report. The purpose of the Council is to issue a framework for integrated reporting, based on the feedback from the affected actors. Integrated Reporting is a process founded on integrated thinking with the purpose to issue a periodic integrated report by an organization, about value creation over time.

Integrated reporting tries to put together the financial and non-financial information, developing the integrated thinking, underling the interdependencies between them, improving the quality of information.

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identifying the material issues that affect the business, leading to a better allocation of the resources. All these elements support integrated thinking, decision-making and actions that are focused on the creation of value over the short, medium and long term. According to IIRC, integrated thinking takes into account the connectivity and interdependencies between the range of factors that affect an organization’s ability to create value over time, including:

- The capitals that the organization uses or affects, and the critical interdependencies, including tradeoffs, between them;
- The capacity of the organization to respond to key stakeholders’ legitimate needs and interests;
- How the organization tailors its business model and strategy to respond to its external environment and the risks and opportunities it faces;
- The organization’s activities, performance (financial and other) and outcomes in terms of the capitals – past, present and future.

Through an integrated report, a series of advantages will be gain, (IIRC, 2013):

- Improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital
- Promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organization to create value over time
- Enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social and relationship, and natural) and promote understanding of their interdependencies
- Support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term.

The IIRC framework contains the following: guiding principles (strategic focus and future orientation, connectivity of information, stakeholder relationship, materiality, conciseness, reliability and completeness, consistency and comparability) and content elements (organizational overview and external environment; governance; business model; risks and opportunities; strategy and resource allocation; performance; outlook; basis of preparation and presentation).

There are also other reporting initiatives like Global Reporting Initiative (GRI) who also issued guidelines regarding how to prepare a GRI report. The aim of the GRI is to make corporate responsibility reporting as common and comparable as financial reporting. But, this has common points with the IIRC framework,
as sustainability reporting is an intrinsic element of integrated reporting (GRI 4, 2013). Moreover, in order to reach a global adoption of the integrated report, IIRC established collaborations with different partners such as: CDP, GRI (Global Reporting Initiative), IFRS Foundation, IFAC (International Federation of Accountants), SASB (Sustainability Accounting Standards Board), WBCSD (World Business Council for Sustainable Development). The support for a global adoption is through endorsement, advocacy and profile-raising (IIRC website).

The research was made on integrated reports due to the fact that is a growing phenomenon, more companies choosing to voluntarily issue this type of report, and it might be the corporate reporting norm in the near future. Thus, we want to analyze whether issuing this type of report might be influenced by the characteristics of the company’s board, mainly because this type of reporting is not mandatory (excepting South Africa Stock Exchange), giving us a slight sense under which circumstances IR might occur.

As will be explained in the following paragraph, a series of other studies, analyze the correlation between board features and voluntary, environmental reporting. The contribution to accounting literature of this study is that it analyzes a possible correlation between the integrated reports and the company’s board characteristics.

2. Literature review

Companies play the main role into capitalist economies, creating economic grow which leads to a better social environment. In order to create added value, companies interact with different actors like: investors, employees, regulators, suppliers, customer, to whom delivers: products, services and information. But in order to establish new relationships, the actors need information to enter into an exchange with the company. In this sense the companies disclose information to reduce the asymmetry between them and investors. This assumption refers to shareholders theory which is concerned to resolve two problems: “first is the agency problem…the second is the problem of risk sharing” (Eisenhardt, 1989) which may occur in the relation between the principal, which delegates the work to another party, the agent.

Back in the 60’s, the disclosed information was only financial, lately, due to globalization and the enlargement of companies, other issues occurred come into the public attention: environmental and social issues. This company’s function is met by corporate reporting which disclose the overall picture of the activities of a corporate enterprise. It includes the following dimensions: financial reporting, executive remuneration, corporate governance and responsibility, narrative reporting, environmental and social reporting, human resource reporting, segment reporting, integrated reporting.
The need to report on a broader information area, is argued by the explanatory factors of market value, which consisted, in 1975, 83% from physical and financial assets, 17% other factors, while in 2009 the ratio reversed: 81% other factors, 19% physical and financial assets. Thus, a new type of reporting appeared as an option to encompass both financial and non-financial information, which is integrated reporting. An integrated report is a concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term (IIRC, 2013).

