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The Impact of Corporate Governance on the Level of Compliance with Integrated Reporting

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Abstract: *Integrated reporting represents the latest development in corporate disclosure, aiming to provide comprehensive information about an organization's strategy, business model, performance, and governance while providing a clear view of its ability to create value in the long term. In recent years, academic interest in integrated reporting has increased significantly. However, the level of compliance of these reports with the requirements of the International Integrated Reporting Council (IIRC) remains an area that needs further research. This research seeks to fill the gap by analyzing the impact of three board characteristics (board size, board independence, and board activity) on how well integrated reporting corresponds to the integrated reporting framework. The results show that board independence and size have a positive and significant effect on how well reports conform to the integrated reporting framework. On the other hand, participation by board activity has no discernible impact on the degree of compliance to the integrated reporting system.*
Keywords: Integrated reporting, corporate governance, disclosure

INTRODUCTION

The interest of large companies, due to the size of their assets and operations, in an environment characterized by significant social disparities, in addition to the environmental, labor, and ethical issues that may arise during their activities, has led to a significant increase in the preparation and publication of reports and media documents, whether mandatory or voluntary. Therefore, the annual financial statements that reflect the economic and financial situation of the company are now accompanied by additional reports that address topics such as corporate governance, social responsibility, and intellectual capital. These reports aim to highlight the extent to which the

company complies with economic, social, and environmental standards, which enhances transparency and reflects its commitment to society and stakeholders. (Frias-Aceituno et al., 2013).

The importance of investor relations has increased significantly since the establishment in 2010 of the International Integrated Reporting Committee (IIRC), which later became known as the International Integrated Reporting Council). Although the IIRC has become the world's leading body for formulating policies and practices related to integrated reporting, the concept was not exclusively born of it. The concept of integrated reporting emerged earlier through two separate bodies: the King III Report on Governance in South Africa, issued by the Integrated Reporting Council of South Africa (IRCSA) in 2011, and the International Integrated Reporting Council of the United Kingdom (IIRC) in 2013. (Morros, 2016) The Integrated Reporting Framework's December 2013 release may have marked a turning point in the development of corporate reporting. With the use of a "multi-capital" approach that identifies the organization's value creation process across the short, medium, and long term, integrated reporting is a new reporting model that pushes businesses to give a succinct and thorough assessment of corporate performance. Reporting on a company's business model, improving comprehension of the relationships between the financial and non-financial components of a company's strategy, and revealing significant opportunities and dangers are all essential components of integrated reporting. (Simnett & Huggins, 2015). Integrated reporting (IR), pioneered by the International Integrated Reporting Council (IIRC), stems from integrated resource management (integrated thinking) with the aim of supporting a company in creating value (Marrone, 2020). Integrated reporting also helps stakeholders through enhancing the standard of the data that is given to them, as well as by enhancing management and accountability.

Integrated reporting improves the allocation of resources in the decision-making process and promotes a more coherent, concise, and efficient approach to corporate reporting, demonstrating how organizations can create value over time (Hamad et al., 2020). Prior research has mostly examined the factors that contributed to the acceptance of integrated reporting; nevertheless, the degree of conformance of integrated reports with the Integrated Reporting Framework remains a neglected area. The degree of adherence to Integrated Reporting Framework standards can help investors and other shareholders understand and carefully consider documents. Additionally, investors' comprehension of various company facts is aided by the degree of adherence to the Integrated Reporting Framework, which allows for comparison of reports from other companies and prioritizes looking for the essential information. Because of this large disparity, an analysis of the degree of adherence to the Integrated Reporting Framework is required. This research goals to identify levels This work aims to identify the antecedents of the level of compliancy, with

particular reference to corporate governance variables, represented by the characteristics of the CEO and the board of directors. In fact, both the board of directors and the CEO play a particularly important role in corporate communication policies, serving as a control system that enables management and stockholder benefits align (Jensen & Meckling, 1976). This work aims to fill this gap by analyzing the effects of three board characteristics (size, board independence, and board activity) Concerning the integrated reports' level of IIRC Framework compliance.

