

# Chapter 2

## Integrated Reporting

**Abstract** The voluntary decision to issue an integrated reporting is in the hands of internal managers and managers in different countries behave differently, by producing different kinds of social and environmental information. We focus on the analysis of non-financial voluntary disclosure with a further investigation on the Integrated Report (IR) and its role within the corporate disclosure. In particular, we provide a practical and theoretical framework of integrated reporting and propose a comparison of the main frameworks available within the relevant literature. An analysis of the literature reveals some streams of studies in this area, such as integrated reporting and sustainability, integrated reporting and corporate governance, integrated reporting and its components, and the assurance of integrated reporting. This Chapter ends with a focus on the South African experience. Since the end of apartheid in 1994, the need for the social and economic empowerment of the black population has been a driving force in the development and evolution of the King Reports. As a matter of fact, it has been widely acknowledged that South African companies were the first to address IR issues because of the consequences of the end of apartheid.

### 2.1 Introduction

The following sections deal with the analysis of non-financial voluntary disclosure with a focus on the integrated report (IR) and its role within the corporate disclosure. In particular, we will provide a practical and theoretical framework of IR and propose a comparison of the main frameworks available within the relevant literature. Furthermore, we will analyze the IR standards in South Africa.

### 2.2 Non-Financial Voluntary Disclosures

Corporate disclosure is an important means that management can use to communicate a firm's performance and governance to stakeholders (Healy and Palepu 2001); therefore, it is mainly aimed at satisfying a wide range of stakeholders and

should be disclosed to improve the firm's consensus and reputation among stakeholders (Watts and Zimmerman 1990). However, a firm's reputation can increase only if its disclosure is reliable (Anderson 1978; Root and Grumman 1998). According to Beyer et al. (2010), corporate disclosure has a twofold role. The first role regards the ability of disclosure to allow investors and capital providers to evaluate the return of investment opportunities. In this context, investors and capital providers have less information than managers, since they are outsiders, while managers could exaggerate the firms' economic results to attract capital, thereby generating lemons problems.<sup>1</sup> The second role regards the ability of disclosure to allow capital providers to define the corporate governance system and monitor the use of capital resources (Beyer et al. 2010). In the end, corporate disclosure is used by management as a mechanism for addressing market imperfections, thus reducing information asymmetry between managers and investors (Bushman and Smith 2001; Christie and Zimmerman 1994; Khanna et al. 2004; Watts and Zimmerman 1990, 2006). However, corporate disclosure also addresses the internal need of a company to correctly disclose information to the market about its performance, thereby reducing uncertainties for investors and, as a result, the cost of capital (Lambert and Verrecchia 2015).

It is possible to identify three levels of analysis of corporate disclosure: mandatory and voluntary disclosure, financial and non-financial information, and forward-looking and historical information, even if these three levels of analysis are not independent of one other and the relative boundaries are not easily detected and defined (Trucco 2015). The mandatory disclosure refers to corporate disclosure which is mandated by legal requirements and audited by external parties (audit firms), whereas the voluntary disclosure regards corporate disclosure which goes beyond the legal requirements (Meek et al. 1995). The issue of voluntary disclosure has been studied by several scholars for many years (Admati and Pfleiderer 2009; Bamber et al. 2010; Ben-Amar and McIlkenny 2014; Bens et al. 2011; Bischof and Daske 2013; Core 2001; Graham et al. 2005; Guidry and Patten 2012; Healy and Palepu 2001; Verrecchia 1983). According to the literature, companies tend to undertake voluntary disclosure in the form of management forecasts, press releases, conference calls, and presentations and websites to provide greater clarity for investors and thus reduce information asymmetry between the company and its stakeholders (Verrecchia 1983), the cost of raising equity capital (Botosan 1997; Shroff et al. 2013) and the cost of debts (Sengupta 1998). However, voluntary disclosure can be considered as a complement of and not a substitute for mandatory

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<sup>1</sup>Akerlof (1970) defined the lemons problem as those situations in which buyers need to evaluate the quality of goods offered by sellers in a situation of information asymmetry. If buyers do not have enough information about the quality of goods sold, sellers of lower quality goods (lemons) can exploit the information asymmetry for themselves (moral hazard). In this situation, buyers could overestimate the price of lemons. As a consequence, the price of higher quality goods is underestimated (adverse selection). Therefore, the only way for sellers of higher quality goods not to be cheated is to eliminate the information asymmetry, by signaling the higher quality of their products (e.g., through warranties, etc.) (Akerlof 1970).

disclosure (Ball et al. 2012). Moreover, voluntary disclosure is aimed at reducing the power imbalance between the company's management and stakeholders, who have more than just monetary interests in the company (Abeysekera 2013).

According to disclosure theory, companies provide voluntary disclosures if their benefits cover their costs. Thus, the decision to disclose (and in what form) voluntary information is a strategic one (Abeysekera 2013). In particular, the costs of disclosing voluntary information regard disadvantages linked to giving away sensitive information of a firm, resulting in a dangerous loss of competitive advantage or in litigation and proprietary costs (Beattie and Smith 2012; Elliot and Jacobson 1994; Healy and Palepu 2001). However, the recent trend has been a general increase in the amount of voluntary disclosures, thanks also to some reforms issued in an international setting, which have fostered a reduction in the information asymmetry between managers and investors, and to the growing development of the Internet, which allows managers to use corporate websites to present company reports (Ismail 2002).

The increase of voluntary disclosure may reduce information risk, but only if the disclosed information is reliable and accurate (Bebbington et al. 2008; Fombrun et al. 2000). The consequences of unreliable voluntary disclosure are negative for firms, since some authors have demonstrated that if stakeholders discover a firm which discloses unreliable information, then they are likely to consider as unreliable all information subsequently disclosed by the firm (Fama and Miller 1972; Jensen and Meckling 1976). Some scholars have demonstrated that if the mandatory disclosure is reliable and credible, even the non-verifiable voluntary disclosure seems to be perceived as credible by investors and stakeholders at large (Ball et al. 2012; Gigler and Hemmer 1998; Lundholm 2003; Stocken 2000). Gigler and Hemmer found that mandatory reporting plays a confirmatory role in an agency setting. Furthermore, they argued that voluntary disclosures are more informative, since they are mainly based on managers' private information (Gigler and Hemmer 1998). In a similar vein, Stocken stated that voluntary disclosures are ignored by the market and considered not credible if there are no mechanisms to enforce verifiability (Stocken 2000). On the other hand, in the presence of proper mechanisms to enforce verifiability, voluntary disclosure may be considered credible and informative (Dhaliwal et al. 2011; Lundholm 2003; Stocken 2000). Lundholm also highlighted that if the mandatory disclosure is mainly backward-looking, the voluntary disclosure becomes more credible (Lundholm 2003).

