Integrated Reporting - Is it value relevant A quantitative study on Colombo Stock Exchange

Pathiraja PMDS[a] , Priyadarshanie WAN[b]

[a]Department of Accountancy, Wayamba University of Sri Lanka, Sri Lanka,

[b]Department of Accountancy, Wayamba University of Sri Lanka, Sri Lanka,
dhananjayapathiraja01@gmail.com

Introduction

Business world has been rapidly advanced and almost all people are willing to concentrate towards its future betterment. Hence the necessity of proper communication between entity and its stakeholders has been arisen and this emphasizes the reporting requirement in business organizations. When considering the Accounting arena, the reporting dimensions have been gradually evolved and it is still transforming for new aspects which gives superior disclosures. At the beginning there was financial reporting, and then sustainability reporting come in to practice and now the business paradigm is moving towards Integrated Reporting (IR). The movements towards IR led to a criticism that the sustainability reporting is unable to demonstrate the holistic view of an entity. Stakeholders are not willing refer number of reports so as to take the view of the entity (Hoque, 2017). At the present time IR is being explored by companies throughout the world. Local regulatory bodies in some countries impose laws and regulations for business organizations to comply with IR. Since this concept has no long history, it is still developing and new aspects are blooming as a result of investigations done by various scholars. Many researches in international context have proved that IR adds value to the business entity. Sometimes these findings may not suitable to generalize in Sri Lankan context since those studies have been conducted by using data relating to their own countries and economies. Thus the purpose of this study is to examine whether IR adds value to the companies listed in Sri Lanka.

The research question of this study is “Is there any relationship between IR and market return in listed companies in Sri Lanka?”. The objective of this study is to examine whether there is a relationship between IR and market return in listed companies in Sri Lanka. Market return is one of most influencing factors towards the determining the investors behavior (Ahmad,2017). Amir and Lev (1996) concluded that non-financial information has a significant relation to stock price and its value-relevance. Since there are few studies on outcomes and benefits of

IR, only few companies have adopted IR (Higgins et al.,2014). Most companies in Sri Lanka also still have not adopted IR. IR adopted firms have highest market valuation (Yeo et al.,2014). So this study helps to identify the relationship between IR and market return in Sri Lankan context. It will useful for the IR non adopted companies to adopt IR by knowing its value addition to the entity.

Literature Review

Evolution of Financial Reporting Paradigm

At various times scholars and academicians as well as practitioners emphasized various reporting aspects which depicts various dimensions in reporting perspectives. Social reporting mostly highlighted the impact of business operations on society; that means social impact of businesses. The True-blood Committee Report (AICPA, USA, 1973) observes that an objective of financial statements is to report on those activities of the enterprise affecting society which can be determined and described or measured and which are important to the role of the enterprise in its social environment. Environmental reporting focused towards the contribution of business entities to sustainable and eco-friendly industry. Cormier and Gordon (2001) found that environmental disclosures seem to be related to information costs and benefits. Triple Bottom Line reporting demonstrates that only earning profit is not enough by the business entity and it should necessarily be concerned about the betterment of the people and ultimately the prosperity of the planet. Sustainability reporting depicts economic, environmental, social and governance performance of an entity by producing many reports. Users were able to refer the particular report and get the idea about pertaining matters. With the time, users disincline to refer many reports in order to grab the holistic view of the entity. Stakeholders are not willing refer number of reports so as to take the view of the entity (Hoque, 2017).

Empirical Findings on Value Relevance of IR

Number of studies have investigated the effect of IR towards the firms Value. The Firm value has been differently persuaded by various scholars. So various determinants were used for measuring firms value. Almost all studies try to investigate how IR affect firms value and whether or not it create additional value to the business entity.

Kosovix and Patel (2013) have investigated the value-relevance of IR for the market values of companies listed on Johannesburg Stock Ex-change's Main Board, in South Africa. That was a pure quantitative study. The data for 2009 and 2011 has been collected from selected companies' annual reports. The self-constructed disclosure index has been applied for defining the IR and determining the relationship between IR and a company's value-relevance. As per the findings disclosure of level of compliance value of IR adopted companies have been increased from 2009 to 2011. The degree of incorporation of IR affects to determine the level of compliance between the sectors and characterizes.

Firms with higher IR score have higher market valuation (Yeo et al., 2014). Further this study has revealed that equity investors do value IR. This study has used 100 South African companies listed on Johannsburg Stock Exchange for the period 2009 to 2012. IR was valued by using a self-constructed index.

Lee et al., (2015) have investigated the association between IR and firm Valuation. The sample was the listed firms in South Africa. This study has explored the association between cross-sectional variation in IR disclosures and firm valuation in the period after the implementation of IR. As the conclusion it suggests that the firm valuation is positively associated with IR disclosures. Study revealed that the benefits of IR exceed its costs.