Integrated Reporting

In the wake of financial crises and corporate scandals, economic and social problems have worsened, leading to a loss of confidence in the global economic system and business practices. These problems include huge debts, high unemployment rates, social inequality, fraud, and environmental concerns. As a result, there has been increasing pressure on the private sector to take responsibility for its social and environmental impact. Many companies have adopted reporting approaches that focus on sustainability and social responsibility, with the help of coalitions and organizations that aim to improve reporting to meet the need for more transparent and balanced accountability (Busco et al., 2013). Because financial reports are sometimes criticized for failing to adequately convey an organization's total performance, social and environmental recording has a long history in both the public and commercial sectors. The incapacity of financial reporting to properly reveal intangible assets has been viewed by some academics as a failing to address the financial reporting's initial information role. (Katsikas et al., 2017). Several attempts have been made to organize and standardize these wide range of reports provided by companies. over time, various reporting guidelines and standards have been developed by organizations such as GRI, A4S, WICI, Enhanced Business Reporting Consortium, CDP, International Corporate Governance Network, Sustainability Accounting Standards Board, and CDSB. As noted by scholars, there are significant overlaps and duplications among the different documents, and the differences in the types of reporting adopted by organizations are quite wide. (Katsikas et al., 2017). Organizations have started to make more social and environmental disclosures, using media other than the annual report to reveal a large portion of the information, as the practice of social and environmental reporting has grown in popularity and the amount of social and environmental information reported by many organizations has increased. The annual report for a number of these companies now focuses mostly on informing financial shareholders of information that is of vital importance. Stand-alone social and environmental reports and/or other interactive media (such sustainability websites) have published information that has been judged to be of main significance to other shareholders, frequently in growing number and complexity. (Villiers et al., 2020). In recent years, a number of organizations and oversight

agencies have risen to the challenge of providing a more thorough picture of the intertwined social, environmental, and economic activities and repercussions in sustainability reports. Instead of continuous reporting, the Danish pharmaceutical company Novo Nordisk was the first regulatory enterprise on integrated reporting in 2008. These are some of the top reporting firms that have pioneered integrated reporting as shown in Figure (1) (de Villiers et al., 2014) Novo Nordisk commemorated ten years of IR in the 2013 annual report, which included a combined financial, social, and environmental presentation. In order to promote transparency, the consolidated reporting was designed to place more emphasis on the elements that management felt had the biggest influence on the business's performance from a triple bottom line perspective. (de Villiers et al., 2014).

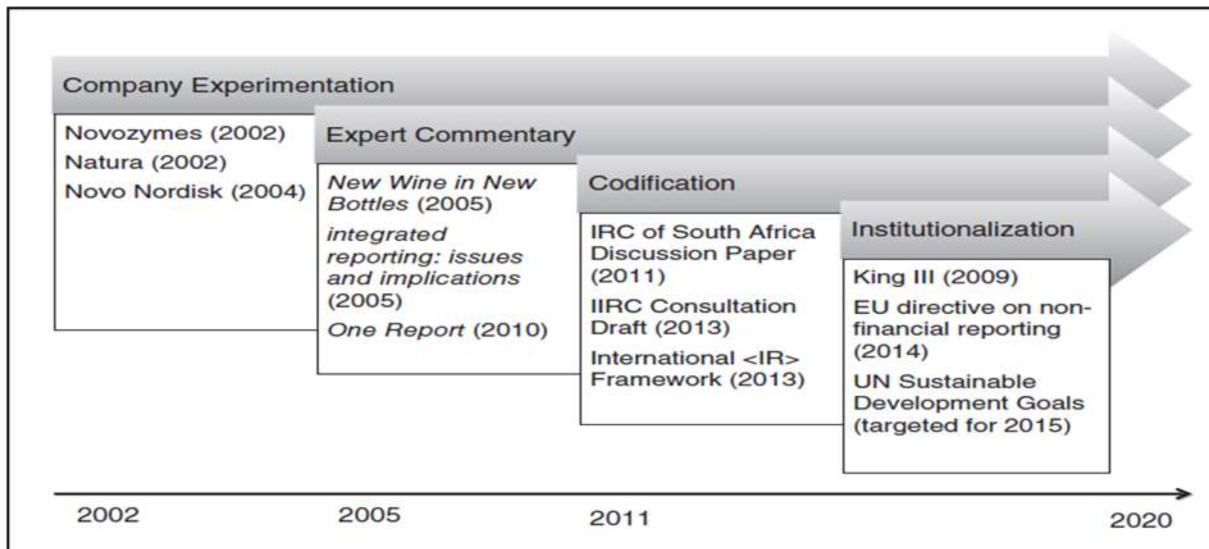

Figure (1) Stages of development of integrated reporting

Morros, J. (2016). The integrated reporting: A presentation of the current state of art and aspects of integrated reporting that need further development. Intangible Capital, 12(1), 336-356.