The purpose of an integrated report, as IIRC highlights, is to explain to providers of financial capital how an organization creates value over time. It therefore contains relevant information, both financial and other. Therefore, the integrated report is used by investors and shareholders to make decisions. But not any type of information is taken into account by investors, but the one which influences the investment decision. Furthermore, the investor’s behavior is not influenced only by mandatory disclosed financial information, but also by non-financial information and voluntary disclosed information. Thus, deciding whether or not to adopt and disclose on a broader range of information might influence the capital suppliers (investors).

This is mainly driven by corporate governance, because the management of the company decides what should be disclosed or not. Thus, corporate governance should be considered an influence on disclosure, because the board of directors manages information disclosure in annual reports and therefore disclosure may be a function of the structure, characteristics and constituents of boards, resulting the agency relationship, where the shareholders and investors require more information to be disclosed by the management (Haniffa & Cooke, 2002). It is considered that non-executive directors tend to have interests aligned with external stakeholders.

As the framework proposed by IIRC is mainly voluntary adoptable, it is important that this voluntary disclosed information could change the shareholders and investor’s behavior or at least to reduce the asymmetry between them and management, based on the shareholders theory. Voluntary disclosures lead to an improvement of creditability of reported earnings and lower the information asymmetry between investors and managers, thus voluntary disclosure is relevant for investors (Cormier & Magnan, 2007). But when voluntary discloses, companies, have to be cautious, due to the fact that disclosing certain type of information might negatively affect the company’s reputation or reveal competition-sensitive information.

*Previous studies*
The voluntary disclose of information was prior analyzed in other studies. Mainly, voluntarily disclosed information was non-financial.

Regarding the board characteristics, Brammer & Pavelin (2008), analyzes whether or not the quality of voluntary environmental disclosure tends to be higher the more non-executive directors the firm has. They find a significant correlation but these two are negatively linked, thus, the higher the number of non-executive directors higher the probability of not voluntarily disclosing environmental issues. The sample is formed from 447 companies, representing 64% of FTSE All-Share Index, for years 1999 and 2000.

Lim et al. (2007) examines the association between board composition and different types of voluntary disclosure, such as strategic information, historical financial information. The overall finding suggests that there is a positive and significant relation between board composition and total voluntary disclosure in company annual reports. The results indicated that boards composed of largely independent directors voluntarily disclose more forward looking quantitative and strategic information and board structure does not influence the non-financial and financial voluntary information disclosure. The sample is formed from 181 Australian Top 500 companies, for year 2001.

Villiers et al. (2011) investigates the relationship between corporate environmental performance and board characteristics, such as the role of directors. They find that companies having a higher concentration of independent directors and larger boards have a higher environmental performance. The sample is formed from 1,216 companies from KLD database from U.S., with 2,151 observations for years 2003 (981 observations) and 2004 (1,170 observations).

Cheng and Courtenay (2006) analyses the association between board monitoring and the level of voluntary disclosure. They focus on the proportion of independent nonexecutive directors, board size, whether or not the same person is both CEO and chairman. The results highlight that there is a significant and positive association between the proportion of independent non-executive directors and voluntary disclosure, in the sense that they tend to disclose more than the companies with a lower proportion of independent non-executive directors. Board size and CEO duality are not correlated with the level of voluntary disclosure. The sample is formed from 104 listed companies on Singapore Stock Exchange, for year 2000.

3. Data and variables

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time (short, medium and long term), based on it’s resources (financial, manufactured, intellectual, human, social and relationship, and natural capital) and relationships (IIRC,
Thus, we can state that issuing an integrated report aspects like: environmental reporting, corporate social responsibility, are embedded in this report (integrated report).

Therefore we want to seek for any possible correlation between the disclosure (issuing) of an integrated report and the company’s board characteristics. Issuing an integrated report is mainly optional, excepting South Africa, and by doing it, investors might understand better the company, convincing them to invest. Certain board characteristics might influence the voluntarily adoption, in accordance with IIRC Framework, of integrated reporting. Due to the fact that all the companies from the sample, issued an integrated report, we will check the extent to which these are in accordance with the IIRC Examples Database, by an Disclosure Index.

The board characteristics refer to the following: independence, duality, diversity (Prado-Lorenzo & Garcia-Sanchez, 2010). In this study these characteristics of the board will be determined using: board size, the percentage of independent non-executive directors reported to the total number of board members, CEO gender, whether or not the CEO is also the president/chairman of board of directors, if there has been a CEO change during that year and the percentage of women in board.