Martinez (2016) has investigated the effects of IR on the firm's Value by considering the voluntary adopters of the IIRC's framework. The purpose of this paper was to evaluate potential external benefits related to capital markets of the IR Framework on a sample of international voluntary adopters. The selected data sample is comprised exclusively of firms included in the IIRC's database as of September 2016. The results indicate IR is positively associated with market value and expected future cash flows, but not with bid-ask spread or implicit cost of capital.

Senaratne et al., (2015) investigated how IR as a managerial technology diffuses in an emerging economy taking Sri Lanka as the case. This is a mix study that used both qualitative and quantitative data. Data was collected through annual reports and semi structured interviews. The study finds that the early adopting companies of IR in Sri Lanka have been engaged in sustainability reporting (SR) in the past. The study finds a transitional approach to IR in these companies evolving through the incremental changes to systems and processes that are already established in them in relation to SR.

Methodology

For this study, all companies listed on Colombo Stock Exchange (CSE) which are adopted IR have been selected and it was revealed that 61 companies have adopted IR by 2016 financial year. The analyzing time period was determined based on the financial year which IR adopted for each company. The ex-post years were considered as the reporting years from the year which IR adopted, to year 2016. Ex-ante years were equal number of years as ex-post years. Thus, the total number of observations were 164. Data was collected from annual reports of selected companies. Research data was analyzed through descriptive statistics and student t-test analysis in order to estimate the relationship between IR and market return. Significance level of this study was 0.01 (99% confidence interval). All IR adopted companies have been selected for analysis. There were two groups of firms' market return by looking at the same firms before and after the adoption of IR. So Paired t-test was applied for data analysis.

Development of Hypothesis

Following hypotheses were developed in line with available literature.

H_0: There is no association between IR and market return

H_1: There is an association between IR and market return

Results and Discussions

Table 1 represents the descriptive data relating to independent variable in two conditions

Table 1: Paired Sample Statistics

	Mean	N	Std. Deviation	Std. Error Mean
After IR adoption	0.2404	164	0.3107	0.0243
Before IR adoption	0.0430	164	0.9094	0.0900

In the Paired Samples Statistics table, the mean for the after IR adopted condition (IR) is 0.2404. The mean for the before IR adopted condition is 0.0430. The standard deviation for the after IR adopted condition is 0.3107 and for the before IR adopted condition,0.9094. The number of participants in each condition (N) is 164. Table 1 revealed that the Mean number of market return for after IR adopted condition was greater than the Mean for the before IR adopted condition. Thus, it can be concluded that the years after adopting IR were able to make significantly more market return than the years before IR adoption.

The proposed associations in the research model were tested by using t-test analysis. The Table 2 shows the results.

A paired-samples t-test was conducted to compare market return in after IR adoption and before IR adoption conditions. There was a significant difference in the scores for after IR adopted (M=0.2404, SD=0.3107) and before IR adopted (M=0.0430, SD=0.9094) conditions; $t(163)=-2.5527$, $p = 0.0113$. These results suggest that IR adoption really does have an effect on market return ($p<0.05$). Therefore, it can be rejected the null hypothesis that there is no association between Integrated Reporting and market return and accept alternate hypothesis that there is an association between Integrated Reporting and market return. Specifically, this study finding suggest that when company adopt IR, market return of the company increases.

Table 2: Paired Samples Test

Paired Differences					t	df	Sig.(p) (2-tailed)
Mean	Std. Deviation	Std. Error Mean	99% confidence interval of the difference				
			Lower	Upper			
0.1974	0.5987	0.077	0.0451	0.3496	2.5527	163	0.0113

Conclusions and Recommendations

There is a significant difference between companies market return before and after adoption of IR. Further results conclude that after IR adopted years have higher mean value of IR while before IR adopted years record lower mean value. Since this study consider all companies which adopted IR listed in CSE, findings can be generalized to the population with high reliability. But this study was conducted in Sri Lankan context only. So, result reflects the condition within Sri Lankan companies listed in CSE. This study contributes to depict the relationship between IR adoption and market return. As IR is linked with the value creation process of corporate entities, the findings of the study will have wider social implication in terms of convincing corporate entities to adopt IR since it directly associated with market return. Market return is one of most influencing factors determining the investors behavior (Ahmad,2017). Identifying IR as a significant factor that determining the market return, entities' management is able to identify the necessity of adopting IR. As an emerging phenomenon, few studies only available in Sri Lankan context which demonstrates IR and its' association with entity related factors. Hence, this study provides some useful insights into IR with relating to market performance of an entity. Companies should realize that financial factors lonely do not influence to the performance of the entity. Amir and Lev (1996) concluded that non-financial information has a significant relation to stock price and its value-relevance. As non-financial reporting, IR can be considered as a significant factor which plays a vital role in accounting arena while influencing firms market performance.

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