The concept of integrated reporting (IR) has progressed through four continuous and comprehensive stages of “sense-making” (Figure 1). The first stage, represented by the Novo Nordisk (2004) experience, started in the early 2000s, when several companies made initial attempts to produce their first integrated report. This phase is regarded as the beginning of the

practice and the conceptualization of integrated reporting. The second stage, referred to as expert commentary, was initiated by consultants, academics, and other experts who began to establish basic principles for integrated reporting based on their observations of company practices. This stage, which began in the mid-2000s, focused on building the theory around integrated reporting, highlighting lessons about its costs, benefits, challenges, and ways to address them. The third stage, known as codification, began in the late 2000s and concentrated on the development of frameworks and standards by NGOs in collaboration with other stakeholders, such as companies, investors, and accounting firms. The fourth and most recent stage, the institutionalization stage, focuses on shaping the regulatory and market environment to make it more supportive of integrated reporting practices. (The Integrated Reporting Movement, 2015). According to the IIRC (2013a), integrated reporting is “a concise communication about the contribution of an organization’s strategy, governance, performance, and prospects to value creation in the short, medium, and long term in the context of its external environment” (Pistoni et al., 2018). The International Integrated Reporting Council (IIRC) has defined it as “a process based on integrated thinking that leads to the preparation of a periodic integrated report by the organization on value creation over time and related communications related to aspects of value creation” (Barth et al., 2016). Integrated reporting is a key component of the evolving corporate reporting system, facilitated by comprehensive frameworks and standards that address the measurement and disclosure of all types of capital, appropriate regulation, and effective assurance. It emphasizes conciseness, strategic focus, future orientation, and coherence of information. Capital and emphasizes the importance of integrated thinking within the organization (IIRC, 2021) Integrated reporting is merely the tip of the iceberg; it represents the visible aspect of a deeper process, with integrated thinking being the underlying activity happening beneath the surface. (Hoque, 2017) and integrated thinking means "the ability to find an ideal balance between managing short-term business imperatives and creating sustainable value in the long term. This approach requires aligning immediate operational goals with broader strategic goals that emphasis on sustainable growth and value creation for all shareholders. This approach focuses on the interconnectedness between financial performance and environmental, social and governance factors, which promotes a more holistic view of business impacts and potential (Churet, 2014). The Integrated Reporting Framework defines it as “a process by which an organization actively considers the associations between its various operational and functional units and the capital they use or influence. Integrated thinking leads to integrated decision-making and actions that take into account short-, medium- and long-term value creation” (IIRC, 2013). Integrated thinking supports decision-making and actions that focus on short-, medium- and long-term value creation. One of the most important goals of the Integrated Reporting Framework (IIRC, 2013). Integrated thinking has two key dimensions. The first

dimension refers to understanding and discussions that span across the organization's operational units. For instance, reporting on natural capital may facilitate integrated thinking by requiring the accounting team to work together with scientific experts from operational departments. The second dimension refers to a more comprehensive understanding of the organization's interactions with external stakeholders. For example, the International Center for Research in Memory claims that integrated thinking enhances Full consideration of the legitimate needs and interests of stakeholders (Tweedie & Martinov-Bennie, 2015) The primary goal of integrated reporting (IR) is to enhance accountability and resource management across six types of capital: (financial, manufactured, intellectual, human, social and relational, and natural) as well as to clarify the interconnectedness of these types of capital, supporting integrated thinking and decision-making that focuses on creating sustainable value for shareholders (Busco et al., 2013).