Thus, in order to test the possible correlation between issuing an integrated report, more specifically the extent to which an integrated report, issued by a company complies with the recommendations from the IIRC framework, and company’s board characteristics, we will use the following variables:

- The extent to which the integrated report is issued in accordance with the IIRC framework, using a Disclosure Index (DI) – dependent variable; and
- The board characteristics, based on previous studies: board size, the percentage of independent non-executive directors reported to the total number of board members, CEO gender, whether or not the CEO is also the president/chairman of board of directors, if there has been a CEO change during that year and the percentage of women in board.

The Disclosure Index is build up based on the IIRC framework. Thus, in order to build up the Disclosure Index the following issues, from the framework, were taken into account: the presentation of “Six Capitals”, the “Content Elements” – which are presented based on the “Guiding Principles”, to which we add whether the report is audited from the integrated report perspective. To make integrated reports as reliable and comparable as financial reports, an integrated assurance opinion will have to be provided (Eccles et al, 2011). Ideally, it will be in the form of “positive assurance” rather than the “negative assurance”. Furthermore, is most probably to give assurance on the methods, methodology and procedures on which the integrated report was built on rather than on the accuracy of information.
Therefore for the DI we checked whether or not the issued report contains or not the following content elements: *organizational overview and external environment; governance; business model; risks and opportunities; strategy and resource allocation; performance; outlook; basis of preparation and presentation.*

Thus, each of the above mentioned items, became a binary variable: if the report presented the element the variable took “1” as value and if not “0”. The same principle was applied whether the report was audited, as an integrated report, when the value was “1” or not, when the variable was “0”. Also if the company presented information regarding the six capitals (*financial, manufactured, intellectual, human, social and relationship, natural*), which could be applicable to their business model and activity, the value was “1” and if not “0”. The same principle was applied for CEO gender, where “1”=male and “0”=female, *whether or not the CEO is also the president/ chairman of board of directors*, where “0”=CEO is also the president/ chairman of board of directors and “1”=if is not and if there has been a CEO change during that year, where “0”=there was no CEO change and “1”=there was a CEO change.

Thus, if the company presented the content elements, information regarding the six capitals and the issued report was audited as an integrated report, it could score a “10”.

One of the advantages of using the **Disclosure Index** is that it measures and compares the actual presented information, in the issued reports, with the maximum possible presented information that it could be disseminated by the company. In this case it measures to which extent the analyzed reports are issued and presented based on the IIRC framework.

In this case DI is the dependent variable and is computed as follows: 

\[
DI = \frac{\sum_{i=1}^{m} di}{\sum_{i=1}^{n} di}; \text{ where }
\]

\[
DI = \text{Disclosure Index, } DI=[0;1]
\]

\[d_i = 1 \text{ if the item is disclosed and } 0 \text{ if not; }\]

\[m = \text{ the number of the disclosed items; }\]

\[n = \text{ maxim number of analyzed items.}\]

So, if the company have been presented all the items and audited, it took 1 as value. Disclosure Index takes values between 0 and 1, due to the fact that is a arithmetic average, a value closer to 1 indicating a greater compliance with the IIRC framework of the analyzed report.

The independent variables express the board characteristics through **board size, the percentage of independent non-executive directors reported to the total number of board members, CEO gender,**
whether or not the CEO is also the president/ chairman of board of directors, if there has been a CEO change during that year and the percentage of women in board.

The data was collected manually for each company, from the uploaded reports in the IIRC Examples Database, on the IIRC website. The sample initially included 122 observations and 89 companies for years: 2012 (22; 19), 2013 (39; 30), 2014 (45; 32) and 2015 (13; 8). We decided to exclude the reports for year 2011 due to the fact that was the first year, and the reports were not familiar with the framework and our result might be distorted.

In Figure 1 – Appendix is displayed the DI composing items for all 122 observations. Most of the companies, out of 89, 74 are publicly listed companies, 15 are private companies. They are from: 7 from North America, 5 from South America, 49 from Europe, 11 from Africa, 13 from Asia, 4 from Australasia. The average length for a report was 167 pages.