Voluntary disclosure may be financial and non-financial in nature. An example of voluntary financial information might be earnings estimates (Chow and Wong-Boren 1987; Graham et al. 2005; Kent and Ung 2003), whereas voluntary non-financial information could regard social, human and environmental disclosures, such as Corporate Social Responsibility (CSR) (Dhaliwal et al. 2011), Intellectual Capital disclosure (Bontis 2001) and IR (Abeysekera 2013). Professional associations have pointed out the growing relevance of non-financial information; the Association for Investment Management and Research argued that this kind of disclosure could represent a good means of communicating a firm's progress and evolutionary paths to stakeholders (AIMR 1992).

Disclosing voluntary, non-financial information could contribute to reducing the gap between external and internal information and the cost of capital, and to attracting institutional and specialized investors (Dhaliwal et al. 2011; Zhou et al. 2016). On the other hand, environmental reporting seems not to have improved environmental performance (Cho and Patten 2013), and some scholars have shown that even financial analysts have begun to use and to evaluate non-financial indicators (Breton and Taffler 2001; Previts et al. 1994). Furthermore, other authors have highlighted the increasing relevance of soft information, that is, unquantified and unquantifiable information. In their view, soft information is not possible to quantitatively determine and quantify with accuracy, especially when information is future-oriented (Beattie et al. 2004).

The Global Reporting Initiative (GRI) contributes to promoting forward-looking and non-financial indicators by helping firms to disclose environmental and social sustainability items. Similarly, the World Intellectual Capital Initiative (WICI) supports firms in defining and disclosing internal Key Performance Indicators (KPIs) on intangibles (WICI 2010). Therefore, examples of non-financial and forward-looking information are Intellectual Capital and the CSR disclosures. Despite the aforementioned considerations about the growing relevance of this kind of financial accounting information, a survey by PricewaterhouseCoopers (PwC 2007) demonstrates that analysts and investors do not rely on management information, since they do not expect neutral behaviour by managers in disclosing sensitive information. Managers are indeed prone to emphasizing the positive performance of the company, hiding or simply omitting negative news and performance (Silvi and Bartolini 2011).

In this framework, we can conclude that, especially recently, scholars have emphasized the importance of reporting on governance, sustainability and social topics in order to meet stakeholders' expectations (Frías-Aceituno et al. 2013; Skouloudis et al. 2010). The following sections will focus on IR, its role in non-financial voluntary disclosure, and its theoretical and practical frameworks.

## **2.3 The Role of Integrated Reporting in Company Disclosure**

The voluntary decision to disclose IR is in the hand of internal managers, and firms from different countries behave differently by producing different kinds of social and environmental information (Dong and Stettler 2011; Frías-Aceituno et al. 2013). In this way, firms can meet stakeholders' needs (Cohen et al. 2012) and improve transparency, governance and decision-making (Adams and Simnett 2011). However, to date only 21% of listed firms disclose any sustainability information (Bloomberg 2010). IR is embedded into the integrated thinking. As pointed out by Churet and Eccles, integrated reporting is only the tip of the iceberg: the visible part of what is happening below the surface. Integrated thinking is

related to what is happening below the surface (Churet and Eccles 2014). The IR framework clearly states that “The more that integrated thinking is embedded into an organisation’s activities, the more naturally will the connectivity of information flow into management reporting, analysis and decision- making. It also leads to better integration of the information systems that support internal and external reporting and communication, including preparation of the integrated report” (IIRC 2013: 2).

The IR Committee of South Africa defines the main aim of IR as follows, *The core objective of the Framework is to guide organizations on communicating the broad set of information needed by investors and other stakeholders to assess the organization’s long-term prospects in a clear, concise, connected and comparable format. This will enable those organizations, their investors and others to make better short and long-term decisions*, (Integrated Reporting Council of South Africa (IRCSA) 2011: 2). This confirms the relevance of IR in corporate disclosure in order to create long-lasting value for each class of a firm’s stakeholders.

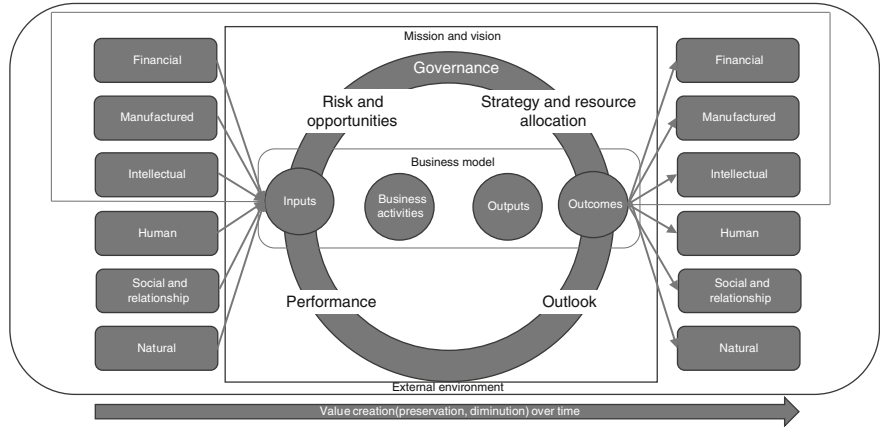
Furthermore, the International IR Committee defines IR as follows: “IR brings together the material information about an organization’s strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates. It provides a clear and concise representation of how an organization demonstrates stewardship and how it creates value, now and in the future. IR combines the most material elements of information currently reported in separate reporting strands (financial, management commentary, governance and remuneration, and sustainability) in a coherent whole, and importantly: (1) shows the connectivity between them; and (2) explains how they affect the ability of an organization to create and sustain value in the short, medium and long term.” (International Integrated Reporting Council, U.K. (IIRC) 2011: 2).<sup>2</sup>

At the core of this framework is the need to link the financial and economic impact of a firm to its social, governmental and environmental impacts as well. This approach has its roots in ‘triple bottom line accounting’ (Elkington 1994), where social and environmental reporting gained relevance.