Conferring to the international framework, the essence of an organization is its "business model" (IIRC, 2013). The concept of "business model" as used in the framework characterizes the method an organization creates value, which includes all its events, its relationships with shareholders, its tangible and intangible assets and liabilities, and lastly the responsibilities of the board of directors. For the board of directors, "corporate governance" and the support and development of the company's business model are essentially the same (Mähönen, 2020). The organization's business model is defined as its system for transforming inputs, through its business activities, into outputs and outcomes aimed at achieving the organization's strategic purposes and creating value in the short, medium and long term (IIRC, 2013). The concept of the business model in integrated reporting (IR) is centered around value creation. Therefore, the concept of value creation has evolved over time and has moved from a focus on sustainability to financial capital providers as target users of integrated reporting (Mähönen, 2020). The business model is a very important element for investors in order to assess a company's ability to create and maintain value over time. Integrated thinking must be fully embedded and shared by management in order to create a successful business model (Mio et al., 2016)

According to the International Integrated Reporting Framework (IIRF), which was developed by the International Integrated Reporting Council (IIRC), an integrated report must have eight elements (IIRC, 2013). The first part, the organizational overview and external environment, answers inquiries concerning the business's operations and the areas in which it conducts business. The organization's vision and objective, as well as shifts in quantitative data like the number of employees, total revenue, and the number of countries the company operates in, can all be used to illustrate this part.

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The second component is governance, which addresses how the company's governance structure supports its capacity to create value over the short, medium, and long term. This section includes details about the organization's leadership structure, including the experience, skills, and diversity of its leaders, as well as how incentives and rewards contribute to value creation.

The third component is the business model, which explains the type of business model implemented by the company. It encompasses six types of capital—financial, manufactured, intellectual, human, social and relationship, and natural—as inputs. Additionally, it covers the company's business activities, outputs, and the results of those activities.

The section on risks and opportunities, which makes up the fourth component, answers questions concerning potential threats to the company's short-, medium-, and long-term value creation as well as how it handles these risks and opportunities.

The company's direction and the steps it intends to take to achieve its goals are addressed by the fifth component, strategy and resource allocation.

The sixth element is performance, which assesses how well the business is accomplishing its annual strategic goals and how those goals impact its capital.

Expectations, the seventh element, covers potential obstacles and ambiguities the firm may encounter when carrying out its plan, as well as any potential effects on both the business model and future performance. Both quantitative and qualitative changes throughout time must be analyzed for this part.

The eighth and final component is basis for preparation and presentation, which explains how the company determines which issues to include in its integrated report and the process used to identify or evaluate those issues. It outlines the organization's approach to materiality determination and provides a summary of how these decisions are made.

Integrated Reporting and Corporate Governance

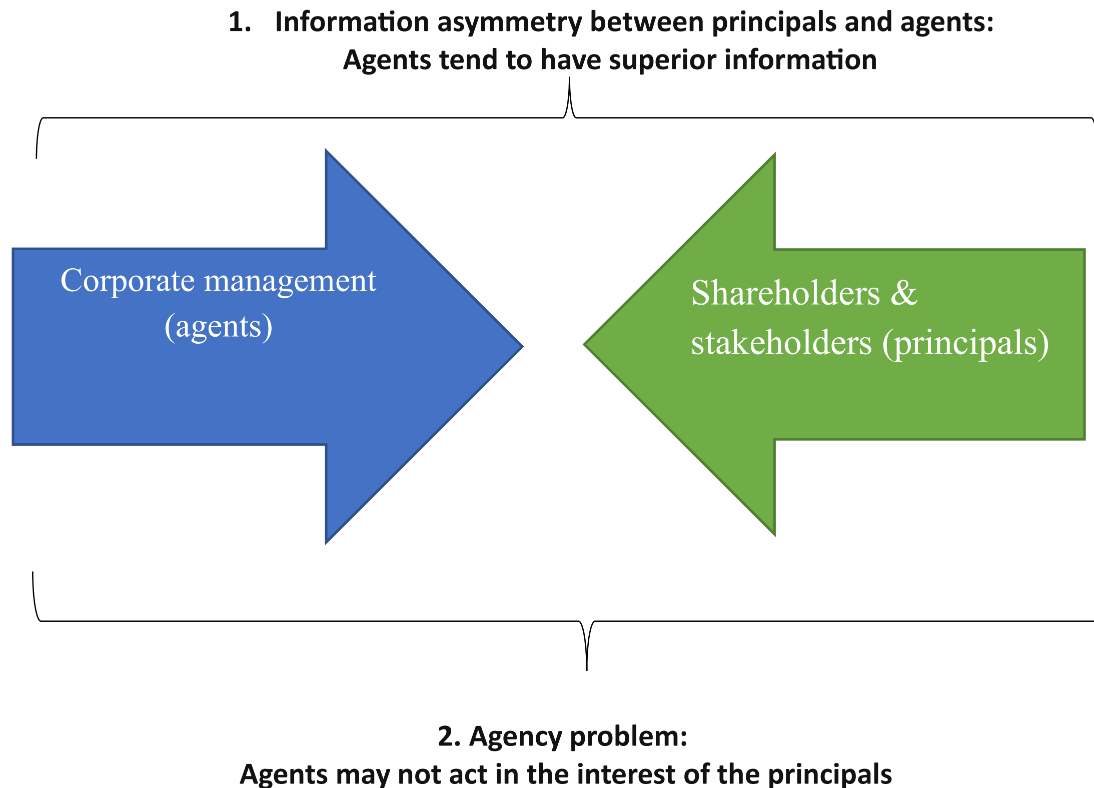
Throughout the past few decades, corporate governance has been increasingly important in both developed and emerging economies, particularly in the wake of global financial crises and economic collapses that brought governance to the attention of the globe. (Abdallah et al., 2021). Corporate governance is important because it keeps the company's managers and the community in which it operates apart from its stakeholders, or shareholders. Two issues are central to corporate governance, as shown in Figure (2): The first is the asymmetry of information between the company's management (internal) and stakeholders (external), and the second is the agency