4. Analysis and Results

In order to test the possible correlation between Disclosure Index, which is the dependent variable, respectively board size, the percentage of independent non-executive directors reported to the total number of board members, CEO gender, whether or not the CEO is also the president/ chairman of board of directors, if there has been a CEO change during that year and the percentage of women in board, independent variables, we used the Pearson Correlation and ANOVA tests, using SPSS. Due to the fact that for some companies the variables could not be determined, we eliminated them from the sample, remaining 119 observations. Nevertheless the sample kept its’ structure and the parameters of central tendency their values.

In order to verify whether the distribution of the sample (population) follows normal law, we used the Kolmogorov-Smirnov Test. The results are highlight in the below table:

<table>
<thead>
<tr>
<th>Population</th>
<th>DI</th>
</tr>
</thead>
<tbody>
<tr>
<td>119</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Normal Parameters</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0,6</td>
<td>0,15</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Asymp. Sig. (2-tailed)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0,21</td>
</tr>
</tbody>
</table>

Source: SPSS computations

Based on the above results, we can state that the distribution is normal, as the significance level of the test (0,21) is greater than the significance level (0,05). The same conclusion results from computing the parameters: mean (0,6), median (0,6) and mode (0,6), because all three are equal.
Computing the variance coefficient results 25%, which is lower than 35% resulting that the mean is significant for the studied reports. The histogram is in Figure 2 – Appendix.

For the analyzed variables the descriptive statistics is as below:

<table>
<thead>
<tr>
<th>Parameter</th>
<th>DI</th>
<th>Board size</th>
<th>Indep. Non-exec</th>
<th>CEO president</th>
<th>CEO gender</th>
<th>CEO change</th>
<th>Women board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>0.62</td>
<td>11,35</td>
<td>0.50</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>0.20</td>
</tr>
<tr>
<td>Mean</td>
<td>0.60</td>
<td>11.00</td>
<td>0.54</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>0.20</td>
</tr>
<tr>
<td>Mode</td>
<td>0.60</td>
<td>9</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>0.15</td>
<td>3.36</td>
<td>0.30</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>0.12</td>
</tr>
<tr>
<td>Variance</td>
<td>0.02</td>
<td>11.32</td>
<td>0.09</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>0.01</td>
</tr>
<tr>
<td>Minimum</td>
<td>0.30</td>
<td>5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Maximum</td>
<td>0.90</td>
<td>21</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>0.56</td>
</tr>
</tbody>
</table>

Source: SPSS computations

We also tested whether or not the average score for DI is different depending on: organization type, industry and region. For the organization type we had two segmentation variables: public listed company and private company. In this case the mean was the same (0.61) this meaning that disclosing process is not influenced by the company ownership structure. In case of the industry where companies operate, we obtained the following results: Consumer goods and services – 31 observations (mean= 0.61), Financial and professional services – 28 observations (mean= 0.67), Healthcare – 7 observations (mean= 0.51), Industrials and Basic materials – 27 observations (mean= 0.61), Telecommunications – 5 observations (mean= 0.58) and Utilities – 21 observations (mean= 0.6). Based on industry segmentation we can state that companies operating in financial sector tend to disclose more than those in healthcare.

Regarding the region where the company has it’s headquarter we had the following regions: Africa – 16 observations (mean= 0.65), Asia - 17 observations (mean= 0.62), Australasia - 5 observations (mean= 0.68), Europe – 67 observations (mean= 0.6), North America – 8 observations (mean= 0.66) and South America – 6 observations (mean= 0.68). Based on the results highlighted previously, we can state that, in average, companies does not disclose, in accordance with IIRC framework, significantly different.

In order to analyze the possible correlation between DI and the independent variables, we used Pearson Correlation and ANOVA tests for which we stated the following two hypothesis, for each of the independent variables:
- **$H_0$:** according to which board size, the percentage of independent non-executive directors reported to the total number of board members, CEO gender, whether or not the CEO is also the president/ chairman of board of directors, if there has been a CEO change during that year and the percentage of women in board, does not influence the extent to which the issued integrated report, by the companies from the IIRC Examples Database, is in accordance with the IIRC Framework, highlight by Disclosure Index; with the alternative

- **$H_1$:** according to the Disclosure Index, the extent to which the issued integrated report is in accordance with the IIRC Framework, is influenced by these variables.