Figure 2.1 shows the value creation process, presenting IR as designed by the IIRC. The process encompasses the six pillars of IR, along with the mission, vision and business model. In fact, IR is focused on six pillars, namely: (1) financial capital; (2) manufactured capital; (3) human capital; (4) intellectual capital; (5) natural capital and (6) social capital (see Fig. 2.1). The IIRC points out that the role of the six forms of capital, in value creation, changes for different organizations, working in different industries, under different contextual factors (International Integrated Reporting Council, U.K. (IIRC) 2011). For instance, natural capital will be pretty much more important in the mining than in the service

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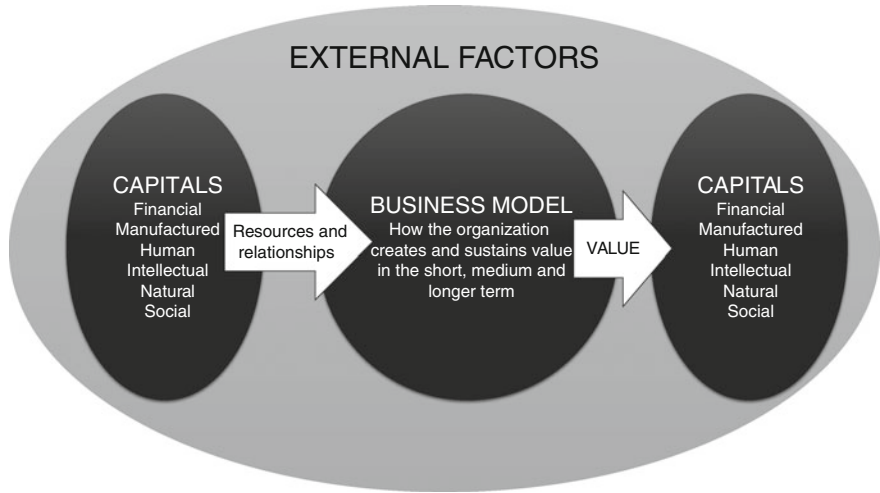
<sup>2</sup>The International IR Committee (IIRC) is an international cross-section of leaders from the corporate, investment, accounting, securities, regulatory, academic, civilian and standard-setting sectors (IIRC 2011: 3).



**Fig. 2.1** The value creation process (adapted from: IIRC (International Integrated Reporting Council, U.K.) 2013)

industry. Moreover, intellectual capital will add a greater value in the fashion industry, than in the commodity market, since the value relevance of brands will be higher in the former, compared to the latter context.

Figure 2.2 shows that each class of capital is necessary to create value. Moreover, the IIRC highlighted the relevance in disclosing the relationship between different classes of capital in the value creation process (IIRC 2011). In fact, reporting performance related to different classes of capital within the same firm is



**Fig. 2.2** The business model (Adapted from: IIRC (International Integrated Reporting Council, U.K.) 2013)

different than issuing an IR. In order to effectively disclose the relationships between different forms of capital, White contends that the concept of capital stewardship should be taken into account (White 2010). This concept refers to the “preservation and enlargement of multiple forms of capital, all of which contribute to long-term value creation by the firm” (White 2010: 30). The capital stewardship approach requires the reporting of three different linkages between capital classes and their performance. First, the company’s ownership, control and influence of different types of capital. Secondly, the change in the stock of each capital over the observed period. Thirdly, how the change in stock of one form of capital affected changes in other forms (White 2010).

The UK standard setter also identified content elements, which should be included in an integrated report, i.e., an introductory section which should contain the organizational overview and business model, the firm’s operating context (including risks and opportunities), a section on strategic objectives and related strategies to achieve them, followed by a governance and remuneration section, and a performance and concluding section on the future outlook (IIRC 2011).

In order to produce an effective integrated report, companies should adhere to the following main principles of IR:

1. Strategic focus and future orientation: an integrated report should provide insight into the organization’s strategy and how that strategy relates to the organization’s ability to create value in the short, medium, and long term and its use of and effects on its forms of capital.
2. Connectivity of information: an integrated report should show, as a comprehensive value creation story, the combination, interrelatedness and dependencies among the components that are material to the organization’s ability to create value over time.
3. Stakeholder responsiveness: an integrated report should provide insight into the quality of the organization’s relationships with its key stakeholders and how and to what extent the organization understands, takes into account, and responds to their legitimate needs, interests, and expectations.
4. Materiality and conciseness: an integrated report should provide concise information that is material to assessing the organization’s ability to create value in the short, medium, and long term.
5. Reliability and completeness: an integrated report should include all material matters, both positive and negative, in a balanced way and without material error.
6. Consistency and comparability: the information in an integrated report should be presented on a basis that is consistent over time and in a way that enables comparison with other organizations, to the extent it is material to the organization’s own value creation story (International Integrated Reporting Council, U.K. (IIRC) 2011: 5).

## 2.4 Integrated Reporting: Literature Review

The topic of IR has recently interested scholars, managers, professionals, organizations, audit firms and the mass media from all over the world. The following sections will analyze the literature streams which deal with IR. Recently, some studies analyzed and reviewed the relevant literature on IR, by highlighting antecedents and consequences of IR, such as country and firm characteristics correlated to early-adopters of IR (Frias-Aceituno et al. 2013; Perego et al. 2016), or a relation between the adoption of IR and quality of management (Churet and Eccles 2014). According to Dumay and colleagues' literature review (Dumay et al. 2016), the relevant studies in IR can be analyzed according to jurisdiction, organizational focus, country of research, research methods, IR frameworks and models, the inclusion of academics, practitioners and consultants. Even though the literature review by Perego et al. (2016) contends that the adoption of IR is higher in civil law, compared to common law, countries, the investigation on the country of origin of the firms adopting IR deserves more attention due to contextual variables that can affect the decision and the implementation of IR and its thinking.

### 2.4.1 *Integrated Reporting and Sustainability*

IR can be seen as a response to a growing interest and requests from stakeholders regarding social and environmental matters that affect the companies' sphere (Azcárate et al. 2011). Sustainability reporting and the transparency of environmental and social performance have received more and more attention from scholars, practitioners, and even the mass media (Kolk 2008). In fact, CSR could be considered as a worldwide movement (Ditlev Simonsen and Gottschalk 2011) even if this kind of reporting is mostly voluntary for firms all over the world. However, recent literature has questioned the role of social and environmental accounting in effectively supporting sustainable development, since many environmental indicators are showing a decline in the natural environment condition (Cho et al. 2015; Milne and Gray 2012).