problem, as agents (company management) may not act in the interest of managers (stakeholders) (Schoenmaker & Schramade, 2023.)

Corporate governance was defined by the Organization for Economic Co-operation and Development (1992) as "the system through which commercial companies are directed and controlled" (Hamad et al., 2020).

According to agency theory, the incompatibility of ownership and control separation results in an agency dilemma. Rewards for managers and shareholders In this situation, managers take advantage of opportunities to forward their own agendas. Jensen and Meckling talked on the necessity of developing systems that can curb managers' self-serving behavior and enhance their rapport with external investors. The several contracting and monitoring actions that occur within the parameters of the agency relationship are among these mechanisms, but they are not the only ones. (Jensen & Meckling, 1976). According to Eisenhardt (1989), the goal of agency theory is to resolve two issues that arise in agency relationships. When the principle and the agent have different objectives or ambitions and it is difficult or expensive for the principal to confirm what the agent is doing and if the agent has acted appropriately, this is known as the first agency problem. (Eisenhardt, 1989). Adopting integrated reporting, according to Cerbioni & Parbonetti (2007), reduces agency issues by providing owners with a means of obtaining more comprehensive information about the company, which encourages transparency and accountability. (Cerbioni & Parbonetti, 2007).

Figure (2) The two main corporate governance problems



Schoenmaker, Dirk and Schramade, Willem, **Corporate Finance for Long-Term Value** (June 4, 2023). Corporate Finance for Long-Term Value, Springer, 2023., Available at SSRN: https://ssrn.com/abstract=4468886 or http://dx.doi.org/10.2139/ssrn.4468886

Hypotheses Development

Board of Directors and Integrated Reporting

It is a group of executive and non-executive directors responsible for protecting shareholders' wealth and ensuring that the requirements of various stakeholders are met. It plays a vital role as an internal governance mechanism in monitoring and supervising operations within the company. It enhances transparency of reporting and reduces risks, agency costs, and private managerial interests (Hamad et al., 2020). It is also referred to as the company's governing board, which is in

charge of publishing and revealing information to safeguard the owners of different stakeholders, minimize agency issues, and stop opportunistic behavior. (Frias-Aceituno et al., 2013).

Board Size

The board of directors is a corporate governance mechanism that determines the policies and strategies that managers must follow. Due to the oversight role of boards of directors, companies Effective boards of directors have the power to improve information disclosure by influencing management choices. Therefore, board composition may have a big impact on company disclosures. (Kılıç & Kuzey, 2018). According to the literature, boards with a high number of members are probably ineffective and, as a result, are less likely to engage in decision-making processes that involve determining whether or not to raise the amount of voluntary disclosure. (Wang & Hussainey, 2013). Based on the aforementioned, we believe that larger boards will be more successful in putting pressure on management to provide forward-looking disclosures.We suggest the following hypothesis:

H1: There is a positive relationship between the board size and level of integrated report (IR) content disclosure

Board Independence

One of the most significant internal control systems is the board of directors, which is elected by shareholders. Boards typically have some independent directors, who are experts who do not own the business, do not have managerial positions, and do not work for the company, in order to reduce agency expenses. (Mawardani & Harymawan, 2021). Board composition (independence) is measured as the ratio of the number of non-executive directors to the total number of board members. The literature shows that board independence reduces information asymmetry and leads to increased levels of information disclosure in firms (Wang & Hussainey, 2013). According to agency theory, boards with a greater proportion of directors who are independent are better at keeping an eye on and reining in management and getting them to focus on creating long-term value. (Jizi et al., 2014). Since independent board members are less biased toward the firm's management, they may have a greater tendency to encourage firms to disclose higher levels of voluntary information (Kılıç & Kuzey, 2018). Taking into account the viewpoint of agency theory and the previously mentioned debates, we propose the following hypothesis:

H2: There is a positive relationship between the board independence and level of integrated report (IR) content disclosure.

Board Activity

Board activity refers to the involvement of its members in managing several aspects of the company's business, giving them a comprehensive view of different operations. However, diversity within the board of directors enhances their collective expertise, as different backgrounds and skills contribute to providing multiple visions that support the management of the company's operations more efficiently and effectively (Yani, et al, 2020). One of the most prominent tasks of the board is to determine the company's vision and strategic objectives, in addition to reviewing and approving financial and operational plans. The board also plays an important oversight role by evaluating the performance of executive management and ensuring its compliance with ethical and legal standards. According to a study by (Hermalin & Weisbach, 1991), "Board activity is a vital means of ensuring that executive management decisions are in the interest of shareholders and other stakeholders." Accordingly, we propose the following hypothesis:

H3: There is a positive relationship between the activity of the Board of Directors and the level of disclosure of the content of integrated reports.

METHODOLOGY

Sample and Data

The sample selection process included all banks listed on the Iraq Stock Exchange due to their importance in driving the wheel of local development, numbering 45 banks. The reason for choosing banks was that they are obligated by the Central Bank of Iraq to apply international financial reporting standards, unlike other companies. The research sample was represented by selecting banks that continue to report without interruption, numbering 10 for the year 2023, while Islamic banks, numbering 18 banks, were removed, and the rest of the banks were removed for not continuing to report by a decision of the Central Bank of Iraq.

Variables and Model Specification

The dependent variable in this study is the degree of conformance with the Integrated Reporting Framework (IRAL). This work employs the scoreboard created by (Marrone & Oliva 2019) to evaluate the presence of information pertaining to the fundamental concepts and content elements within the integrated report (IIRC, 2013) in order to gauge the degree of conformance of integrated reports with the IIRC framework. Consequently, this scoreboard evaluates the existence of eight components: Governance, external environment and regulatory overview, strategy and resource allocation, business model, performance, expectations, presentation basis, and risks and

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opportunities are the eight content elements that are portrayed. These dimensions were measured based on (0,1) through analyzing the content of the annual reports of the banks in the study sample, where a value of (1) is given in the event that the bank discloses the dimension and a value of (0) in the event of non-disclosure.

The independent variables for this study are: board size, board independence, and number of board meetings. Board size (BS) represents the number of directors on the board. Board independence (BI) is measured as the ratio of the number of non-executive board members to the total number of board members. As for board activity (BODA), it is represented by the number of board meetings during the year.

We have included some control variables. First, this study controls for firm size (FSIZE), return on assets (ROA) and leverage (LEV), firm size is calculated by total assets and converted to a natural logarithm, while return on assets is measured by dividing net profit by return on assets, and leverage is measured by dividing liabilities by assets. A regression model is used in this study to examine the hypotheses. In particular, the following equation reflects the analysis model that this study recommends:

$$IRAL = \beta 0 + \beta 1BS + \beta 2BI + \beta 3BA + \beta 5FSIZE + \beta 6LEV + \beta 7ROE + \varepsilon$$

RESULTS

Correlation and Descriptive Analysis

Descriptive data and a correlation analysis between the independent and dependent variables are shown in Table (1). Our dependent variable, the degree of compliance with the Integrated Reporting Framework (IRAL), has an average value of 0.37, according to descriptive statistics. This suggests that the majority of banks have a comparatively low degree of Integrated Reporting Framework compliance.