Applying the Pearson Correlation Test, to test the correlation between the dependent variable (DI) and the independent quantitative variables, we obtained the following results:

<table>
<thead>
<tr>
<th>Table 3. Pearson Correlation Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>DI</td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>DI</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
</tr>
<tr>
<td>N</td>
</tr>
</tbody>
</table>

*Source: SPSS computations*

In order to explain the obtained results, the following remarks need to be made: if the Pearson Correlation coefficient is positive it means that we have a direct link and if it is negative we have an indirect link, between the variables. If the value of the coefficient is between \([0;0,3]\] the link is weak, between \((0,3;0,7]\] the link has an medium intensity and between \((0,7;1]\] the link is strong.

In this case, only for Board size we flag a significant correlation. The Pearson Coefficient is 0.191 which means that is a weak and direct link between DI and Board size, being also significant as the significance level is 0.038 which is smaller than 0.05. In this case we accept $H_1$ hypothesis. The same methodology is applied for the other variables resulting that for: Independent non-executive and Women board variables, $H_0$ hypothesis is accepted, thus there is no correlation.

To analyze the qualitative variables (CEO gender, whether or not the CEO is also the president/ chairman of board of directors, if there has been a CEO change during that year) in correlation with DI we used ANOVA. The results are as below:

<table>
<thead>
<tr>
<th>Table 4. ANOVA Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>DI:</td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>Sig.</td>
</tr>
</tbody>
</table>

*Source: SPSS computations*
Due to the fact that the significance level for each of the analyzed variables which is greater than 0.05 $H_0$ hypothesis is accepted. So, nor the CEO gender, whether or not the CEO is also the president/ chairman of board of directors, if there has been a CEO change during that year influences the extent to which the issued integrated report, is in accordance with the IIRC Framework (expressed by DI).

The only correlation found, is between the board size and the extent to which the issued integrated report, is in accordance with the IIRC Framework (expressed by DI), with a direct and weak link. So, according to this finding the more directors the board has the more the issued integrated report, is in accordance with the IIRC Framework. Our result is in accordance with Villiers et al. (2011) findings.

5. Conclusions and limitations

Previous studies analyze the possible correlation between board features and voluntary disclosure. The results highlight that there is a link between the percentage of independent and non-executive directors in the board structure and board size and different types of voluntary disclosure.

Starting from previous mentioned studies we tested to whether or not board characteristics of the companies from the IIRC Examples Database influence the extent to which company’s issued integrated report is in accordance with the IIRC framework. Here we can find some similarities with the previous studies, due to the fact that: issuing an integrated report in accordance with the IIRC proposed framework is voluntary.

Using the Pearson Correlation and ANOVA Tests we verified whether or not there is any correlation between DI and independent variables. For the board characteristics, only for board size we found that there is a direct and weak link between board size and the extent to which the issued integrated report, is in accordance with the IIRC Framework. So, according to this finding the bigger the board is the more the issued integrated report, is in accordance with the IIRC Framework. For the other variables no correlation could be found. Thus issuing an integrated report does not depend on the percentage of independent non-executive directors reported to the total number of board members, CEO gender, whether or not the CEO is also the president/ chairman of board of directors, if there has been a CEO change during that year and the percentage of women in board.

Some of the reasons of this result is that the framework is not mandatory, the principles and the guidelines being very flexible, being also something new for the participating companies and also an exercise to issue this type of report.
Nevertheless, issuing an integrated report should not depend on some features of the company board, because this type of reporting develops the integrated thinking, improving the quality of information available to providers of financial capital leading to a more efficient and productive allocation of capital. Moreover, integrated reporting intends to become the norm.

Limitation of this study is the size of sample and also the independent variables. Possible future research questions could take into consideration other variables which highlight the economical, regulatory, legal, labor and cultural backgrounds for the countries from which the analyzed companies are (based on the institutional theory).

References


Appendices
Figure 1. Disclosure index – drilled by items

Source: author’s projection

Figure 2. Histogram

Source: SPSS computations

Table 5. Disclosure index – drilled by score

<table>
<thead>
<tr>
<th>DI score</th>
<th>1</th>
<th>0.9</th>
<th>0.8</th>
<th>0.7</th>
<th>0.6</th>
<th>0.5</th>
<th>0.4</th>
<th>0.3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of companies</td>
<td>5</td>
<td>11</td>
<td>25</td>
<td>29</td>
<td>22</td>
<td>20</td>
<td>7</td>
<td>3</td>
<td>122</td>
</tr>
</tbody>
</table>

Source: author’s projection