IR provides some benefits in bringing together in a single document both financial and non-financial information on the firm's performance (Eccles and Saltzman 2011). Such benefits could also be extended to not-for-profit organizations (Adams and Simnett 2011). In particular, Eccles and Saltzman have highlighted three main classes of benefits for firms that adopt IR, namely: (1) internal benefits; (2) external market benefits; and (3) benefits from managing regulatory risk. The first type of benefit, internal, regards lower reputational risk and a better use of internal resources. On the other hand, external market benefits regard the fact that stakeholders may be more and better informed about the financial and non-financial performance of a company. Similarly, Arguelles et al. (2015) tested the value relevance of IR and posited that early-movers, i.e., those companies which

decided to voluntarily disclose an integrated report, also reported higher market values compared to non-early-moving firms. However, there is a negative relationship between early-movers and market values for those firms showing a strong adherence to the IIRC standards. Finally, the third class of benefits regards advantages that firms can have regarding regulators, such as the possibility of being involved as a main actor in developing frameworks and standards (Eccles and Saltzman 2011).

Despite such considerations, only a few firms have adopted IR as a single document (Eccles and Krzus 2010); this low rate of adoption could be due to extra costs and resources needed to produce IR and to communicate this to external users (Prado-Lorenzo and Garcia-Sanchez 2010).

Moreover, some scholars, such as Flower (2015), contend that IR has abandoned the principles of sustainability, whereas others think that integrated and sustainability reporting can coexist (Adams 2015).

### ***2.4.2 Integrated Reporting and Corporate Governance***

A recent debate among scholars has focused on the relationship between corporate governance and sustainability, by investigating if good features of corporate governance may foster sustainability in terms of social, environmental and organizational aspects (Aras and Crowther 2008; Jamali et al. 2008; Huang 2013). Some scholars have investigated the relationship between board diversity and CSR performance, finding that some features, such as generational and age diversity, are relevant factors in improving corporate governance (Ferrero-Ferrero et al. 2015; Post et al. 2011).

This topic has received growing attention from scholars and practitioners, since a sound corporate governance is necessary to satisfy internal and external stakeholder needs.

This kind of relationship is particularly relevant at a time where the topic of corporate governance has become pivotal, especially after the global financial crisis and the corporate scandals, since scholars have proven that weaknesses in corporate governance may bring about earnings manipulation and financial statement fraud (Carcello and Neal 2000) and, in the end, a firm's failure (Kirkpatrick 2009). Beltratti found that both corporate governance and CSR problems were responsible for failures in the financial sector (Beltratti 2005), arguments which Sharma and Khanna agree with (Sharma and Khanna 2014).

### ***2.4.3 Integrated Reporting and Its Components***

Although <IR> is the most common framework in the IR literature, there is still open debate on which forms of capital and related items should be reported to

assure the transparency and comparability of performance among companies. Table 2.1 shows which items should be included for each component of the <IR>. This list of items is not meant to be comprehensive, since in the spirit of *integrated thinking*<sup>3</sup> each company should report those components and items that best represent their social, environmental and economic position at the time of reporting.

#### 2.4.4 Empirical Research on Integrated Reporting

Starting in 2013, when the IIRC framework was released, the amount of interest in IR has mounted among accounting scholars (Velte and Stawinoga 2016). Velte and Stawinoga (2016) have developed a research agenda for IR based on the level of analysis, the main theories used by researchers, research methodologies, the main input factors, and the output achieved. According to their findings, IR research is mainly focused on the market and organizational levels of analysis, with few studies at the group or individual levels of investigation. As for the research methodology in use, surveys, interviews and archival studies are the most common methods. IR assurance is an underdeveloped topic to date (Velte and Stawinoga 2016). The quality of integrated reports issued by the top 40 listed companies on the JSE varies from excellent to poor (Marx 2014). Recently, the IIRC has been strongly accused of being a “story of failure” (Flower 2015: 1). Flower, in fact, stated that some of the definitions of capitals are “tricky” and the boundaries between different capitals are “fuzzy” (Flower 2015: 3). However, he also acknowledges that the main value of the <IR> framework is not the structure of the scheme itself but its capability to focus managers’ attention on the integrated management of the six forms of capital included in the framework. When discussing the value that should be represented and analyzed in the integrated report, Flower contends that there is a bias in the selection of items included in the capitals, since they are included in the framework only when they contribute to the creation of value for the firm. As a matter of fact, capital items are not included when their value could be affected by the firm’s operations.<sup>4</sup> Adams replied to this argument by highlighting how IR is helping in aligning the corporate objective of maximizing profit with social and environmental objectives (Adams 2015). Moreover, when a trade-off between different types of capital occurs, the company is allowed to describe it and justify its negative impact (Flower 2015).

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<sup>3</sup>Integrative thinking is a term coined by the IIRC, which defines this approach as “The active consideration by an organisation of the relationships between its various operating and functional units and the capitals that the organisation uses or affect”. It adds “Integrated thinking leads to integrated decision-making and actions that considers the creation of value over short, medium and long term” (IIRC 2013: 2).

<sup>4</sup>The IIRC framework states that, *where a stewardship responsibility is not imposed by law or regulation, the organization may nonetheless accept stewardship responsibilities in accordance with growing stakeholder expectations*, (IIRC 2013: 18).

**Table 2.1** Literature review on the components of IR

	Items of each component of the IR	Literature streams and standard setters
Financial	Assets, debt, equity or grants Intangibles, non-current assets, short-term loans	IIRC Abeysekera (2013)
Manufactured	Buildings, equipment, and infrastructure Supplier audits Product recalls Failed inspections	IIRC Novo Nordisk Novo Nordisk Novo Nordisk
Intellectual	New patents Intellectual capital Culture Brands Customers Copyrights Software and organizational systems Procedures, processes, and protocols	IIRC, Novo Nordisk, Abeysekera (2013) IIRC, Abeysekera (2013) Abeysekera (2013) IIRC, Abeysekera (2013) Abeysekera (2013), Novo Nordisk IIRC IIRC IIRC
Human	Corporate governance Number of employees Employee turnover Gender in management Frequency of accidents Training and development Health and safety Ethical values Leadership	IIRC, King's report Novo Nordisk Novo Nordisk Novo Nordisk, Abeysekera (2013), UN Global Compact Novo Nordisk Abeysekera (2013) Abeysekera (2013), UN global compact IIRC, Novo Nordisk, King's report, UN global compact IIRC
Social and relationship	Donations Animal purchased for research Independent directors Audit committee Common values and behaviours Key relationships Reputation, trust and loyalty	Novo Nordisk Novo Nordisk Abeysekera (2013), King's report Abeysekera (2013) King's report IIRC IIRC IIRC, Novo Nordisk
Natural	Energy consumption Water consumption CO <sub>2</sub> emissions from energy consumption CO <sub>2</sub> emissions from transport Organic residues Waste Non-hazardous waste Breaches of regulatory limit values Minerals and forests Biodiversity Eco-system health	Novo Nordisk, Abeysekera (2013) IIRC, Novo Nordisk, Abeysekera (2013) IIRC, Novo Nordisk Novo Nordisk IIRC, Novo Nordisk Novo Nordisk Novo Nordisk Novo Nordisk, UN global compact IIRC IIRC IIRC, UN global compact