The boards of directors of banks are characterized by an average of 7.2 members, which indicates a moderate and appropriate board size. The standard deviation of 0.359 indicates stability in the size of the boards, as the number ranged between 5 and 9 members. The independence of the boards of directors is shown by an average of 6.2 independent members, which reflects the companies' commitment to independence and enhancing governance. The activity of the board of directors showed a large variation between banks, as the average was 21.2 meetings annually, with a minimum of 8 meetings and a maximum of 93 meetings. The large number of meetings may reflect high administrative activity, but it may indicate challenges in making decisions or

addressing problems within banks. Regarding the second component, the largest association was discovered between the size of the board of directors and the degree of adherence to the integrated reporting system (0.371) and the size of the company (0.349).

Table 1. Descreptive statistics and correlation analysis

Table 1. Descreptive statistics and correlation analysis

VARIABLES	Mean	S.D.	IRAL	BS	BI	BA	FSIZE	LEV	ROE
IRAL	0.37	0.034	1						
BS	7.20	0.35	0.371	1					
BI	6.20	0.35	0.291	**1.000	1				
BA	21.2	8.19	0.168	-0.032	-0.032	1			
FSIZE	11.93	0.098	0.349	-0.120	-0.120	0.052	1		
LEV	0.51	0.111	0.001	0.028	0.028	-0.221	-0.513	1	
ROE	0.059	0.032	-0.1.3	0.021	0.021	0.078	0.219	-0.293	1

**correlation is significant at the 0.01 level (2-tailed)

The findings of a regression model are shown in Table (2), and they corroborate Hypothesis (1) by demonstrating that the Board of Directors (BS) has a positive and substantial impact on the degree of Integrated Reporting Framework (IRAL) compliance at the P = 0.036 level. This suggests that banks with more board members in the research sample are more likely to prepare a report that more closely complies with IIRC guidelines. Hypothesis 2 is also supported by the findings. Indeed, at p = 0.059, these findings demonstrate a favorable and marginally significant impact of the boards of directors' (BI) independence on the degree of adherence to the Integrated Reporting Framework (IRAL).

This indicates that the banks that have A more comprehensive report that complies with IIRC requirements is more likely to be prepared by a board of directors with a greater proportion of independent members. On the other hand, the results do not support Hypothesis 3. In fact, there is an insignificant relationship between the activity of the Board of Directors (BA) and the level of compliance with the Integrated Reporting Framework. IIRC

The findings indicate that, with respect to the control variables, firm size and FSIZE have a favorable impact on the degree of IRAL Integrated Reporting Framework compliance, respectively at p = 0.060.

Table 2. Hypotheses tests

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Variables	Coefficient	Standard error	p-value
CONS	0.045	0.203	0.000
BS	0.057	0.291	0.036
BI	0.001	1.728	0.059
BA	0.298	0.885	0.426
FSIZE	0.131	2.660	0.060
LEV	-0.205	1.277	0.271
ROE	0.045	-0.683	0.532

DISCUSSION AND CONCLUSION

The goal of this study is to examine how corporate governance factors affect integrated reporting guidelines. It specifically examined how specific characteristics of the CEO and the board of directors affected how closely integrated reports adhered to the IIRC framework. The findings demonstrate, first, that the integrated reports under analysis were highly aligned with the IIRC standards, and second, that the size and independence of the board of directors had a favorable effect on the degree of IIRC framework compliance. However, the findings indicated that the board of board of directors actions had little effect on the degree of IIRC framework compliance.

The characteristics of the board of directors are one of the important topics that have received great attention in the last two decades, especially after the crises and financial collapses, due to their major role in directing and controlling the economic unit and enhancing disclosure. The results show that the characteristics of the board of directors have a major role in enhancing transparency in the economic unit by supporting integrated reporting.

The findings have significant ramifications for top corporate governance organizations. In fact, they ought to make an effort to assemble boards with members who can raise the bar for corporate transparency. In this regard, companies should consider appointing more directors, particularly increasing the proportion of women on their boards. These factors, combined with the absence of CEO duality, can enhance the board's ability to oversee and control, ultimately fostering the production of integrated reports that align more effectively with our framework.

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