### 2.4.5 Assurance of Integrated Reporting

Professional auditing of an organization's financial performance is mandatory in many European and non-European countries, whereas auditing of non-financial performance is not mandatory in any country worldwide. Although integrated thinking and reporting is becoming more and more widespread as a management and accounting practice, few standards are available for the assurance of the reported non-financial information. Hence, to get credibility on their reported information and provide accountability, companies have to assure stakeholders that they are committing themselves to creating social value (O'Dwyer and Owen 2005). Dando and Swift (2003) believe that independent third-party assurance represents an instrument to bridge the credibility gap that characterizes the practice of Social, Ethical and Environmental (SEE) reporting (Dando and Swift 2003). However, to date assurance has been confined to some areas of the integrated report: namely, sustainability performance, the GRI application check level, and three accountability principles (Cheng et al. 2014). Some of the causes that prevent an effective assurance of integrated reports are listed below:

1. liability concerns of the main accounting firms (Eccles et al. 2012);
2. lack of consensus on what "true and fair view" means for an integrated report (Eccles et al. 2011);
3. lack of agreed upon guidelines and measures for the development of a standard assurance procedure, or change in the extant standard auditing procedures (de Villiers et al. 2014);
4. relevance of the assurance on the reported information, without an assurance of the related procedures (Cheng et al. 2014).

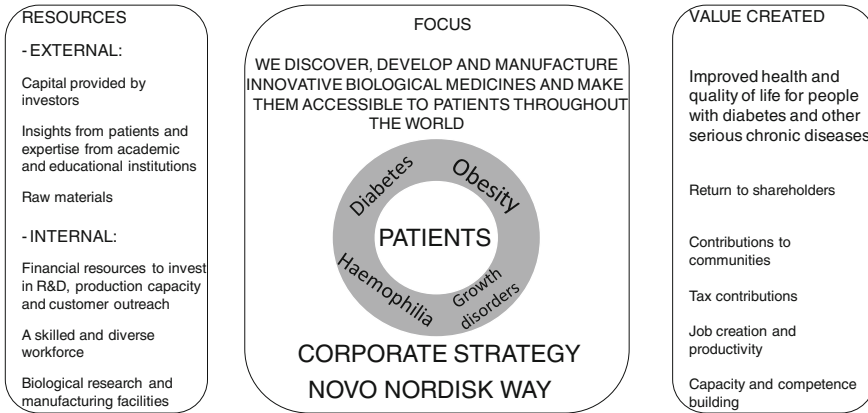
Even though these limitations are not going to be sorted out in a foreseeable future, preparers of the integrated report have to provide a strong assurance regarding the disclosed non-financial information and find a way to link it to financial performance (Adams 2015).

Mandating assurance of integrating reporting (IR) is another open question in the related literature. As a matter of fact, Faisal et al. (2012) clearly stated that "'voluntary' assurance statements play an important role in improving the credibility of disclosed information" (Faisal et al. 2012: 20). In fact, according to the findings of research carried out by Faisal et al. (2012), companies with additional voluntary assurance statements disclose more sustainability information compared with organizations without those statements. Faisal et al. explain that "[f]rom the legitimacy perspective, the adoption of such voluntary assurance statements may lift the reputation of companies and strengthen and legitimise their social responsibility activities" (Faisal et al. 2012: 30). Nonetheless, without a set of shared assurance standards, voluntary assurance statements will be comparable only by chance. In fact, given the different quality and content of assurance statements, the

comparability of sustainability reports and performances is not realistic. Standardized models used in financial auditing could be seen as an example but, since the SEE assurance regards different dimensions of the performance, a standard providing assurance for all dimensions of an organization's social, environmental and ethical information is needed, and the AA1000 assurance standard seems to respond to this request. Moreover, Manetti and Becatti (2009) believe that the credibility gap related to sustainability reports could be narrowed through assurance service. They identify ISAE 300028 and AA100029 as the main international standards for implementing assurance processes on sustainability reports. To improve the current assurance services, the authors believe stakeholder expectations should head the criteria for the relevance and materiality of the information disclosed in the report; the responsibility for the entire procedure should be given to the professional assurance provider and not divided among external experts; the levels of assurance adopted (reasonable, limited or no assurance) in the different parts of the audit should be explicitly communicated; and the assurance provider should verify legal compliance with the more restrictive national or international norms (Manetti and Becatti 2009). In addition, recognizing that collaborating with the financial audit team could be profitable for both audits, Manetti and Becatti (2009) "recommend that a financial report be part of a broader sustainability report. Alternatively, where these documents are separate, it is important that they are published concurrently" (Manetti and Becatti 2009: 296).

## 2.5 Integrated Reporting: Comparison of the Main Frameworks

A few IR frameworks have been developed over time. One of the pioneering frameworks in this field is the one put forward by Novo Nordisk (de Villiers et al. 2014). Novo Nordisk's approach was aimed at developing voluntary non-financial disclosure together with financial mandatory disclosure. Although Novo Nordisk has been recognised as a leader in the IR field (Dey et al. 2010), the mainstream literature usually refers to two IR systems, i.e., the South African one and the British one. The former, the King Report, is a set of standards that, starting from March 1, 2010, has been enforced by the Johannesburg Stock Exchange on any listed firm. Thus, South African listed companies have either to issue an IR or explain the justification for not publishing it, following an 'apply or explain' approach (Barth et al. 2015). The latter, the Integrated model of the IIRC, is a voluntary framework for reporting six different "resources and relationships" or "capitals", which provides a comprehensive situation of the company (International Integrated Reporting Council, U.K. (IIRC) 2011). The remainder of this section will present and critically compare the most relevant IR frameworks.



**Fig. 2.3** Corporate strategy Novo Nordisk way (adapted from: Novo Nordisk 2016 Annual Report: 4)

### 2.5.1 *Novo Nordisk*

Novo Nordisk is a Copenhagen-based healthcare company which has been widely recognized as one of the companies producing high quality integrated reports (Eccles and Krzus 2010).<sup>5</sup> In 1995, it started issuing an environmental report along with the annual financial report. In the following years, it continued to disclose environmental and social information in a specific report. Starting from 2001, it has also reported on the Triple Bottom Line (TBL) (Elkington 1994), and from 2004 it has consistently issued an integrated report as a comprehensive corporate disclosure. The company has also introduced a new managerial philosophy called “The Novo Nordisk Way of Management”, which is grounded on the TBL approach, where financial performance combines with social and environmental performance. The company’s way of management is made up of eight specific topics ranging from leadership, innovation, IR, ethics, and engagement. In 2015, the Novo Nordisk way of management turned into the corporate strategy Novo Nordisk way, which describes the company’s business model and takes into account the resources used to create value for a variety of stakeholders (Fig. 2.3).

Financial performance is first disclosed in the report, followed by social and environmental disclosures. This approach provides a hierarchy of different disclosures, and thus of stakeholders, with the financial information at the top of the company’s pyramid of disclosure. Novo Nordisk’s framework, which is consistent

<sup>5</sup>Novozymes was the first company to issue an integrated report, although under the name of “combined” rather than “integrated” report. Novo Nordisk and Novozymes demerged in 2000, which gave the two companies the opportunity to carry on a similar reporting approach (Eccles and Krzus 2010).

with the TBL approach, links financial responsibility to social and environmental responsibility, accounting for both short- and long-term targets.

### 2.5.2 *The King Reports*

In South Africa, the committee chaired by Professor Mervyn E. King issued four sets of guidelines for the preparation of the integrated report. In 1994, the first version of the report addressed issues of corporate governance and a code of conduct to be voluntarily disclosed by South African firms.

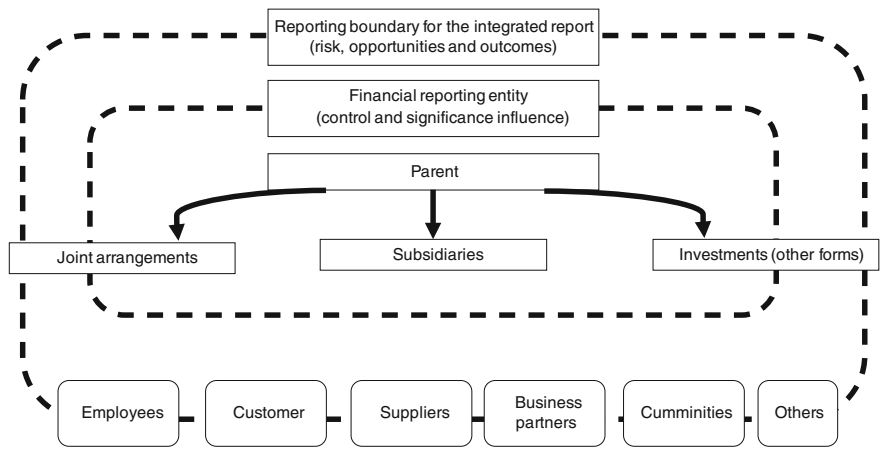
Chapter 20 points out the key elements of the King I report (Institute of Directors 1994):

1. the makeup of the board of directors and its mandate, including the role of non-executive directors and guidance on the categories of people who should make up the non-executive directors;
2. appointments to the board and guidance on the maximum term for executive directors;
3. the determination and disclosure of salaries for executive and non-executive directors;
4. the frequency of board meetings;
5. balanced annual reporting;
6. the requirements for effective auditing;
7. affirmative action programs;
8. the company's code of ethics.

In 2002, the second version of the King report was issued. King II focused more on risk management and the triple bottom line approach to accounting, with a specific section on integrated sustainability reporting. The need to revise the second version of the King report is due to the Companies Act no. 71. In 2010, the King III report was released with a stronger emphasis on IR, in order (for South African firms) to effectively disclose (a) “how a company has, both positively and negatively, impacted on the economic life of the community in which it operated during the year under review”; and (b) “how the company intends to enhance those positive aspects and eradicate or ameliorate the negative aspects in the year ahead” (IR Council of South Africa (IRCSA) 2011: 3). As previously stated (Sect. 2.5), starting from financial year 2010, all the companies listed on the Johannesburg Stock Exchange must issue or explain the reason for not adopting an integrated report following King III guidelines.<sup>6</sup> Thus, the JSE became the first stock market to

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<sup>6</sup>Since 2010 JSE companies have been called to comply with the IFRS and provide “(i) a narrative statement of how it has applied the principles set out in the King Code, providing explanations that enable its shareholders to evaluate how the principles have been applied; and (ii) a statement addressing the extent of the company's compliance with the King Code and the reasons for non-compliance with any of the principles in the King Code, specifying whether or not the



**Fig. 2.4** Stakeholders and entities in the IR process [adapted from: International Integrated Reporting Council, U.K. (IIRC) 2013]

require a mandatory integrated report. More recently, in 2016 the King committee shared a draft IV version of their report on corporate governance, which should be applicable starting from 2017. The latest version of the South African guidelines on IR focuses more on an ‘outcome-based’ rather than a ‘rule-based’ approach. As for the integrated approach, the King IV report aligns itself with the principles provided by the IIRC and the integrated thinking approach (Institute of Directors Southern Africa 2016).

**2.5.3 The Integrated Report <IR>**

The International IR Council was founded in 2010 by two leading institutions in the sustainability reporting landscape: the Prince’s Accounting for Sustainability Project (A4S) and the Global Reporting Initiative (GRI). In December 2013, a draft framework, the integrated report <IR> was released (IIRC 2013). The <IR> accounts for six different forms of capital, ranging from financial capital to natural, human, intellectual, social and manufactured capital (Fig. 2.4).

Financial capital has been defined as the “pool of funds available to the organization for use in the production of goods or the provision of services; it is obtained through financing, such as debt, equity or grants, or generated through operations or

(Footnote 6 continued)

company has complied throughout the accounting period with all the provisions of the King Code, and indicating for what part of the period any non-compliance occurred” (JSE Listing Requirements: 135).

investments” (International Integrated Reporting Council, U.K. (IIRC) 2011: 11). Manufactured capital refers to “manufactured physical objects (as distinct from natural physical objects) that are available to the organization for use in the production of goods or the provision of services, including: buildings, equipment, and infrastructure” (International Integrated Reporting Council, U.K. (IIRC) 2011: 11). According to the IIRC, intellectual capital refers to “intangibles that provide competitive advantage, including: intellectual property, such as patents, copyrights, software and organizational systems, procedures and protocols, and the intangibles that are associated with the brand and reputation that an organization has developed” (International Integrated Reporting Council, U.K. (IIRC) 2011: 11). Human capital regards “people’s skills and experience, and their motivations to innovate, including their: alignment with and support of the organization’s governance framework and ethical values such as its recognition of human rights, ability to understand and implement an organization’s strategies, and loyalties and motivations for improving processes, goods and services, including their ability to lead and to collaborate” (IIRC (International Integrated Reporting Council, U.K.) 2011: 11). Social and relationship capital is the set of “institutions and the relationships within and between each community, groups of stakeholders and other networks, to enhance individual and collective well-being. Social capital includes: common values and behaviors, key relationships, and the trust and loyalty that an organization has developed and strives to build and protect with customers, suppliers and business partners, and an organization’s social licence to operate” (IIRC (International Integrated Reporting Council, U.K.) 2011: 11). Natural capital addresses an input to the production of goods or the provision of services. An organization’s activities also impact, positively or negatively, on natural capital. Such activities include: air, water, land, minerals and forests, and biodiversity and eco-system health (IIRC (International Integrated Reporting Council, U.K.) 2011: 11).

#### 2.5.4 *The UN Global Compact*

Produced in 1999 as a challenge by the secretary-general of the United Nations, Kofi Annan, to the business leaders at the World Economic Forum, the United Nations Global Compact aims at providing shared values and principles in a globalized economic environment (Williams 2004). The United Nations Global Compact sets out ten principles, which can be grouped into four main areas (United Nations Global Compact 2016: 3)<sup>7</sup>:

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<sup>7</sup>The ten principles of the UN Global Compact are grounded on agreements signed by governments at UN forums, such as The Universal Declaration of Human Rights (1948), the Rio Declaration on Environment and Development (1992); The international labor organization’s fundamental principles and rights at work (1998); the UN convention against corruption.

1. “Human rights:
  - (a) Businesses should support and respect the protection of internationally proclaimed human rights;
  - (b) They should make sure that they are not complicit in human rights abuses;
2. Labour standards:
  - (a) Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
  - (b) The elimination of all forms of forced and compulsory labour;
  - (c) The effective abolition of child labour;
  - (d) The elimination of discrimination in respect of employment and occupation;
3. Environment:
  - (a) Businesses should support a precautionary approach to environmental challenges;
  - (b) Undertake initiatives to promote greater environmental responsibility;
  - (c) Encourage the development and diffusion of environmentally friendly technologies;
4. Anti-corruption:
  - (a) Businesses should work against corruption in all its forms, including extortion and bribery”.

As of 2016, the UN Global Compact is the largest network of sustainable businesses in the world, with 8800 businesses in 165 countries. It has evolved from general management principles to specific areas of sustainable development, such as the Principles of Responsible Management Education (PRME)<sup>8</sup> and the Principles for Responsible Investment (PRI).<sup>9</sup> As a result of the World Economic Forum meeting, in 2015 a 2030 agenda was produced, comprising a collection of 17 aspirational Sustainable Development Goals (SDG):

1. No poverty;
2. Zero hunger;
3. Good health and well-being;
4. Quality education;
5. Gender equality;
6. Clean water and sanitation;
7. Affordable and clean energy;

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<sup>8</sup>The PRME initiative aims at inspiring and championing responsible management education, research and thought leadership globally. It was launched in 2007 at the UN Global Compact Leaders Summit (Kell 2013).

<sup>9</sup>The PRI started in 2006 at the New York Stock Exchange. They were defined by a network of international investors working together to integrate environmental, social, and governance issues into the investment decision-making process (Kell 2013).

8. Decent work and economic growth;
9. Industry, innovation and infrastructure;
10. Reduced inequalities;
11. Sustainable cities and communities;
12. Responsible consumption and production;
13. Climate action;
14. Life below water;
15. Life on land;
16. Peace, justice and strong institutions;
17. Partnerships for the goals.

Kell (2013) identified four main strengths of the Global Compact over the first 12 years of its existence: the relevance of its “underlying idea” (Kell 2013: 45); the fact it has been strongly supported by the secretary-generals of the United Nations; the support it has received from member states; and the operationalization of its underlying idea in a robust governance framework with strong private sector engagement and the design of “effective” accountability measures. An example of this is the visible expression of each participant’s commitment to the principles addressed by the Global Compact, that is, the Communication on Progress (COP); (United Nations Global Compact 2015). The COP is an annual report issued by the participants on the sustainability performance over the reporting period in accordance with accountability and transparency principles. The report is structured into three sections:

1. a statement by the CEO of the participants on the support for the Global Compact’s principles;
2. a description of specific actions to implement the ten principles;
3. a measurement of outcomes.

The UN Global Compact supports the use of international standard frameworks, such as GRI, IR, ISO 26000 and CDP, when preparing their COP (United Nations Global Compact 2016).

Even though the COP has been regarded as a commendable initiative to monitor the degree of implementation of the ten principles by participants, there is still a lack of effective tools to check whether or not participants are putting in place dysfunctional behaviors (United Nations 2010).

## 2.6 A Focus on the South African Experience

As discussed in the previous section, a general widespread framework of IR is due to two entities, which are the King Report on Governance for South Africa (Integrated Reporting Council of South Africa (IRCSA) 2011) and the International IR Council in the U.K. (International Integrated Reporting Council, U. K. (IIRC) 2011). Since the IR council of South Africa decided to set up the IR

Committee (IRC),<sup>10</sup> the guidance in South Africa on how to prepare and apply IR became a good practice among practitioners, and companies listed on the South African Johannesburg Stock Exchange (JSE) have to disclose an integrated report.

South Africa is the first country in which IR is used on a large scale across listed companies (King Committee on Governance 2013).

### ***2.6.1 The South African Context***

South Africa, with a population of around 53 million people, is a multi-ethnic country encompassing a wide variety of cultures, languages, and religions and containing 11 official languages. Until 2015, South Africa was classified as an upper-middle-income economy by the World Bank, whereas today it is classified as a developed and a newly industrialized country (STAT SA 2011).

Even if South Africa has a relatively high GDP per capita compared to other countries in Sub-Saharan Africa, it also has a high rate of poverty, unemployment and income inequality. Since the end of apartheid in 1994, the need for social and economic empowerment of the black population has been a driving force in the development and evolution of the King Reports. As a matter of fact, it has been widely acknowledged that South African companies were the first to address IR issues because of the consequences of the end of apartheid.

### ***2.6.2 The Quality of Integrated Reporting in South Africa***

In 2012, the Association of Chartered Certified Accountants (ACCA) issued a report on the content analysis performed on the integrated reports of the ten major listed companies in South Africa (Solomon and Maroun 2012). They developed measures to assess the degree of integration in the social, environmental and ethical information reported by JSE listed companies.<sup>11</sup> The findings highlight a variation

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<sup>10</sup>The IRC is an association composed of practitioners in South Africa. The association was founded in 2010 in order to develop guidelines on good practice in IR and to promote IR in South Africa. The five founding organizational bodies in South Africa are: Association for Savings & Investment South Africa (ASISA), Business Unity South Africa (BUSA), Institute of Directors in Southern Africa (IoDSA), JSE Ltd, the South African Institute of Chartered Accountants (SAICA), the Banking Association South Africa (BASA), and the Chartered Secretaries Southern Africa (CSSA). In 2011, the Principal Officers Association and the Government Employees Pension Fund joined the IRC. Other entities have also joined the IRC: namely, the Institute of Internal Auditors South Africa (IIA SA), Financial Services Board (FSB), and SASBO, the finance union.

<sup>11</sup>There are three main measures used by ACCA to assess the level of integration in a company's report (Solomon and Maroun 2012: 10): 1. "cumulative change over time (CCOT) measures the cumulative change (increase/decrease) in the number of sections in which each item of environmental, social and ethical information is recorded over the two/three years examined"; 2. "%

in the items reported by companies in the survey. However, the vast majority of the disclosed items are included in the social category, which is also more integrated compared to environmental and ethical ones. Across the sample, some of the areas that are more frequently disclosed by the surveyed sample are related to employee health and safety, compensation, risk and risk management, and materiality. KPIs are largely used in most of the reports. Moreover, with the introduction of the mandatory requirement for disclosing an integrated report, companies have started reporting new items and sections related, for instance, to transparency, HIV/AIDS, climate change and biodiversity, and carbon offsetting. As for the stakeholder orientation, the sample reports stressed the shift from shareholders to a broader set of stakeholders, which is also witnessed in the rhetoric of the Chairman's statement. In fact, most of the reports disclose environmental, social and ethical performance integrated with corporate governance policy and structure. From this perspective, companies are effectively achieving one of the objectives of IR, which is the design and implementation of corporate governance procedures to improve social, environmental and ethical issues. Finally, the ACCA report discusses the IR assurance policy. The Johannesburg Stock Exchange does not require listed companies to provide an assurance statement for the integrated report. However, some of the companies are looking at alternative assurance options, ranging from large audit firms to "boutique" assurance firms, to assure sustainability information (Rhianon Edgley et al. 2010). The ACCA's report provides some recommendations for the improvement of IR. First, a more focused and synthetic approach should be pursued in order to effectively increase the readability and usability of the report by a large set of stakeholders. Secondly, stakeholders' views and needs should be increasingly solicited when preparing the report in order to present a comprehensive approach to IR. Thirdly, an assurance statement is desirable, though it is not mandatory yet, in order to ensure that the company is actually having an impact on social, environmental and ethical issues. Therefore, companies should strive to present sustainability information previously checked by an assurance firm (Solomon and Maroun 2012). The ACCA's analysis has the advantage of taking a longitudinal approach. However, it is focused on a limited sample size, which is made up of only ten companies. Therefore, the findings cannot be generalized to the whole JSE population.

The 2014 PricewaterhouseCoopers survey on the integrated reports disclosed by the top 40 companies listed on the JSE pointed out relevant issues. The audit firm took into account one hundred factors to assess the quality of a company's IR. The findings revealed that some areas are effectively reported whereas others are not. While reporting related to strategy and resource allocation turned out to be

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(Footnote 11 continued)

positive changes in number (N) of sections measures the percentage of items in each grouping (social, environmental and ethical) that are reported in an increased number of sections over the period"; 3. "% positive changes or no change in the number (N) of sections measures the percentage of items in each grouping (social, environmental and ethical) that are reported in an increased or the same number of sections over the period".

effectively communicated, governance was not. Thus, the following six themes were put forward and discussed (PricewaterhouseCoopers 2015: 2–3):

1. who is the audience?;
2. agility in the face of change;
3. embedded integrated thinking;
4. putting the ‘K’ in KPI;
5. approaching business with an outcome in mind;
6. thinking about tomorrow, today.

As for the audience theme, results from the survey highlighted that only a third of the companies effectively identified who the relevant stakeholders are, as well as the opportunities, challenges and threats linked to an effective prioritization of stakeholder needs: i.e., the material issue for the future viability of the business.

The second issue deals with market changes, which are rapid and unpredictable. Thus, there is a need for companies to effectively adjust strategies accordingly. In fact, only 53% of the sample explains the effect of external drivers of future growth in the IR report.

The PwC highlighted that although there has been a general improvement in the reporting quality of South African companies, most of this is due to “cosmetic” changes (PricewaterhouseCoopers 2015, p. 6). Therefore, companies are called to adopt a more integrated thinking approach when deploying their strategy. In the PwC survey, 39% of the companies failed to address a clear strategic vision; however, 81% discuss plans to achieve that vision.

Effective evaluation is linked to an ongoing assessment of key areas of a company’s performance, a consequence of which, the report pointed out, is a general need to refocus performance on key strategic areas. In fact, only 31% of the reports clearly identified the KPIs and the reason behind their inclusion in the performance measurement system.

The fifth issue involves the management and reporting of a corporate’s impact, which entails effectively linking managerial information to the value created. According to the PwC report, only 39% of the companies discussed their impact on external non-financial capitals and only 11% effectively addressed the link between non-financial capitals and financial performance (PricewaterhouseCoopers 2015).

The surveyed reports failed to effectively portray the outlook of the business, since the section about the forward view is lacking in content and materiality. This is true in 92% of the cases.

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